NEW ISSUE BOOK-ENTRY ONLY **RATINGS:**

S&P: "AA-"
Fitch: "AA-"
Moody's: "A1"
(See "Ratings" herein.)

In the opinion of Fulbright & Jaworski L.L.P., Los Angeles, California, Bond Counsel, under existing law, interest on the Series 2009A Bonds is exempt from personal income taxes of the State of California, and, assuming continuing compliance after the date of initial delivery of the Series 2009A Bonds with certain covenants contained in the Indenture authorizing the Series 2009A Bonds and subject to the matters set forth under "TAX EXEMPTION" herein, interest on the Series 2009A Bonds for federal income tax purposes under existing statutes, regulations, published rulings, and court decisions will be excludable from the gross income of the owners thereof pursuant to Section 103 of the Internal Revenue Code of 1986, as amended, to the date of initial delivery of the Series 2009A Bonds, and will not be included in computing the alternative minimum taxable income of individuals or, except as described herein, corporations. See "TAX EXEMPTION" herein.

$157,190,000
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)

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

The $157,190,000 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 "Series 2009A Bonds") are being issued by the Public Facilities Financing Authority of the City of San Diego (the "Authority") pursuant to the provisions of the Joint Exercise of Powers Act (commencing with Section 6500) of the Government Code of the State of California (the "State") and an Indenture, dated as of January 1, 2009 (the "Indenture"), by and between the Authority and Wells Fargo Bank, National Association, as Trustee (the "Trustee"). The proceeds of the Series 2009A Bonds will be used to prepay a portion of the Outstanding Obligations (herein defined), fund the Reserve Fund (as described herein) to satisfy the Series 2009A Reserve Requirement (as described herein) and pay costs of issuance with respect to the Series 2009A Bonds.

THE SERIES 2009A 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 INDENTURE (OTHER THAN AMOUNTS ON DEPOSIT IN THE REBATE FUND). THE SERIES 2009A BONDS DO NOT CONSTITUTE A DEBT OR LIABILITY OF THE AUTHORITY, THE CITY OR OF THE STATE 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 SERIES 2009A BONDS. THE AUTHORITY HAS NO TAXING POWER.

The pledge and assignment of and lien on the Revenues and amounts on deposit in the funds and accounts established under the Indenture pursuant to the Indenture and the 2009A Supplement (as described herein) to secure the 2009A Installment Payments (as described herein) are, in all respects, on parity with the pledge and assignment of and lien on the Revenues granted securing the other Parity Obligations (as described herein) executed and delivered in accordance with the Installment Purchase Agreement (as described herein). The principal of and interest on the Series 2009A Bonds and any premiums upon the redemption of any thereof are not a debt of the City or the Authority nor a legal or equitable pledge, charge, lien or encumbrance upon any of its property or upon any of its income, receipts or revenues except the Revenues and amounts on deposit in the funds and accounts established under the Indenture.

The Series 2009A 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, 2009. The Series 2009A Bonds will bear interest at the respective rates set forth on the inside cover page hereof. See "Description of the Series 2009A Bonds – General" herein and Appendix E – "SUMMARY OF PRINCIPAL LEGAL DOCUMENTS" attached hereto.

The Series 2009A Bonds will be issued only in fully-registered form in denominations of $5,000 and any integral multiple thereof, and when issued, will be registered in the name of Cede & Co., as the nominee of The Depository Trust Company, New York, New York ("DTC"). DTC will act as securities depository for the Series 2009A Bonds. Ownership interests in the Series 2009A Bonds may be purchased in book-entry form only. So long as DTC or its nominee is the Owner of the Series 2009A Bonds, principal, redemption premium, if any, and interest on the Series 2009A Bonds will be made as described in Appendix H – "INFORMATION REGARDING THE BOOK-ENTRY ONLY SYSTEM" attached hereto.

The Series 2009A Bonds are subject to optional redemption and mandatory sinking fund redemption prior to maturity as described herein. See "Description of the Series 2009A Bonds – Redemption" herein.

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

The Series 2009A Bonds are offered when, as and if issued, subject to the legal opinion of Fulbright & Jaworski L.L.P., Los Angeles, California, Bond Counsel. Certain legal matters will be passed upon for the San Diego Facilities and Equipment Leasing Corporation by Fulbright & Jaworski L.L.P., for the Authority by Hawkins Delafield & Wood LLP, Los Angeles, California, Disclosure Counsel, and by Jan I. Goldsmith, City Attorney, and for the Underwriters by their counsel, Nixon Peabody LLP, Los Angeles, California. It is anticipated that the Series 2009A Bonds will be available for delivery through the facilities of DTC in New York, New York on or about January 29, 2009.

Morgan Stanley **J.P. Morgan**

Estrada Hinojosa & Company, Inc. **Ramirez & Co., Inc.** **Siebert Brandford Shank & Co., LLC**

Dated: January 13, 2009

$157,190,000
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)

MATURITY SCHEDULE

Maturity Date (August 1)	Principal Amount	Interest Rate	Yield	Price	CUSIP†
2009	$ 1,035,000	3.000%	0.920%	101.046	79730CCA0
2010	1,110,000	3.000	0.970	103.026	79730CCB8
2011	1,140,000	2.500	1.970	101.289	79730CCC6
2012	1,170,000	3.000	2.190	102.718	79730CCD4
2013	1,215,000	4.000	2.400	106.794	79730CCE2
2014	1,265,000	4.000	2.650	106.873	79730CCF9
2015	2,200,000	3.000	2.890	100.648	79730CCG7
2016	15,015,000	5.000	3.110	112.564	79730CCH5
2017	15,780,000	5.000	3.320	112.360	79730CCJ1
2018	16,590,000	5.000	3.540	111.697	79730CCK8
2019(1)	9,650,000	4.000	3.760	101.903	79730CCL6
2019(1)	7,740,000	5.000	3.760	109.833	79730CCM4
2020	3,570,000	4.000	4.050	99.543	79730CCN2
2020(1)	14,645,000	5.000	4.050	107.433	79730CCP7
2021	2,545,000	4.250	4.300	99.519	79730CCQ5
2021(1)	16,575,000	5.000	4.300	105.414	79730CCR3

$9,670,000 5.000% Term Bonds due August 1, 2026 – Priced to Yield: 4.890%(1) – CUSIP†: 79730CCS1
$7,070,000 5.000% Term Bonds due August 1, 2029 – Priced to Yield: 5.140% – CUSIP†: 79730CCT9
$29,205,000 5.250% Term Bonds due August 1, 2038 – Priced to Yield: 5.400% – CUSIP†: 79730CCU6

(1) Priced to par call date of August 1, 2018

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 Series 2009A Bonds by a person in any jurisdiction in which it is unlawful for such person to make an offer, solicitation or sale.

This Official Statement is not a contract with the purchasers of the Series 2009A Bonds. Statements contained in this Official Statement which involve estimates, forecasts or matters of opinion, whether or not expressly so described herein, are intended solely as such and are not to be construed as a representation of facts.

The information set forth herein has been furnished by the City and by other sources which are believed to be reliable. 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 Series 2009A Bonds, the Indenture, the 2009A Supplement, the Assignment Agreement (each as described herein) 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 execution and delivery of the Series 2009A 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 at http://www.sandiego.gov. However, the information presented there is not part of this Official Statement, is not incorporated by reference herein and should not be relied upon in making an investment decision with respect to the Series 2009A Bonds.

IN CONNECTION WITH THIS OFFERING, THE UNDERWRITERS MAY OVERALLOT OR EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKET PRICE OF THE SERIES 2009A BONDS AT A LEVEL ABOVE THAT WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME. THE UNDERWRITERS MAY OFFER AND SELL THE SERIES 2009A BONDS TO CERTAIN DEALERS AND DEALER BANKS AND BANKS ACTING AS AGENT AT PRICES LOWER THAN THE PUBLIC OFFERING PRICE STATED ON THE COVER PAGE HEREOF AND SAID PUBLIC OFFERING PRICE MAY BE CHANGED FROM TIME TO TIME BY THE UNDERWRITERS.

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CITY OF SAN DIEGO

Mayor

Jerry Sanders

City Council

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

City Attorney

Jan I. Goldsmith

City Officials

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

Water Department

Jim Barrett, Director of Public Utilities
Alex Ruiz, Assistant Director
Rod Greek, Deputy Director, Business and Support Services
Mike Bresnahan, Deputy Director, Customer Support Division
Marsi Steirer, Deputy Director, Water Policy and Strategic Planning Division
Jim Fisher, Deputy Director, Water Operations Division

Special Services

BOND COUNSEL
Fulbright & Jaworski, L.L.P.
Los Angeles, California

DISCLOSURE COUNSEL
Hawkins Delafield & Wood LLP
Los Angeles, California

FINANCIAL ADVISOR
Montague DeRose and Associates LLC
Walnut Creek, California

TRUSTEE
Wells Fargo Bank, National Association
Los Angeles, California

FEASIBILITY ENGINEER
Camp Dresser & McKee Inc.
Cambridge, Massachusetts

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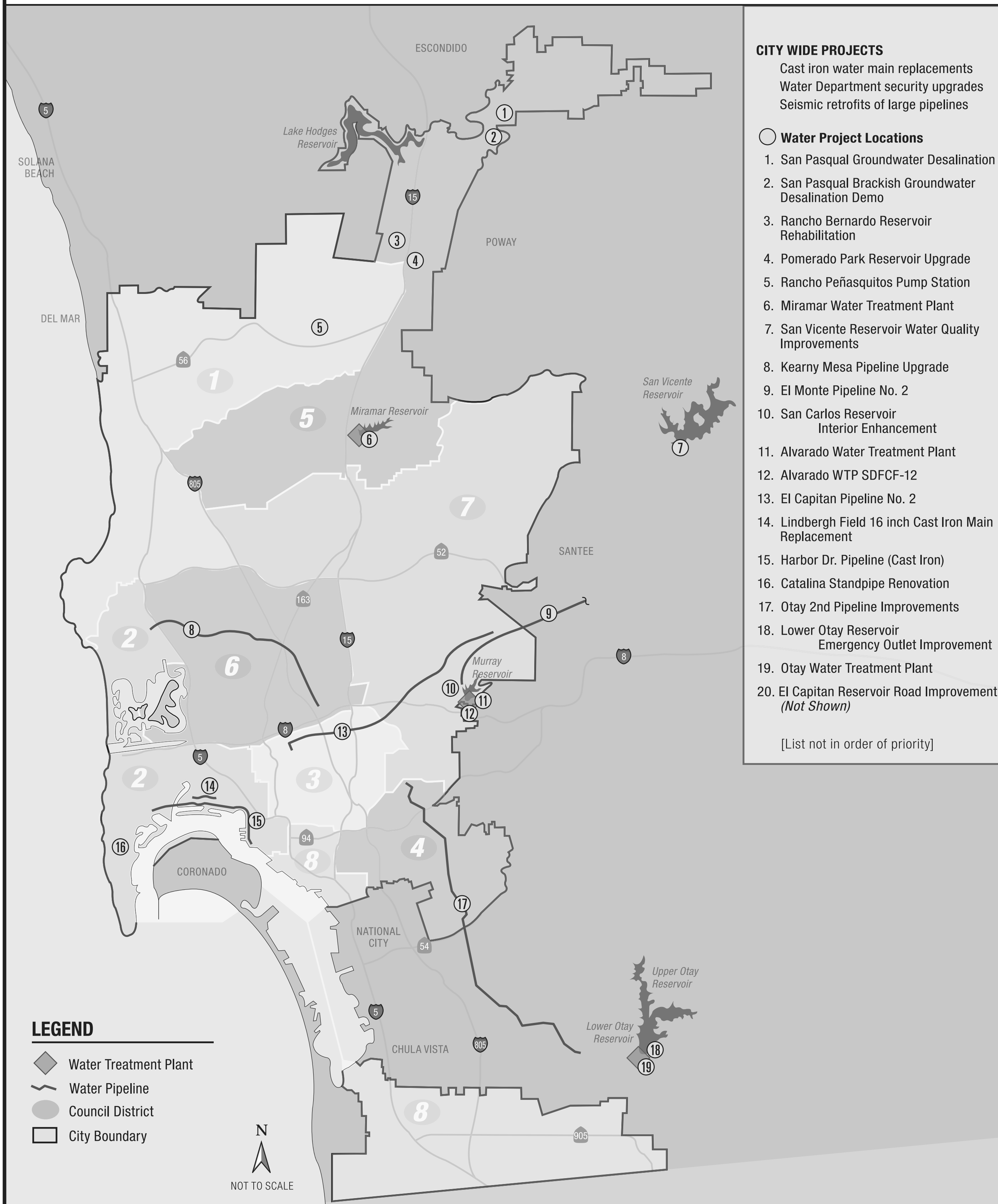

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OFFICIAL STATEMENT

$157,190,000
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)

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 and appendices hereto, and the documents described herein. All statements contained in this introduction are qualified in their entirety by reference to the entire Official Statement. References to, and summaries of the laws of the State of California and any documents referred to herein do not purport to be complete and such references are qualified in their entirety by reference to the complete provisions. All capitalized terms used in this Official Statement and not otherwise defined herein have the meanings set forth in the Indenture.

General

The $157,190,000 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 "Series 2009A Bonds") are being issued by the Public Facilities Financing Authority of the City of San Diego (the "Authority") pursuant to the provisions of the Joint Exercise of Powers Act (commencing with Section 6500) of the Government Code of the State of California (the "State") and an Indenture, dated as of January 1, 2009 (the "Indenture"), by and between the Authority and Wells Fargo Bank, National Association, as Trustee (the "Trustee"). The proceeds of the Series 2009A Bonds will be used to prepay a portion of the Outstanding Obligations (herein defined), fund the Reserve Fund (as described herein) to satisfy the Series 2009A Reserve Requirement (as described herein) and pay costs of issuance with respect to the Series 2009A Bonds.

The Series 2009A Bonds

The Series 2009A 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, 2009 (each, an "Interest Payment Date"). The Series 2009A Bonds will bear interest at the respective rates set forth on the inside cover page hereof. See "DESCRIPTION OF THE SERIES 2009A BONDS – General" herein and Appendix E – "SUMMARY OF PRINCIPAL LEGAL DOCUMENTS" attached hereto.

The Series 2009A Bonds will be issued only in fully-registered form in denominations of $5,000 and any integral multiple thereof, and when issued, will be registered in the name of Cede & Co., as the nominee of The Depository Trust Company, New York, New York ("DTC"). DTC will act as securities depository for the Series 2009A Bonds. Ownership interests in the Series 2009A Bonds may be purchased in book-entry form only. So long as DTC or its nominee is the Owner of the Series 2009A Bonds, principal, redemption premium, if any, and interest on the Series 2009A Bonds will be made as described in Appendix H – "INFORMATION REGARDING THE BOOK-ENTRY ONLY SYSTEM" attached hereto.

Security and Sources of Payment for the Series 2009A Bonds

The City owns the Water System and operates such system through its Water Department. The City 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. See "WATER SYSTEM ORGANIZATION AND MANAGEMENT" and "WATER SYSTEM SERVICE AREA AND FACILITIES" herein.

The Series 2009A Bonds are primarily secured by Revenues (herein defined) of the Authority consisting primarily of 2009A Installment Payments (herein defined) to be made by the City to the San Diego Facilities and Equipment Leasing Corporation (the "Corporation"), under the Amended and Restated Master Installment Purchase Agreement, dated as of January 1, 2009 (the "Master Installment Purchase Agreement"), as supplemented by the 2009A Supplement to Master Installment Purchase Agreement, dated as of January 1, 2009 (the "2009 Supplement" and, together with the Master Installment Purchase Agreement and any other supplements and amendments thereto, the "Installment Purchase Agreement"), each by and between the City and the Corporation, which 2009A Installment Payments have been assigned by the Corporation to the Authority pursuant to the Assignment Agreement, dated as of January 1, 2009 (the "Assignment Agreement"), by and between the Corporation and the Authority. See "SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2009A BONDS" herein.

THE SERIES 2009A 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 INDENTURE (OTHER THAN AMOUNTS ON DEPOSIT IN THE REBATE FUND). THE SERIES 2009A BONDS DO NOT CONSTITUTE A DEBT OR LIABILITY OF THE AUTHORITY, THE CITY OR OF THE STATE 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 SERIES 2009A BONDS. THE AUTHORITY HAS NO TAXING POWER.

Recent Events Regarding the City

There have been various investigations regarding the City and certain of its financial statements. Such investigations have led to the restatement of certain of the City's financial statements, including financial statements relating to the water utility component of the City's enterprise fund. However, the investigations into the City have not, to the knowledge of the City, specifically involved the Water Department (the "Water Department") and do not relate to the security for or sources of payment of any of the City's water revenue bonds.

Investigations regarding Misleading Disclosures

In early 2004, the City filed three voluntary disclosure filings with the Nationally Recognized Municipal Securities Information Repositories. The first two filings, on January 27, 2004, described the unfunded accrued actuarial liability of the San Diego City Employees' Retirement System ("SDCERS"), which is a public employee retirement system that acts as a common investment and administrative agent for the City, the San Diego County Regional Airport Authority (the "Airport Authority"), and the San Diego Unified Port District (the "District") (see "SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM" herein), and certain errors discovered in the comprehensive annual financial report (the "CAFR") of the City as of June 30, 2002 and the financial statements of the Metropolitan Wastewater Utility as of June 30, 2002 and 2001. The filing included projections anticipating the growth of this liability, an estimate of the accrued post-retirement healthcare benefits for City workers and a description of the mechanism by which the City funded SDCERS. The City previously disclosed that its UAAL (defined herein; see "SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM - UAAL and its

Calculation") as of June 30, 2003 was expected to be approximately $950 million but revised such amount to $1.157 billion pursuant to the January 27 filing. A subsequent filing, on March 12, 2004, described numerous errors in the notes of the City's audited annual financial reports for Fiscal Year 2001-02 (the City's fiscal year, beginning on July 1 and ending on June 30 of the following year, is referred to herein as "Fiscal Year"). The March 12 filing stated that, in the opinion of the original auditor of the City's CAFR for Fiscal Year 2001-02, such errors were not, individually or in the aggregate, material and that the City would retain the accounting firm of KPMG LLP ("KPMG") to perform a full scope audit of the City's Fiscal Year 2002-03 financial reports.

As a result of the January 27 filings, on February 13, 2004, the Securities and Exchange Commission (the "Commission") began an investigation into the City's disclosure practices relating to the funding of SDCERS. At the same time, the United States Attorney's office for the Southern District of California began its own investigation into the same matters.

The law firm of Vinson & Elkins L.L.P. ("V&E") was retained by the City on February 11, 2004 to review the City's disclosure practices from 1996 to 2004 and determine whether the City had met its disclosure obligations concerning the funding of SDCERS. V&E released its initial report on September 16, 2004. KPMG determined that the V&E report did not provide KPMG with a basis to determine whether there was any intentional misconduct or other conduct that had violated any laws or regulations with the force of law. The San Diego City Attorney's office also published several reports on issues related to the funding of SDCERS, including possible abuse, fraud, or illegal acts by the City or its officials.

At the suggestion of KPMG, Kroll, Inc. ("Kroll") was retained by the City in February 2005 to evaluate the investigative reports of V&E and the City Attorney and to make appropriate recommendations to the City Council. Kroll retained the law firm of Willkie, Farr & Gallagher LLP ("Willkie") as its independent counsel and Kroll and Willkie constituted themselves as the Audit Committee of the City of San Diego ("Kroll Audit Committee").

On August 8, 2006, the Kroll Audit Committee released its report on its investigation into, among other things, abuses and illegal conduct in the City's funding of SDCERS ("Kroll Report"). The Kroll Report concluded that the City government, including its officials, contributed to the City's failure to conform to the requirements of law and to adhere to principles of sound governance and financial reporting.

On November 14, 2006, the City entered into a cease-and-desist order (the "Order") with the Commission relating to violations of the antifraud provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934 in connection with the offer and sale of municipal securities in 2002 and 2003, and other related public financial disclosures concerning its pension and retiree health care liabilities.

The Commission concluded that the "City's public disclosures in the preliminary official statements and official statements for its 2002 and 2003 offerings, its 2003 continuing disclosures, and presentations to the rating agencies failed to disclose material information regarding the City's current funding of its pension and retiree health care obligations, the City's future pension and retiree health care obligations, and the City's ability to pay those future obligations." The Commission further concluded that "[t]he City, through its officials, acted with scienter," because "City officials acted recklessly in failing to disclose material information regarding [pension and retiree health care] liabilities."

The Order also imposed certain remedial sanctions, including the retention of an independent consultant to review and assess the City's policies, procedures and internal controls with respect to bond offerings, including disclosures made in its financial statements. On January 16, 2007, the City retained

Stanley Keller of the law firm of Edwards Angell Palmer & Dodge, LLP to serve as Independent Consultant. The Independent Consultant is required to conduct annual reviews of the City's policies, procedures and internal controls for a three year period, and provide copies of such annual reports to the Commission. On June 7, 2007, the Independent Consultant released its initial report (the "Initial Report") and on March 25, 2008, the Independent Consultant issued its First Annual Report (the "First Annual Report"). The Initial Report, as supplemented by the First Annual Report, included 36 recommendations with respect to, among other things, finalizing the City's internal audit function and hiring a qualified internal auditor, completing the organization of the City's Audit Committee and selecting citizen advisors and professional consultants to advise members of such committee, upgrading to a new financial accounting system, reevaluating the roles and accountability of the City's Chief Financial Officer and the City's Auditor and Comptroller and evaluating the disclosure process and considering moving to a shelf-like disclosure system. The Mayor and the City Council have begun to implement a number of the recommendations and continue to work towards establishing best practices in the City's financial reporting and disclosure.

Pursuant to recommendations made by V&E, the City established in 2004 its Disclosure Practices Working Group ("DPWG"), a collaborative, consensus-based group formed to address the City's disclosure requirements. The purpose of DPWG is to ensure the compliance by the City (including the City Council, City officers, and staff) with federal and State securities laws and to promote the highest standards of accuracy in disclosures provided by the City relating to securities issued by the City or by its related entities. Among other things, DPWG reviews and certifies, if appropriate, securities offering documents prior to their consideration by the City Council. Such certification specifies that, to the best knowledge of the signatory, such offering documents do not make any untrue statement of material fact or omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading. DPWG consists of five voting members (the Chief Operating Officer, the Chief Financial Officer, the City Director of Debt Management, the City Attorney and the Deputy City Attorney for Finance and Disclosure) and two non-voting members (the City's outside Disclosure Counsel and the City Internal Auditor). The City's Independent Budget Analyst or, from time to time, that official's designee, is an ex officio participant of DPWG. The Independent Budget Analyst is appointed by majority vote of the City Council. The Office of the Independent Budget Analyst was created in 2006 to assist the City Council in the conduct of budgetary inquiries and in the making of budgetary decisions, which includes providing budget oversight on legislative initiatives that have policy and financial impacts. The Office of the Independent Budget Analyst was made a permanent component of the City's governance structure pursuant to voter-approved amendments to the City Charter in June 2008. These amendments to the City Charter also created a separate Office of the City Auditor whose purpose is to advance open and accountable government through accurate, independent, and objective audits that seek to improve the economy, efficiency, and effectiveness of City government.

The City understands that other investigations by the Commission or other government agencies are still ongoing as to entities or individuals other than the City. On December 11, 2007, the Commission filed a settled civil fraud action against the City's Independent Auditor, Thomas J. Saiz and his firm Calderon, Jaham & Osborn, in connection with the City's false and misleading financial statements in five bond offerings in years 2002 and 2003. On April 7, 2008, the Commission filed securities fraud charges against five former City officials, including the former City Manager, former Auditor and Comptroller, former Assistant Auditor and Comptroller, former Deputy City Manager and former City Treasurer for allegedly giving false and misleading statements regarding City bond offerings in 2002 and 2003. On December 19, 2008, the Commission notified the aforementioned former City officials that it had concluded its investigation into their involvement in the five bond offerings in years 2002 and 2003 and did not intend to recommend enforcement action against them.

Audited Financial Reports

As a result of the investigations into the City, the completion and release of the City's financial reports were substantially delayed. KPMG, the City's outside auditor for the Fiscal Year 2002-03 audited financial statements, issued an unqualified opinion on the Fiscal Year 2002-03 financial statements on March 16, 2007 and the City Council received and filed the City's CAFR for Fiscal Year 2002-03 on June 5, 2007. On May 11, 2007, Macias Gini & O'Connell LLP ("Macias"), the City's outside auditor for the Fiscal Years 2003-04 through 2006-07 financial statements, issued an unqualified opinion on the City's Fiscal Year 2003-04 financial statements and the City Council received and filed the City's CAFR for Fiscal Year 2003-04 on July 24, 2007.

On October 26, 2007, Macias issued an unqualified opinion on the City's Fiscal Year 2004-05 financial statements. On December 12, 2007, the City voluntarily re-opened the Fiscal Year 2004-05 financial reports for the limited purpose of revising certain disclosures related to the City's Preservation of Benefits Plan. In the opinion of the City, these revisions were not material. Macias issued an unqualified opinion on the revised Fiscal Year 2004-05 financial statements with the original opinion date of October 26, 2007 and a dual date of February 8, 2008 for certain specified statements, as noted therein. The City's CAFR for Fiscal Year 2004-05 was received and filed by the City Council on March 25, 2008.

On March 21, 2008, Macias issued an unqualified opinion on the City's Fiscal Year 2005-06 financial statements and the City Council received and filed the City's CAFR for Fiscal Year 2005-06 (the "2006 CAFR") on April 22, 2008. On October 17, 2008, Macias issued an unqualified audit opinion on the City's Fiscal Year 2006-07 financial statements (the "2007 CAFR"), which were received and filed by the City Council on November 10, 2008.

City Ratings

A further consequence of the City's voluntary disclosures and the ensuing investigations was a series of actions taken by the rating agencies. In 2004, Moody's Investors Service, Inc. ("Moody's"), and Fitch Ratings ("Fitch") downgraded the credit ratings on the City's obligations and changed the outlook on those ratings to negative. Standard & Poor's Ratings Services, a division of The McGraw-Hill Companies, Inc. ("S&P"), put the City's credit rating on negative outlook and subsequently suspended its credit ratings on all City obligations. In connection with the release of the 2006 CAFR, the City received and currently maintains ratings from all three rating agencies. See "RATINGS" herein for a description of the ratings assigned to the Series 2009A Bonds.

The Authority and the Corporation

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 Authority was organized, in part, to finance, acquire, construct, maintain, repair, operate and control certain capital facilities improvements for the City. 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.

Forward-Looking Statements

Certain statements included or incorporated by reference in this Official Statement constitute "forward-looking statements." Such statements are generally identifiable by the terminology used such as "plan," "expect," "estimate," "budget," "projected" or other similar words. The achievement of certain results or other expectations contained in such forward-looking statements involve known and unknown risks, uncertainties and other factors which may cause actual results, performance or achievements described to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Although such expectations reflected in such forward-looking statements are reasonable, there can be no assurance that such expectations will prove to be correct. None of the City, the Authority or the Corporation is obligated to issue any updates or revisions to the forward-looking statements if or when expectations, or events, conditions or circumstances on which such statements are based do or do not occur.

Continuing Disclosure

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

Miscellaneous

Copies of the Indenture, the Installment Purchase Agreement, the 2009A Supplement, the Assignment Agreement, other financing documents and additional information may be obtained upon request from the Trustee at Wells Fargo Bank, National Association, 707 Wilshire Boulevard, 17th Floor, Los Angeles, CA 90017.

PLAN OF FINANCE

A portion of the proceeds of the Series 2009A Bonds will be used to prepay the Outstanding Obligations identified in the table below (the Outstanding Obligations to be prepaid with proceeds of the Series 2009A Bonds are referred to herein as the "Refunded Obligations").

REFUNDED OBLIGATIONS

Series	Maturity Date(s)	Principal Amount	Prepayment Price	Prepayment/ Payment Date	CUSIP[†]
Series 1998 Certificates	August 1, 2015	$ 895,000	101%	February 11, 2009	797263AW0
	August 1, 2016	13,670,000	101	February 11, 2009	797263AY6
	August 1, 2017	14,370,000	101	February 11, 2009	797263AZ3
	August 1, 2018	15,105,000	101	February 11, 2009	797263AQ3
	August 1, 2021	50,125,000	101	February 11, 2009	797263BA7
Series 2007A Notes	January 30, 2009	57,000,000	100	January 29, 2009	79730CBU7

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

A portion of the proceeds of the Series 2009A Bonds will be also be used to fund the Reserve Fund to satisfy the Series 2009A Reserve Requirement and pay costs of issuance with respect to the Series 2009A Bonds.

ESTIMATED SOURCES AND USES OF FUNDS

The proceeds of the Series 2009A Bonds and other available funds are expected to be applied as set forth below:

SOURCES:	
Principal Amount of the Series 2009A Bonds	$157,190,000.00
Net Original Issue Premium	8,266,404.75
Release from Debt Service Fund for the Refunded Obligations	2,354,125.00
Total Sources	$167,810,529.75
USES:	
Prepayment of Series 2007A Notes	$ 57,000,000.00
Prepayment of Series 1998 Certificates	97,591,559.72
Deposit into Reserve Fund	11,125,361.19
Costs of Issuance[(1)]	2,093,608.84
Total Uses	$167,810,529.75

(1) Includes Underwriters' discount, trustee fees, financial advisor fees, rating agency fees, escrow agent fees, bond counsel fees and expenses, disclosure counsel fees and expenses, verification agent fees, printing costs and other miscellaneous expenses.

DESCRIPTION OF THE SERIES 2009A BONDS

General

The Series 2009A Bonds will be issued as fully-registered bonds in denominations of $5,000 and any integral multiple thereof and when issued, will be registered in the name of Cede & Co., as the nominee of The Depository Trust Company, New York, New York ("DTC"). DTC will act as securities depository for the Series 2009A Bonds. Ownership interests in the Series 2009A Bonds may be purchased in book-entry form only. So long as DTC or its nominee is the Owner of the Series 2009A Bonds, principal of redemption premium, if any, and interest on the Series 2009A Bonds will be made as described in Appendix H – "INFORMATION REGARDING THE BOOK-ENTRY ONLY SYSTEM" attached hereto.

The Series 2009A 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, 2009. The Series 2009A Bonds will bear interest at the respective rates set forth on the inside cover page hereof. See Appendix E – "SUMMARY OF PRINCIPAL LEGAL DOCUMENTS" attached hereto.

Interest on the Series 2009A Bonds shall be calculated on the basis of a 360-day year, comprised of twelve thirty-day months. Interest coming due on a date which is not a Business Day shall be payable on the immediately following Business Day. Each Series 2009A Bond shall bear interest from the Interest Payment Date next preceding the date of authentication thereof, unless such date of authentication is during the period commencing after a Record Date through and including the next succeeding Interest Payment Date, in which event it shall bear interest from such Interest Payment Date, or unless such date of authentication is on or before the first Record Date, in which event it shall bear interest from its dated date; provided, however, that if on the date of authentication of any Series 2009A Bonds, interest is then in default on the Outstanding Series 2009A Bonds, such Series 2009A Bonds shall bear interest from the Interest Payment Date to which interest has previously been paid or made available for payment on the Outstanding Series 2009A Bonds. Payment of interest on the Series 2009A Bonds due on or before the maturity or prior redemption thereof shall be made to the Owner or Owners of record as of the Record Date preceding the applicable Interest Payment Date, on the registration books kept by the Trustee, such interest to be paid by check mailed by first class mail on such Interest Payment Date to such Owner at his address as it appears on such books; provided, that in the event the ownership of such Series 2009A Bonds is no longer maintained in book-entry form by the Depository, such payment shall be made by wire transfer to any Owner of at least $1,000,000 in aggregate principal amount of Series 2009A Bonds, in immediately available funds to an account in the continental United States designated in writing by such Owner to the Trustee prior to the applicable Record Date.

Other Parity Obligations

The 2009A Installment Payments shall be Parity Obligations under the Installment Purchase Agreement and the payment of the 2009A Installment Payments shall be on parity with the right of payment of other Parity Obligations under the Installment Purchase Agreement, including the Installment Payments securing the Series 1998 Certificates currently outstanding in the aggregate principal amount of $245,010,000. See "PLAN OF FINANCE - Refunding" herein.

Redemption

Optional Redemption. The Series 2009A Bonds 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, 2018, at any time, from and to the extent of prepaid 2009A Installment Payments paid pursuant to the 2009A Supplement, at a redemption price equal to the principal amount of the Series 2009A Bonds called for redemption, together with interest accrued thereon to the date fixed for redemption, without premium.

Mandatory Sinking Fund Redemption. The Series 2009A Bonds which are Term Bonds shall be subject to mandatory redemption, on each date which a sinking account payment for such Term Bonds is payable from sinking account payments set forth below, by lot, in an amount equal to such sinking account payments, plus accrued interest to the redemption date and without premium. At the option of the Authority, it may credit against any sinking account payment requirement Term Bonds or portions thereof which are of the same maturity as the Term Bonds subject to redemption and which, prior to said date, have been purchased, with funds other than moneys in a Sinking Account, at public or private sale or redeemed and cancelled by the Authority and not theretofore applied as a credit against any mandatory sinking account payment requirement.

The Series 2009A Bonds which mature on August 1, 2026, are subject to mandatory sinking fund redemption, with sinking account payments payable on August 1 in each of the years, at a redemption price of par, plus interest accrued to the date fixed for redemption, in the principal amounts as follows:

Series 2009 Term Bonds Maturing August 1, 2026

Sinking Fund Payment Dates (August 1)	Sinking Account Payments
2022	$1,745,000
2023	1,835,000
2024	1,930,000
2025	2,030,000
2026†	2,130,000

† Maturity.

The Series 2009A Bonds which mature on August 1, 2029, are subject to mandatory sinking fund redemption, with sinking account payments payable on August 1 in each of the years, at a redemption price of par, plus interest accrued to the date fixed for redemption, in the principal amounts as follows:

Series 2009 Term Bonds Maturing August 1, 2029

Sinking Fund Payment Dates (August 1)	Sinking Account Payments
2027	$2,240,000
2028	2,355,000
2029†	2,475,000

† Maturity.

The Series 2009A Bonds which mature on August 1, 2038, are subject to mandatory sinking fund redemption, with sinking account payments payable on August 1 in each of the years, at a redemption price of par, plus interest accrued to the date fixed for redemption, in the principal amounts as follows:

Series 2009 Term Bonds Maturing August 1, 2038

Sinking Fund Payment Dates (August 1)	Sinking Account Payments
2030	$2,605,000
2031	2,745,000
2032	2,895,000
2033	3,050,000
2034	3,215,000
2035	3,390,000
2036	3,570,000
2037	3,765,000
2038†	3,970,000

† Maturity.

Notice of Redemption. Pursuant to the Indenture, notice of redemption shall be mailed to the Owners 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 Series 2009A 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 Series 2009A Bonds thereof and in the case of a Series 2009A Bond to be redeemed in part only, the specified portion of the principal amount thereof to be redeemed, and that from and after such redemption date, interest thereon shall cease to accrue, and shall require that such Series 2009A 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.

Effect of Redemption. If notice of redemption has been duly given as provided in the Indenture and money for the payment of the redemption price of the Series 2009A Bonds called for redemption is held by the Trustee, then on the redemption date designated in such notice, the Series 2009A Bonds shall become due and payable, and from and after the date so designated, interest on the Series 2009A Bonds so called for redemption shall cease to accrue, and the Owners of such Series 2009A Bonds shall have no rights in respect thereof except to receive payment of the redemption price thereof.

SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2009A BONDS

Source of Payment; Priority of Pledge of Net System Revenues

The Series 2009A Bonds shall be limited obligations of the Authority payable solely from the Revenues and amounts on deposit in the funds and accounts established under the Indenture (other than amounts on deposit in the Rebate Fund). "Revenues" means all 2009A Installment Payments to be paid pursuant to the 2009A Supplement and the interest or profits from the investment of money in any account or fund (other than the Rebate Fund). The 2009A Installment Payments are secured by and payable solely from Net System Revenues and are required to be paid by the City to the Authority, as assignee of the Corporation under the Assignment Agreement, in an amount equal to the principal of and interest due on the Series 2009A Bonds. See "SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2009A BONDS – Net System Revenues" herein for a description of Net System Revenues.

The pledge and right of payment from Net System Revenues securing the 2009A Installment Payments (which, in turn, secure the Series 2009A Bonds) is on parity with the pledge and right of payment from Net System Revenues securing the Installment Payments represented by the San Diego Facilities and Equipment Leasing Corporation Certificates of Undivided Interest (In Installment Payments Payable from the Net System Revenues of the Water Utility Fund of the City of San Diego) Series 1998 (the "Series 1998 Certificates") outstanding in the aggregate principal amount of $245,010,000, prior to the refunding described in this Official Statement, and any other Parity Obligations that may be issued from time to time in accordance with the Installment Purchase Agreement. See "PLAN OF FINANCE" and "SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2009A BONDS – Parity Obligations" herein. All Parity Obligations, including Installment Payments represented by the Series 1998 Certificates, shall be secured by a first priority lien on and pledge of Net System Revenues. All Parity Obligations shall be of equal rank with each other without preference, priority or distinction of any Parity Obligations over any other Parity Obligations.

The pledge and right of payment from Net System Revenues securing the 2009A Installment Payments (which, in turn, secure the Series 2009A Bonds) is senior to the pledge and right of payment from Net System Revenues securing the Subordinated Installment Payments with respect to 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 Net System Revenues of the Water Utility Fund) (the "Series 2002 Subordinated Bonds") outstanding in the aggregate principal amount of $272,845,000, the Public Facilities Financing Authority of the City of San Diego Non–Transferable Subordinated Water Revenue Notes, Series 2007A (Payable Solely From Subordinated Installment Payments Secured By Net System Revenues of the Water Utility Fund) (the "Series 2007A Notes") outstanding in the aggregate principal amount of $57,000,000, all of which will be paid with proceeds of the Series 2009A Bonds as described herein, and the Public Facilities Financing Authority of the City of San Diego Subordinated Water Revenue Notes, Series 2008A (Payable Solely From Subordinated Installment Payments Secured By Net System Revenues of the Water Utility Fund) (the "Series 2008A Notes" and, together with the Series 2002 Subordinated Bonds and the Series 2007A Notes, the "Outstanding Subordinated Obligations") outstanding in the aggregate principal amount of $150,000,000. See "PLAN OF FINANCE" and "SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2009A BONDS – Subordinated Obligations" herein. All Subordinated Obligations, including the Subordinated Installment Payments with respect to the Outstanding Subordinated Obligations, shall be secured by a second priority lien on and pledge of Net System Revenues that are junior and subordinate to the lien on and pledge of Net System Revenues securing Parity 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 except that Subordinated Obligations not issued under the Indenture would not have access to any Reserve Fund created thereunder for Subordinated Obligations. The Installment Purchase Agreement provides that nothing therein shall limit the ability of the City to grant liens on and pledges of Net System Revenues that are subordinate to the liens on and pledges of Net System Revenues for the benefit of Priority Obligations and Subordinated Obligations contained in the Installment Purchase Agreement. See Appendix E – "SUMMARY OF PRINCIPAL LEGAL DOCUMENTS" attached hereto.

The Water Department also has outstanding one State of California Department of Health Services Safe Drinking Water State Revolving Fund ("SRF") loan in the principal amount of approximately $18.9 million, which is payable on an annual basis and matures in 2025. Such SRF loan constitutes a Subordinated Obligation payable on a parity with the outstanding Subordinated Obligations. The Water Department has applied for an additional SRF loan in the approximate amount of $30 million. The California Department of Water Resources ("DWR") has acknowledged receipt of the Water Department's loan application and is currently reviewing it for approval. DWR is expected to fund certain selected applications by June 2009. By such time, the Water Department will have received notification of whether its application was selected for funding. See "WATER SYSTEM CAPITAL IMPROVEMENT PROGRAM – Financing Plans for the CIP" herein. No other SRF loans are currently being contemplated and no additional SRF loans will be applied for by the time this issuance goes to market.

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 by amendment to the City Charter effective February 11, 1963 and is accounted for separately from other funds of the City. Pursuant to the Installment Purchase Agreement, 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 herein. Pursuant to the Installment Purchase Agreement, the City shall pay from the Water Utility Fund: (i) directly or as otherwise required all Maintenance and Operation Costs of the Water System; and (ii) 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 (ii) 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. The Installment Purchase Agreement also provides that after the payments described 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: (a) all Maintenance and Operation Costs of the Water System are being and have been paid and are then current; and (b) all deposits and payments contemplated by clause (ii) 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 (ii) above. The Installment Purchase Agreement further provides that after the deposits described in this paragraph have been made, any amounts thereafter remaining in the Water Utility Fund may be used for any lawful purpose of the Water System.

Net System Revenues

Pursuant to the Installment Purchase Agreement, "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. "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 of California; 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 permitted by the Installment Purchase Agreement, and any amounts transferred from current System Revenues to the Secondary Purchase Fund as permitted 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. See "WATER SYSTEM FINANCIAL OPERATIONS – Rate Stabilization Fund and Secondary Purchase Fund" below.

"Maintenance and Operation Costs of the Water System" is defined in the Installment Purchase Agreement as (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 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 or subordinate to the Installment Payments. "Qualified Take or Pay Obligation" means the obligation of the City to make use of any facility, property or services, or some portion of the capacity thereof, or to pay therefor from System Revenues, or both, whether or not such facilities, properties or services are ever made available to the City for use, and there is provided to the City a certificate of 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 Series 2009A Bonds, there will be no outstanding Take or Pay Obligations.

Obligation of the City Under Installment Purchase Agreement

Pursuant to the Installment Purchase Agreement, the City commits, absolutely and unconditionally, to make Installment Payments solely (including the 2009A Installment Payments) from Net System Revenues until such time as the Purchase Price shall have been paid in full (or provision for the payment thereof has been made pursuant to the Installment Purchase Agreement). The City will not discontinue or suspend any Installment Payments (including the 2009A Installment Payments) 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 Installment Payments (including the 2009A 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.

Rate Covenant

The City has covenanted in the Installment Purchase Agreement to fix, prescribe and collect rates and charges for the Water System 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 the Installment Purchase Agreement. "Adjusted Net System Revenues" is defined in the Installment Purchase Agreement to mean, for any Fiscal Year, 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. "Adjusted Debt Service" is defined in the Installment Purchase Agreement to mean, 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. Net System Revenues (and thus 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 "– Net System Revenues" above. For information on the possible limitation on the City's ability to comply with the rate covenant as a consequence of Proposition 218, see "CONSTITUTIONAL LIMITATIONS ON TAXES AND WATER RATES AND CHARGES – Articles XIIIC and XIIID" herein. For a description of the two reserve funds established by the City within the Water Utility Fund, see "WATER SYSTEM FINANCIAL OPERATIONS – Rate Stabilization Fund; Other Funds and Accounts" herein.

Pledge Under the Indenture

Pursuant to the Indenture, the Authority has irrevocably pledged all Revenues (generally consisting of the 2009A Installment Payments and amounts on deposit in the funds and accounts established under the Indenture (other than amounts on deposit in the Rebate Fund)) to the payment of principal of and interest on the Series 2009A Bonds. In addition, in order to secure the pledge of the Revenues under the Indenture, the Authority has irrevocably pledged and transferred to the Trustee, for the benefit of the Owners all of the Authority's rights, title and interest in the right to receive the 2009A Installment Payments from the City under the 2009A Supplement.

Reserve Fund

A portion of the proceeds of the Series 2009A Bonds will be deposited in the Reserve Fund in an amount equal to the Series 2009A Reserve Requirement, which is, as of any date of calculation, the least of (i) ten percent (10%) of the proceeds (within the meaning of Section 148 of the Internal Revenue Code of 1986, as amended, and the regulations thereunder, and any successor laws or regulations (the "Tax Code")) of the Series 2009A Bonds; (ii) 125% of average annual debt service on the then-Outstanding Series 2009A Bonds; or (iii) the Maximum Annual Debt Service for that and any subsequent year. The term "Series 2009A Reserve Requirement" means, initially, the sum of $11,125,361.19. Upon early redemption of any of the Series 2009A Bonds, the Authority, at the request of the City, may request the Trustee to recalculate and reduce the Series 2009A Reserve Requirement established under the Indenture, whereupon any excess in the Reserve Fund over and above such Reserve Requirement shall be transferred to the Payment Fund. The Authority may replace all or a portion of the Series 2009A Reserve Requirement with one or more Surety Bonds.

The Series 1998 Certificates and the Series 2002 Subordinated Bonds are each secured by a reserve fund separate and apart from the Reserve Fund securing the Series 2009A Bonds. The holders of the Series 1998 Certificates and the Series 2002 Subordinated Bonds have no claim on the Reserve Fund for the Series 2009A Bonds, and the holders of the Series 2009A Bonds have no claim on the reserve fund for the Series 1998 Certificates or the Series 2002 Subordinated Bonds.

Parity Obligations

The pledge and right of payment from Net System Revenues securing the 2009A Installment Payments (which, in turn, secure the Series 2009A Bonds) is on parity with the pledge and right of payment from Net System Revenues securing the Installment Payments represented by the Series 1998 Certificates outstanding in the aggregate principal amount of $245,010,000, prior to the refunding described in this Official Statement, and any other Parity Obligations that may be issued from time to time in accordance with the Installment Purchase Agreement. See "PLAN OF FINANCE" herein.

Subordinated Obligations

The pledge and right of payment from Net System Revenues securing the 2009A Installment Payments (which, in turn, secure the Series 2009A Bonds) is senior to the pledge and right of payment from Net System Revenues securing the outstanding Subordinated Obligations, consisting of the Series 2002 Subordinated Bonds, of which $272,845,000 are currently outstanding, the City's $57,000,000 aggregate principal amount of Series 2007A Notes, all of which will be prepaid with proceeds of the Series 2009A Bonds, and the City's $150,000,000 aggregate principal amount of Series 2008A Notes.

Issuance of Additional Obligations

Parity Obligations under the Installment Purchase Agreement. Pursuant to the Installment Purchase Agreement, the City may at any time and from time to time issue or create additional Parity Obligations secured by and payable solely from Net System Revenues, provided that: (1) 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 (2) the City obtains or provides a certificate or certificates, prepared by the City or at the City's option by a Consultant, showing that: (A) the Net System Revenues as shown by the books of the City for any 12 consecutive month period 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 (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.

For purposes of preparing the certificate or certificates in clause (2)(A) in the preceding paragraph, the City or its Consultant may rely upon financial statements prepared by the City, which have not been subject to audit by an independent certified public accountant if audited financial statements for the period are not available. The determination of Net System Revenues pursuant to clause (2)(B) in the preceding paragraph (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)(B) in the preceding paragraph, be effective during a Fiscal Year ending within the five-Fiscal-Year period for which such estimate is being 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 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 clause (2)(B) above, all as shown by such certificate of the City or its Consultant, as applicable; and (3) for the period contemplated by clause (2)(B) in the preceding paragraph, 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 clause (2)(B) in the preceding paragraph. See Appendix E – "SUMMARY OF PRINCIPAL LEGAL DOCUMENTS" attached hereto.

The certificate or certificates described under this caption "– Parity Obligations under the Installment Purchase Agreement" is not required if the Parity Obligations being issued are for the purpose of 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. See Appendix E – "SUMMARY OF PRINCIPAL LEGAL DOCUMENTS" attached hereto.

Subordinated Obligations under the Installment Purchase Agreement. Pursuant to the Installment Purchase Agreement, the City may at any time and from time to time issue or create additional Subordinated Obligations secured by and payable solely from Net System Revenues, provided that: (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 Subordinated Obligations, and such Subordinated Obligations shall be paid in accordance with the provisions of 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: (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 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 (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 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.

For purposes of preparing the certificate or certificates described in clause (A) in the preceding paragraph, the City and its Consultant(s) may rely upon audited financial statements and, 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. For purposes of the computations to be made as described in clause (B) in the preceding paragraph, the determination of Net System Revenues: (A) 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 (B) in the preceding paragraph, be effective during any Fiscal Year ending within the five-Fiscal-Year period for which such estimate is made; and (B) 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 (B) in the preceding paragraph, all as shown by such certificate of the City or its Consultant, as applicable; and (C) for the period contemplated by clause (B) in the preceding paragraph, 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 (B) in the preceding paragraph. See Appendix E – "SUMMARY OF PRINCIPAL LEGAL DOCUMENTS" attached hereto.

The certificate or certificates described under this caption "– Subordinated Obligations under the Installment Purchase Agreement" is not 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. See "SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2009A BONDS" herein and Appendix E – "SUMMARY OF PRINCIPAL LEGAL DOCUMENTS" attached hereto.

Additional Bonds under the Indenture. Pursuant to the Indenture, the Trustee will, upon Written Request of the Authority, by a supplement to the Indenture, establish one or more other series of Bonds (the "Additional Bonds") secured by the pledge made under the Indenture equally and ratably with any Bonds previously issued and delivered, including the Series 2009A Bonds (together with the Additional Bonds, the "Bonds"), in such principal amount as shall be determined by the Authority, but only upon compliance with the provisions hereof and any additional requirements set forth in the applicable Supplemental Indenture, which are 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 of 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 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 for all Bonds and Additional Bonds to be then Outstanding; (d) 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; (e) 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; (f) 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 (g) 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.

2009A Installment Payments

Pursuant to the 2009A Supplement, the City agrees to pay as 2009A Installment Payments, solely from Net System Revenues as provided in the Installment Purchase Agreement, the following:

Fiscal Year	Principal Portion of Installment	Interest Portion of Installment	Combined Installment Payment
2009-10	$ 1,035,000.00	$ 7,644,420.14	$ 8,679,420.14
2010-11	1,110,000.00	7,569,925.00	8,679,925.00
2011-12	1,140,000.00	7,539,025.00	8,679,025.00
2012-13	1,170,000.00	7,507,225.00	8,677,225.00
2013-14	1,215,000.00	7,465,375.00	8,680,375.00
2014-15	1,265,000.00	7,415,775.00	8,680,775.00
2015-16	2,200,000.00	7,357,475.00	9,557,475.00
2016-17	15,015,000.00	6,949,100.00	21,964,100.00
2017-18	15,780,000.00	6,179,225.00	21,959,225.00
2018-19	16,590,000.00	5,369,975.00	21,959,975.00
2019-20	17,390,000.00	4,568,725.00	21,958,725.00
2020-21	18,215,000.00	3,744,700.00	21,959,700.00
2021-22	19,120,000.00	2,838,718.75	21,958,718.75
2022-23	1,745,000.00	2,326,637.50	4,071,637.50
2023-24	1,835,000.00	2,237,137.50	4,072,137.50
2024-25	1,930,000.00	2,143,012.50	4,073,012.50
2025-26	2,030,000.00	2,044,012.50	4,074,012.50
2026-27	2,130,000.00	1,940,012.50	4,070,012.50
2027-28	2,240,000.00	1,830,762.50	4,070,762.50
2028-29	2,355,000.00	1,715,887.50	4,070,887.50
2029-30	2,475,000.00	1,595,137.50	4,070,137.50
2030-31	2,605,000.00	1,464,881.25	4,069,881.25
2031-32	2,745,000.00	1,324,443.75	4,069,443.75
2032-33	2,895,000.00	1,176,393.75	4,071,393.75
2033-34	3,050,000.00	1,020,337.50	4,070,337.50
2034-35	3,215,000.00	855,881.25	4,070,881.25
2035-36	3,390,000.00	682,500.00	4,072,500.00
2036-37	3,570,000.00	499,800.00	4,069,800.00
2037-38	3,765,000.00	307,256.25	4,072,256.25
2038-39	3,970,000.00	104,212.50	4,074,212.50
Total	$157,190,000.00	$105,417,970.14	$262,607,970.14

WATER SYSTEM ORGANIZATION AND MANAGEMENT

History

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 San Diego County.

The 1.3 million people living in the City used an average of 217.8 million gallons per day ("MGD"; one MGD is equal to 1,120 acre feet per year ("AFY")) of potable water in Fiscal Year 2007-08. The City's population is projected to increase 26% in the next 25 years, and the City projects this growth will increase demand for potable water by approximately 13%. The City currently provides water to its customers by purchasing up to 90% of its water from CWA, a wholesale water agency that provided approximately 660,455 acre-feet ("AF") of imported water to its member agencies in San Diego County in Fiscal Year 2006-07. CWA, in turn, 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 ("SWP") through DWR. In Fiscal Year ended June 30, 2008, MWD sold approximately 2.30 million AF of imported water to customers. Both CWA and MWD are developing storage and additional supplies, such as water transfers, to augment their imported water. See "WATER SUPPLY."

Governance and Management

General. The Water System is owned by the City and operated by the City through the Water Department. The Water Department ultimately reports to the Mayor, who has the authority to supervise the Water Department and appoint managers and directors who are charged with the operations of the department. The City's Chief Operating Officer oversees all departments within the Mayor's purview, which excludes the office of the City Attorney. A Director of Public Utilities, who reports to the Chief Operating Officer, oversees the Water Department and the Metropolitan Wastewater Department (the "Wastewater Department"). The day-to-day operational responsibility for the Water Department rests with the Water Department Assistant Director, who reports to the Director of Public Utilities. The Water Department management team is further comprised of the Water Department Deputy Directors who head each of the four major divisions of the Water Department plus a small number of Program Managers who report to the division heads. The Director of Public Utilities, Water Department Assistant Director, Deputy Directors, and Program Managers make up the Water Executive Team that provides management of the Water Department. The Water Department and the Wastewater Department have determined that consolidation of certain administrative and financial functions common to the two departments would create opportunities for greater efficiency, reduced personnel costs and enhanced services to both internal personnel and external customers. The Water Department and the Wastewater Department are in the final planning stages for such consolidation, which is expected to be implemented with the Fiscal Year 2009-10 budget beginning on July 1, 2009.

The Water Department has managed the Water System since July 1, 1996, after assuming the duties from the City's Water Utilities Department as a part of a general reorganization of certain City's departments. The Water Department had approximately 779 budgeted full-time equivalent employees as of July 1, 2008. The City Council retains the authority to approve the Water 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 and Collection of Water Service Charges," " - Historical Rates and Charges," " - Current Rates and Charges" herein. In accordance with the provisions of the City Municipal Code, these funds are administered in an enterprise account separate from the City of San Diego's General Fund.

Officers. The current officers of the Water Department and their respective biographies are as follows:

Mr. Jim Barrett currently serves as the City's Director of Public Utilities. Mr. Barrett is a licensed Professional Civil Engineer in the State of California and has been with the City for approximately two years. Mr. Barrett is an appointed member on the Board of Directors for both the San Diego County Water Authority and the Metropolitan Water District of Southern California. He also serves as a member of the Association of California Water Agencies Federal Affairs Committee. Prior to joining the City, Mr. Barrett served as Vice President of Federal Programs with Earth Tech, Incorporated, and retired from the U.S. Navy with extensive experience in infrastructure, contract and utilities management after more than twenty years of service.

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

Ms. Marsi A. Steirer currently serves as the City's Deputy Director for the Water Resources and Planning Division. Ms. Steirer has been a City employee for 23 years and has worked for the Water Department for 20 years. Ms. Steirer was responsible for formulating several of the Water Department's strategic initiatives including the conservation program, a 30-year water resources plan, and strategic business plan. Ms. Steirer is a member of the American Water Works Association, and serves as the chairperson of the Management Division.

Mr. Jim Fisher, a licensed Professional Civil Engineer with 18 years experience, currently serves as the Water Department's Deputy Director of the Water Operations Division. Mr. Fisher holds a Grade 5 Water Treatment Plant Operator and Grade 4 Distribution Operator certification with the State of California.

Mr. Rod Greek, a Certified Public Accountant with 18 years experience, currently serves as the Water Department's Deputy Director of Business and Support Services. Mr. Greek is an active member of the California/Nevada American Water Works Association. Mr. Greek was appointed as the Financial Management Committee's Vice Chair in November 2006.

Mr. Mike Bresnahan currently serves as the Water Department's Deputy Director of Customer Support. Mr. Bresnahan has worked for the City of San Diego for 33 years. He is a member of AWWA.

Divisions.

<u>*Business and Support Services*</u>. This division provides administrative support for the Department including: Human Resources, Information Systems, Budget Development and Monitoring, Rate Setting and Finance, Contract and Grant Administration, Internal Compliance Oversight, Records Management, and Public Information.

Customer Support. This division provides Customer Information Services, Billing and Collection, Meter Services (including meter reading and servicing), Water Conservation Programs, and Public Information.

Water Operations. This division provides Water Purchases, Raw Water Storage and Distribution, Water Treatment, Water Laboratory Services, Treated Water Distribution, System Engineering, Construction and Maintenance, Maps and Records, Safety, and Public Information.

Water Resources and Planning. This division provides Long-Range Planning, Water Legislation and Policy Analysis, Water Resources Development, Facilities Master Planning, Capital Improvement Program ("CIP") Prioritization and Program Controls, Development Review, Reclaimed water Program Management, Asset Management, and Watershed and Resources Protection.

Oversight. The Independent Rates Oversight Committee ("IROC") was established in 2007 to assume and expand upon the oversight previously undertaken by the Public Utilities Advisory Commission. There are 11 members on the IROC, all of whom are appointed by the Mayor. The membership of IROC consists of representatives of each rate class and professional experts in such fields as finance, engineering, construction and the environment. IROC serves as an official advisory body to the Mayor and the City Council on policy issues relating to the oversight of Water Department and Wastewater Department operations including, but not limited to, resource management, planned expenditures, service delivery methods, public awareness and outreach efforts, high quality and affordable utility services provided by Water Department and the Wastewater Department. IROC's duties and functions include reviewing reports from staff and an independent audit organization on rate and bond proceed expenditures, advising on the efficiency and performance of the Water System and the Wastewater System, advising on future cost allocation models and the preparing an annual public report on such issues to the Mayor and City Council. IROC meets at least every other month to review activities and issues for the Water Department and the Wastewater Department.

WATER SYSTEM SERVICE AREA AND FACILITIES

Service Area

The Water System serves the City and certain surrounding areas, including retail, wholesale, and reclaimed water customers. The Water System's service area covers 403 square miles, including 342 square miles in the City, and approximately 1.3 million retail customers. See Appendix A – "CERTAIN INFORMATION REGARDING THE CITY OF SAN DIEGO AND AREA." The map which 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 Fiscal Year 2007-08, retail customers accounted for approximately 92% of total water deliveries and such sales represented approximately 95% of the revenues from total sales of water. Of the Water System's more than 270,000 retail service connections, approximately 91% are single family residential accounts and multi-family residential accounts, with the balance for commercial, industrial and other users. For the Fiscal Year ended June 30, 2008, single family and multi-family residential accounts comprised approximately 61% of total water sales revenue, with the balance for commercial, industrial and other users. Some of the Single Family, 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 2007 Rate Case, these residential classes are assumed to be homogenous in water usage and therefore are assigned the same peaking factors. It is noted however that usage and peaking will vary among the individual customers.

Single Family Residential. SFR refers to individual dwelling units served by a separate meter, and accounted for approximately 42% of total water sales revenues in Fiscal Year 2007-08.

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 19% of total water sales revenues in Fiscal Year 2007-08.

Commercial/Industrial. Commercial and Industrial user classes are comprised of a diverse group of customers and accounted for 20% of total water sales revenues in Fiscal Year 2007-08. 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.

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. This diverse group of customers accounted for 13% of total water sales revenue for Fiscal Year 2007-08.

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 2007-08.

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 Rate Case, peak usage is more costly to deliver than constant usage because it requires more pumping.

Table 1 sets forth the historical number of connections to the Water System for each year from Fiscal Year 2003-04 through 2007-08.

TABLE 1

HISTORICAL NUMBER OF RETAIL CONNECTIONS TO WATER SYSTEM
Fiscal Year 2003-04 through Fiscal Year 2007-08

Customer Type	**2003-04**	**2004-05**	**2005-06**	**2006-07**	**2007-08**
Single Family	217,009	217,933	219,079	219,984	220,519
Multi-Family	29,088	29,234	29,276	29,239	29,208
Commercial	15,609	15,542	15,558	15,604	15,603
Industrial	294	269	253	231	215
Irrigation(1)	7,278	7,467	7,431	7,463	7,462
Temporary Construction(1)	462	422	391	374	345
Outside City(2)	52	50	48	45	46
TOTAL	269,792	270,917	272,036	272,940	273,398
Percent Growth	0.83%	0.42%	0.41%	0.33%	0.17%

Source: City of San Diego Water Department.

(1) Established as separate customer classification in Fiscal Year 2007-08; prior year figures developed from historical reports.

(2) Comprised of predominantly single family domestic customers outside of the City's limits to whom the City has agreed to provide water.

Table 2 sets forth the 10 largest non-governmental retail customers and the top 10 governmental customers of the Water System for Fiscal Year 2007-08, which provided approximately 1.64% and 10.66%, respectively, of the total sales revenues for such fiscal year.

TABLE 2

**MAJOR NON-GOVERNMENTAL RETAIL CUSTOMERS
AND TOP GOVERNMENTAL CUSTOMERS
Fiscal Year 2007-08
(Unaudited)**

Customers	Millions of Cubic Feet	Billings	% of Total Sales Revenues
MAJOR NON-GOVERNMENTAL RETAIL CUSTOMERS			
CP Kelco	41.22	$ 1,006,594	0.35%
Marine Park Corp	35.62	856,728	0.30
San Diego Zoo	27.73	675,092	0.23
Marriott Full Service	17.10	428,031	0.15
Coca Cola Bottling Co	13.95	334,889	0.12
Costa Verde Dev LLC	11.56	319,700	0.11
Sharp Memorial Hospital	10.87	286,379	0.10
Qualcomm Inc	10.71	274,522	0.10
The Irvine Holding Co	9.52	267,079	0.09
Kaiser Permanente	9.36	253,517	0.09
TOTAL TOP 10 NON-GOVERNMENTAL RETAIL CUSTOMERS	187.64	$4,702,531	1.64%
TOP GOVERNMENTAL CUSTOMERS			
City of San Diego	423.13	$11,543,256	4.00%
U.S. Navy	290.55	7,975,320	2.76
University of California at San Diego	104.10	2,632,737	0.91
California Dept of Transportation	85.43	2,380,308	0.82
San Diego Unified School District	56.57	1,896,418	0.66
All Federal Agencies	65.45	1,678,160	0.58
San Diego Port District	32.85	929,739	0.32
San Diego State University	31.29	812,063	0.28
County of San Diego	20.35	575,140	0.20
Poway Unified School District	13.90	382,291	0.13
TOTAL TOP 10 GOVERNMENTAL CUSTOMERS	1,123.62	$30,805,432	10.66%

Source: City of San Diego Water Department.

Wholesale Customer Base. For Fiscal Year 2007-08, wholesale customers accounted for approximately 6% of total water deliveries and such sales represented approximately 5% 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 five wholesale customers: (1) the California-American Water Company (“Cal-American”), (2) the City of Del Mar (“Del Mar”), (3) the Santa Fe Irrigation District, (4) the San Dieguito

Irrigation District (together with the Santa Fe Irrigation Districts, the "Irrigation Districts"), and (5) Otay Water District ("OWD").

<u>Cal-American</u>. 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 2007-08, the City made approximately 6% of its total water deliveries to Cal-American and such sales represented approximately 4% of the revenues from total sales of water. The City's agreement with Cal-American is renewed on an annual basis and permits mid-year rate adjustments to account for any purchased water cost increases from CWA.

<u>Del Mar</u>. Pursuant to an existing contract between the City and Del Mar, the City treats raw water which Del Mar purchases from CWA. The treatment price paid by Del Mar is primarily based on the Del Mar's pro-rata share of the Operation and Maintenance expenditures (herein described) attendant to the City's provision and treatment services. For Fiscal Year 2007-08, deliveries from the treatment of Del Mar water represented less than 0.1% of total deliveries and less than 0.1% of revenues from total sales of water. The City's agreement with Del Mar is renewed on an annual basis.

<u>Irrigation Districts</u>. Pursuant to existing contracts between the City and each of the Irrigation Districts, which expire in September 2009, the City delivers raw water from the Lake Hodges Reservoir. Each contract sets the terms and rates pursuant to which the applicable Irrigation District may purchase water from the City and provides each Irrigation District with the right to purchase a specified amount of water. The purchase price charged each Irrigation District is based on portion of Operation and Maintenance expenditures and capital improvement costs related to the City's provision of water to such Irrigation District. For Fiscal Year 2007-08, these water sales represented less than 0.1% of total deliveries and such sales represented less than 0.5% of the revenues from total sales of water. The City's contracts with the Irrigation Districts are renewed every two years.

<u>OWD</u>. The City's Otay Water Treatment Plant ("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 the OWD to deliver up to 10 MGD of surplus treated water, which deliveries began in November 2005. The amounts paid by the OWD for such treated water are determined in part by allocating to the City and the 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 acre foot, 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, the OWD may elect to pay its proportional share of costs to expand the treatment plant 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.

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 reclaimed 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 the OWD and the Olivenhain Municipal Water District for reclaimed water in Fiscal Year 2006-07. The City also provides reclaimed water to the City of Poway under the terms of an agreement entered into in 1998. Pursuant to the Water Department's calculations, approximately $1 million is due each year from the City of Poway. However, the City of Poway and the City disagree about the cost per acre-foot of water delivered pursuant to this agreement, though the resolution of this disagreement is not expected to have a material adverse impact on the Net System Revenues available to pay debt service on the Series 2009A Bonds. In calendar year 2007, reclaimed water represented 3% of the City's water supply portfolio. For Fiscal Year 2007-08, reclaimed water customers and processing accounted for approximately 2% of total water deliveries and accounted for approximately 1% the revenues from total sales of water.

Existing Water System Facilities

The Water System consists of nine raw water storage facilities, three water treatment plants, 29 treated water storage facilities and over 3,460 miles of water transmission and distribution lines. Water is transported through 50 water-pumping stations and nearly 274,000 metered service connections.

***Raw Water Reservoirs*.** The City has nine reservoirs with a total capacity of 408,593 AF, of which 226,770 AF was in storage as of June 30, 2008. 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), is currently being connected to the Olivenhain Reservoir (completion projected for 2010) and will be used pursuant to an agreement between the City and CWA as part of the Emergency Storage Project, which was developed through CWA to provide approximately 90,100 AF of reservoir storage and supporting distribution facilities to supplement existing emergency water supplies in San Diego County in case of a prolonged interruption of imported water supplies. The City has agreements with neighboring water agencies 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 18% of the storage capacity of the Lake Hodges Reservoir 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 ("AWTP") in central San Diego; and the Miramar Reservoir (6,682 AF total capacity) services the Miramar Water Treatment Plant ("MWTP") in north San Diego. According to City Council policy, the City shall have approximately 7.2 months of the annual 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. In 2006, a number of the City's raw water storage reservoirs were listed as "impaired" water bodies pursuant to Section 303(d) of the federal Clean Water Act as a result of an initiative to apply federal wastewater standards to drinking water reservoirs. The City currently has a proactive watershed protection and improvement plan for its reservoirs. The application of federal wastewater standards to drinking water reservoirs is being challenged through the courts in Florida. If the challenge is unsuccessful and the determination with respect to the City's raw water storage reservoirs remains unchanged, the City will implement a plan to identify, manage and control the contaminant run-off that contributes to the determinations under Section 303(d) of the federal Clean Water Act. The potential costs for such a plan cannot be determined at this time.

Table 3 sets forth the City's raw water reservoirs and their respective storage capacities and storage levels.

TABLE 3

RAW WATER RESERVOIRS
(As of December 8, 2008)

Reservoir	Storage Capacity (AF)	Storage (AF)	Percent Full
Lake Hodges	30,251	17,414	58%
Lower Otay	49,849	31,476	63
Barrett	34,806	25,256	73
Morena	50,694	6,673	13
El Capitan	112,807	55,121	49
San Vincente	89,312	47,223[(1)]	53
Sutherland	29,508	6,594	22
Lake Murray	4,684	4,160	89
Miramar	6,682	5,370	80
	408,593	199,287	

Source: City of San Diego Water Department.
(1) Approximately 32% of the raw water stored at the San Vincente Reservoir will be drawn down in Fiscal Years 2007-08 and 2008-09 in connection with improvements thereto.

Water Treatment Plants. The Water Department maintains and operates three water treatment plants with a combined rated capacity of 294.2 MGD through which potable water is supplied. Supplemental treated supplies from CWA are used to help operate the distribution system reliably and efficiently. On-going upgrades to all three plants are expected to increase future rated capacity to 455 MGD, thereby further reducing the need to purchase treated water and providing capacity for customer growth. Treated water accounted for approximately 10% of the approximately 219,250 AF of water purchased by the City from CWA during Fiscal Year 2007-08.

Alvarado Water Treatment Plant. The AWTP was originally constructed in 1951 with an original rated capacity of 66 MGD. Several hydraulic improvements constructed in the mid-1970's and additional upgrades completed recently will, upon approval by the State of California Department of Public Health ("DPH"), increase the plant from its current rated capacity of 120 MGD to a rated capacity of 150 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. The CIP includes further upgrades to increase the AWTP's rated capacity to 200 MGD by Fiscal Year 2010-11.

Miramar Water Treatment Plant. The MWTP was originally constructed in 1962 and has a current rated capacity of 140 MGD. 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 CIP includes various upgrades to the plant, which are expected to increase MWTP's rated capacity of 215 MGD by 2011.

Otay Water Treatment Plant. The current OWTP was constructed in 1989 and has a current rated capacity of 34.2 MGD. The OWTP serves the general area along the Mexico border and the southeastern portions of central San Diego. The CIP includes an upgrade to the plant that will increase its rated capacity to 40 MGD by Fiscal Year 2010-11. Table 4 sets forth the original design capacity, current rated capacity and future rated capacity for each of the City's water treatment plants and the current average demand and current peak demand supported by such plants.

TABLE 4

CAPACITY AND DEMAND OF WATER SYSTEM WATER TREATMENT PLANTS
(In MGD)
(As of June 30, 2008)

Water Treatment Plant	Original Design Capacity	Current Rated Capacity	Future Rated Capacity[1]	Current Average Demand	Current Peak/Max Demand
Alvarado	66	120.0	200	89.5	116.8
Miramar	100	140.0	215	88.1	135.3
Otay	40	34.2	40	20.7	30.5
Total	206	294.2	455	198.3	282.6[2]

Source: City of San Diego Water Department.

(1) Future Rated Capacity is based upon the completion of projects described above relative to the AWTP, MWTP and OWTP in the CIP by Fiscal Year 2010-11.

(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.

Treated Water Storage Facilities. The Water 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 200 million gallons.

Delivery System. The Water System consists of approximately 3,460 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 Water Department also maintains and operates 49 water pump stations that deliver treated water from the water treatment plants to nearly 274,000 metered service connections in over 114 different pressure zones. In addition, the Water Department maintains several emergency connections to and from neighboring water agencies, including the Santa Fe Irrigation District through the MWTP, the Poway Municipal Water District through the MWTP, Cal-American through the AWTP and the OWTP, the Sweetwater Authority through the OWTP, and the OWD through the OWTP.

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 which 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 $5,000,000.

Utility Costs

The Water System is supplied with electricity and gas by an investor owned utility. The gas and electric services accounts for approximately 2% of the Water System's annual operating budget. To date, the Water System has not experienced any significant power shortages and there has not been any disruption in service to the Water System. Further, the Water System has sufficient self-generating resources to provide water services to domestic customers in the event of the occurrence of more significant power shortages. The Water Department recently completed installation of a 1 megawatt photovoltaic solar panel "farm" at the AWTP which supplies approximately 40% of the local electrical demand.

WATER SUPPLY

Current Water Supply

The Water System currently receives its water supply from two sources: (1) local runoff and (2) water imported by CWA. Historically, approximately 10% of the water supply for the Water System comes from local rain runoff. This runoff is seasonal and variable in nature. The balance of the Water System water supply is imported from Northern California and the Colorado River and is supplied to the City by CWA, of which the City is a member agency. CWA, in turn, purchases the majority of its water from the MWD, which is comprised of 26 public water agencies. CWA also has rights to purchase water supplies from the Imperial Irrigation District ("IID") in the amount of 60,000 AF in calendar year 2008, which volume will increase by 10,000 AFY until calendar year 2020, when the transfer amount reaches 200,000 AFY. In addition, CWA has rights to 77,700 AFY of water supplies dedicated to CWA as a result of water-conserving canal lining projects on the All-American and Coachella Canals. Although the water supplied from the canal lining projects will reduce CWA, and hence the City's, reliance upon MWD for imported water, the canal lining projects convey water from the Colorado River basin which has experienced significant drought events over the last several years resulting in diminished reservoir storage levels along the river. See Appendix C – "INFORMATION CONCERNING THE SAN DIEGO COUNTY WATER AUTHORITY AND METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA" attached hereto for a description of CWA's water supplies.

For Fiscal Year 2007-08, the City's average daily water use, including Del Mar and Cal-American deliveries, was approximately 217.8 MGD, with peak day demands as high as 298.5 MGD. The City's three Water Treatment Plants provided 198.3 MGD or 91.04% of average demand and 273.8 MGD or 91.7% of peak 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. See Appendix B – "REPORT ON THE ENGINEERING AND FINANCIAL FEASIBILITY STUDY" and Appendix C – "INFORMATION CONCERNING THE SAN DIEGO COUNTY WATER AUTHORITY AND METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA" attached hereto for a description of CWA's water supplies.

The City is the largest purchaser of water from CWA. During Fiscal Year 2007-08, the Water Department purchased approximately 219,500 AF of water from CWA at a cost of $113.4 million. Currently, the City pays CWA $515 per AF for untreated water and $679 per AF for treated water.

The Strategic Plan for Water Supply, which was adopted by the City Council in August 1997 (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 and 32,250 AFY of water savings for calendar years 2006, 2007 and 2008, 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. See Appendix C – "INFORMATION CONCERNING THE SAN DIEGO COUNTY WATER AUTHORITY AND METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA" attached hereto.

Water sales for the current Fiscal Year 2008-09 through October 2008 are 6% less than water sales in the same period for the last Fiscal Year 2007-08. The City has taken into account the effect of the current state-wide drought (including any potential reduction of water sales by CWA in 2009) by assuming in its budget for Fiscal Year 2008-09 a 15% reduction in water sales and purchases. However, based on the year-to-date experience, it is anticipated that the Fiscal Year 2008-09 water sales will be reduced by no more than 7.5% and such level of savings, along with a corresponding increase in water purchases, is reflected in the financial projections for Fiscal Year 2008-09. See Table 17 under the caption "WATER SYSTEM FINANCIAL OPERATIONS – Financial Projections and Modeling Assumptions". Fiscal Year 2009-10 reflects a 15% reduction in water sales and purchases based on current estimates of MWD/CWA restrictions on water supplies, which is expected to result in reduced revenues which are generally offset by reductions in both its operating budget and its capital improvement budget. See "RISK FACTORS – Drought Risks" herein. To address water supply issues, the City plans to expand its development of ground water assets including desalination of brackish groundwater and its utilization of reclaimed water. As part of this development, the City will consider, among other things, an independent energy and economic analysis of all water supply augmentation methods in the Long Range Water Resource Plan and a one-year pilot indirect potable reuse demonstration project (the "IPR Project"). If the IPR Project meets regulatory requirements and provides evidence of the viability of the indirect potable reuse through reservoir augmentation process, the City may consider the feasibility of constructing a full scale indirect potable reuse through reservoir augmentation process plant. Such a plant would send advanced treated water to the San Vicente Reservoir via a 23-mile pipeline where it would be redistributed as potable water after months of blending and additional treatment. See "WATER SYSTEM FINANCIAL OPERATIONS - Establishment of Water Service Charges" herein for a description of the commodity charge increase approved by the City Council and the Mayor to fund the IPR Project. Bond proceeds will not be used to finance the current IPR Project but may be used in the future if a full-scale indirect potable reuse project is pursued.

In July 2008, the City declared a Stage 1 Voluntary Compliance Water Watch (the "Stage 1 Voluntary Compliance Water Watch"), which applied during periods when the possibility exists that the Water 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 the 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 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. Various water conservation practices will be encouraged during Drought Response Level 1; such practices become mandatory upon the declaration of Drought Response Level 2. The City's drought response plan includes four levels and culminates in the declaration of drought emergency conditions.

The declaration of the Stage 1 Voluntary Compliance Water Watch is consistent with the Mayor's endorsement of CWA's "20 Gallon Challenge" in June 2007 pursuant to which San Diego residents and businesses are 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 is not required by law and any failure to meet the challenge will not result in penalty to the City. The City also has been actively monitoring the management of water supplies at both MWD and CWA. While a degree of uncertainty does exist, depending on trends in the State's water levels, the City may consider declaring a Drought Response Level 2, together with the mandatory reduction of water use attendant thereto, in the spring of calendar year 2009. See Appendix C – "INFORMATION CONCERNING THE SAN DIEGO COUNTY WATER AUTHORITY AND METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA" attached hereto for a description of DWR's initial allocation of for water delivery to SWP contractors for calendar year 2009.

Future Water Supply for the Water System

1997 Strategic Plan for Water Supply. 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.

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

The objectives of the Long-Range Water Resources Plan were to extend water demand projections through 2030 and also develop a decision-making framework for evaluating water supply options. The Long-Range Water Resources Plan identified various options to meet this medium to long-term demand. These options include water conservation, water reclamation, groundwater desalination, groundwater storage, ocean desalination, marine transport, Central Valley Water Transfers, and imported supply from CWA and MWD. Various alternative portfolios of water supply options were evaluated against a set of planning objectives to determine the appropriate strategic direction for development of water resources.

The Long-Range Water Resources Plan concluded that no single supply source will be sufficient to meet the City's future water demand. The priority supply portfolio options identified for implementation by 2010 are: conservation, reclamation, groundwater and transfers of surplus waters from the water agencies in the Central Valley under long-term contracts or as spot commodity purchases.

The Long-Range Water Resources Plan recommended, among other things, that the common resource elements from the three top-scoring portfolios be implemented by 2010 (Phase 1). Resource elements that are different among these portfolios should then be examined to determine under what conditions they would become most feasible for the City to implement. Based on such factors as the success or failure of CALFED, emergence of a strong water transfer market, technology improvements in membrane treatment, and the outcome of the City's field investigations of local groundwater, three distinct paths or strategies could be taken and possibly implemented by 2020 (Phase 2 of the Plan). Once a particular strategy is chosen by the City, then Phase 3 of the Long-Range Water Resources Plan would implement a variety of resource options by 2030, depending on the continued success of prior resource implementation and/or achievement of planning objectives.

Although the Long-Range Water Resources Plan initially prescribed the implementation of the common resource elements by 2010, development of these options and implementation of the common resource elements (except for conservation) have been delayed until 2012 or later because of delays in related capital projects from 2005 through 2007, when there was limited access to bond financing. The

Water Department currently anticipates meeting the initial conservation goal set forth in the Long-Range Water Resources Plan. By 2030, the City's reliance on imported water could be as low as 57%, based on projected water demands of 297,000 AF in calendar year 2030, if most of the alternative resources options available to the City were implemented.

2005 Urban Water Management Plan. The City completed its Urban Water Management Plan (the "UWMP"), which builds upon the previously approved Long-Range Water Resources Plan and the Strategic Plan. Together, the UWMP, the Long-Range Water Resources Plan and the Strategic Plan set water savings goals of 32,000 AFY by 2010, 36,000 AFY by 2020 and 46,000 AFY by 2030. The UWMP reports the activities the City is embarking upon to secure a safe, reliable water supply for the City, including establishment of the City's Water Conservation Program (the "Water Conservation Program"), improvements to the City's water treatment plants, identification and securing of additional sources of water and improve most of water supply reliability in the region through groundwater investigation, alternative storage projects and participation in emergency storage projects.

The City is currently in the early stages of preparing its next update to the UWMP (the "2010 UWMP"), which will relate to general long-range water resources and is scheduled to be completed in 2010. The 2010 UWMP will also focus on global warming, compliance with AB 32 (The Global Warming Solutions Act of 2006), energy efficiency, regional water supply issues and recent legislation aimed at increasing water-use efficiency and improvements in water resources planning.

Conservation. The Water Department's Water Conservation Program was established by the City Council in 1985 and promotes permanent water savings. The Water Conservation Program accounts for over 32,000 AFY of potable water savings in Fiscal Year 2007-08. 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 Water Department works closely with the City's Planning and Development Services Departments 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 Water Department continues to work with its proven water conservation programs while implementing new irrigation management programs to maximize water savings.

In February 2008, an administrative County Grand Jury issued a report entitled "Water Conservation: Sober Up San Diego, The Water Party Is Over" (the "Grand Jury Report") examining water uses and how to reduce water usage. The Grand Jury Report recommended, among other things, structuring water rates for multiple-family residences and for commercial, industrial and agricultural users, into tiered block structures to make charges proportionate to use, more careful consideration of the City's growth policy as it relates to San Diego's long-term water prospects and the beginning of more rigorously enforcing the requirement that any large project proposal be able to ensure a 20-year supply of water, basing the cost of new water meters on the current and projected water conditions, formalizing concrete triggers for water alerts to make them automatic, making some or all of the voluntary usage restrictions in Stage 1 Voluntary Compliance Water Watch permanently mandatory in San Diego, raising the cost of reclaimed water to at least 80% of that of potable water and using this income to finance expansion of the reclaimed water distribution system, approving the use of reclaimed water for reservoir augmentation, and implementing the use of reclaimed water in all appropriate City facilities. The City Council and the Mayor responded to the Grand Jury Report and indicated that several of the recommendations have already been implemented. Among the recommendations that have been implemented are a review of the City's growth policy, enforcement of a 20-year water supply assessment in connection with approval for large-scale development projects (in accordance with which a water source or water offset must be identified prior to project approval) and use of reclaimed water in all appropriate City facilities. The responses to the Grand Jury Report also indicated that the other recommendations may be implemented in the future, if implementation would be appropriate and allowable under applicable law. See "RISK FACTORS – Drought Risks" herein.

Groundwater. The City has several relatively small groundwater basins within its jurisdiction, from San Pasqual in the north, to the San Diego River in the center of the City, to the Tijuana River Valley in the south. The largest basin, the San Diego Formation, lies along the coast from the Mexican border to Point Loma.

The City is presently pursuing groundwater feasibility projects in San Pasqual, Mission Valley, and the San Diego Formation and exploring new technologies such as desalinating brackish groundwater that can provide affordable water supply sources. This supply source is a possible alternative and is part of the City's planning efforts. Local water supply projects, particularly groundwater exploration, are locally controlled and can offer enhanced drought protection.

Reclaimed Water. The majority of expenses relating to the production of reclaimed water accrue to the City's Wastewater System while revenues from the sale of reclaimed water accrue to the Water System primarily because of a $70 million investment that the Water System made in expanding the non-potable reclaimed water distribution system (purple pipe) in the late 1990's. The City has made significant capital investments in the reclaimed water program. To date, over $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 for the past 11 years and has a wastewater treatment capacity of 30 MGD. During the summer of 2007, the NCWRP's reclaimed water production peaked at 9 MGD, with the remainder of the wastewater being treated to secondary levels and sent to Point Loma for discharge to the Pacific Ocean. The secondary effluent helps reduce the concentration of suspended solids in the wastewater being discharged. The plant currently serves nearly 450 retail customers and two wholesale customers.

The SBWRP is located on Dairy Mart Road, near the international border with Mexico. The SBWRP, which commenced delivery of reclaimed water to customers in the summer of 2006, has a wastewater treatment capacity of 15 MGD. Wastewater flows to the plant are about 9 MGD, and during the summer of 2007 beneficial reuse peaked at 8 MGD. The majority of the reclaimed water is sold to the Otay Water District, a local water agency with more than 600 meter connections. The SBWRP also sells water to three retail customers including the U.S. International Boundary & Water Commission treatment plant, located just to the east of the water reclamation facility.

Citywide beneficial reuse projections are estimated to be 12,000 AF for calendar year 2008 increasing to more than 14,000 AF per year by 2013. Reclaimed water usage is seasonal and is primarily used for irrigation. Customers are also using the water for dust suppression or soil compaction at construction sites, in cooling towers and for office building toilet and urinal flushing (dual plumbing). During the summer of 2008, the two reclamation plants met a peak demand of over 16 MGD. Conversely, during cooler months, demands range from two to nine MGD. Reclaimed 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 reclaimed water distribution lines.

Reclaimed water rates were lowered from $1.34 to $0.80 per hundred cubic feet ("HCF") on July 1, 2001, following the completion of a detailed rate study. As of July 1, 2008, the reclaimed water rate was approximately 28% of the equivalent potable water rate charged to irrigation customers. The Water Department is currently conducting a reclaimed water pricing study to determine the cost of producing and distributing reclaimed water. The scope of the study includes development of recommendations for reclaimed water commodity rates, base fees, capacity charges, alternative rate structures and a reclaimed water rate model. Factors included in the pricing study include cost of operation and maintenance for production and distribution facilities as well as capital costs for the most feasible expansion projects. It is anticipated that the reclaimed water pricing study will be completed in Fiscal Year 2008-09. See "WATER SYSTEM SERVICE AREA AND FACILITIES – Reclaimed Water Customer Base" herein for a description of reclaimed water produced by the City.

Table 5 below sets forth the City's planned water supply sources from Fiscal Year 2009-10 to Fiscal Year 2029-2030.

TABLE 5

PROJECTED WATER SUPPLY SOURCES
Fiscal Years 2009-10 to 2029-30
(AFY)

Water Supply Sources	2010	%	2015	%	2020	%	2025	%	2030	%
CWA	201,901	84%	205,178	83%	212,260	83%	222,238	83%	231,725	84%
Local Surface Water	29,000	12	29,000	12	29,000	11	29,000	11	29,000	11
Reclaimed Water	8,525	4	12,200	5	15,200	6	15,200	6	15,200	5
Total	239,426	100%	246,378	100%	256,460	100%	266,438	100%	275,925	100%

Source: Urban Water Management Plan, as supplemented.

WATER SYSTEM REGULATORY 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 EPA (with direct oversight by the California Department of Public Health) and includes, among other things, standards for 90 chemical, microbiological, radiological, and physical contaminants in drinking water and requirements for the preparation of consumer confidence reports, water system operator certifications and drinking water source assessments. The Safe Drinking Water Act also requires that every five years the EPA establish a list of contaminants which 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 which 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 is currently evaluating the risks from several specific health concerns, including: microbial contaminants (*e.g.*, Cryptosporidium); the byproducts of drinking water disinfection; radon; and water systems that do not currently disinfect their water but get it from a potentially vulnerable ground water source. The Water 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 cosmetic (such as tooth discoloration) or aesthetic effects (such as taste or odor). Water systems are not required to adopt these secondary standards, but states may choose to adopt and enforce them. The City currently meets such standards. See Appendix B – "REPORT ON THE ENGINEERING AND FINANCIAL FEASIBILITY STUDY" for a further description of federal requirements applicable to the Water System.

State Regulations

As an operator of a large municipal water system, the City is responsible for complying with various state requirements, including the State of California Environmental Quality Act, 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 certificate of water treatment and distribution operators. Failure to meet these standards may subject the City to civil or criminal sanctions. The Water Department is currently in compliance with all applicable state regulations. See "– Compliance Order by the California Department of Public Health" herein. See also Appendix B – "REPORT ON THE ENGINEERING AND FINANCIAL FEASIBILITY STUDY" for a further description of federal requirements applicable to the Water System.

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, which built upon prior rules to address protection of public water systems against microbial contaminants, especially Cryptosporidium, and at the same time, reduce 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 to date and expects to complete its initial distribution system evaluation and comply with its reporting and monitoring requirements by the compliance deadlines set forth in the Stage 2 DBPR, a portion of which is expected to be financed with proceeds of additional water revenue bonds described under "Financing Plans for the CIP" herein.

Other new regulations, including regulations that are in effect but whose compliance are not yet mandated (such as the Ground Water Rule promulgated by the EPA pursuant to the National Primary Drinking Water Regulation) 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 arsenic, radon, sulfate, groundwater and filter backwash, are currently unknown. See "RISK FACTORS – Statutory and Regulatory Compliance" herein.

Compliance Order by the California Department of Public Health

DPH 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, DPH notified the City that certain deficiencies in the Water System were found during a routine sanitary survey of the Water System conducted by the DPH 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 DPH 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 DPH 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 "DPH Compliance Order"), to include additional items that were not in the 1997 Compliance Order. The DPH Compliance Order will remain in effect until the projects required thereunder are completed.

The Water Department has made substantial progress in completing the projects set forth in the DPH Compliance Order and is currently meeting the ongoing requirements thereof, including the obligation to provide DPH 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 2007-08 through 2010-11 to finance projects mandated in the DPH Compliance Order as well as other CIP projects.

DPH has the authority to impose civil penalties if the City fails to meet DPH Compliance Order deadlines, although DPH has not imposed such penalties to date. Violation of the DPH Compliance Order may be subject to judicial action, including civil penalties specified in 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, citation 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. The estimated DPH Compliance Order project costs and DPH-related project costs for Fiscal Year 2008-09 through Fiscal Year 2012-13 is approximately $515 million. The Water Department anticipates financing such costs with existing net assets, present and future revenues, and financing proceeds secured by system revenues.

Permits and Licenses

The Water System holds a Water Supply Permit from the DPH for operation of certain 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 DPH during the design, construction and subsequent operations of all improvements which 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. The City does not anticipate any problems with continued Water System operation under existing and planned future permits and licenses.

WATER SYSTEM CAPITAL IMPROVEMENT PROGRAM

General

The Water System's CIP, which was originally prescribed in the Strategic Plan developed in 1997 and supplemented and updated in 2002 by the Long Range Water Resources Plan, each with the assistance of a citizen task force, was developed to ensure that the City has a cost-effective, safe and reliable water supply. See "WATER SUPPLY – Future Water Supply for the Water System" herein. The City reevaluates the projects contained in the CIP and the timing of improvements on an annual basis. Changes to the CIP are made to reflect changing priorities within the Water System and may occur as a result of project scope changes, date revisions, project sequencing and operational considerations. There are five fundamental driving forces behind the expansion and upgrades of the City's Water System: replacement of aging infrastructure to reduce pipeline breaks and emergency repairs, increasing treatment capacity and improving process technology, expansion of the Water System to accommodate retail growth, compliance with Federal Safe Drinking Water Act and satisfaction of the DPH Compliance Order. Approximately 71% of the anticipated projects to be constructed from Fiscal Years 2008-09 to 2012-13 are either mandated by the DPH Compliance Order or are related to DPH projects.

In April 2002, the City Council adopted increases to the water base fee rates and commodity rates to increase revenues from retail sales in each of the following five fiscal years by 6% per year. The revenues generated by such rate increases were used to fund the continued upgrade and expansion of the Water System as prescribed by the CIP.

Despite not accessing the public bond market in Fiscal Years 2004-05 and 2005-06 and relying on short-term private financing in Fiscal Years 2006-07 and 2007-08, the Water Department completed 86 capital projects aggregating approximately $595 million between Fiscal Year 2002-03 and Fiscal Year 2007-08, including improvements to water treatment plants, water storage reservoirs, water pump stations, water pipelines, reclaimed water projects and cast iron projects. In February of 2007, the City Council adopted rate increases of 6.5% per year for Fiscal Years 2007-08 through 2010-11 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 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 Water Department has developed a comprehensive CIP to address current and future Water System needs. See "– Project Schedule and Cost" herein.

The CIP projects can be classified into one of nine categories as they relate to the Water System. Some of these projects were included in the original CIP as set forth in the Strategic Plan, while others have been added to the CIP or had their schedules modified since the Strategic Plan was finalized. See Appendix B – "REPORT ON THE ENGINEERING AND FINANCIAL FEASIBILITY STUDY" for a further description of these projects. The map which 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 CIP includes projects which will rehabilitate and upgrade the AWTP, the MWTP and the OTWP. As part of the Alvarado Upgrade, the rated capacity of the AWTP will be expanded to 200 MGD by Fiscal Year 2010-11 to meet future water demands through 2030. The MWTP will be expanded to a capacity of 215 MGD by Fiscal Year 2009-10 to meet future water demands through 2030. The improvements to the OWTP, which will increase the OWTP's rated capacity from 34.2 MGD to 40 MGD, are expected to be completed by Fiscal Year 2010-11. Such improvements to the City's water treatment plants will also assist the City in complying with the requirements of the Federal Safe Drinking Water Act and the DPH Compliance Order. See "WATER SYSTEM REGULATORY REQUIREMENTS – Federal Requirements" and "– Compliance Order by the California Department of Pubic Health" herein.

Pipelines. The CIP includes pipeline projects relating to the continued rehabilitation, replacement and installation of distribution and transmission lines throughout the Water System. Included in the anticipated pipeline projects is the replacement of approximately 20 miles per year of existing cast iron distribution mains which have passed their 50-year service life. Approximately 193 miles of such mains remain to be replaced.

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 outlet improvements at the Lower Otay Reservoir.

Treated Water Storage Facilities. The rehabilitation and construction projects included in the CIP through Fiscal Year 2010-11 will increase treated water storage capacity by 6% as compared to the amount available at July 1, 1998, when implementation of the CIP projects began.

Reclaimed Water Facilities. The North City Reclamation Plan System Expansion is currently in the design phase and construction will begin in Fiscal Year 2010. Currently, there is an annual allocation of $500,000 to expand the reclaimed water system to connect new customers.

Groundwater Projects. See the caption "WATER SUPPLY – Future Water Supply for the Water System – 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 located in the city of Chollas.

Miscellaneous Projects. Miscellaneous CIP projects include air valve adjustments, corrosion control for existing facilities, installation of pressure reducing stations, installation of flow meters and security enhancements at various water facilities. Also included are pooled contingencies, which are contingency amounts identified for each project to protect against uncertainties in the construction of such projects. All of the project contingencies are aggregated into a single pool of contingencies rather than included in the budget for each project.

Project Schedule and Costs

The current cost estimate of CIP projects for the period from Fiscal Year 2008-09 through Fiscal Year 2012-13, the period through which water service rate increases have been approved, is approximately $724 million. 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.

Table 6 shows categories of projects with the estimated cost of expenditures contained in the CIP for the period of Fiscal Years 2008-09 to 2012-13. Final CIP project costs will be refined as the CIP progresses.

TABLE 6

SUMMARY OF PROJECTED CIP PROJECTS[1]
Fiscal Years 2008-09 through 2012-13

Description	2008-09	2009-10	2010-11	2011-12	2012-13	Total
Water Treatment Plants	$ 86,756,020	$ 83,881,204	$ 31,310,409	$ 1,639,389	$ 3,905,061	$207,492,083
Pipelines	57,705,209	48,074,621	53,410,139	61,430,309	59,022,991	279,643,269
Pump Stations	9,550,000	3,840,792	831,375	2,438,729	3,523,976	20,184,872
Raw Water Reservoirs	2,333,035	449,014	914,062	3,440,796	9,135,167	16,272,074
Treated Water Reservoirs	4,461,387	493,575	608,607	768,112	1,848,048	8,179,729
Reclaimed Water Facility	3,104,606	7,106,101	7,414,401	2,980,224	1,000,000	21,605,332
Groundwater	2,019,816	7,643,634	18,528,908	20,127,520	1,209,935	49,529,813
Security	3,796,050	10,109,000	7,592,776	326,295	0	21,824,121
Miscellaneous	7,897,506	7,800,000	21,178,596	29,023,958	33,762,636	99,662,696
Total	$177,623,629	$169,397,941	$141,789,273	$122,175,332	$113,407,814	$724,393,989

Source: City of San Diego Water Department.

(1) Amounts reflect the aggregate costs of all CIP projects required to satisfy the DPH Compliance Order as well as projects related thereto or necessary for the operation thereof. For Fiscal Year 2008-09 through Fiscal Year 2012-13, DPH Compliance Order required projects cost approximately $413 million and DPH-related projects cost approximately $102 million.

Financing Plans for the CIP

The CIP is funded through a combination of System Revenues, bond proceeds and SRF loans. As of November 1, 2008, the Water Department had approximately $106 million in remaining Series 2008A Note proceeds to fund the majority of CIP costs through May, 2009. The Water Department currently expects that approximately 80% of the costs of the CIP through 2013 will be funded with the proceeds of future financings, including water revenue bonds to be issued later in 2009 on either a parity or a subordinated basis, as further described below:

Fiscal Year	Total
2008-09	$391 million[1]
2010-11	$124 million
2011-12	$206 million

(1) Consists of the Series 2009A Bonds to pay in full the Series 2007A Notes and an additional series of water revenue bonds on either a parity or subordinated basis to refund the Series 2008A Notes, finance approximately $150 million of CIP costs and fund the required debt service reserve fund. Excludes the prepayment of a portion of the Series 1998 Certificates, as described under "PLAN OF FINANCE" herein.

The remaining 20% of the 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 a 4% annual inflation factor due to anticipated increases in construction costs over time, which assumed inflation rate is intended to be a conservative estimate to ensure that the Water Department has adequate resources reserved to complete the necessary projects.

The Water 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 and bond proceeds. Capacity charge revenues will range from $3.9 to $9.5 million over the period from Fiscal Year 2008-09 through Fiscal Year 2012-13 at increased capacity fee levels.

In addition, the Water Department has applied for an additional SRF loan in the approximate amount of $30 million. Proceeds of such SRF loan, if received, will be used for the following projects: the OWTP Upgrade – Phase II in the amount of $8 million; the OWTP Upgrade – Phase II in the amount of $10 million; and the AWTP Upgrade – Phase IV in the amount of $12 million. This additional SRF loan, if approved and entered into, would constitute a Subordinated Obligation payable on a parity with the outstanding Series 2002 Subordinated Bonds and the Series 2008A Notes. The Water Department anticipates that the amount of bonded indebtedness to be issued in the future will be reduced by the amount of SRF loan received from DWR, if any.

Environmental Compliance

The projects contained in the CIP are generally subject to the California Environmental Quality Act ("CEQA"), as amended (Division 13 of the California Public Resources Code). Under CEQA, a project which may have a significant effect on the environment and which is to be carried out or approved by a public agency must comply with a comprehensive environmental review process, including the preparation of an Environmental Impact Report ("EIR"). An EIR reflects not only an independent technical analysis of the project's potential impacts, but also the comments of other agencies with some form of jurisdiction over the project and the comments of interested members of the public. Contents of an EIR include a detailed statement of the project's potentially significant environmental effects; any such effects which cannot be avoided if the project is implemented; mitigation measures proposed to eliminate or minimize such effects; alternatives to the proposed project; and any significant irreversible environmental changes which would result from the project. Approximately 4% of CIP projects reviewed between May 2002 and August 2008 have required an 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. A Negative Declaration was prepared for approximately 2% of CIP projects reviewed between May 2002 and August 2008. 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 7% of CIP projects reviewed between May 2002 and August 2008 resulted in the preparation of a 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 May 2002 and August 2008, approximately 87% of CIP projects have 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, all projects are evaluated under the City's environmental impact review procedures, developed in compliance with State law and regulations.

Separate environmental documents for each of the CIP projects either have been or will be prepared in accordance with local, State and/or federal law and regulations.

Since much of the CIP involves replacement, upgrading or increasing capacity of existing facilities, 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 Water Department. A reorganization of engineering functions for the City as a whole, including the Water 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 Water CIP projects are now managed by CIP project managers in the City's Engineering and Capital Projects Department ("E&CP"). Planning of and program controls for Water CIP projects are conducted and monitored by the Water Policy and Strategic Planning Division of the Water Department. See "WATER SYSTEM ORGANIZATION AND MANAGEMENT – Governance and Management" herein.

E&CP provides a full range of engineering services for the City's capital investment in its various types of infrastructure and provides traffic engineering services to the community. E&CP 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. E&CP's activities include work on various public infrastructure assets to rehabilitate, restore, improve, and add to the City's capital facilities. E&CP'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 sewer pipelines, treatment plants, and pump stations; and dry utilities under-grounding projects. These functions are provided through four of the five divisions within the E&CP.

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.

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 Water Department, as well as other departments in the City. These services include preliminary engineering and asset management, project controls, CIP fund management, Americans with Disabilities Act compliance review for CIP projects, quality control and standards, and environmental and permitting assistance.

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.

Contract Disputes

From time to time, the City is engaged in disputes with the contractors and subcontractors working on the CIP. As of December 1, 2008, there are no pending contract disputes with vendors or contractors working on the CIP.

Insurance

Insurance for the projects contemplated in the CIP is required by contract to be provided by the consultant/contractor selected to design/construct the project. Design consultants are required to provide 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, and architect and engineers professional liability insurance of $1 million per occurrence/$2 million aggregate. Construction contractors are required to provide, 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; contractors builders risk property insurance in an amount equal to the replacement cost of the completed project.

WATER SYSTEM FINANCIAL OPERATIONS

Establishment of Water Service Charges

The City's deposits to the Water Utility Fund are primarily derived from 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 of San Diego's General Fund.

The City establishes fees based upon the costs incurred by the City to meet customer demand for water and required capital improvements. The Water Department has personnel and resources to analyze rates and charges necessary to support the Water System. They are responsible for collecting and collating revenue and expenditure data from key administrative, engineering, financial and budgetary elements within the various divisions of the Water Department, then evaluating the adequacy of revenues and recommending rate adjustments to correspond with expected changes in maintenance and operations costs and the timing and magnitude of capital expenditures. This process, conducted semiannually for management purposes and as required to facilitate planned financings and rate adjustments, involves an extensive technical review by senior staff with oversight from senior city management.

Subsequent to consideration of the recommendations set forth in the December 14, 2006 Cost of Service Rate Study (as adopted by the City Council in 2007, the "2007 Rate Case"), in February 2007 the City Council adopted rate increases of 6.5% per year for Fiscal Years 2007-08 through 2010-11 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 2007-08 through 2010-11, which were based upon the City's budgeted Fiscal Year 2006-07 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” herein. The current water rates are slightly less than 1% of the 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 Water Department incurs certain costs in order to be in a position to serve the commodity to the customer upon demand. Those costs are incurred by the Water Department regardless of whether the customer uses the commodity or not. They include such costs as the general administrative costs of the Water Department for billing, payment processing, and account management. 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 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 the CWA, which is 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 calculates the impact to its cost of purchased water and the rate adjustment it must make to its customers to recover those increased costs. It then follows 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 acts on the proposed rate adjustments for the recovery from Water Department customers of increased costs resulting from CWA’s rate increases. The purchase water cost increase affects both the base fee and commodity charges within the City’s water billing structure. In October 2007, the City Council approved a 2.9% CWA-related rate increase to recover revenue in the amount of the purchase water cost increase from CWA, which is anticipated to generate approximately \$9.8 million annually. On November 18, 2008, the City Council and Mayor approved a \$0.20 per EDU increase to the base fee and an 8.5% increase to the commodity charge to generate sufficient revenue to offset the increased water wholesale purchase costs from CWA, which increase will become effective in January 2009 and is anticipated to generate approximately \$19.5 million annually.

In addition, the City Council and Mayor also approved on November 18, 2008 a commodity charge increase of 3.08% to provide revenue to offset the cost of a \$11.8 million IPR Project to determine the feasibility of indirect potable reuse, which consists of using highly treated reclaimed water to augment the City’s drinking water supply. The approved commodity charge rate increase is scheduled to remain in effect through the end of Fiscal Year 2009-10, at which time such rate increase will sunset.

Water rates have also been increased to help fund the Water Department’s DPH Compliance Order project and DPH-related project costs and to permit the City to recover increased utility costs. Utility cost-related increases have not occurred since the 1980s. Any such increases will be subject to the procedures necessary to satisfy Proposition 218’s public notice and hearing requirements and procedures established by the City. See “WATER SYSTEM REGULATORY REQUIREMENTS – Compliance Order by the California Department of Public Health” herein.

Table 7 sets forth the five-year water service charge for each customer class from Fiscal Year 2004-05 through Fiscal Year 2008-09.

TABLE 7

FIVE-YEAR WATER SERVICE CHARGE HISTORY FOR SINGLE FAMILY RESIDENTIAL UNITS AND MULTI-FAMILY, COMMERCIAL, INDUSTRIAL AND IRRIGATION/TEMPORARY CONSTRUCTION
Fiscal Years 2004-05 through 2008-09

Justification for Increase:		**Revenue Requirement**	**Increase in Water Costs from CWA**	**Revenue Requirement**	**Increase in Water Costs from CWA**	**Revenue Requirement**	**Revenue Requirement**	**Increase in Water Costs from CWA**	**Revenue Requirement**	**Increase in Water Costs from CWA and IPR Project**
BASE FEES(1)		7/1/04	1/1/05	7/1/05	1/1/06	7/1/06	7/1/07(3)	1/1/08	7/1/08	1/1/09
Meter Size:	5/8 inch	$13.08	$13.08	$14.31	$14.56	$15.87	$15.18	$15.32	$16.32	$16.52
	¾ inch	13.08	13.08	14.31	14.56	15.87	15.18	15.32	16.32	16.52
	1 inch	13.97	13.97	15.29	15.69	17.11	22.17	22.41	23.86	24.20
	1 ½ inch	62.52	62.52	68.41	69.16	75.41	38.13	38.59	41.10	41.76
	2 inch	96.24	96.24	105.31	106.61	116.24	58.09	58.83	62.66	63.72
	3 inch	345.44	345.44	377.98	380.38	414.73	104.98	106.38	113.29	115.29
	4 inch	576.30	576.30	630.59	634.69	692.00	171.83	174.17	185.49	188.83
	6 inch	1,286.28	1,286.28	1,407.45	1,414.95	1,542.72	337.46	342.12	364.36	371.02
	8 inch	1,733.10	1,733.10	1,896.36	1,909.36	2,081.78	537.01	544.47	579.86	590.52
	10 inch	2,323.85	2,323.85	2,542.76	2,562.26	2,793.63	770.49	781.23	832.01	847.35
	12 inch	3,232.55	3,232.55	3,537.06	3,570.06	3,892.44	1,435.00	1,455.06	1,549.64	1,578.30
	16 inch	5,394.93	5,394.93	5,903.13	5,974.63	6,514.14	2,499.62	2,534.62	2,699.37	2,749.37

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Justification for Increase:		Revenue Requirement	Increase in Water Costs from CWA	Revenue Requirement	Increase in Water Costs from CWA	Revenue Requirement	Revenue Requirement	Increase in Water Costs from CWA	Revenue Requirement	Increase in Water Costs from CWA and IPR Project
COMMODITY CHARGE										
Customer Type:	**Usage[4]:**	7/1/04	1/1/05	7/1/05	1/1/06	7/1/06	7/1/07	1/1/08	7/1/08	1/1/09
Single Family Dwelling										
Tier 1	0-7 HCF	$1.487	$1.541	$1.609	$1.656	$1.731	$2.262	$2.352	$2.505	$2.795
Tier 2	8-14 HCF	1.884	1.938	2.023	2.070	2.163	2.461	2.551	2.717	3.032
Tier 3	15+ HCF	2.076	2.130	2.223	2.270	2.372	2.775	2.865	3.051	3.404
Multi-family Dwelling[2]	per HCF[5]	1.737	1.791	1.870	1.917	2.003	2.461	2.551	2.717	3.032
Commercial [2]	per HCF[5]	1.737	1.791	1.870	1.917	2.003	2.357	2.447	2.606	2.908
Industrial[2]	per HCF[5]	1.737	1.791	1.870	1.917	2.003	2.357	2.447	2.606	2.908
Irrigation[2]	per HCF[5]	-	-	-	-	-	2.524	2.614	2.784	3.107
Temporary Construction[2]	per HCF[5]	-	-	-	-	-	2.524	2.614	2.784	3.107

Source: City of San Diego Water Department.
(1) The base fee is dependent on the meter size.
(2) In July 1, 2007, the City established separate categories for Multi-Family Dwelling, 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.
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. Table 7 sets forth the base fees for the various water meter sizes in the Water System as of January 1, 2009. Table 8 sets forth such base fees for Fiscal Year 2009-10 and 2010-11, which rates have been adopted by the City Council.

TABLE 8

BASE FEE
Fiscal Years 2009-10 and 2010-11
(As of January 1, 2009)

Meter Size (inch)	July 1, 2009	July 1, 2010
5/8	$ 17.59	$ 18.73
3/4	17.59	18.73
1	25.78	27.45
1 1/2	44.47	47.37
2	67.86	72.27
3	122.79	130.77
4	201.10	214.17
6	395.14	420.82
8	628.91	669.79
10	902.43	961.08
12	1,680.89	1,790.15
16	2,928.08	3,118.40

Source: City of San Diego Water Department.

The City has separate commodity rates for SFR customers. 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. SFR customers have a tiered rate structure which is broken down by water usage within each rate block. See Table 7 for a schedule of commodity rate(s) applicable to each customer class as of January 1, 2009. Table 9 sets forth the commodity rates for the Water System for Fiscal Years 2009-10 and 2010-11, which have been adopted by the City Council.

TABLE 9

COMMODITY RATE
Fiscal Years 2009-10 through 2010-11
(As of January 1, 2009)

Customer Class	Volume Block HCF	July 1, 2009 $/HCF	July 1, 2010 $/HCF
SFR			
Block 1	0-7	2.977	3.073
Block 2	8-14	3.229	3.333
Block 3	Over 14	3.625	3.742
Multi-family Dwelling	All Volume	3.229	3.333
Commercial	All Volume	3.097	3.196
Industrial	All Volume	3.097	3.196
Irrigation	All Volume	3.309	3.415

Source: City of San Diego Water Department.

Capacity Charges. In February 2007 the City Council and Mayor approved raising the capacity charge by 19.5% to $3,047 per equivalent dwelling unit ("EDU"), which was estimated to provide for full cost recovery for Water System expansion projects planned through Fiscal Year 2014-15. The water used by an average SFR is equated to one EDU and equals 500 gallons per day ("GPD"). 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 revenue 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.

Table 10 sets forth the capacity charges for Fiscal Years 2003-04 through 2007-08, which have been adopted by the City Council.

TABLE 10

RECENT RATE HISTORY FOR WATER CAPACITY CHARGES
Fiscal Years 2003-04 through 2007-08
(As of July 1, 2008)

Fiscal Year	Water Capacity Charges (Per EDU)	% Increase / (Decrease)[1]
2003-04	$2,500	0.0%
2004-05	2,550	2.0
2005-06	2,550	0.0
2006-07	2,550	0.0
2007-08	3,047	19.5

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

Table 11 sets forth the historical capacity charge revenues from Fiscal Year 2003-04 through Fiscal Year 2007-08. 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, such as a customer's credit score and the availability of an incentive rate. Since capacity charge revenue is dependent on development activity within the City of San Diego, capacity charge revenues are impacted by the slow down in residential construction. For Fiscal Year 2007-08, the estimated capacity charge revenue was $8,458,512 and the estimated amount for Fiscal Year 2008-09 is approximately $3.9 million.

TABLE 11

WATER UTILITY FUND
HISTORICAL CAPACITY CHARGE REVENUES
Fiscal Years 2003-04 to 2007-08

Fiscal Year	New Equivalent Dwelling Units[1]	Capacity Charge Revenues[2]
2003-04	7,475	$17,653,915
2004-05	5,602	13,113,046
2005-06	5,713	12,936,691
2006-07	5,788	13,682,238
2007-08[3]	4,338	8,458,512

Source: City of San Diego, Office of the Comptroller; Water Department.
(1) Unaudited.
(2) Audited and included with Capital Contributions on Statement of Revenues, Expenses and Changes in Net Assets in comprehensive annual financial report of the indicated year, except as otherwise noted.
(3) Estimated.

Collection of Water Service Charges

In order for a person to be billed by the City for water fees, he or she must contact the Water 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 Water 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, one hundred percent of the water used is billed, no matter how far back the water usage occurred, and time extensions for payment are granted by Water 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 Water 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 $20 will be imposed per returned check.

Typically, the City seeks to collect unpaid bills by (i) issuing a reminder notice as early as 25 days after a bill is issued, (ii) issuing a shut-off notice as early as 38 days after a bill is issued, and (iii) shutting off the customer's water service as early as 45 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. If an account is closed with an amount due which remains unpaid, that account is referred to the City Treasurer for collection activities. An allowance is taken each fiscal year for accounts receivable which are not expected to be paid. During the five-year period from Fiscal Year 2003-04 through 2007-08, the allowance for the billed account receivables amount ranged from a low of $324,726 to a high of $564,228. 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 currently rendered on a bi-monthly basis for single family and most multi-family dwellings and on a monthly basis for all other customers.

Table 12 sets forth information related to accounts receivable and number of shut-offs.

TABLE 12

WATER CUSTOMER ACCOUNTS RECEIVABLE
AND SHUT-OFFS BY FISCAL YEAR
Fiscal Years 2003-04 to 2007-08[(1)]
($ In Thousands)

	2003-04	2004-05	2005-06	2006-07	2007-08
Water Sales Revenue	$221,623	$245,287	$ 258,900	$289,127	$288,741
Accounts Receivable[(2)]	$ 20,957	$ 33,622	$ 25,404	$ 28,126	$ 25,995
Accounts Receivable Over 120 Days[(2)]	$ 1,450	$ 1,727	$ 3,672	$ 3,645	$ 2,940
% of Total Water Sales Revenues	0.7%	0.7%	1.42%	1.26%	1.02%
No. of Shut-Offs[(3)]	21,689	24,459	21,230	20,451	22,420
Write-Off Amounts[(4)]	$ 478	$ 402	$ 325	$ 531	$ 564

Source: The City's 2004 – 2007 Comprehensive Annual Financial Reports with respect to "Water Sales Revenue" amounts for Fiscal Years 2003-04 through 2006-07; Water Department and Office of the Comptroller, City of San Diego with respect to all other amounts, which are unaudited.

(1) Audited, excepted for Fiscal Year 2007-08 figure, which is preliminary and 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) Shut-Offs for non-payment may include multiple shut-offs at the same address throughout the fiscal year.

(4) Write-Off amount for entire water bill, which includes billing for water, sewer, and storm drain services.

Revenues

The Water Utility Fund's principal source of revenues is water service charges to City residents and commercial enterprises. Table 13 sets forth the historical sources of water service revenues of the Water Utility Fund for each of the fiscal years from Fiscal Year 2003-04 to 2007-08.

TABLE 13

HISTORICAL SOURCES OF WATER SERVICE REVENUES[(1)]
(In Thousands)
Fiscal Years 2003-04 through 2007-08

Sources	2003-04	2004-05	2005-06	2006-07	2007-08
Retail[(2)]					
Single Family Domestic	$ 85,262	$ 92,630	$102,505	$ 114,461	$123,063
Multi-Family[(3)]	46,230	51,505	55,514	61,754	61,193
Commercial	75,571	82,477	82,669	93,042	85,644
Industrial	3,951	3,914	3,880	3,091	2,663
Reclaimed	3,465	3,751	4,452	5,528	2,073
Outside City	93	123	246	144	45
Wholesale to Other Retailers[(2)]					
Other Utilities[(4)]	6,505	10,439	8,982	9,776	12,780
Irrigation Districts	546	448	652	1,331	1,280
TOTAL[(5)]	$221,623	$245,287	$258,900	$289,127	$288,741[(2)]

Source: The City's 2004 – 2007 Comprehensive Annual Financial Reports with respect to the "Total" amounts; Water Department and Office of the Comptroller, City of San Diego with respect to all other amounts.

(1) Excludes capacity charges or other operating revenues.
(2) Unaudited.
(3) Multi-Family primarily consists of multi-family dwellings.
(4) Primarily reflects wholesale revenues from Cal-American.
(5) Audited, except for data for Fiscal Year 2007-08.

The four annual water rate increases approved in February 2007 and described previously are projected to increase water service charge revenues from $287 million in Fiscal Year 2006-07 to $370 million by Fiscal Year 2010-11. These revenue estimates include 6.5% annual rate increases in Fiscal Year 2007-08 through Fiscal Year 2010-11, but do not include revenues generated by purchase water cost increases that were affected as a result of rate increases implemented by CWA. Table 7 herein sets forth the Water System's water service rate increases from Fiscal Year 2003-04 to Fiscal Year 2008-09. Such rate increases are approved by the City Council and Mayor following the required Proposition 218 noticing process on an *ad hoc* basis as cost increases become effective, usually in January of each year.

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 Water Department (collectively, "Operation and Maintenance expenditures"). The City used an inflationary factor of 4% in projecting all Operation and Maintenance expenditures, except for salaries and wages. Salaries and wages that were increased by 4% in Fiscal Year 2007-08 but are not increased thereafter. Electricity and gas expenses were assumed to increase at 8% per year and data processing costs were based on a long-range plan which reflected planned changes to data processing systems.

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. The City estimates that the projected water purchase costs will vary from $123 million to $139 million in Fiscal Years 2007-08 through 2010-11, excluding any additional price adjustments from MWD or CWA after Fiscal Year 2007-08. As described previously, as MWD or CWA price adjustments occur, the City makes corresponding adjustments to its customer rates, subject to the requirements of Proposition 218. Absent those price adjustments from MWD and CWA, water purchase costs were forecast to increase at an average of 0.9%, based on the growth in accounts, over the same period. This can be attributed to the fact that conservation efforts and the reclaimed water program will partially offset the demand for additional potable water supplies that will result from population growth. The current water rate model has since been adjusted to reflect an assumed 7.5% reduction in water sales for Fiscal Year 2008-09 and an assumed 15% reduction in water sales for Fiscal Year 2009-10 based on the Water Department's estimate of supply restrictions that may be in place for those years, including any potential reduction of water sales by CWA in 2009. For Fiscal Year 2008-09, the Water Department has included in its operating budget the anticipated reduction in water supply availability and a corresponding decrease in water purchases and reduced sales. The resulting revenue reduction is offset by reductions in water purchases and other budget reductions which also carry forward into future years. Actual water sales through October 2008 of the current Fiscal Year 2008-09 are 6% less than water sales from the prior Fiscal Year.

Table 14 sets forth the statement of revenues, expenses and changes in fund net assets for Fiscal Years 2002-03 through 2006-07.

TABLE 14

REVENUES, EXPENSES, CHANGES IN FUND NET ASSETS
(In Thousands)
Fiscal Years 2002-03 through 2006-07
(Audited)

	2002-03	2003-04	2004-05	2005-06	2006-07
OPERATING REVENUES					
Sales of Water	$ 206,383	$ 221,623	$ 245,287	$ 258,900	$ 289,127
Charges for Services	887	965	1,027	1,031	1,147
Revenue from Use of Property	4,075	4,969	4,701	4,833	6,162
Storage and Transportation of Water for Other Agencies	178	188	230	-	-
Usage Fees	1,239	1,426	1,756	1,943	1,594
Other	9,700	10,362	14,648	13,860	12,262
TOTAL OPERATING REVENUES	$ 222,462	$ 239,533	$ 267,649	$ 280,567	$ 310,292
OPERATING EXPENSES					
Maintenance and Operations	$ 94,345	$ 95,182	$ 92,959	$ 94,433	97,821
Cost of Purchased Water Used	100,094	100,445	102,096	110,263	124,880
Taxes	1,260	1,359	1,457	570[1]	163[1]
Administration	30,134	33,602	37,762	35,370	30,964
Depreciation	19,045	21,745	27,277	29,230	27,644
TOTAL OPERATING EXPENSES	$ 244,878	$ 252,333	$ 261,551	$ 269,866	$ 281,472
OPERATING INCOME (LOSS)	$ (22,416)	$ (12,800)	$ 6,098	$ 10,701	$ 28,820
NONOPERATING REVENUES (EXPENSES)					
Earnings on Investments	$ 11,590	$ 7,643	$ 7,258	$ 6,966	$ 11,461
Federal Grant Assistance	565	506	640	424	283
Other Agency Grant Assistance	1,068	50	694	359	284
Loss on Sale / Retirement of Capital Assets	(707)	(1,251)	(26,141)	(9,819)	(5,076)
Debt Service Interest Expense	(23,075)	(15,925)	(12,737)	(23,935)	(26,370)
Other	857	606	32	(67)	175
TOTAL NONOPERATING REVENUES (EXPENSES)	$ (9,702)	$ (8,371)	$ (30,254)	$ (26,072)	$ (19,243)
INCOME (LOSS) BEFORE CONTRIBUTIONS AND TRANSFERS	$ (32,118)	$ (21,171)	$ (24,156)	$ (15,371)	$ 9,577
Capital Contributions	86,376	72,040	41,954	44,262	80,859
Transfers from Other Funds	1,204	197	3,377	220	352
Transfers from Governmental Funds	14	-	27	-	84
Transfers to Other Funds	(422)	(238)	(319)	(158)	(234)
Transfer to Governmental Funds	(1,021)	(1,563)	(1,046)	(1,481)	(1,713)
CHANGE IN NET ASSETS	$ 54,033	$ 49,265	$ 19,837	$ 27,472	$ 88,925
Net Assets at Beginning of Year	1,075,816	1,129,849	1,179,114	1,198,951	1,226,423
NET ASSETS AT END OF YEAR	$1,129,849	$1,179,114	$1,198,951	$1,226,423	$1,315,348

Source: Comprehensive annual financial report of the indicated year.
(1) Decrease represents in lieu taxes paid to the CWA and property taxes paid to the County Tax Collector.

Table 15 sets forth the debt service coverage for Fiscal Years 2002-03 through 2006-07.

TABLE 15

CALCULATION OF HISTORIC DEBT SERVICE COVERAGE
(In Thousands)
Fiscal Years 2002-03 through 2006-07
(Unaudited)

				Parity Obligations						All Obligations[1]	
Fiscal Year Ended June 30	Total Income	Total Expenses	Net System Revenue	Earnings on Reserve Fund	Adjusted Net System Revenue	Total Debt Service	Less: Interest Earnings	Adjusted Debt Service	Adjusted Debt Service Coverage	Total Debt Service (Parity and Subordinated)	Aggregate Debt Service Coverage
2002-03	$256,968	$226,058	$30,910	($1,305)	$29,605	$23,363	($1,305)	$22,058	1.34x	$27,002	1.14x
2003-04	267,649	232,193	35,456	(1,296)	34,160	21,355	(1,296)	20,059	1.70	34,861	1.02
2004-05	294,904	234,392	60,512	(1,262)	59,250	21,355	(1,262)	20,093	2.95	34,861	1.74
2005-06	303,453	242,180	61,273	(1,228)	60,045	21,355	(1,228)	20,127	2.98	35,549	1.72
2006-07	336,599	255,486	81,113	(1,346)	79,767	21,351	(1,346)	20,005	3.99	40,759	1.99

Source: Statistical section (unaudited) of comprehensive annual financial report of the indicated year for Parity Obligations; City of San Diego Debt Management Department for all Obligations.
(1) Based on debt service coverage calculations set forth in the Installment Purchase Agreement.

Management's Discussion and Analysis

As of June 30, 2007, the Water Department's assets exceeded liabilities by $1.32 billion, an increase of $88.9 million from the previous year. This increase is primarily the result of increased capital assets, net of related debt and depreciation, of $99.5 million and a decrease of $10.5 million in unrestricted assets.

Current assets increased $49.1 million primarily due to an increase in cash and investment of $41.6 million, and an increase in accounts receivable of $6.3 million. Current liabilities decreased $1.3 million primarily due to a decrease in accounts payable. Non-current liabilities increased $44.2 million due to a combination of principal payments due within one year on outstanding bonds of $13.5 million offset by an increase to Notes Payable of $57.0 million in connection with the Series 2007A Notes to provide short-term financing of the Water Department's CIP. The Series 2007A Notes will be paid with proceeds of the Series 2009A Bonds described in this Official Statement.

Total operating revenues for Fiscal Year 2006-07 were $310.3 million, an increase of $29.7 million over the previous fiscal year. The increase was primarily due to a rate increase of 6% and an increase of 521 million cubic feet over the prior year in water delivery. This was a 5.5% increase in delivery quantity from the prior fiscal year.

Non-operating revenues increased by $4.5 million. This was a result of an increase in interest earnings of $4.5 million mainly due to higher average cash and investments during the fiscal year. Capital contributions increased by $36.6 million to $80.9 million in Fiscal Year 2006-07 and were primarily attributable to sub-division developer contributed assets of $36.8 million.

Total operating expenses for Fiscal Year 2006-07 were $281.5 million, an increase of $11.6 million from the prior year. This was mainly a result of an increase in water purchases of $14.6 million. Water purchases accounted for approximately 44% of the Operating Expenses as the City purchased approximately 90% of the water distributed from the San Diego County Water Authority.

Administration expenses included long range strategic planning, policy, information systems, and general and administrative expenses. This represented 11% of total operating expenses. Administration expenses decreased $4.4 million in Fiscal Year 2006-07. This continued a three-year trend of finding opportunities to create administrative efficiencies and better serve our customers.

Operation and Maintenance included the operation of 3 treatment facilities as well as operation and maintenance of approximately 3,400 miles of distribution mains and associated pump stations. Operation and Maintenance costs were 35% of Operating Expenses and totaled $97.8 million. This was an increase of $3.4 million or 4% over the prior fiscal year.

Non-operating expenses decreased by $2.4 million down to $31.4 million. This was due to a $4.7 million decrease in losses attributable to the retirement of capital assets, and an increase in debt service interest expense of $2.4 million.

Net cash provided by operating activities for Fiscal Year 2006-07 was $51.8 million, an increase of approximately $645,000 from the previous year. This change is generally attributable to an increase in receipts from customers and users and a decrease in payments to employees and payments for interfund services used, which were partially offset by an increase in payments to suppliers.

As of June 30, 2007, the Water Department had total reserves of $99.3 million. As of June 30, 2008, the Water Department increased its total reserves to $101.3 million in compliance with a reserve policy adopted by the City in Fiscal Year 2007-08.

As of June 30, 2008, the Water Department had outstanding debt of approximately $757.7 million. More detailed information about the Water Department's long-term debt as of June 30, 2007 is presented in the notes to the City's 2007 audited financial statements attached in Appendix D – "EXCERPTS FROM THE COMPREHENSIVE ANNUAL FINANCIAL REPORT OF THE CITY OF SAN DIEGO FOR FISCAL YEAR 2006-07," including certain information regarding the Water Department's bond 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 are currently no expected transfers to or from the Rate Stabilization Fund, which is expected to be maintained at $20,500,000, the amount in such fund as of June 30, 2008.

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 therefor, 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. As of June 30, 2008, amounts in the Secondary Purchase Fund equaled $7,132,377.

The City has also established within the Water Utility Fund the 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 described below). The Operating Reserve is required to be replenished during any fiscal year in which amounts were withdrawn. The Fiscal Year 2008-09 budget included approximately $23.1 million for the Operating Reserve, which accounts for 50 days' operating costs. The City is in the process of gradually increasing such reserve to a level sufficient for 70 days' operating costs by Fiscal Year 2013.

Other reserves established by the City include an SRF Loan Reserve (the "SRF Loan Reserve") for payment of principal and interest on its SRF loan; two Debt Service Reserve Funds (the "Debt Service Reserve Funds") for payment of principal and interest on its bonds; an Emergency Reserve (the "Emergency Reserve") annually budgeted at $5.0 million to provide for emergency capital expenditures or other unanticipated capital needs; and an Appropriated Reserve (the "Appropriated Reserve") annually budgeted in at amount determined by the Water Department in its discretion 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 Director of the Water Department, 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") for the Water Fund for use in connection with the City's efforts to protect and preserve savings found by increasing efficiencies, changing priorities or other actions related to reducing costs of the CIP or operations and maintenance of the Water System. The DRES is intended to track funds that can be used for accelerating CIP project schedules and help offset the need for future rate increases. At the end of each fiscal year, any savings not required for compliance with established reserve policies will be transferred into the DRES. At the end of four years, any funds transferred into the DRES and not used for capital improvements will be used to lower future rates for the Water System. The DRES has not been funded as of the date of this Official Statement.

Table 16 sets forth the funding levels of the funds and reserves established within the Water Utility Fund as of June 30, 2008.

TABLE 16

WATER UTILITY FUND RESERVES
(As of June 30, 2008)

Fund Name	Funding Level
Rate Stabilization Fund	$ 20,500,000
Secondary Purchase Fund	7,132,377
Operating Reserve	19,936,102
SRF Loan Reserve	1,376,000
Debt Service Reserve Funds	47,312,000
Emergency Reserve	5,000,000
	$101,256,479

Source: City of San Diego Water Department.

For information on the possible limitation on the City's ability to set rates and charges at levels which 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 17 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 Water System CIP.

Financial Projections and Modeling Assumptions

Table 17 sets forth the estimated and projected operating revenues and expenses for Fiscal Years 2007-08 through 2011-12.

TABLE 17

ESTIMATED OPERATING REVENUE AND EXPENSES
Fiscal Year 2007-08 through 2011-12
(In Thousands)
(Unaudited)

DESCRIPTION	2007-08 Estimated	2008-09 Projected	2009-10 Projected	2010-11 Projected	2011-12 Projected
Net Operating Revenues (1)	$43,862	$75,118	$ 87,175	$142,299	$143,664
Interest Income on Operating Funds	8,268	5,139	6,183	8,394	12,382
Interest Income on Capital Monies (2)	2,465	5,187	4,725	3,257	5,704
Capacity Fee Proceeds(3)	8,459	3,869	9,512	13,510	14,139
Total Adjusted Net System Revenues (4)(5)	$63,054	$89,312	$107,594	$167,460	$175,889
Projected Senior Debt Service	$21,354	$21,354	$ 41,180	$ 41,180	$ 50,155
Senior Debt Service Reserve Fund Interest (6)	$ 1,370	$ 998	$ 1,634	$ 2,063	$ 2,837
Adjusted Debt Service	$19,984	$20,356	$ 39,546	$ 39,117	$ 47,318
Senior Debt Service Coverage (4)	316%	439%	272%	428%	372%
Aggregate Debt Service Coverage					
Net Operating Revenues	$43,862	$75,118	$ 87,175	$142,299	$143,664
Interest Income on Operating Funds	8,268	5,139	6,183	8,394	12,382
Interest Income on Capital Monies	1,922	4,638	4,067	2,489	4,827
Capacity Fee Proceeds	8,459	3,869	9,512	13,510	14,139
Debt Service Reserve Fund Interest	2,435	1,546	2,292	2,831	3,714
Total Net System Revenues (5)	$64,945	$90,310	$109,228	$169,523	$178,726
Projected Senior Debt Service	$21,354	$21,354	$ 41,180	$ 41,180	$ 50,155
Projected Subordinate Debt Service	$21,728	$26,271	$ 31,504	$ 28,668	$ 28,672
Aggregate Debt Service (7)	$43,082	$47,625	$ 72,684	$ 69,849	$ 78,827
Aggregate Debt Coverage (8)	151%	190%	150%	243%	227%

Source: Feasibility Engineer.

(1) Fiscal Year 2008-09 figures include an assumed 7.5% reduction in water sales and deliveries and Fiscal Year 2009-10 figures include an assumed 15% reduction in water sales and deliveries. Thereafter, figures reflect pre-water conservation levels. Figures include service charges and reclaimed water sales, revenues generated from proposed rate adjustment to pass through CWA purchased water cost increases for Fiscal Year 2008-09 but not potential future adjustments to pass through CWA supply cost increases.

(2) Includes interest income on Subordinate Debt Service Reserve Fund.

(3) Amount for Fiscal Year 2008-09 reflects reduced revenue due to year-to-date experience and amount for Fiscal Year 2009-10 reflects lower estimated revenue for such Fiscal Year.

(4) As defined in the Installment Purchase Agreement.

(5) Figures may not add to total due to independent rounding.

(6) Includes anticipated bond issuances subsequent to Fiscal Year 2008-09.

(7) Includes Parity Obligations, Subordinated Obligations, and SRF debt service without adjustment for Debt Service Reserve Fund earnings.

(8) Ratio of total Net System Revenues to Aggregate Debt Service.

The data set forth in Table 17 is based upon various assumptions, including those set forth below, adopted by the Water Department and used by Camp Dresser & McKee Inc. (the "Feasibility Engineer") for purposes of its Report on the Engineering and Financial Feasibility Study attached as Appendix B hereto. The achievement of certain results or other expectations contained in Table 17 involve known and unknown risks, uncertainties and other factors which may cause actual results, performance or achievements reflected in Table 17 to be materially different from any future results, performance or achievements expressed or implied by such Table. Although, in the opinion of the Water 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.

The Water System's growth projections 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 for Fiscal Year 2007-08 to Fiscal Year 2009-10 are 1.1% annually and 1% annually thereafter. These rates are applied to the number of customer accounts. The Water Department has based the current number of accounts from the Water Utilities Customers Information System Monthly Rate Code Summary (Actual).

Reclaimed water revenues, which are a component of water sales, are expected to increase from approximately $2 million to $9.5 million over the period from Fiscal Year 2006-07 to Fiscal Year 2010-11 due to new customers and increased demand from existing customers. Reclaimed revenues will continue to supplant revenues from potable water service charges as existing customers convert from potable to reclaimed water supplies. Revenues will also be lost as customers convert to reclaimed water since reclaimed water is priced below potable water. Reduced water purchases will offset a portion of revenue losses of conversion to reclaimed. However, a large portion of reclaimed 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, the Olivenhain Water District, and the International Boundary and Water Commission. These districts/agencies comprise approximately 45% of current reclaimed water used. Reclaimed water used by these districts do not offset potable water sales in the City so they do not have a negative revenue impact to the Water Utility Fund.

The Water Department is actively pursuing Proposition 50 grants and other grants. Such amounts, however, are not included in the model unless grant agreements have been approved by the Water 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. An inflation factor, calculated as described above is added to the costs in the out-years.

The Water Department's model reflects a capacity charge as a full-cost recovery charge reviewed as part of the 2007 Rate Case. The result of that study increased the capacity charge to $3,047 (from $2,550) which is incorporated in the rate model.

The Water Department's model includes the anticipated issuance of additional revenue bonds secured by installment payments pursuant to the Installment Payment Agreement, including bonds in the approximate principal amount of $730 million maturing 30 years from their respective dates of issuance. The Water Department anticipates that the amount of revenue bonds to be issued in the future will be reduced by the amount of SRF loan received from DWR, if any.

Interest rates estimated for projected earnings on fund balance are 2.5% for Fiscal Year 2008-09, 3.0% for Fiscal Year 2009-10, 3.5% for Fiscal Year 2010-11 and 4.0% for Fiscal Year 2011-12 and Fiscal Year 2012-13. The interest rate for the projected public financing is reflected in the model to be 6%, based on the financial advisors' estimates. The model assumes annual inflation for Operations and Maintenance expenditures, except salaries and wages (which are assumed at 0%), is 4% based on the most recent 15-year San Diego area consumer price index for all urban consumers. The annual inflation for capital projects is 4% based on the Engineering News Record Construction Cost Index most recent 10-year annual average and 15-year annual average.

The Water Department's current rate model reflects an increase in salaries and wages in the amount of 4% in Fiscal Year 2007-08 and no increase in subsequent years until Fiscal Year 2012-13, consistent with the City's current Five-Year Financial Outlook (the "Five-Year Financial Outlook"). Actual results may be materially different from the assumptions respecting salary and wage increases included in Table 17. To the extent that actual salary and wage increases are higher than the assumed amounts, the Water System's expenditures may materially increase. The Water Department reduced 63.16 positions in Fiscal Year 2007-08 (net of hires) to reflect the Mayor's direction to streamline and reduce an additional 92.4 positions in Fiscal Year 2008-09 (net of hires) both to continue streamlining and re-engineering efforts and to accommodate the reduced revenues resulting from the assumed 7.5% reduction in water sales. Various other Operations and Maintenance reductions were also made to bring Fiscal Year 2008-09 expenditures into line with the reduced revenues.

Additional pension costs are reflected in the model based on the Water Utility Fund's proportionate share to fully fund the City's annual required contribution to the Pension System. See "WATER SYSTEM FINANCIAL OPERATIONS – Water System Share of Contribution to Pension System and NPO" herein. The Water Utility Fund also contributes its proportional share to the Retiree Health fund which was estimated at 7.94% of the total City contribution. See "WATER SYSTEM FINANCIAL OPERATIONS – Post-Retirement Healthcare Benefits" herein.

The data in Table 17 is based upon an assumption of the Water Utility Fund's proportionate share of costs for implementation of an Enterprise Reporting Program consistent with the Mayor's response to the Kroll Report. Additional costs for General Government Services are reflected based on the reorganization of the City government and the allocation of additional departments not previously included in the calculation.

The rate model assumes the City will not be a net purchaser of treated water beginning in Fiscal Year 2010-11. Treated Water Purchases averaged approximately 25,000 AFY from Fiscal Year 2003-04 through Fiscal Year 2007-08.

Based on the City's Long-Range Water Resources Plan, conservation is compared to water sales in Fiscal Year 1988-89. Conservation is anticipated to increase from 11.38% in Fiscal Year 2007-08 to 13.50% in Fiscal Year 2017-18 with an additional 2% added each year for passive conservation. In addition, the City is assuming an additional conservation factor of 7.5% and 15% for Fiscal Year 2008-09 and Fiscal Year 2009-10, respectively, to reflect potential restricted water supplies from CWA in 2009.

See a description of the Water Department's long-term debt as of June 30, 2007 as presented in Note 6 to the City's 2007 audited financial statements attached in Appendix D hereto. Except for covenants relating to its continuing disclosure undertakings, the Water Department was and is in compliance with bond covenants and debt service coverage ratio requirements as of June 30, 2008.

Outstanding Indebtedness

As of September 1, 2008, the aggregate principal amount of Parity Obligations payable from Net System Revenues was $245,010,000 and the aggregate principal amount of Subordinated Obligations payable from Net System Revenues was $498,785,380. The aggregate principal amount of loans payable from Net System Revenues as of September 1, 2008 was $18,940,380, consisting of loans payable to the State of California Water Resources Control Board, which is included in the amount of Subordinated Obligations.

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. The Water Department had not issued any general obligation debt as of June 30, 2008.

Table 18 sets forth the outstanding indebtedness payable from Net System Revenues as of September 1, 2008. See "PLAN OF FINANCE" herein for a description of the prepayments to be effected with proceeds of the Series 2009A Bonds.

TABLE 18

OUTSTANDING DEBT
(As of September 1, 2008)

Series	Final Maturity	Outstanding Principal Amount	Principal Amount to be Refunded
Parity Obligations:			
Series 1998 Certificates	August 1, 2028	$245,010,000	$94,165,000
Total Parity Obligations:		$245,010,000	
Subordinated Obligations:			
Series 2002 Subordinated Bonds	August 1, 2032	$272,845,000	$ 0
Series 2007A Notes	January 30, 2009	57,000,000	57,000,000
Series 2008A Subordinated Notes	August 28, 2009	150,000,000	0
State Revolving Fund Loan	July 1, 2025	18,940,380	0
Total Subordinated Obligations:		$498,785,380	
Total Parity Obligations and Subordinated Obligations:		$743,795,380	

Source: City of San Diego, Debt Management Department.

Annual Debt Service Requirements

Table 19 sets forth the amounts required in each fiscal year for the payment of principal of and interest on existing bonded indebtedness payable from the Water Utility Fund and amounts payable on the Series 2009A Bonds. See "SECURITY FOR THE SERIES 2009A BONDS" herein.

TABLE 19

DEBT SERVICE ON ALL PARITY OBLIGATIONS AND SUBORDINATED OBLIGATIONS(1)

Fiscal Year	Series 1998 Certificates(2)	Series 2002 Subordinated Bonds	Series 2008A Notes(3)	Series 2009A Bonds(4) Principal	Interest	Total Principal and Interest	Total Debt Service(5)
2008-09	$ 21,353,503	$ 18,036,568	$ 4,551,000	--	--	--	$ 43,941,070
2009-10	7,380,823	27,299,110	152,829,000	$ 1,035,000	$ 7,644,420	$ 8,679,420	196,188,353
2010-11	7,380,823	27,292,513	--	1,110,000	7,569,925	8,679,925	43,353,260
2011-12	7,380,823	27,296,456	--	1,140,000	7,539,025	8,679,025	43,356,304
2012-13	7,380,823	27,299,238	--	1,170,000	7,507,225	8,677,225	43,357,285
2013-14	7,380,823	27,298,400	--	1,215,000	7,465,375	8,680,375	43,359,598
2014-15	7,380,823	27,295,813	--	1,265,000	7,415,775	8,680,775	43,357,410
2015-16	7,380,823	26,924,438	--	2,200,000	7,357,475	9,557,475	43,862,735
2016-17	7,380,823	13,733,800	--	15,015,000	6,949,100	21,964,100	43,078,723
2017-18	7,380,823	13,735,350	--	15,780,000	6,179,225	21,959,225	43,075,398
2018-19	7,380,823	13,737,250	--	16,590,000	5,369,975	21,959,975	43,078,048
2019-20	7,380,823	13,732,525	--	17,390,000	4,568,725	21,958,725	43,072,073
2020-21	7,380,823	13,733,925	--	18,215,000	3,744,700	21,959,700	43,074,448
2021-22	7,380,823	13,735,138	--	19,120,000	2,838,719	21,958,719	43,074,679
2022-23	25,370,603	13,736,875	--	1,745,000	2,326,638	4,071,638	43,179,115
2023-24	25,374,423	13,735,325	--	1,835,000	2,237,138	4,072,138	43,181,885
2024-25	25,369,800	13,732,525	--	1,930,000	2,143,013	4,073,013	43,175,338
2025-26	25,370,750	13,737,263	--	2,030,000	2,044,013	4,074,013	43,182,025
2026-27	25,370,156	13,733,413	--	2,130,000	1,940,013	4,070,013	43,173,581
2027-28	25,373,619	13,734,625	--	2,240,000	1,830,763	4,070,763	43,179,006
2028-29	25,373,644	13,734,500	--	2,355,000	1,715,888	4,070,888	43,179,031
2029-30	--	13,736,875	--	2,475,000	1,595,138	4,070,138	17,807,013
2030-31	--	13,735,375	--	2,605,000	1,464,881	4,069,881	17,805,256
2031-32	--	13,733,625	--	2,745,000	1,324,444	4,069,444	17,803,069
2032-33	--	13,735,000	--	2,895,000	1,176,394	4,071,394	17,806,394
2033-34	--	--	--	3,050,000	1,020,338	4,070,338	4,070,338
2034-35	--	--	--	3,215,000	855,881	4,070,881	4,070,881
2035-36	--	--	--	3,390,000	682,500	4,072,500	4,072,500
2036-37	--	--	--	3,570,000	499,800	4,069,800	4,069,800
2037-38	--	--	--	3,765,000	307,256	4,072,256	4,072,256
2038-39	--	--	--	3,970,000	104,213	4,074,213	4,074,213
Total(5):	$294,907,189	$442,235,921	$157,380,000	$157,190,000	$105,417,970	$262,607,970	$1,157,131,080

Source: City of San Diego, Debt Management Department.

(1) Excludes debt service on the SRF Loan.

(2) Excludes debt service on the portion of the Series 1998 Certificates to be prepaid with proceeds of the Series 2009A Bonds. See "PLAN OF FINANCE" herein.

(3) Matures on August 28, 2009; will be prepaid in full prior to maturity.

(4) Proceeds of the Series 2009A Bonds will be used to prepay in full the Series 2007A Notes currently outstanding in the amount of $57 million. See "PLAN OF FINANCE" herein.

(5) Amounts have been rounded; total may not equal the sum of the components.

Labor Relations

General. The total number of regular full-time Water Department employees as of July 1, 2008 was 779, of which 464 were represented by the Municipal Employees Association ("MEA") and 266 were represented by American Federation of State, County and Municipal Employees, AFL-CIO, Local 127 ("Local 127"). The remaining 49 employees are unrepresented. The two bargaining units represent approximately 94% of the Water Department's employees. Contract negotiations with both units for Fiscal Year 2008-09 ended without an agreement. The terms of the existing labor agreements will carry forward into Fiscal Year 2008-09 with no salary increase. On May 27, 2008, the City Council approved the salary ordinance for Fiscal Year 2008-09, which sets the same pay and benefit levels as the prior fiscal year for the MEA. For employees represented by Local 127, the salary decrease of 1.9% from the July 1, 2005 labor agreement will be reinstated as a result of provisions of such labor agreement. MEA has settled and Local 127 is negotiating a settlement with the City with respect to the use of negotiated employee pension contribution increases pursuant to their respective labor agreements. The negotiated salary and compensation amounts due under the MEA settlement were previously paid by the Water Department and no additional amounts are expected to be paid from the Water Utility Fund in connection therewith. The MEA settlement and the potential Local 127 settlement are not expected to have a material adverse impact on the Water Utility Fund.

Worker-Related Insurance. The Water Department is self-insured for workers' compensation and long-term disability and for public liability claims exposure up to $5 million per occurrence. For liability between $5 million and $50 million, the Water Department is covered by the City which purchases insurance from commercial insurers in layers for its public liability exposure.

Table 20 reflects the public liability expense and cash payments for liability claims of the Water System for Fiscal Years 2002-03 through 2006-07.

TABLE 20

LIABILITY CLAIMS
PUBLIC LIABILITY EXPENSE AND CASH PAYMENTS
Fiscal Years Ending June 30, 2003 to 2007

Fiscal Year	Public Liability Expense(1)	Cash Payments
2002-03	$4,694,818	$2,226,903
2003-04	1,447,227	1,125,404
2004-05	966,319	1,146,732
2005-06	2,852,333	3,028,169
2006-07	4,794,657	2,483,122

Source: City of San Diego, Risk Management Department.
(1) Public Liability Expense includes actual cash payments plus the change in accrued liabilities from the previous fiscal year.

The City maintains commercial property insurance on all City-owned buildings of an insurable nature, and currently carries property and extended loss insurance coverage of $25 million per occurrence with a $25,000 deductible on all City buildings, with earthquake insurance coverage of up to $25 million on all bond-funded buildings under its primary policy. 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 as such insurance is not commercially available.

Investment of Funds

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

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

Oversight and Reporting Requirements. The City Treasurer provides an investment report on a monthly basis to the Chief Financial Officer, the City Comptroller and the City Council and annually presents the Investment Policy to the Chief Financial Officer, the Investment Advisory Committee and the City Council. The Investment Advisory Committee is comprised of two City employees, currently the Chief Financial Officer and the Director of Debt Management, and three investment professionals from the private sector and is charged with overseeing the review of the City's Investment Policy and practices of the City Treasurer and recommending changes thereto. Investments in the City Pool are audited annually by an independent firm of certified public accountants as part of the overall audit of the City's financial statements.

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

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

Pool Liquidity and Other Characteristics. The City Pool (including both the "Liquidity" and the "Core" portfolios) is highly liquid. Based on preliminary and unaudited month-end data as of December 31, 2008, approximately 10% of the pool investments mature within 62 days, 21% within 92 days and 22% within 184 days, 41% within 1 year, 84% within 2 years, 99% within 3 years, and 100% within 5 years (on a cumulative basis). As of December 31, 2008, the Pool had a weighted average maturity of 1.30 years (473 days) and its weighted yield was 2.461%. 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 1.65 years as of December 31, 2008. 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 1.65% for every 1% increase in market interest rates. The City Pool's composition is designed with a goal of having sufficient liquid funds available to meet disbursement requirements. The composition and value of investments under management in the City Pool will vary from time to time depending on cash flow needs of the City, maturity or sale of investments, purchase of new securities, and fluctuations in interest rates.

Table 21 sets forth the City Pool results at December 31, 2008.

TABLE 21

CITY OF SAN DIEGO POOLED INVESTMENT FUND[1]
(At December 31, 2008)
In Thousands
(Preliminary Unaudited)

Investment Instrument	Book Value	Market Value	Percent of Total [1]
U.S. Treasury Bills and Notes	$ 979,934	$ 998,167	49.02%
Federal Agency Securities [2]	807,812	823,995	40.41
Medium Term Notes (Corporate) [3]	98,942	99,800	4.94
Money Market Instruments [4]	88,170	87,984	4.41
Local Agency Investment Fund	24,395	24,395	1.22
NET ASSETS	$1,999,253	$2,034,341	100.00%

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

(1) Based on book value.

(2) Federal National Mortgage Association ("Fannie Mae") securities and Federal Home Loan Mortgage Corporation ("Freddie Mac") securities represent 30.67% and 30.78%, respectively, of total Federal Agency Securities, which is approximately 12.39% and 12.44%, respectively, of the City Pool.

(3) These notes consist of both fixed and floating interest rate securities. The notes with floating interest rates are reset at intervals ranging from one day to three months. 50.48% of these notes were issued under the Temporary Liquidity Guarantee Program and are backed by the full faith and credit of the FDIC.

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

San Diego City Employees' Retirement System

The City faces significant financial challenges in addressing an unfunded pension liability of approximately $1.3 billion, as of June 30, 2008. This liability is the product of a number of factors, including (i) improvements in benefits to members without corresponding funding, (ii) the use of pension funds to pay non-pension benefits, including contingent benefits and certain healthcare costs, rather than retaining such earnings in the Pension System (herein described), (iii) funding by the City at lower than actuarially required levels, (iv) use of realized earnings in excess of the assumed actuarial rate of return to make supplemental or contingent payments, and (v) investment returns lower than the actuarially assumed rate of return. Factors (i) through (iv) have been corrected through changes to the City's and SDCERS' polices and practices; factor (v) is the result of market conditions and may recur in the future.

The challenges posed by the unfunded pension liability are significant and, together with significant costs related to post-retirement healthcare benefits, pose a threat to the future fiscal health of the City. However, as explained below under the caption, "Water System Share of Contribution to Pension System and NPO," the Water System's proportionate share of the City's annual required contributions to the Pension System is approximately 5%. Estimates of the Water System's share of the City's annual contributions of approximately $11.5 million for each of Fiscal Years 2007-08 through 2010-11 were included in the 2007 Rate Case model that served as the basis for the annual rate increases through Fiscal Year 2010-11 that were approved by the City Council. For Fiscal Years 2007-08 and 2008-09, the actual contributions required from the Water System were less than the amounts that were assumed in the 2007 Rate Case model. The City fully funded its annual required contribution to the Pension System in Fiscal Years 2005-06 through 2008-09.

The amounts and percentages set forth under this caption relating to the City's Pension System, including, for example, actuarial accrued liabilities and funded ratios, are based upon numerous demographic and economic assumptions, including investment return rates, inflation rates, salary increase rates, cost of living adjustments, post-retirement mortality, active member mortality, and rates of retirement. The prospective purchasers of the Series 2009A Bonds are cautioned to review, and carefully assess the reasonableness of the assumptions set forth in the documents that are cited as the sources for the information under this caption. In addition, the prospective purchasers of the Series 2009A Bonds are cautioned that such sources and the underlying assumptions speak as of their respective dates, and are subject to change, any one of which could cause a significant change in the UAAL (as defined below).

The City is authorized by the City Charter to establish a pension system for its employees, and the City did so by an ordinance adopted in 1926, which was replaced by a new ordinance in 1962 (the "Pension System"). City employees participate with the full-time employees of the Airport Authority and the District in the SDCERS. The information below relates solely to the City's participation in SDCERS and not to the participation of the Airport Authority or the District. The plan assets of the City, the Airport Authority and the District were previously commingled, but separate cost calculations and actuarial valuation reports were completed annually for each employer. Since Fiscal Year 2007-08, the respective pension plan assets of each of the City, the Airport Authority and the District have been administered by SDCERS as separate trusts.

SDCERS is considered part of the City's financial reporting entity and is included in the City's CAFR as a pension system trust fund. SDCERS does prepare its own CAFR, the most recent of which is for Fiscal Year 2007-08.

UAAL and its Calculation. According to the City's June 30, 2008 Annual Actuarial Valuation of SDCERS, dated as of December 2008 (the "2008 Valuation") and prepared by Cheiron, Inc. ("Cheiron"), the funded ratio (the actuarial value of assets available for benefits to total actuarial accrued liability) of the SDCERS fund as of June 30, 2008 was 78.2%, and the SDCERS fund had an unfunded actuarial accrued liability (the "UAAL") of $1.301 billion as of June 30, 2008. Thus, for every dollar of benefits due (all vested liabilities), if all vested benefits were due on June 30, 2008, SDCERS had $0.782 in assets available for payment. The UAAL is the difference between total actuarially accrued liabilities (the "AAL") ($5.964 billion as of June 30, 2008) and actuarially calculated assets allocated to funding ($4.663 billion as of June 30, 2008).

Global financial markets have experienced significant volatility over the last several months, with a significant decline in market value since September 2008. This volatility has had a negative impact on SDCERS' portfolio. Although the impact on the *actuarial* value of SDCERS' plan assets cannot be determined without an official actuarial valuation, which occurs as of June 30 each year, SDCERS will be providing to the City the unaudited *market* values of plan assets and the recalculated pro forma actuarial value as of the end of each month. The market value represents, as of the date specified, the value of the plan assets if they were to be liquidated on that date. Unlike the market value, the actuarial value of plan assets is used to smooth the impact of annual investment return performance over multiple years, thereby reducing the impact of annual investment volatility on the City's annual required contribution ("ARC"). Investment earnings is one component that impacts the ARC each year. Because the actuarial value as of June 30, 2009 will be used in determining the City's ARC for Fiscal Year 2010-11, the intervening market values are not determinative to that calculation. Nevertheless, the City believes that it may be useful to the investment community to be apprised of the monthly market values during this period of market instability. The actuarial value of assets (City's portion) as of June 30, 2007, June 30, 2008, and December 31, 2008, were, respectively, $4.413 billion, $4.663 billion, and $4.179 billion. The market value of assets (City's portion) as of June 30, 2007, June 30, 2008, and December 31, 2008, were, respectively, $4.641 billion, $4.420 billion, and $3.482 billion. A decline in the actuarial value of assets over time will result in an increased ARC to the City from that estimated in the Five-Year Financial Outlook for Fiscal Years 2009-2010 through 2013-2014; however, the impact on the Water Utility Fund would be expected to be minimal. See "San Diego City Employees' Retirement System – Water System Share of Contributions to Pension System and NPO" below.

Actuarial Assumptions. The following are the principal actuarial assumptions used by SDCERS' actuary in preparing the valuation as of June 30, 2008 (as modified to reflect the adoption by the SDCERS Board of Administration (the "SDCERS Board of Administration") of new actuarial assumptions effective June 30, 2008 based upon an experience study dated July 18, 2008 prepared by SDCERS' actuary):

1. *Investment Return Rate*: 7.75% a year, net of administrative expenses, compounded annually. The rate is comprised of two elements: a 4.00% inflation rate and a 3.75% real rate of return.
2. *Inflation Rate*: 4.00% a year, compounded annually.
3. *Interest Credited to Member Contributions*: 7.75% compounded annually.
4. *Salary Increase Rates*: 4.50% a year, comprised of a 4.00% inflation rate and a 0.50% merit and longevity component.
5. *Annual 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.

"Smoothing" Methodology. In determining the actuarial value of its assets, SDCERS, as permitted by applicable actuarial guidelines, uses a "smoothing" methodology to reduce the impact of market volatility on plan assets. The market value of assets represents, as of the valuation date, the value of the assets as if they were liquidated on that date. The actuarial value of assets is a value that attempts to smooth annual investment return performance over multiple years to reduce annual investment volatility. The actuarial value of assets is what is used to determine SDCERS' contribution rates for the City. As of June 30, 2008, the market value of plan assets was $4.420 billion, and the actuarial value was $4.663 billion. By the smoothing method used in the 2008 Valuation, the calculation of the actuarial value of assets at June 30, 2008 started with the actuarial value of assets at June 30, 2007, added to that 100% of the actuarially assumed rate of return (7.75%), plus the contribution towards plan assets, less payments out from plan assets, plus 25% of the difference between the expected actuarial value of assets at June 30, 2008 (using the above calculation) and the actual market value of assets at June 30, 2008. The impact of this smoothing methodology will vary each year depending upon the year's actual investment performance compared to the then-remaining amount to be smoothed, either as a net gain or a net loss.

City Contributions to SDCERS. The City's ARC consists of: (i) the "normal cost," being the present value of the benefits that SDCERS expects to become payable in the future attributable to a current year's employment, and (ii) payments made to amortize the UAAL. SDCERS currently amortizes the UAAL over a 20-year period with no negative amortization, as approved by the SDCERS Board of

Administration in its administrative capacity pursuant to its plenary authority over the Pension System. See Note 12 to the City's 2007 audited financial statements attached hereto in Appendix D for a description of the potential impact of shorter amortization period prescribed by the City Charter. For many years, the City was paying less than the full ARC. The reasons for this are numerous, including prior agreements between the City and SDCERS, earnings on pension assets at greater than the actuarially assumed rate of 8% being credited against contributions, payments pursuant to litigation settlements that were mistakenly characterized as "contingent" and therefore not made in certain years, and other reasons explained in detail in Note 12 to the City's 2007 audited financial statements. See Appendix D – "EXCERPTS FROM THE COMPREHENSIVE ANNUAL FINANCIAL REPORT OF THE CITY OF SAN DIEGO FOR FISCAL YEAR 2006-07" attached hereto.

The City paid the full ARC, as calculated by SDCERS, for Fiscal Years 2005-06 and 2006-07. However, the calculation of the ARC by SDCERS for Fiscal Years 2004-05, 2005-06, and 2006-07 did not include certain benefit payments that the SDCERS Board of Administration views as having been contingent. Subsequent to those payments, SDCERS and its actuary determined that the liabilities were not contingent and the ARC for financial reporting was restated from the original ARC. Accordingly, the City Net Pension Obligation ("NPO") has been increased by such amounts. NPO is the cumulative difference between the annual pension cost of the City to the Pension System and the actual contribution in a particular year. Annual pension cost is equal to (i) the ARC, (ii) one year's interest on the NPO, and (iii) an adjustment to the ARC to offset, approximately, the amount included in item (i) for amortization of the past contribution deficiencies. The City has taken various actions to reduce the NPO and the related UAAL, including contributions of $142.6 million in addition to the ARC through the securitization of future tobacco settlement revenue, transfers of actual tobacco settlement revenue receipts, and additional employee "pick up" savings.

The City's NPO at the end of Fiscal Year 2006-07 was $195.3 million. In Fiscal Year 2007-08, the City's total pension payment was $165 million. The City's pension payment for the Fiscal Year 2008-09 is $161.7 million and has been paid in full.

Table 22 below sets forth the City's portion of SDCERS historical funding progress for Fiscal Years 2003-04 through 2007-08.

TABLE 22

CITY OF SAN DIEGO
Schedule of Funding Progress
Fiscal Years 2003-04 through 2007-08
(In Thousands)

Valuation Date (June 30)	Valuation Assets	AAL	Funded Ratio	UAAL[(1)]
2004	$2,628,680	$3,997,328	65.8%	$1,368,648
2005	2,983,080	4,377,093	68.2	1,394,013
2006[(2)]	3,981,932	4,982,699	79.9	1,000,768
2007[(2)]	4,413,411	5,597,653	78.8	1,184,242
2008[(3)]	4,662,836	5,963,550	78.2	1,300,713

Source: SDCERS Comprehensive Annual Financial Report of the indicated year. Amounts set forth in this table differ from corresponding amounts set forth in the City's Comprehensive Annual Financial Reports due to adjustments made by the City to include the impact of the Corbett settlement. See Note 12 to the City's 2007 audited financial statements attached hereto in Appendix D.

(1) Actuarial gains and losses reduce or increase the UAAL, which is being amortized over a 20-year period with no negative amortization as of the 2007 Actuarial Valuation.

(2) Reflects revised actuarial methodologies, including the return to the entry age normal actuarial funding method.

(3) Reflects revised actuarial assumptions.

Water System Share of Contribution to Pension System and NPO. For Fiscal Year 2007-08, the Water Utility Fund's proportionate share to fully fund the City's contribution to the Pension System was $8.8 million, and for Fiscal Year 2008-09 such share will be $8.1 million. In the Water System's 2007 Rate Case projection, which was the basis for the annual rate increases of 6.5% approved by the City Council for Fiscal Years 2007-08 through 2010-11 (see "WATER SYSTEM FINANCIAL OPERATIONS – Establishment and Collection of Water Service Charges" and " – Historical Rates and Charges" herein), the Water System used $11.5 million each year for the assumed amount of the Water Utility Fund's proportionate share of the City's ARC for Fiscal Years 2007-08 through 2010-11. The City expects that the $11.5 million estimate included in the Water System's 2007 Rate Case projection for Fiscal Years 2007-08 through 2010-11 will be sufficient to pay the Water Utility Fund's proportionate share to fully fund the City's contribution to the Pension System for such years. The Water System's share of the NPO at June 30, 2007, is approximately $9.8 million. See the City's 2007 audited financial statements, line item entitled "Non-Current Liabilities - Net Pension Obligation" under the table entitled "Proprietary Funds - Statement of Net Assets".

Table 23 sets forth, for Fiscal Years 2007-08 through 2010-11, the City's pension payments, the pension contributions included in the Water System's 2007 Rate Case projection and the corresponding actual/budgeted amounts, which have been lower than the projected amounts.

TABLE 23

CITY OF SAN DIEGO AND WATER DEPARTMENT
Pension Contribution
Fiscal Years 2007-08 through 2010-11
(In Millions)

	City	Water Department	
Fiscal Year	**Pension Payment**	**Rate Case Projection**	**Actual/Budgeted/Estimated**
2007-08	$165.0[(1)]	$11.5	$8.8[(2)]
2008-09	161.7[(3)]	11.5	8.1[(3)]
2009-10	169.0[(4)]	11.5	8.3[(5)]
2010-11	176.0[(4)]	11.5	10.0/11.8[(6)]

Source: City of San Diego Financial Management Department and Water Department.
(1) Unaudited actual. Consists of the City's ARC of $137.7 million, an additional $20 million to ensure no negative amortization of the UAAL and an additional $7.3 million to offset contribution shortfalls from prior fiscal years.
(2) Unaudited actual.
(3) Final budgeted.
(4) Estimated annual required contribution to the Pension System; projections assume a 4.25% growth rate pursuant to the City's Five-Year Financial Outlook for Fiscal Years 2009-10 through 2013-14. Excludes impact of market declines since September 2008.
(5) Estimated, as set forth in the City's Five-Year Financial Outlook for Fiscal Years 2009-10 through 2013-14.
(6) Estimated amounts based on two different scenarios, each as set forth in the City's Five-Year Financial Outlook for Fiscal Years 2009-10 through 2013-14. In Scenario One, the City's ARC for Fiscal Year 2009-10 is estimated to be $166 million, increasing by $33 million to $199 million in 2011, based on the various assumptions, including the assumption that the market value of Pension System assets will experience a significant loss during Fiscal Year 2008-09 and not recover substantially by June 30, 2009. Scenario Two for ARC payments presents a more negative forecast, assuming an increase to the ARC of $70 million in Fiscal Year 2010-11 with increases of an additional $15 to $20 million a year and a future return equal to the 7.75% assumed rate of return by SDCERS in fiscal years 2011-2014. Among other things, Scenario Two excludes any offsetting effects to mitigate current investment losses and any actuarial gains from lower than expected salary increases and a reduction in the number of City employees. Both figures exclude the impact of market declines since September 2008, the potential impact of which is described under the caption "– UAAL and its Calculation " herein.

Post-Retirement Healthcare Benefits

The City is authorized pursuant to the San Diego Municipal Code to provide certain healthcare benefits to certain retired employees through SDCERS. Expenses for post-retirement healthcare benefits were paid for on a pay-as-you-go basis through Fiscal Year 2006-07 from City contributions, retiree contributions and amounts from the 401(k) Plan established by the City in 1985. In Fiscal Years 2005-06 and 2006-07, the annualized cost of retiree health benefits was approximately $24.1 million and $27.1 million, respectively. The City's portion of such cost was $17.4 million and $20.4 million, respectively, for such fiscal years. The remainder was paid from retiree contributions. The Water Utility Fund's proportionate share of such post-retirement healthcare benefits was approximately $1.36 million, $2.1 million and $3.9 million for Fiscal Years 2005-06, 2006-07 and 2007-08, respectively. The City expects to contribute $26.1 million to such pay-as-you-go post-retirement healthcare benefits in Fiscal Year 2008-09, of which $1.89 million represents the Water Utility Fund's proportionate share.

The City has taken various actions to ensure that sufficient resources are available to pay for retiree healthcare expenses in future periods, including entering into an agreement with CalPERs on January 18, 2008 as a participating employer in the CalPERS irrevocable retirement trust fund to pre-fund expenses related to other post-employment benefits ("OPEB") and contributing approximately $30.1 million to CalPERS in connection therewith. The City made a partial ARC contribution in Fiscal Year 2008-09 of $23.9 million for OPEB liabilities, of which $1.73 million represents the Water Utility Fund's proportionate share. All future contributions for post employment healthcare benefits will be credited toward the City's ARC for retiree healthcare liabilities in accordance with Governmental Accounting Standards Board ("GASB") Statement No. 43, "Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans" ("GASB 43"), and GASB Statement No. 45, "Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions" ("GASB 45"). See Note 13 to the City's 2007 audited financial statements attached hereto in Appendix D for a description of GASB 45 and the City's OPEB contributions as of October 17, 2008.

An actuarial valuation of the City's post-retirement medical benefit program as of June 30, 2008 (the "2008 OPEB Valuation") was performed by Buck Consultants for the purpose of determining the City's annual cost in accordance with GASB 45. The valuation, dated December 10, 2008, reflected a discount rate of 6.69% based on the City's actual and expected contributions to the CalPERS Retiree Benefit Trust Fund, inflation factors for increases in healthcare costs and premium costs, and a 30-year amortization period. According to the 2008 OPEB Valuation, using the assumptions described above and consistent with GASB 45, the UAAL for OPEB for all retirees, deferred retirement participants, vested terminated and active members as of June 30, 2008 was $1.25 billion and the ARC for OPEB will be $113.43 million for Fiscal Year 2009-10 (as reported in the actuarial valuation dated June 30, 2008). Table 24 sets forth the retiree health contributions included in the Water System's 2007 Rate Case projection for Fiscal Years 2007-08 through 2010-11 and the corresponding actual/budgeted amounts, which have been lower than the projected amounts. The City expects that such amount will be sufficient to pay the Water Utility Fund's proportionate share to fund the City's contribution to OPEB for such years.

TABLE 24

WATER DEPARTMENT
Retiree Health Contribution
Fiscal Years 2007-08 through 2010-11
(In Millions)

Fiscal Year	Rate Case Projection	Actual/Budgeted/Estimated
2007-08	$3.7	$3.9(1)
2008-09	5.7	3.6(2)
2009-10	6.0	4.1(3)
2010-11	6.0	4.6(3)

Source: City of San Diego, Financial Management Department.

(1) Unaudited actual. Consists of the Water Utility Fund's proportionate share of pay-as-you-go post-retirement healthcare benefits and its proportionate share of contributions to CalPERS for OPEB.

(2) Final budgeted.

(3) Estimated, as set forth in the City's Five-Year Financial Outlook for Fiscal Years 2009-10 through 2013-14. Excludes impact of market declines since September 2008.

RISK FACTORS

The ability of the City to pay principal of and interest on the Series 2009A Bonds depends primarily upon the receipt by the City of Net Revenues. Some of the events which could prevent the City from receiving a sufficient amount of Net Revenues to enable it to pay the principal of and interest on the Series 2009A Bonds are summarized below. The following description of risks is not intended to be an exhaustive list of the risks associated with the purchase of the Series 2009A Bonds and the order of the risks set forth below does not necessarily reflect the relative importance of the various risks.

Limited Obligations

The obligation of the City to pay the 2009A Installment Payments securing the Series 2009A 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 2009A Installment Payments does not constitute an obligation of the City to levy or pledge any form of taxation or for which the City has levied or pledged any form of taxation. The City is obligated under the Installment Purchase Agreement to make the Installment Payments solely from Net System Revenues.

No assurance can be made that Net System Revenues, estimated or otherwise, will be realized by the City in amounts sufficient to pay the 2009A 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 establish, maintain and collect rates and charges sufficient pay for Operation and Maintenance costs and the 2009A Installment Payments. See "WATER SYSTEM FINANCIAL OPERATIONS – Historical Rates and Charges."

Water System Expenses and Collections

The Operation and Maintenance costs of the Water System are expected to increase in the next five years. See "WATER SYSTEM FINANCIAL OPERATIONS – Financial Projections and Modeling Assumptions" herein. However, there can be no assurance that the City's projected future Maintenance and Operation costs for the Water System will actually be as projected by the Water Department and described in this Official Statement. In addition, demands on the Water System will 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 pay the 2009A Installment Payments securing the Series 2009A 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. Further, although the City has covenanted to prescribe, revise and collect rates and charges for Water Service in amounts necessary to pay the 2009A Installment Payments, there can be no assurance that such amounts will be collected in the amounts and at the times necessary to pay the 2009A Installment Payments sufficient to provide for the payment of the Series 2009A Bonds.

Rate-Setting Process under Proposition 218

Proposition 218, which added Articles XIIIC and XIIID to the California Constitution, affects the City's ability to impose future rate increases, and no assurance can be given that future rate increases will not encounter majority protest opposition or be challenged by initiative action authorized under Proposition 218. In the event that future proposed rate increases cannot be imposed as a result of majority protest or initiative, the City might thereafter be unable to generate Net System Revenues in the amounts required by the Installment Purchase Agreement to pay 2009A Installment Payments. See "CONSTITUTIONAL LIMITATIONS ON TAXES AND WATER RATES AND CHARGES—California Constitution Articles XIIIC and XIIID."

Notwithstanding the foregoing, the City has covenanted 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 effected in compliance with Proposition 218.

Statutory and Regulatory Compliance

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.

Claims against the Water System for failure to comply with applicable laws and regulations could be significant. 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 Water 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 2009A Installment Payments. See "WATER SYSTEM REGULATORY REQUIREMENTS - Compliance Order by the California Department of Public Health" herein.

Although the City has covenanted in the Installment Purchase Agreement to fix, prescribe and collect rates and charges for the Water Service which will yield Net System Revenues for each fiscal year sufficient to pay debt service on the Series 2009A Bonds, 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 2009A Installment Payments.

Risks Relating to the Water Supply

Drought Risks. The San Diego region and its primary sources of water supply can be subject to drought conditions. The region is situated in an arid and semi-desert environment. While suppliers of water to the City, including CWA and MWD, have planned and managed reserve supplies to account for normal occurrences of drought conditions, decreased runoff from Sierra Nevada snow pack, environmental issues in the Sacramento-San Joaquin Delta and a severe drought in the Colorado River Basin are restricting the ability to transport water supplies to Southern California. APPENDIX C – "INFORMATION CONCERNING THE SAN DIEGO COUNTY WATER AUTHORITY AND METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA – Metropolitan Water District of Southern California – California's Colorado River Water Use Plan" attached hereto. Due to drought conditions and court-ordered restrictions, on June 4, 2008, California Governor Arnold Schwarzenegger issued an Executive Order proclaiming a condition of statewide drought (the "Executive Order"). The Executive Order directs DWR to expedite existing conservation grant programs, facilitate water transfers, conduct a water conservation and outreach campaign in cooperation with local water agencies and organizations, and take additional drought response and water conservation actions. The Executive Order recognizes that some communities have worked to improve their drought preparedness and ability to cope with water shortages, but there are wide variations within the State. It orders State and local agencies to identify public water systems at risk of health and safety impacts due to drought and water delivery limitations and to mitigate these impacts. The Executive Order encourages local water agencies and districts to work cooperatively on actions to reduce water consumption locally and regionally. MWD, which supplies water to the City through CWA, is currently supplementing supplies from the Colorado River and the State Water Project by drawing on its stored water supplies to meet near-term demands and anticipates additional actions to stretch reserve supplies. The City has taken into account the effect of the current drought on operations in the Water Department's Fiscal Year 2008-09 and Fiscal Year 2009-10 budgets by assuming in its estimated budget for Fiscal Year 2008-09 a 7.5% reduction in water sales and deliveries and assuming in its operating budget for Fiscal Year 2009-10 a 15% reduction in water sales and deliveries, which is expected to result in reduced revenues that are expected to be offset by reductions in both its operating budget and its capital improvement budget. As described under the caption "WATER SUPPLY - Current Water Supply," the City has also taken various actions to address the drought conditions, including declaring a Stage 1 Voluntary Compliance Water Watch, amending its drought response plan and implementing the 20 Gallon Challenge. These actions may result in reduced revenues which are expected to be offset by reductions in the Water Department's operating budget and its capital improvement budget. In addition, the City has initiated the IPR Project to determine the feasibility of using highly treated reclaimed water to augment the City's drinking water supply. The City cannot predict the result and impact of the IPR Project.

Earthquakes, Wildfires and Other Natural Disasters. Southern California is characterized by a number of geotechnical conditions which represent potential safety hazards, including expansive soils and areas of potential liquefaction and landslide. Earthquakes or other natural disasters could interrupt operation of the Water System and thereby interrupt the ability of the City to realize Net System Revenues sufficient to pay the 2009A Installment Payments securing the payment of the Series 2009A Bonds. The San Diego area is characterized by a number of geotechnical conditions which 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. 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. Additionally, the Water Department has two capital improvement projects currently underway to mitigate earthquake damage to selected pipelines. 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 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 Water 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 Water 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 Water 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 San Diego County.

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 Water Department, extend for hundreds of miles and cross several major fault lines en route to San Diego 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 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 City's reservoirs. To date, the City has found Quagga mussels in San Vicente, El Capitan, Otay, Murray, Miramar, and Hodges 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.

Security of the Water System. Military conflicts and terrorist activities may adversely impact the operations and finances of the Water System. The Water Department continually plans and prepares for emergency situations and immediately responds to ensure the quality and service of water is maintained. The Water 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 DPH, 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; 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 pay debt service on the Series 2009A Bonds. The Capital Improvement Program of the Water Department 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 within the Water Utility Fund an Operating Reserve (the "Operating Reserve") funded at a minimum 45 days' operating costs (to be gradually increased to 70 days of operating costs in Fiscal Years 2009-10 to 2010-11) which may be used under certain circumstances for repairs to the Water System. See "WATER SYSTEM FINANCIAL OPERATIONS – Rate Stabilization Fund and Other Funds and Accounts" herein.

Suppliers of water to the Water Department have also taken actions to increase the security of water from the Colorado River Aqueduct and the SWP. MWD has reported that it has increased ground and air patrols of the Colorado River Aqueduct. In addition, MWD has increased the frequency of monitoring and testing at all treatment plants in addition to various sites along the Colorado River Aqueduct. Although MWD has constructed redundant systems and other safeguards, no assurance can be given that existing or additional safety and security measures will prove adequate in the event that terrorist activities are directed against the Water System to prevent a disruption of MWD's ability to deliver water to its member agencies, including CWA, from which the Water 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 2009A Installment Payments.

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 Water 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 2007-08 through 2010-11 allow for 8% inflation in gas and electric costs. The Water Department also cannot guarantee that additional increases in water rates charged by the City's wholesale provider or other charges imposed by the 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 – Articles XIIIC and XIIID" herein.

Impact of Current Fiscal Crisis

The United States financial market is presently experiencing extreme volatility precipitated by major economic disruptions, indications of a severe economic recession and significant credit and liquidity problems. The City cannot predict the extent of the fiscal problems that will be encountered in this or in any future Fiscal Years, and it is not clear what measures will be taken by the State or federal government to address the current fiscal crisis. Accordingly, the City cannot predict the final outcome of future State or federal actions or the impact that such actions will have on the Water System's finances and operations.

The Water Department's current water rate model reflects an assumed 7.5% and 15% reduction in water sales for Fiscal Year 2008-09 and Fiscal Year 2009-10, respectively. In general, the resulting revenue reduction is offset by reductions in water purchases and other budget reductions that also carry forward into future years. See "WATER SYSTEM FINANCIAL OPERATIONS – Operation and Maintenance Expenditures" herein. The Water Department also prepared an alternate projection that included an assumed 15% reduction in water sales from Fiscal Year 2009-10 through Fiscal Year 2012-13, which projection continued to reflect the generation of Net System Revenues in amounts sufficient to pay the 2009A Installment Payments. In addition, pursuant to the Installment Purchase Agreement, the City is obligated to 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, including the 2009A Installment Payments, payable in such Fiscal Year or (2) Adjusted Net System Revenues during each Fiscal Year equal to 120% of the Adjusted Debt Service (as such terms are defined in the Installment Purchase Agreement) for such Fiscal Year. The Installment Purchase Agreement also prohibits the City from reducing the rates and charges then in effect unless the Net System Revenues from such reduced rates and charges will at all times be sufficient to meet the requirements of the Installment Purchase Agreement. Further, the Indenture provides that upon the occurrence and continuance of any Event of Default (as defined in the Indenture), including nonpayment of principal of or interest on the Series 2009A Bonds, the holders of the Series 2009A Bonds may proceed to enforce their beneficial rights by mandamus, or other suit, action or proceeding at law or in equity, which includes an action for specific performance by the City with respect to its rate covenant and any other agreement contained in the Installment Purchase Agreement. See also "RISK FACTORS – Rate-Setting Process" and "CONSTITUTIONAL LIMITATIONS ON TAXES AND WATER RATES AND CHARGES – Articles XIIIC and XIIID" for a description of limitations on the rate-setting process under the California Constitution.

However, the City cannot predict the extent to which the current or any future financial crisis, alone or together with the drought conditions described under the caption "RISK FACTORS – Risks Relating to the Water Supply – Drought Risks", will impact its ability to generate Net System Revenues in the amounts required by the Installment Purchase Agreement to pay 2009A Installment Payments. In particular, the City cannot predict the extent to which an economic recession and credit crisis will affect future water demands, the impact of any reduced demand on the Water System's finances and operations or whether a sustained fiscal crisis would create sufficient pressure on the City Council to effect a reduction in water fees.

Limitations on Remedies

The rights of the Owners of the Series 2009A Bonds are 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. Additionally, enforceability of the rights and remedies of the Owners of the Series 2009A Bonds, and the obligations incurred by the City, may become subject to the federal bankruptcy code and applicable bankruptcy, insolvency, reorganization, moratorium, or similar laws relating to or affecting the enforcement of creditor's rights generally, now or hereafter in effect, equity principles which may limit the specific enforcement under State law of certain remedies, the exercise by the United States of America of the powers delegated to it by the Constitution, the reasonable and necessary exercise, in certain exceptional situations, of the police powers inherent in the sovereignty of the State and its governmental bodies in the interest of serving a significant and legitimate public purpose, and the limitations on remedies against counties in the State. Bankruptcy proceedings, or the exercise of powers by the federal or State government, if initiated, could subject the Owners of the Series 2009A Bonds to judicial discretion and interpretation of their rights in bankruptcy or otherwise and consequently may entail risks of delay, limitation, or modification of their rights.

CONSTITUTIONAL LIMITATIONS ON TAXES AND 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 which 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. Accordingly, if a portion of the District's water or wastewater user rates or Capacity Fees were determined by a court to exceed the reasonable cost of providing service, the District would not be permitted to continue to collect that portion unless it were authorized to do so by a two-thirds majority of the votes cast in an election to authorize the collection of that portion of the rates or fees. The reasonable cost of providing wastewater services has been determined by the State Controller to include depreciation and allowance for the cost of capital improvements. In addition, the California courts have determined that fees such as capacity fees will not be special taxes if they approximate the reasonable cost of constructing the water or wastewater capital improvements contemplated by the local agency imposing the fee. See "FINANCIAL SYSTEM FINANCIAL OPERATIONS – Revenues" herein.

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, fee and charges collected by the City are used to pay the costs of maintaining and operating the Water System and payments due on the Series 2009A Bonds (including the funding of the Reserve Fund), the City believes that such moneys are not subject to the annual appropriations limit of Article XIIIB.

Articles XIIIC and XIIID

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 XIII C and XIII D 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"). However, on July 24, 2006, the California Supreme Court ruled in *Bighorn-Desert View Water Agency v. Virjil (Kelley)* (the "*Bighorn Decision*") that charges for ongoing water delivery are property-related fees and charges within the meaning of Article 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 which was not affected by a prior initiative or impose an entirely new charge.

The Supreme Court further stated in the *Bighorn Decision* that it was not holding that the initiative power is free of all limitations and was not determining whether the initiative power is subject to the statutory provision requiring that water service charges be set at a level that will pay debt service on bonded debt and operating expenses. Such initiative power could be subject to the limitations imposed on the impairment of contracts under the contract clause of the United States Constitution. Additionally, SB 919 provides that the initiative power provided for in Proposition 218 "shall not be construed to mean that any owner or beneficial owner of a municipal security, purchased before or after [the effective date of Proposition 218] assumes the risk of, or in any way consents to, any action by initiative measure that constitutes an impairment of contractual rights" protected by the United States Constitution. No assurance can be given that the voters of the City will not, in the future, approve initiatives which repeal, reduce or prohibit the future imposition or increase of assessments, fees or charges, including the City's water service fees and charges, which are the source of Net System Revenues pledged to the payment of debt service on Series 2009A 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 which meet the requirements of the Installment Purchase Agreement in accordance with applicable law.

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." 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 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 water rate measures and otherwise complied with the applicable notice and protest procedures of Article XIIID for its current water rates and charges. There has not been nor is there any pending challenge to any of the City's water fees and charges approved since the effective date of Proposition 218. While the City Attorney is of the opinion, based upon the judicial precedent in place during the period of these rate increases, that a reviewing court could reasonably uphold the validity of those increases, neither the City nor the City Attorney can predict with certainty the outcome of a challenge to the 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 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.

Existing, new or increased assessments are subject to the procedural provisions of Proposition 218. However, certain assessments existing on November 6, 1996, are classified as exempt from the procedures and approval process of Article XIIID. Expressly exempt assessments include (i) an assessment imposed exclusively to finance capital costs or maintenance and operation expenses for sewers, water, flood control and drainage systems, but subsequent increases are subject to the procedures and approval requirements; (ii) an assessment imposed pursuant to a petition signed by all affected landowners (but subsequent increases are subject to the procedural and approval requirements); (iii) assessments, the proceeds of which are used exclusively to pay bonded indebtedness, where failure to pay would violate the U.S. Constitution's prohibition against the impairment of contracts; and (iv) any assessment which has previously received approval by a majority vote of the voters (but subsequent increases are subject to the procedural and approval requirements).

On July 14, 2008, the California Supreme Court ruled in *Silicon Valley Taxpayers Association, Inc. v. Santa Clara County Open Space Authority* (the "SCCOSA Decision") that the Santa Clara County Open Space Authority's county-wide assessment which was designed to fund the acquisition and maintenance of unspecified open-space lands in the County of Santa Clara was invalid under Proposition 218. The Court held that deference should not be accorded to local agencies when Proposition 218 legislative acts are challenged. Under Proposition 218, courts must make an independent review of whether the assessment and formation of an assessment district meet the "special benefit" and proportionality requirements of Article XIIID. Further, while an assessment will not be invalidated because it confers a benefit upon the public at large, the "special benefit" must affect the assessed property in a distinct and particular manner not shared by other parcels and the public at large. Specifically, in the SCCOSA Decision the assessment did not meet the requirements of a "special benefit" and the assessment was not proportional to the special benefits conferred. Finally, the Court held that the Santa Clara Open Space Authority did not meet the proportionality requirement of Article XIIID because it did not specifically identify the improvements to be financed by the assessment and failed to sufficiently connect any costs of and benefits received from the open space assessment to the specific assessed parcels.

The City and the City Attorney are of the opinion that current water fees and charges that are subject to Proposition 218 comply with the provisions thereof and that the City will continue to comply with the rate covenant set forth in the Installment Purchase Agreement in conformity with the provisions of Article XIIID of the California State Constitution. The City and the City Attorney are also of the opinion that current water capacity fees are not subject to Proposition 218. 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. It is unclear whether under existing standards, rates and charges may be established at levels which would permit deposits to a Rate Stabilization Fund or maintenance of uncommitted cash reserves. See "WATER SYSTEM FINANCIAL OPERATIONS – Financial Projections and Modeling Assumptions" herein.

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

TAX EXEMPTION

The delivery of the Series 2009A Bonds is subject to delivery of the opinion of Bond Counsel, to the effect that interest on the Series 2009A Bonds for federal income tax purposes under existing statutes, regulations, published rulings, and court decisions (1) will be excludable from the gross income, as defined in section 61 of the Internal Revenue Code of 1986, as amended to the date of initial delivery of the Series 2009A Bonds (the "Code"), of the owners thereof pursuant to section 103 of the Code, and (2) will not be included in computing the alternative minimum taxable income of the owners thereof who are individuals or, except as hereinafter described, corporations. The delivery of the Series 2009A Bonds is also subject to the delivery of the opinion of Bond Counsel, based upon existing provisions of the laws of the State of California, that interest on the Series 2009A Bonds is exempt from personal income taxes of the State of California. The form of Bond Counsel's anticipated opinion is included as Appendix F. The statutes, regulations, rulings, and court decisions on which such opinions will be based are subject to change.

Interest on all tax-exempt obligations, including the Series 2009A Bonds, owned by a corporation will be included in such corporation's adjusted current earnings for purposes of calculating the alternative minimum taxable income of such corporation, other than an S corporation, a qualified mutual fund, a financial asset securitization investment trust, a real estate investment trust (REIT), or a real estate mortgage investment conduit (REMIC). A corporation's alternative minimum taxable income is the basis on which the alternative minimum tax imposed by section 55 of the Code.

In rendering the foregoing opinions, Bond Counsel will rely upon the representations and certifications of the Authority and the City made in a certificate of even date with the initial delivery of the Series 2009A Bonds pertaining to the use, expenditure, and investment of the proceeds of the Series 2009A Bonds and will assume continuing compliance with the provisions of the Indenture by the Authority subsequent to the issuance of the Series 2009A Bonds. The Indenture contains covenants by the Authority with respect to, among other matters, the use of the proceeds of the Series 2009A Bonds and the facilities and equipment financed or refinanced therewith by persons other than state or local governmental units, the manner in which the proceeds of the Series 2009A Bonds are to be invested, the calculation and payment, if required, to the United States Treasury of any "arbitrage profits" and the reporting of certain information to the United States Treasury. Failure to comply with any of these covenants may cause interest on the Series 2009A Bonds to be includable in the gross income of the owners thereof from the date of the issuance of the Series 2009A Bonds.

Except as described above, Bond Counsel will express no other opinion with respect to any other federal, State or local tax consequences under present law, or proposed legislation, resulting from the receipt or accrual of interest on, or the acquisition or disposition of, the Series 2009A Bonds. Prospective purchasers of the Series 2009A Bonds should be aware that the ownership of tax-exempt obligations such as the Series 2009A Bonds may result in collateral federal tax consequences to, among others, financial institutions, life insurance companies, property and casualty insurance companies, S corporations with subchapter C earnings and profits, certain foreign corporations doing business in the United States, individual recipients of Social Security or Railroad Retirement benefits, individuals otherwise qualifying for the earned income tax credit, owners of an interest in a financial asset securitization investment trust, and taxpayers who may be deemed to have incurred or continued indebtedness to purchase or carry, or who have paid or incurred certain expenses allocable to, tax-exempt obligations. Prospective purchasers should consult their own tax advisors as to the applicability of these consequences to their particular circumstances.

Bond Counsel's opinion is not a guarantee of a result, but represents its legal judgment based upon its review of existing statutes, regulations, published rulings and court decisions and the representations and covenants of the Authority and the District described above. No ruling has been sought from the Internal Revenue Service (the "Service") or the State of California with respect to the matters addressed in the opinion of Bond Counsel, and Bond Counsel's opinion is not binding on the Service or the State of California. The Service has an ongoing program of auditing the tax-exempt status of the interest on municipal obligations. If an audit of the Series 2009A Bonds is commenced, under current procedures, the Service is likely to treat the Authority as the "taxpayer," and the Owners of the Series 2009A Bonds would have no right to participate in the audit process. In responding to or defending an audit of the tax-exempt status of the interest on the Series 2009A Bonds, the Authority may have different or conflicting interests from the Owners of the Series 2009A Bonds. Public awareness of any future audit of the Series 2009A Bonds could adversely affect the value and liquidity of the Series 2009A Bonds during the pendency of the audit, regardless of its ultimate outcome.

A copy of the proposed form of opinion of Bond Counsel is set forth in Appendix F hereto.

The initial public offering price of certain Series 2009A Bonds (the "Discount Bonds") may be less than the amount payable on such Series 2009A Bonds at maturity. An amount equal to the difference between the initial public offering price of a Discount Bond (assuming that a substantial amount of the Discount Bonds of that maturity are sold to the public at such price) and the amount payable at maturity constitutes original issue discount to the initial purchaser of such Discount Bond. A portion of such original issue discount, allocable to the holding period of such Discount Bond by the initial purchaser, will, upon the disposition of such Discount Bond (including by reason of its payment at maturity), be treated as interest excludable from gross income, rather than as taxable gain, for federal income tax purposes and exempt from California personal income tax, on the same terms and conditions as those for other interest on the Series 2009A Bonds described above. Such interest is considered to be accrued actuarially in accordance with the constant interest method over the life of a Discount Bond taking into account the semiannual compounding of accrued interest at the yield to maturity on such Discount Bond, and generally will be allocated to an original purchaser in a different amount from the amount of the payment denominated as interest actually received by the original purchaser during its tax year.

However, such interest may be required to be taken into account in determining the alternative minimum taxable income of a corporation, for purposes of calculating a corporation's alternative minimum tax imposed by section 55 of the Code, and the amount of the branch profits tax applicable to certain foreign corporations doing business in the United States, even though there will not be a corresponding cash payment. In addition, the accrual of such interest may result in certain other collateral federal income tax consequences to, among others, financial institutions, life insurance companies, property and casualty insurance companies, "S" corporations with "subchapter C" earnings and profits, owners of an interest in a FASIT, individual recipients of Social Security or Railroad Retirement benefits, individuals otherwise qualifying for the earned income tax credit, and taxpayers who may be deemed to have incurred or continued indebtedness to purchase or carry, or who have paid or incurred certain expenses allocable to, tax-exempt obligations. Moreover, in the event of the redemption, sale or other taxable disposition of a Discount Bond by the initial owner prior to maturity, the amount realized by such owner in excess of the basis of such Discount Bond in the hands of such owner (adjusted upward by the portion of the original issue discount allocable to the period for which such Discount Bond was held) is includable in gross income.

Owners of Discount Bonds should consult with their own tax advisors with respect to the determination for federal income tax purposes of accrued interest upon disposition of Discount Bonds and with respect to the state and local tax consequences of owning Discount Bonds. It is possible that, under applicable provisions governing determination of state and local income taxes, accrued interest on Discount Bonds may be deemed to be received in the year of accrual even though there will not be a corresponding cash payment.

The initial offering price (as furnished by the Underwriters) of certain Series 2009A Bonds (the "Premium Bonds"), may be greater than the amount payable on such Series 2009A Bonds at maturity. An amount equal to the difference between the initial public offering price of a Premium Bond (assuming that at least 10% of the Premium Bonds of that maturity are sold to the public at such price) and the amount payable at maturity constitutes premium to the initial purchaser of such Premium Bonds. The basis for federal income tax purposes of a Premium Bond in the hands of such initial purchaser must be reduced each year by the amortizable bond premium, although no federal income tax deduction is allowed as a result of such reduction in basis for amortizable bond premium. Such reduction in basis will increase the amount of any gain (or decrease the amount of any loss) to be recognized for federal income tax purposes upon a sale or other taxable disposition of a Premium Bond. The amount of premium which is amortizable each year by an initial purchaser is determined by using such purchaser's yield to maturity. Purchasers of the Premium Bonds should consult with their own tax advisors with respect to the determination of amortizable bond premium with respect to the Premium Bonds for federal income purposes and with respect to the state and local tax consequences of owning Premium Bonds.

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 each nationally recognized municipal securities information repository and any public or private repository or entity designated by the State as a state repository for purposes of Rule 15c2-12(b)(5) adopted by the Securities and Exchange Commission (each, a "Repository") 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 2007-08, and is to include audited financial statements of the City.

Prior to March 2004, the City had never failed to comply with its previous undertakings with regard to Rule 15c2-12 to provide annual reports or notices of material events. Since that date, the City has failed to comply with various filing deadlines for a number of previous undertakings due to the unavailability of the City's audited financial statements, as described in greater detail below. See "INTRODUCTION - Certain Investigations Regarding the City" herein.

On February 8, 2008, the City filed annual reports (including financial statements) relating to securities issued by the Public Facilities Financing Authority of the City of San Diego that are secured by the Water Utility Fund for Fiscal Years 2002-03 and 2003-04 and on June 13, 2008 the City filed the annual report for such securities for Fiscal Year 2004-05. In addition, on December 11, 2007, the City filed its annual report (including financial statements) relating to seven debt issues that are secured directly or indirectly by the City's General Fund for the Fiscal Years 2002-03 and 2003-04, and on June 13, 2008, the City filed the annual report for such securities for Fiscal Year 2004-05. With regard to special tax and assessment bonds, the affected districts timely filed reports for Fiscal Year 2002-03 without financial statements, did not file reports for Fiscal Year 2003-04 when due, filed reports for Fiscal Year 2003-04 and Fiscal Year 2004-05 prior to the filing deadline for the report due June 30, 2005 without financial statements, timely filed the reports Fiscal Year 2005-06 without financial statements and timely filed the reports for Fiscal Year 2006-07 without financial statements. The financial statements for Fiscal Years 2002-03 through 2006-07 have been filed with the Repositories.

The City failed to comply with the undertakings related to 21 bond issues in each of Fiscal Years 2003-04, 2004-05, 2005-06, and 2006-07. Each required annual report and audited financial statement has subsequently been filed.

LITIGATION

There is no controversy of any nature now pending against the City or, to the knowledge of its respective officers, threatened, seeking to restrain or enjoin the issuance, sale, execution or delivery of the Series 2009A Bonds or in any way contesting or affecting the validity of the Series 2009A Bonds or the Authorizations or any proceedings of the City taken with respect to the issuance or sale thereof, or the pledge or application of any moneys or security provided for the payment of the Series 2009A Bonds or the use of the proceeds of the Series 2009A Bonds.

There are no pending lawsuits that in the opinion of the City Attorney challenge the validity of the above issue, the corporate existence of the City, or the title of the officers to their respective offices. In this review attention has been given to not only litigation pending against the City, but also against the City's Water Department. The Office of the City Attorney has prepared the following summary, as of January 13, 2009, of certain claims and lawsuits (with any potential loss exceeding $1 million) 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.

- ***John Trunkey v. City of San Diego*** (claims stage). On June 21, 2007, Claimant John Trunkey filed a $2,100,000 claim for alleged damages resulting from a December 17, 2006 water main break causing flooding in his La Jolla home. There was a partial settlement of $50,000 for housing expenses to relocate Claimant in a comparable house. This claim is expected to settle for approximately $1 million.

- ***Colony Hills Homeowners Association, Akeson v. City of San Diego.*** On March 4, 2008, the Colony Hills Homeowners Association (the "HOA") and 40 property owners within the HOA filed a lawsuit against the City claiming that on August 6, 2006 a water main broke and caused flooding along a private street in La Jolla belonging to the HOA, resulting in approximately $180.8 million in damages, including damage from soil subsidence, hillside failure, road failure and diminished property value. The City currently anticipates that the liability resulting from this case could range from $0 to 45 million.

- ***Mount Soledad Landslide.*** As a result of a landslide on October 3, 2007, lawsuits were filed in the San Diego Superior Court for inverse condemnation and other property-related torts by multiple plaintiffs. The alleged damages are estimated at between $40 and $60 million. Below are three cases that have been filed against the City as of the date of this Official Statement:

  - *Crabbe, et al. v. City of San Diego* was filed on behalf of twenty-six owners of sixteen separate homes.

  - *Al-Quraini, et al. v. City of San Diego* was filed on behalf of thirty-two claimants owning twenty-three residences.

  - *McCormick, et al. v. City of San Diego* was filed on behalf of 44 individual plaintiffs, eight of whom are minors ranging in age from four to 11 years of age concerning 22 separate single family homes in the Mount Soledad area.

In the opinion of the City Attorney, the City has sufficient defenses against such claims and lawsuits and in no event should these claims and lawsuits result in judgments or settlements which, in the aggregate, would have a material adverse effect on the Water Utility Fund's financial position.

LEGAL OPINION

The validity of the Series 2009A Bonds and certain other matters are subject to the approving opinion of Fulbright & Jaworski L.L.P., Los Angeles, California, Bond Counsel. A complete copy of the proposed form of opinion of Bond Counsel is contained in Appendix F attached hereto. Certain legal matters will be passed upon for the Corporation by Fulbright & Jaworski L.L.P., for the Authority by Hawkins Delafield & Wood LLP, Los Angeles, California, Disclosure Counsel, and by Jan I. Goldsmith, City Attorney, and for the Underwriters by their counsel, Nixon Peabody LLP, Los Angeles, California.

RATINGS

S&P, Fitch and Moody's have assigned the Series 2009A Bonds their ratings of "AA-", "AA-," and "A1,"respectively, and issued "stable" outlooks in connection with their ratings. Such ratings reflect only the views of such organizations and any desired explanation of the significance of such ratings should be obtained from the rating agency furnishing the same, at the following addresses: Standard & Poor's Ratings Services, 55 Water Street, New York, New York 10041; Fitch Ratings, One State Street Plaza, New York, New York 10004; Moody's Investors Service, Inc., 7 World Trade Center, 250 Greenwich Street, New York, New York 10007. Generally, a rating agency bases its rating on the information and materials furnished to it and on investigations, studies and assumptions of its own.

There is no assurance such ratings will continue for any given period of time or that such ratings will not be revised downward or withdrawn entirely by the rating agencies, if in the judgment of such rating agencies, circumstances so warrant. Any such downward revision or withdrawal of such ratings may have an adverse effect on the market price of the Series 2009A Bonds.

UNDERWRITING

The Series 2009A Bonds are being purchased by Morgan Stanley & Co. Incorporated, as representative of the Underwriters named on the cover page to this Official Statement (collectively, the "Underwriters"). The Underwriters have agreed, subject to certain conditions, to purchase the Series 2009A Bonds at a purchase price of $164,321,029.62 (equal to the original principal amount thereof, plus a net original issue premium of $8,266,404.75, less underwriters' compensation in the amount of $1,135,375.13). The Underwriters may offer and sell the Series 2009A 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.

J.P. Morgan Securities Inc., one of the underwriters of the Series 2009A Bonds, has entered into an agreement (the "Distribution Agreement") with UBS Financial Services Inc. for the retail distribution of certain municipal securities offerings, including the Series 2009A Bonds, at the original issue prices. Pursuant to the Distribution Agreement, J.P. Morgan Securities Inc. will share a portion of its underwriting compensation with respect to the Series 2009A Bonds with UBS Financial Services Inc.

PROFESSIONAL ADVISORS

Montague, DeRose and Associates LLC, Walnut Creek, California served as Financial Advisor to the City with respect to the sale of the Series 2009A Bonds. The Financial Advisor has not undertaken to make an independent verification or to assume responsibility for the accuracy, completeness, or fairness of the information contained in this Official Statement.

Camp Dresser & McKee Inc. has served as Feasibility Engineer to the City in connection with the issuance of the Series 2009A Bonds. A complete copy of the Feasibility Engineer's Report on the Engineering and Financial Feasibility Study is attached as Appendix B hereto.

FINANCIAL STATEMENTS

Prior to Fiscal Year 2002-03, the financial statements of the Water Utility Fund were included in the basic financial statements section of the City's CAFR and were also available as a separate annual financial report. Subsequently, financial statements of the Water Utility Fund were included solely as a part of the basic financial statements section of the City's CAFR, beginning with the CAFR of the City for Fiscal Year 2002-03. The City's 2007 basic financial statements have been audited by Macias Gini & O'Connell LLP (the "Independent Auditor"), independent certified public accountants, as stated in their report. The Independent Auditor has agreed to the inclusion of its report in Appendix D.

Those portions of the City's 2007 financial statements relating to the Water Utility Fund, including all of the City's basic financial statements for Fiscal Year 2006-07 audited by Macias Gini & O'Connell LLP, are included in Appendix D. Appendix D also includes the letter of transmittal from the Mayor, required supplementary information with respect to the City's Pension System and unaudited statistical information regarding debt service coverage on Parity Obligations. Certain of the data and information set forth in Appendix D do not pertain to the Water Utility Fund but have been included in Appendix D for purposes of context. The City's General Fund does not secure payment of debt service on the Series 2009A Bonds. The City's CAFRs are available in their entirety on the City's website at http://www.sandiego.gov. However, the information presented there is not part of this Official Statement, is not incorporated by reference herein and should not be relied upon in making an investment decision with respect to the Series 2009A Bonds.

CHANGES FROM THE PRELIMINARY OFFICIAL STATEMENT

In addition to updates to the Preliminary Official Statement dated December 19, 2008 as a result of pricing, the following changes have been made:

- The information under the caption "INTRODUCTION – Recent Events Regarding the City – Investigations Regarding Misleading Disclosures" has been updated to reflect the conclusion of the Commission's investigation of certain former City officials in connection with City bond offerings in 2002 and 2003 and the Commission's stated intent to not recommend enforcement action against such individuals.

- The description of the plan of finance on the cover, under the captions "INTRODUCTION," "PLAN OF FINANCE," "ESTIMATED SOURCES AND USES OF FUNDS" and all references thereto have been revised to reflect prepayment (rather than payment) of all of the Series 2007A Notes.

- The information under the caption "WATER SYSTEM FINANCIAL OPERATIONS – Investment of Funds – Pool Liquidity and Other Characteristics" has been updated to include the City Pool results at December 31, 2008.

- The information under the caption "WATER SYSTEM FINANCIAL OPERATIONS – San Diego City Employees' Retirement System" has been updated to include the actuarial value of assets (City's portion) as of December 31, 2008 of $4.428 billion and the market value of assets (City's portion) as of December 31, 2008 of $3.482 billion and revised to reflect the NPO for Fiscal Year 2006-07 set forth in the City's 2007 CAFR (rather than the NPO set forth in the SDCERS comprehensive annual financial report for the City for Fiscal Year 2006-07) so as to include the impact of the Corbett settlement in Fiscal Years 2004-05 through 2006-07.

- The information under the caption "LITIGATION" has been revised to include an updated claims amount and an update on the status of settlement negotiations for the John Trunkey claim.

- The data set forth in Appendix A under the caption "ECONOMIC AND DEMOGRAPHIC INFORMATION" has been updated to reflect preliminary civilian labor force estimates as of November 2008, calendar year 2007 taxable sales results, revised State per capita personal income for calendar years 2006 and 2007 and calendar year 2008 foreclosure activity.

- The information set forth in Appendix C under the caption "Metropolitan Water District of Southern California" has been updated to reflect MWD's annual net deliveries from the Colorado River through 2008 and include a description of additional petitions and motions filed in connection with the longfin smelt regulation and a description of the potential impact of the December 15, 2008 biological opinion on water delivered to MWD and pending claims under *NRDC v. Kempthorne.*

- The information set forth in Appendix C under the caption "Metropolitan Water District of Southern California – Bay-Delta Regulatory and Planning Activities" has been revised to include potential recommendations of the Delta Vision Committee (as defined in Appendix C) for long-term sustainable management of the Bay-Delta (as defined in Appendix C) and a schedule for completion of the Bay-Delta Conservation Plan (as defined in Appendix C).

- The information set forth in Appendix C under the caption "Quantification Settlement Agreement – Water Authority/Imperial Irrigation District Water Transfer" has been updated to include the projected total calendar year 2009 exchange deliveries of nearly 120,000 AF.

- The information set forth in Appendix C under the caption "Future MWD Water Supply" has been updated to include the 89,000 acre feet of water supply augmentation attributable to conserved water in calendar year 2008, MWD's anticipated water recoveries and requests pursuant to its agreement with the Central Arizona Water Conservation District and MWD's highest level of water in storage and the amount of water in storage as of December 1, 2008.

- This paragraph updates litigation described on page 149 of the City's 2007 CAFR. Litigation between the City and SDCERS, SDCERS v. Aguirre, et al., concerning, in part, agreements between the City and SDCERS allowing the City to pay less into the pension system than actuarially required, is ongoing. The only claim currently outstanding is a cross-complaint filed by SDCERS alleging that the City violated City Charter section 143 by funding the pension system at less than actuarially required levels. SDCERS's cross-complaint alleges that the City must pay immediately the difference between the amount the City paid into the pension system and the actuarially required amount the City should have paid. The cross-complaint did not calculate the amount of this payment and the City is not able to make an estimate of the payment. This claim is awaiting trial. The City is not able to make a determination regarding the likelihood of an unfavorable outcome at this time.

- This paragraph updates information on page 145 of the City's 2007 CAFR concerning the audit by the U.S. Department of Housing and Urban Development ("HUD"), Office of Inspector General (the "OIG") of the City's administration of its Community Development Block Grant ("CDBG") Program. On December 30, 2008, OIG issued its audit report to the HUD, Office of Community Planning and Development (the "OPD"). The City is currently in discussions with OPD on the audit findings and any actions HUD may require of the City, including the possible repayment by the City of certain CDBG funds. The City's Water System does not receive any CDBG funds and would not contribute to the repayment of any such funds to HUD.

MISCELLANEOUS

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

There are appended to this Official Statement a summary of certain provisions of the principal and legal documents, portions of the City's 2007 CAFR, including financial statements of the Water Utility Fund, the Engineer's Feasibility Statement, the proposed form of opinion of Bond Counsel, and a general description of the City and a description of the Book-Entry Only System. The Appendices are integral parts of this Official Statement and must be read together with all other parts of this Official Statement.

This Official Statement is not to be construed as a contract or agreement between the Authority or the City and the purchasers or holders of any of the Series 2009A 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 affairs of the City, the Authority or the Corporation since the date hereof.

PUBLIC FACILITIES FINANCING AUTHORITY OF THE CITY OF SAN DIEGO

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

THE CITY OF SAN DIEGO

By: /s/ Mary Lewis
Chief Financial Officer

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APPENDIX A

CERTAIN INFORMATION REGARDING THE CITY OF SAN DIEGO AND AREA

The information and expressions of opinion set forth herein have been obtained from sources believed to be reliable, but such information is not guaranteed as to accuracy or completeness. Statements contained herein which involve estimates, forecasts, or matters of opinion, whether or not expressly so described herein, are intended solely as such and are not to be construed as representations of facts. The information and expressions of opinion herein are subject to change without notice, and neither delivery of this Official Statement nor any sale thereafter of the securities offered hereby shall under any circumstances create any implication that there has been no change in the affairs of the City or in any other information contained herein since the date of the Official Statement.

INTRODUCTION

The City of San Diego (the "City"), with a total population of approximately 1.3 million in 2008 and a land area of approximately 342 square miles, is the seventh 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 "County").

The City's population increased by approximately 12.4% between 1999 and 2008, with an average annual increase of approximately 16,331, based on population estimates published by the California Department of Finance in May 2008. In addition to having a favorable climate, 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 manufacturing, defense, tourism, agriculture, biotechnology/biosciences, financial and business serves, software and telecommunications.

ECONOMIC AND DEMOGRAPHIC INFORMATION

Set forth below is certain demographic information regarding the City of San Diego (the "City") and the County of San Diego (the "County"). This information is provided for informational purposes only. The Series 2009A Bonds (as defined in this Official Statement) are not a debt of the County, the State of California (the "State"), or any of its political subdivisions, and neither the County, the State nor any of its political subdivisions is liable thereon. The Series 2009A Bonds are payable from System Net Revenues and not from any other funds of the City, including amounts in the City's General Fund. See "SECURITY FOR THE SERIES 2009A BONDS" in the forepart of this Official Statement.

Population

The following Table A-1 sets forth annual population figures for the City, the County and the State for calendar years 1999 through 2008.

Table A-1
Population Growth
Calendar Years 1999 through 2008

Calendar Year[1][2]	City of San Diego	Annual Growth Rate	County of San Diego	Annual Growth Rate	State of California	Annual Growth Rate
1999	1,189,885	1.9%	2,751,011	1.8%	33,140,771	1.5%
2000	1,207,003	1.4	2,801,336	1.8	33,721,583	1.8
2001	1,242,148	2.9	2,865,208	2.3	34,430,970	2.1
2002	1,256,643	1.2	2,922,758	2.0	35,063,959	1.8
2003	1,279,790	1.8	2,975,082	1.8	35,652,700	1.7
2004	1,287,703	0.6	3,011,770	1.2	36,199,342	1.5
2005	1,296,869	0.7	3,038,074	0.9	36,675,346	1.3
2006	1,306,028	0.7	3,065,077	0.9	37,114,598	1.2
2007	1,317,625	0.9	3,100,132	1.1	37,559,440	1.2
2008	1,336,865	1.5	3,146,274	1.5	38,049,462	1.3

Source: State of California Department of Finance, Demographic Research Unit.
(1) As of January 1 of the calendar year.
(2) Population figures and respective growth rates reflect revised figures that are benchmarked to base year 2000.

Employment

The following Table A-2 sets forth information regarding the size of the labor force, employment and unemployment rates for the City for calendar years 2003 through 2007.

Table A-2
Labor Force – Estimated Average Annual Employment and Unemployment of City of San Diego Civilian Labor Force[(1)]
Calendar Years 2003 through 2007

	2003	2004	2005	2006	2007
Civilian Labor Force					
City of San Diego					
Employed	621,300	634,000	643,100	651,700	656,900
Unemployed	34,100	31,500	29,200	27,000	31,600
Unemployment Rates					
City	5.2%	4.7%	4.3%	4.0%	4.6%
County	5.2	4.7	4.3	4.0	4.6
California	6.8	6.2	5.4	4.9	5.4
United States	6.0	5.5	5.1	4.6	4.6

Source: State of California Employment Development Department, Labor Market Information Division; and the U.S. Department of Labor, Bureau of Labor Statistics.
(1) Labor force data are based on a 2007 benchmark; not seasonally adjusted.

The State of California Employment Development Department, Labor Market Information Division (the "EDD"), preliminarily estimates that, on a seasonally unadjusted basis, the civilian labor force in the City in November of calendar year 2008 was 704,100, leaving approximately 48,400 persons unemployed. Based on preliminary estimates of the EDD, the City's unemployment rate in November of calendar year 2008 matched that of the County at 6.9% and was below the unemployment rate of the State, which was 8.3% for the same month. However, the City's unemployment rate exceeded that of the United States, which was 6.5% in November of calendar year 2008.

The following Table A-3 sets forth estimates of total annual civilian nonagricultural wage and salary employment by number of employees in each major industry category in the County for calendar years 2003 through 2007. Annual industry employment information is not compiled by sector for the City.

Table A-3
County of San Diego
Wage and Salary Employment
Calendar Years 2003 through 2007[(1)]

Industry Category	2003	2004	2005	2006	2007
Natural Resources & Mining	300	400	400	500	400
Construction	80,200	87,700	90,800	92,700	87,200
Manufacturing	105,300	104,300	104,500	103,900	102,100
Nondurable Goods	26,500	26,200	25,400	25,500	25,000
Durable Goods	78,800	78,100	79,100	78,400	77,100
Transportation, Warehousing & Utilities	27,300	28,400	28,400	28,700	28,800
Trade	182,400	186,800	191,000	193,400	194,200
Wholesale	41,600	41,900	43,600	45,100	45,500
Retail	140,800	144,900	147,400	148,300	148,700
Financial Activities[(2)]	79,900	81,900	83,200	83,700	80,400
Services[(3)]	547,400	556,400	568,700	580,900	593,000
Government	217,300	214,300	215,100	217,900	222,100
Federal	40,100	39,700	39,700	40,400	40,800
State and Local	177,100	174,600	175,400	177,500	181,400
TOTAL NONAGRICULTURAL[(4)]	1,240,100	1,260,300	1,282,100	1,301,600	1,308,200

Source: State of California Employment Development Department, Labor Market Information Division.
(1) All figures are based on a March 2007 Benchmark.
(2) Includes finance, insurance, and real estate.
(3) Includes professional and business, information, educational and health, leisure and hospitality and other services.
(4) Figures may not add to total due to independent rounding.

Since the industry employment data referenced above is organized by standard industrial classification codes, employment in the various high tech categories, such as telecommunications, software and biotechnology may not fall into a single employment section alone. For example, some telecommunications firms appear in Manufacturing which others appear in Services.

Taxable Sales

The following Table A-4 sets forth taxable transactions in the City for calendar years 2003 through 2007.

Table A-4
City of San Diego
Taxable Transactions
Calendar Years 2003 through 2007
(In Thousands)

	2003	2004	2005	2006	2007[1]
Retail Stores					
Apparel	$ 732,526	$ 785,563	$ 865,833	$ 924,301	$ 959,509
General Merchandise	2,040,450	2,142,892	2,170,831	2,236,087	2,272,494
Food	696,398	741,899	801,351	843,800	881,871
Eating and Drinking	2,066,425	2,197,430	2,311,013	2,466,681	2,617,392
Home Furnishings and Appliances	690,345	728,841	747,339	706,043	655,097
Building Materials	1,248,903	1,440,726	1,396,894	1,427,987	1,098,559
Motor Vehicles and Parts	2,138,480	2,213,662	2,228,510	2,132,207	2,237,019
Service Stations	1,085,386	1,232,354	1,398,512	1,567,032	1,656,784
Other Retail Stores	2,232,817	2,375,353	2,465,882	2,527,653	2,321,276
Total Retail Stores	$12,931,730	$13,858,720	$14,386,165	$14,831,791	$14,700,001
All Other Outlets	4,533,632	4,679,723	5,105,581	5,227,476	5,356,105
TOTAL ALL OUTLETS	$17,465,362	$18,538,443	$19,491,746	$20,059,267	$20,056,106

Source: California State Board of Equalization.
[1] In early 2007 the California State Board of Equalization began a process of converting business codes of sales and use tax permit holders to North American Industry Classification System codes. As a result of the coding change process, industry data for 2007 are not comparable with data from prior years.

Tourism

The tourism industry is the County's third largest industry in terms of business revenue generation, following manufacturing and the military. The following Table A-5 sets forth total visitor spending in the County for the calendar years 2003 through 2007.

Table A-5
County of San Diego
Total Visitor Spending[1]
Calendar Years 2003 through 2007
(In Billions)

Calendar Year	Amount
2003	$5.33
2004	5.52
2005[2]	7.22
2006[2]	7.72
2007[2]	7.90

Source: San Diego Convention and Visitors Bureau.

(1) Visitor spending is an estimate of total direct and indirect visitor expenditures as derived from the Visitor Activity Model/Visitor Profile Study prepared by CIC Research, Inc. for the San Diego Convention and Visitors Bureau.

(2) Figure reflects revised estimate to include Mexican day visitors, non-resident air travelers and conference and convention planners and exhibitor companies.

The following Table A-6 sets forth the City's transient occupancy tax revenues for Fiscal Years 2003-04 through 2007-08.

Table A-6
City of San Diego
Transient Occupancy Tax
Fiscal Years 2003-04 through 2007-08
In Thousands
(Audited)

Fiscal Year	Amount
2003-04	$113,209
2004-05	120,792
2005-06	136,803
2006-07	154,810
2007-08	159,300[1]

Source: Comprehensive annual financial report of the indicated year for the amounts for Fiscal Years 2003-04 through 2006-07; City of San Diego Financial Management Department for the amount for Fiscal Year 2007-08.

(1) Unaudited actual.

The City is the focal point for tourism in the County. The Convention Center, approximately 70% of the County's hotel and motel rooms, and most of the County's major tourist attractions, including the world-renowned San Diego Zoo, the San Diego Wild Animal Park and Sea World, are located in the City. Other attractions located in the City include the Cabrillo National Monument on Point Loma, the historic

Gaslamp Quarter in the downtown area, the Old Town State Park, Balboa Park and a host of other cultural and recreational activities.

In calendar year 2007, there were 9,156,587 airport arrivals and 712,948 Amtrak arrivals in the County. City average hotel occupancy was 75.2%.

In addition to the many permanent attractions available to visitors, the City has also been host to a number of major sporting events. The City annually hosts the Buick Invitational, a Professional Golfers' Association Tour Event played at the world renowned Torrey Pines Golf Course. Torrey Pines, which is owned and operated by the City of San Diego, also held the U.S. open in 2008. In addition, the City has annually hosted a pair of post season contests of elite college football teams, the Holiday Bowl since 1978 and the Poinsettia Bowl since 2005.

The San Diego Convention Center has 2.6 million total gross square feet. According to the San Diego Convention Center Corporation, since opening in 1989, the Convention Center has generated $16.2 billion in economic benefit for the San Diego regional economy through increased visitor spending, additional hotel room nights, and new jobs.

Military

Military and related defense spending is the second largest industry in the County economy, with only manufacturing making a larger contribution to the County's Gross Regional Product. Military installations include Marine Corps Base Camp Joseph H. Pendleton; the Marine Corps Recruit Depot (MCRD); Marine Corps Air Station at Miramar; Naval Air Station North Island; Naval Station San Diego; and Naval Submarine Base, San Diego.

Military base realignments and closures in the 1990s proved to benefit the County. Despite losing the Naval Training Center at Point Loma, the region absorbed military operations from other areas. This transformation received additional impetus with the relocation to San Diego from Virginia of the Space and Naval Warfare Systems Command ("SPAWAR") in 1997. SPAWAR is responsible for the Navy's acquisition and life-cycle management of communications and warfare systems. SPAWAR employs nearly 6,400 military, civilian, and on-site contractors in the County and had an operating budget of $5 billion in 2007. The closing of the Long Beach Naval Shipyard also transferred millions of dollars in shipbuilding and repair contracts to private San Diego companies. Coronado Naval Air Station will is the homeport to three nuclear-powered aircraft carriers.

The following Table A-7 sets forth the military and related defense expenditures and personnel in the City for the federal Fiscal Years ended September 30, 2002 through September 30, 2006.

Table A-7
City of San Diego[1]
Total Defense Expenditure and Personnel
Federal Fiscal Years 2001-02 through 2005-06

	Expenditures (In Thousands)			Military & Civilian Personnel		
Fiscal Year	Payroll Outlays[2]	Grants/ Contracts	Total	Active Duty Military	Civilian	Total
2001-02	$2,961,646	$3,752,107	$6,713,753	22,568	12,351	34,919
2002-03	3,180,150	4,159,879	7,340,029	22,263	12,055	34,318
2003-04	3,456,175	3,898,720	7,354,895	17,801	12,934	30,735
2004-05[3]	3,537,765	4,336,712	7,874,477	45,899	11,758	57,657
2005-06[3]	3,248,103	4,363,867	7,611,970	43,292	6,184	49,476

Source: Department of Defense, Statistical Information Analysis Division Work Force Publications
(1) Does not include Miramar Naval Air Station.
(2) Military & Civilian.
(3) 2005 and 2006 personnel figures include Navy/Marine Corps military personnel afloat. 2001-2004 personnel figures only account for Navy/Marine Corps shore-based personnel. Also, 2005 figures on grants and contracts reflect all grants and contracts for that fiscal year while the 2002-2004 figures only reflect contracts with obligations exceeding $25,000.

International Trade

The following Table A-8 sets forth the valuation of exports originating in the San Diego Customs District for the calendar years 2003 through 2007.

Table A-8
Valuation of Exports
Originating in San Diego Customs District[1]
Calendar Years 2003 through 2007
(In Millions)

Calendar Year	Amount
2003	$12,721
2004	14,049
2005	14,990
2006	15,980
2007	16,002[2]

Source: RAND California, Business and Economic Statistics and US Census Bureau Foreign Trade Statistics.
(1) The San Diego Customs District includes the ports of San Diego, Andrade, Calexico, San Ysidro, Tecate, Otay Mesa Station, and Calexico-East.
(2) Includes certain amounts attributable to calendar year 2008.

Top Ten Principal Employers

The following Table A-9 sets forth the top 10 principal employers in the City of San Diego as of June 30, 2007.

Table A-9
City of San Diego
Top Ten Principal Employers
Fiscal Year-End 2007[1]
(Unaudited)

Employer	Number of Employees	Percentage of Total Employment[2]
United States Navy[3]	71,423	10.54%
Science Applications International Corp	44,000	6.49
San Diego County[4]	17,040	2.51
San Diego Unified School District[5]	15,800	2.33
Scripps Health	11,000	1.62
City of San Diego[6]	10,685	1.58
Sempra Energy	5,600	0.83
Solar Turbines	5,500	0.81
Kaiser Permanente	4,992	0.74
San Diego County Community College District	4,778	0.71
TOTAL TOP EMPLOYERS	190,818	28.16%

Source: 2006-07 Comprehensive Annual Financial Report, unaudited statistical section.

(1) Past data going back to fiscal year-end 1998 is not available for a 10 year comparison.

(2) Percentage based on total employment of 677,700 provided by the State of California's Employment Development Department Labor Force Data.

(3) Employee count includes Navy personnel only (civilian/military).

(4) Employee count is county-wide.

(5) Employee count is district-wide.

(6) Employee count is provided by the City of San Diego, Office of the Comptroller - Payroll Division

Personal Income

The following Table A-10 sets forth the per capita personal income in the County and the State for years 2003 through 2007.

Table A-10
Per Capita Personal Income
2003-2007(1)

Year	County of San Diego	California
2003	$35,676	$33,554
2004	38,452	35,440
2005	40,383	37,311
2006	42,801	39,871
2007	44,832(2)	41,580

Source: U.S. Department of Commerce, Bureau of Economic Analysis.
(1) Data for the County for calendar year 2003 through calendar year 2007 reflect population estimates available as of April 24, 2008. Data for California reflect population estimates available as of September 18, 2008.
(2) Reflects per capita personal income for the San Diego-Carlsbad-San Marcos Metropolitan Statistical Area.

Property Value and Construction

The following Table A-11 sets forth total City assessed value, building permit valuations and the number of new construction permits issued in the City for Fiscal Years 2003-04 through 2007-08. The valuation of commercial permits includes both private, commercial construction and publicly funded, non-tax generating projects.

The San Diego County residential real estate market has continued to decline since hitting its peak in 2005. The subprime mortgage crisis and the resulting dramatic increase in the number or foreclosures have contributed to this downturn.

Table A-11
City of San Diego
Property Value and Construction
Fiscal Years 2003-04 through 2007-08

		Construction Permits Issued			
		Commercial		Residential	
Fiscal Year	Assessed Value(1)(2)	Number of Units	Value(2)	Number of Units	Value(2)
2003-04	$114,853,720	2,543	$717,693	5,882	$1,227,388
2004-05	125,550,046	2,516	641,857	6,605	1,321,526
2005-06	142,010,987	2,562	953,714	4,550	1,006,375
2006-07	158,286,234	2,543	670,497	3,907	820,581
2007-08	172,990,395	2,567	724,811	839	674,315

Source: County of San Diego Report ID VAL File-01 PSVVP7/California Municipal Statistics, Inc.; and Development Services Department, City of San Diego.
(1) Net all other exemptions, except homeowners' exemption which is reimbursed by the State of California.
(2) Amounts expressed in thousands.

According to the County Assessor's Office, there has been an increase in the number of foreclosures and notices of loan default issued in San Diego County in calendar year 2008, relative to calendar year 2007. For the three calendar years from 2004 through 2006, an average 16.2% of notices of loan defaults resulted in foreclosures. This percentage increased to 37.92% in 2007 and 57.53% in 2008. In 2007 an average of 6.31% of total deeds recorded were foreclosures. This percentage increased to 17.01% in 2008. Any reduction in the revenues to be received by the City as a result of the residential foreclosure activity is expected to affect the City's General Fund, not the Water Utility Fund.

The following Table A-12 sets forth foreclosure activity in the County for the calendar years 2004 through 2008.

Table A-12
County of San Diego
Foreclosure Activity
Calendar Years 2004 through 2008

Calendar Year	Foreclosures	Total number of Housing Units[(1)]	% of Total Housing Units
2004	553	1,093,198	0.00%
2005	559	1,107,985	0.00
2006	2,065	1,118,283	0.18
2007	8,417	1,131,749	0.74
2008[(2)]	19,577	1,140,349	1.59

Source: County of San Diego, Assessor's Records; and SANDAG.
(1) As of January 1 of the indicated year.
(2) Cumulative total as of the end of December 2008.

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APPENDIX B

REPORT ON THE ENGINEERING AND FINANCIAL FEASIBILITY STUDY

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City of San Diego Water Utility

Report on the Engineering and Financial Feasibility Study – Revenue Bond Series 2009

January 13, 2009

Final

City of San Diego Water Utility

Report on the Engineering and Financial Feasibility Study – Revenue Bond Series 2009

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Executive Summary

CDM has prepared this Engineering and Financial Feasibility report at the request of the City of San Diego Water Department in connection with the proposed issuance of approximately $400.4 million of Revenue Bonds, Series 2009 A and B. The total amount of bonds issued may increase should refunding of a portion or all of the outstanding 1998 Revenue Bonds be economically feasible. For purposes of this report such refunding has not been included.

Study Methodology

- The City of San Diego Water Department provided extensive documentation related to Department budget, operations, capital planning, water supply planning, and staffing. In addition, CDM conducted interviews with Department operations, engineering and management staff to review operation and capital planning processes.

- Physical inspections of a sample of above ground reservoirs, pump stations, treatment plants and facilities were conducted to review physical condition and operating practices.

- CDM has examined the financial operations of the Department through reviews of financial reports, operating and capital budgets, financial models, and other statistical and financial information, and through discussions with the Department's financial staff. We have performed independent financial tests and analyses necessary to support our findings and opinions.

- The results of our investigations and analyses are presented in this report, with separate sections describing principal assumptions, organization, regulatory issues, water system infrastructure, operations and maintenance, planned capital improvements, water system financing, and the additional bonds coverage test.

Organization

- The City of San Diego Water Department operates under the authority of the City and its elected mayor and City Council. The Water Department Service Area includes the City of San Diego and other wholesale customers (California-American Water Company, City of Del Mar, Santa Fe Irrigation District, San Dieguito Water District).

- Key management personnel have the necessary qualifications and experience to effectively manage the operations of the Water Department and assure timely implementation of the Capital Improvement Program ("CIP").

- The Water Department is operated under an enterprise fund, which meets the budgetary, auditing, cost accounting and other financial needs of the Water

Department. All connection fee proceeds are restricted to growth-related project expenditures and maintained in a separate account.

Water System Infrastructure

- The Water Department is responsible for the construction, operation and maintenance of water treatment plants, reservoirs, pump stations and pipelines within its service area. These facilities include 3 treatment plants, 9 raw water reservoirs, 32 treated water reservoirs, 49 pumping stations, and 3,460 miles of pipeline.

- The City has not been able to access the public municipal bond market for several years, but the Water Department capital program has continued. The planning and design efforts have progressed so that projects would be ready to go to bid and construction when bond funds became available. Moreover, essential project construction has not been postponed, as funding on a cash "pay-go" basis, and short-term notes, have been used for project construction costs.

- The Water Department's capital planning process includes "big picture" strategic planning that considers the impacts of regulations, growth, and rehabilitation and replacement in the development and prioritization of projects for the capital program. While projects related to regulatory requirements have the highest priority, projects for rehabilitation and replacement of aged infrastructure are also included. Work to prepare an updated master plan for water facilities will begin by the end of 2008.

- Field inspections of a representative sampling of the City's facilities were conducted in July 2008, utilizing a ranking system of 1 to 3.

- The City has been working closely with the California Department of Public Health (CDPH) for a number of years to bring the water utility system into compliance with current CDPH requirements, and is in a position to evaluate and address potential impacts that may arise with future regulations. The current CIP list gives high priority to projects that address regulatory compliance issues.

Water System Financing

- The Water Department CIP has been developed using a capital project prioritization process that has been adopted by the City Council. This policy establishes an objective process for ranking CIP projects to have a basis for choosing the most compelling projects for implementation. The following prioritization factors are listed in order of importance:

  - Health and Safety Effects

  - Regulatory or Mandated Requirements

  - o Implications of Deferring the Project
  - o Annual Recurring Cost or Increased Longevity of the Capital Asset
  - o Community Investment
  - o Ease of Implementation
  - o Project Cost and Grant Funding Opportunity
  - o Project Readiness

- The proposed CIP for the study period of FY 09 through FY 13 totals some $724 million, including over $207 million for treatment plant projects, $280 million for pipeline projects and $237 million for other projects.

- The Department plans to fund 80 percent of project expenditures with bond funds, with the remainder funded from net operating revenues on a pay-as-you-go basis.

- Currently, the 273,000 customer accounts serve approximately 1.3 million residents, along with businesses and institutions. Population growth is projected at about 1 percent per year while water demands are less due to increasing water conservation practices.

- Voluntary reduction in water demand of 7.5 percent in FY 09 and 15 percent in FY 10 has been projected in response to a Stage 1 Voluntary Compliance Water Watch declared in July 2008 by the City due to the shortages in regional and imported water supplies.

- Water Department revenues are derived principally from water service charges and impact fees on new connections. In February 2007, the City adopted a series of 6.5 percent rate increases to be implemented annually through 2011. In November, the City Council approved a rate increase to recover revenue in the amount of the increased water wholesale purchase costs from the County Water Authority and to support the Indirect Potable Reuse Pilot Project (IPR). The rate increase becomes effective in January 2009.

- The Water Department maintains a financial planning model (rate case) that identifies rate and fee adjustments required for the long-term sustainable funding of operations and the capital program while maintaining financial reserve fund target levels and complying with all bond covenants.

- The cash flow analysis of projected revenue and revenue requirements presented in Table 4-9 of the report shows that projected revenues, including approved service charges and bond proceeds, will be sufficient to adequately and sustainably operate and maintain the Water System, maintain or exceed all targeted reserve levels, pay existing and proposed debt service, comply with existing bond covenants, and provide cash from net operating revenues for CIP project expenditures.

- As demonstrated in Table 4-10, the Water Department expects to remain in full compliance with its bond covenants for existing and projected debt service coverage over the projection period. Based on the enacted water rates to be effective in FY 09, FY 10 and FY 11, the annual debt service coverage for all senior debt will meet or exceed 272 percent. Moreover, aggregate debt service coverage on existing bonds, after the refinancing of $207 million in private placement notes, will meet or exceed 150 percent.

Opinions

- Based on the engineering and financial studies performed related to the System, we believe that the Water Department's organizational structure, planned CIP, and financing plans are sound for purposes of ensuring reliable service and for repaying the bonded debt service on all existing and proposed bonds during the projection period.

- Correspondence with the California Department of Public Health (CDPH) was compared to the proposed CIP listing to confirm that outstanding compliance issues which would be remediated by capital construction were included within planned projects. Project progress is within the compliance schedule set by CDPH. No other compliance or regulatory issues were identified during the term of this study.

- Estimates of project costs for the planning period are reasonable and include allowances for contingencies and inflation. Moreover, it is our opinion that the projects can be completed as scheduled. While the City's centralized Engineering and Capital Project Department has a limited one-year history of completing projects, they have the personnel, policies and practices in place that indicate the ability to manage and implement the proposed five-year CIP. Many of the Department staff have a history of work with the Water Department and the new Department has the ability to access additional staffing resources when needed as the CIP expenditures increase.

- It is our opinion that the Water Department's practice of cash financing at least 20 percent of total CIP expenditures represents a reasonable balance between cash and debt financing of capital improvement needs for the System. Moreover, our evaluation of sources and uses of funds suggests that additional annual net revenues will be available after FY 09 for cash financed "pay-go" projects in excess of 20 percent of the total CIP.

- The above-ground physical facilities inspected are generally well maintained, modern and in good condition. The projections of operating results presented in our report are based on reasonable projections of future revenue and expenses, and conservative growth estimates. Unanticipated changes in conditions, such as a worsening or long-term continuation of the existing water shortages, would only slightly reduce the annual net revenues, as the reduction in water service revenues would be significantly offset by reductions in the Water Department's cost of water purchases. The Department may, however, need to further adjust the level of revenues, reserves and/or expenses if significant changes in conditions occur.

- Based on the financial projections and analyses presented in this report, it is our opinion that the Water Department will be able to adequately finance the five-year CIP, meet all cash requirements of the Water System, and comply with all debt service coverage requirements during the study period.

These summary statements do not address all of the issues examined and described in the full report. Accordingly, the findings and conclusions presented herein should not be considered complete except in the context of the detailed descriptions and information contained in the report.

Section 1 Introduction

The City of San Diego Water Department (the "Water Department") provides water treatment and distribution services to over 1.3 million people through over 273,000 service connections. Its service area covers 403 square miles, of which 342 square miles are within the City boundaries. The water sold by the Department is a combination of imported supplies purchased from the San Diego County Water Authority ("CWA") and local water supplied by City-owned surface water. The City's water treatment and delivery system ("Water System") comprises three City-owned water treatment facilities and a water delivery system that includes 9 raw water reservoirs, 32 treated water reservoirs, 49 pump stations and over 3,460 miles of water lines. In addition to retail service to residences and businesses within the City, the Water Department supplies water to wholesale customers, including: California-American Water Company, City of Del Mar, Santa Fe Irrigation District and San Dieguito Water District. The Water Department also distributes recycled water for landscape irrigation to a number of customers including City and federal offices and parks, California Department of Transportation (CALTRANS), U.S. Navy, University of California at San Diego (UCSD), and private businesses.

From 2003 to 2008, the City was unable to access the public bond market. However, during that time the Water Department continued to plan, design and construct capital projects using cash and private placement note issuances for financing. During the 2003-2008 period, 86 projects were completed at a capital expenditure of over $595 million.

To continue to operate, maintain and expand the City water facilities while remaining in compliance with state and federal health and safety regulations, the Water Department has identified a capital program that will be 80 percent financed with long-term bonds. Additional funds for the program will come from net operating revenues (primarily service charges). Also, existing short-term notes that funded essential projects in 2007 and 2008 will be refinanced with the proposed bond proceeds.

Throughout this study, references to a particular fiscal year always use the end date. For example, Fiscal Year 2007-2008 (July 1, 2007 through June 30, 2008) is described as FY 08.

1.1 Background

The City of San Diego incorporated in 1850 and purchased the local water company in 1901 to begin municipal water service. The City operates under a "strong mayor" form of government, and as a department of the City's Public Utilities Group, the Water Department ultimately reports to the elected mayor and the eight-member City Council, who are elected by district.

In 1944, the City and other local water purveyors formed the CWA with the express purpose of gaining access to imported water supplies as a member agency of the Metropolitan Water District of Southern California ("MWD"). In 1947, the first MWD water was delivered to the San Diego area. Of the 35 member CWA Board of Directors, the City holds 10 voting positions.

1.2 Purpose

The purpose of this study is to investigate the principal facets of the Water System that may impact the security of the proposed bond issue, and to provide an independent engineering, institutional, operational and financial analysis of the proposed bond's feasibility for review by bond issuing agents and potential investors. This report assesses the condition of the Water System, need for scheduled capital improvements, and the financial feasibility of the Capital Improvement Program ("CIP").

1.3 Scope

This report provides a summary of the engineering evaluation of existing and planned facilities and a five-year (FY 09 – FY13) financial analysis for determining the financial strength of the Water Department and its capability of meeting debt service requirements on existing and proposed bonds.

The scope includes review of key issues relating to water supply and regulatory impacts, the existing facility planning reports, field inspections of certain key water facilities, review of water demand projections used for facility planning, review of environmental and permitting regulations, and review and evaluation of the existing CIP.

Evaluation of the financial feasibility of the proposed CIP is based upon a review of historical financial information provided by the Water Department, an examination of the Water Department's revenue and expenditure projections, and the preparation of cash flow analyses examining the sources and uses of funds relating to the projected system operating and capital expenditures through FY 13. The projected level of debt service coverage for the proposed FY 09 and future revenue bond issues are determined and compared with the requirements of the bond coverage tests.

1.4 CDM Qualifications

CDM has prepared this engineer's statement of bond feasibility. CDM is one of the country's largest engineering firms specializing in water, wastewater, and solid waste, with nearly 4,000 staff located in more than 85 offices throughout the United States. CDM has offices along the entire west coast and is familiar with the unique environments in which our clients operate.

CDM has extensive experience in water and wastewater utility planning, financing, design, and operations analysis. Our clients range from very small communities to large municipalities. CDM, and in particular the project staff for this study, have extensive experience throughout California and a history of working with the City. CDM has prepared more than 50 engineer's statement of bond feasibility reports over the past decade to assist 35 separate entities issue nearly $7.5 billion in bonds. This experience can provide stakeholders with the confidence that a thorough and effective analysis demonstrates that the Water Department is stable, well-managed, and capable of successful project execution and sustainable utility operations.

1.5 Organization

As discussed earlier, the City has been in the business of providing water services to its citizens for over 100 years. During this time, the City has grown from a population of approximately 650 persons in 1850, to 350,000 in 1950, and approximately 1.3 million in 2007. The Public Utilities Group oversees the operations of the Water and Metropolitan Wastewater Departments. In the City's 2009 budget document, the Water Department had a budget of over $533 million and a staff of 778 persons. The Water Department is divided into 4 divisions as illustrated in Figure 1-1.

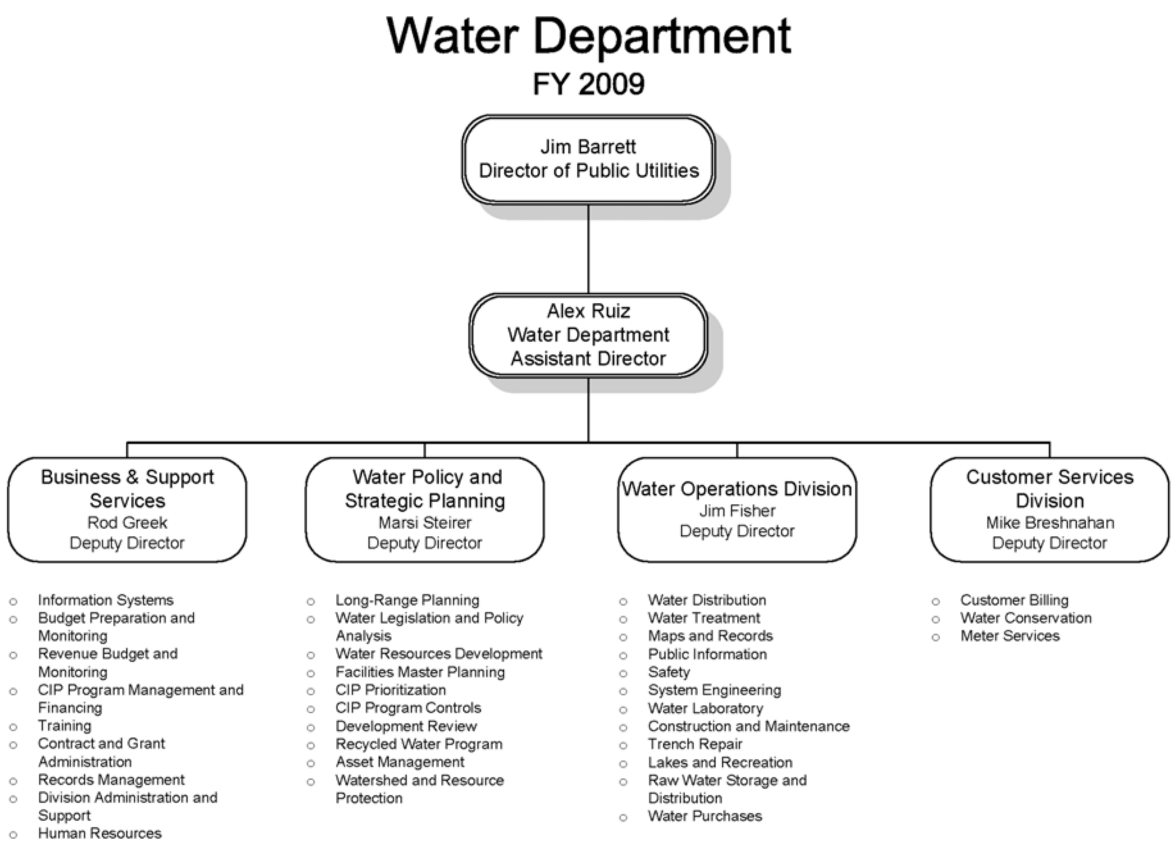


Figure 1-1
Water Department Organization Chart

The Director of Public Utilities and Water Department Assistant Director and the four divisions and their current managers are:

- Director of Public Utilities – Jim Barrett
- Assistant Director – Water - Alex Ruiz
- Business and Support Services – Deputy Director – Rod Greek
- Customer Services Division – Deputy Director – Mike Breshnahan
- Water Operations Division – Deputy Director – Jim Fisher
- Water Policy and Strategic Planning – Deputy Director – Marsi Steirer

In addition to these four divisions, the City has a centralized Engineering and Capital Projects Department that provides the Water Department with a full range of engineering and construction services. Further discussion of the institutional design and operation of the Water Department and other services provided by the City is discussed in Section 3.

Section 2
Assumptions

In the preparation of the forecast of future operations summarized in this report, we have made certain assumptions with respect to conditions, events, and circumstances that may occur in the future. While we believe such assumptions are reasonable and attainable for the purpose of forecasting the Water Department's future operations, the actual results may differ materially from the forecast. The principal assumptions used in the forecast of future operations are as follows:

- In preparation of this report, we have relied on historical, financial, and statistical data supplied by Water Department staff. While such data is considered reliable, we have not independently verified the accuracy of such data.

- The Water Department's estimates of content, scheduling, and cost of the five-year CIP present a projection of the future construction program. Water Department staff is continually updating the CIP, which may result in changes in the project costs and schedule after the publish date of this report. These changes typically are related to updated prioritization of projects that does not materially affect the financial feasibility of the proposed bonds.

- Debt service schedules for existing bonds were provided by Water Department staff. The principal repayments on 2007 and 2008 private placement notes issued for Water Department project expenditures will be funded from the proposed Series 2009 Bonds. The projected debt service for the proposed Series 2009 Bonds has been provided by Water Department staff. As the Series 2009 Bond proceeds will fund projects through FY 2010, this analysis also includes additional Water Department bonds anticipated in the five-year period ending in FY 13. The financing terms for these additional bonds were provided by Water Department staff. The series 2009 Bonds and all additional bonds were assumed to be senior debt.

- An estimated four percent (4 percent) annual inflationary escalation has been used for CIP projects based on the Engineering News Record Construction Cost Index most recent 10-year annual average. Operating expenses generally inflate at 4 percent per year (based upon the Consumer Price Index), except for electricity and other utilities, which are forecasted to inflate at 8 percent per year. After 2009, escalations in the projected unit water supply purchase costs are not included. These increases, when implemented by CWA, are evaluated and customarily passed through to the City's water customers following Proposition 218 notice and upon approval by the City Council and Mayor. Approximately 40 percent of the average customer water bill is for water supply costs, but projections of the unit water purchase rates do not materially affect any findings in this analysis.

- The Water Department operating projections include the expense of improved and expanded Water Department facilities that come on-line during the projection period. The Water Department receives both raw and treated water supplies from CWA. The proportion of these two supplies delivered to the different districts in the City is based on long-term planning criteria to minimize the citywide long-term costs of water services.

- There are no expected material changes in federal and state laws or regulations that would adversely impact the Water Department's ability to secure tax-exempt financing for the capital program, place more stringent limitations on water quality, materially increase the cost of constructing or operating the Water System, or otherwise adversely impact operations of the Water System. The general economy that impacts Water System costs and user's capabilities to pay water service charges is expected to remain relatively stable, in spite of the slowing of the Southern California economy and home sales markets.

- In July 2008, the City declared a Stage 1 Voluntary Compliance Water Watch, and called for voluntary reductions in non-essential water demands. The Water Department, as reflected in this analysis, has projected a 7.5 percent reduction in typical customer demands and in the need for water supply purchases for the projected year FY 09 and a 15 percent reduction for FY 10. Demands are assumed to return to normal by FY 2011.

- Rate adjustments this November to pass through additional CWA water costs and to fund the IPR pilot project will be approved and have been included in the analyses.

- All revenue and revenue requirement projections presented in this report are expressed on a cash basis identifying the sources and uses of funds, consistent with the Water Department's operating budgets and general industry standards for municipally owned and operated water utilities.

Section 3
Water System

The purpose of this section is to describe and discuss the City's water system. These descriptions include discussion of the Department's organizational structure, water supply, regulatory issues, current system facilities, utility operations and maintenance practices, and the capital improvement plan to rehabilitate, replace and expand the water system infrastructure.

3.1 Background

The City has approximately 273,000 retail connections serving 1.3 million residents, businesses and institutions. Citywide water facilities include three water treatment plants, 9 raw water reservoirs, 32 treated water reservoirs, and 49 pumping stations. The water system is managed and operated by the Water Department within the City's Public Utilities Group.

In 2007, the City Council adopted a series of four 6.5 percent water rate adjustments. This revenue stream will support both the operation and CIP expenditures through the projection period of this analysis. The FY2009 budget increased funding for deferred maintenance and capital projects, and funding of the City's general fund, workers' compensation, and public liability reserve funds. In addition, the City has recently issued Comprehensive Annual Financial Reports providing unqualified external audit opinions for fiscal years 2003, 2004, 2005, 2006, and 2007. These actions have increased financial stability of the City at large and the Water Department, and set the stage for renewed use of water revenue bond financing.

Over the last five years, the City has purchased an average of 90 percent of its water from the San Diego County Water Authority ("CWA"), with the remainder from local surface and groundwater sources and the use of recycled water for irrigation. The City projects that with increases in the sale of recycled water and consistent use of local surface water, City purchases of CWA water could drop to around 85% of its water supply. Approximately 90 percent of CWA supplies are currently imported from the Metropolitan Water District of Southern California ("MWD"), a value that is projected to drop significantly over the next decade. In 2007, 230,000 acre-feet of water was delivered to customers citywide. A 7 percent increase in this demand is anticipated between 2007 and 2020, driven primarily by a projected 14 percent increase in the City's population.

As a component of this study, we have reviewed the organizational structure and institutional relationships of the Water Department. This review focuses primarily on the ability of the Water Department to plan and implement capital projects.

3.2 Organizational Structure/Institutional Analysis

The Water Department and the Metropolitan Wastewater Department make up the San Diego Public Utilities Group. The Water Department is divided up into four divisions, which generally fall into the planning, operations and business functions needed for management of the utility. The organization chart in Section 3 on page 1-3 provides a summary list of the program responsibilities of each division. Each of these divisions shares a role in the implementation of the Water Department's capital program including service levels and facility maintenance requirements, regulatory compliance, project definition and prioritization, preliminary design, budgeting and financial management. In addition to the services provided within the Water Department, the City has recently centralized the provision of engineering services for capital projects. The Engineering and Capital Project Department works with the Water Department to take capital projects from the preliminary design phase to full design, bidding and construction. Services provided by this department are formalized through a service level agreement and coordinated regularly with Water Department staff.

3.3 Water Policy and Strategic Planning

The Water Policy and Strategic Planning Division leads the strategic and capital project planning efforts to provide for both water supply and the facilities needed to distribute water to customers. City water supply planning includes consideration of local supply development and management, and active involvement in issues related to the imported water supply. The Water Department is responsible for facilities planning through the preliminary design phase. Facilities planning includes evaluation of regulatory requirements, growth impacts and system condition.

3.3.1 Water Supply Planning

The City's current water supply portfolio includes water purchased from CWA, recycled water produced by the City, and local surface water. The City purchases treated and untreated water from CWA. The City is one of 24 cities and water agencies who make up the membership of the CWA. The City population is 43 percent of the total within the CWA service area, and the City has 10 of the 35 directors on the CWA Board.

Over the last five years (2003-2007), the City has purchased an average of more than 90 percent of its water from the CWA with the other supplies from City-controlled local sources. These include surface water, recycled water and groundwater. Successful efforts to increase local sources could reduce future CWA deliveries to the City to approximately 85 percent within the next five years.

Since 1990, approximately 85 to 90 percent of CWA's water supplies have been from MWD, which imports water from the Bay-Delta area in Northern California and from the Colorado River. In response to the Western region drought conditions, reductions in surplus water available from the Colorado River, and pumping restrictions from the Bay-Delta, MWD has recently instituted reductions in delivery of agricultural water linked to those who purchased water under a voluntary interruptible supply and delivery of water for groundwater recharge projects. These recent reductions have had a minimal impact on the City but depending on the resolution of the environmental issues in the Bay-Delta and the drought-related water shortages, further delivery reductions may occur. Currently the City is in a Stage 1 Voluntary Compliance Water Watch, and voluntary reduction in non-essential demand is projected to reduce water consumption by 7.5 percent below normal levels in 2009 and by 15 percent in 2010.

In recent years, in an effort to diversify water supply sources and reduce reliance on water from MWD, the City and CWA have both worked to expand water supply options. CWA has developed a water transfer agreement with the Imperial Irrigation District and a canal lining project that have resulted in the delivery of 55,000 acre-feet ("AF") in 2007 to the CWA supply structure. By the year 2020, these two programs are expected to provide 267,000 AF per year. These new supplies are expected to reduce the reliance on MWD water by at least half. Other programs that will enhance the development of additional local water supplies include groundwater, recycled water, surface water, and conservation projects. Some projects will be developed by CWA, while others will be managed by other agencies with partial financial support from CWA.

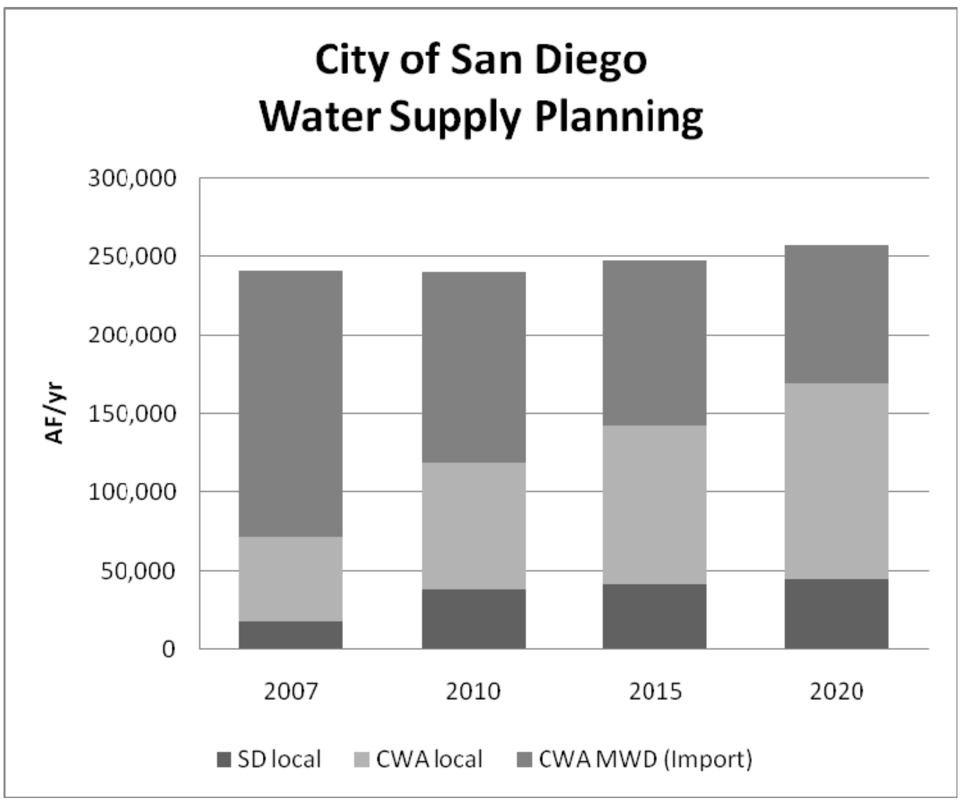
The City has completed a number of planning efforts to identify potential projects that would increase the available water supply under the direct control of the City. These planning efforts include:

- 1997 Strategic Plan for Water Supply
- 2002 Long Range Water Resources Plan
- 2004 Strategic Business Plan
- 2005 Urban Water Management Plan
- 2007 Reclaimed Water Master Plan
- Drought Ordinance
- Water Facilities Master Plan (beginning Fall 2008 for the post FY2013 CIP)

The Urban Water Management Plan is developed and updated on a five-year cycle in accordance with the requirements of the State's Urban Water Management Planning Act. The City has prepared plans in 1985, 1990, 1995, 2000, and 2005. The plan demonstrates water reliability for the coming 25-year period. The plan is prepared in conjunction with information from MWD and CWA, the primary water wholesalers for the City. It considers population factors, demand projections, emergency planning and response requirements, water quality, water recycling, and drought planning.

Along with the development of water management strategies, these planning efforts have resulted in identification of a number of potential projects that could enhance the City's water supply portfolio. These projects include investigation of groundwater recharge/storage projects, brackish water desalination projects, recycled water production and distribution projects, and enhanced conservation programs. In November 2007, the City Council approved the San Pasqual Ground Water Management Plan, under which the City will identify the viability of groundwater basin conjunctive use and storage, with state and federal funding support.

Figure 3-1 below is based upon supply planning data from both the CWA and the City, illustrating how planned programs and projects will reduce the City's reliance on imported water from MWD. The figure represents all water usage including potable and recycled, as well as water losses. Based upon reports from the Water Department and from CWA, Water Department reliance on MWD imported water is projected to reduce from the current levels of about 90 percent to less than 40 percent, provided that planned local CWA and Water Department projects are implemented.



Definitions: **SD Local** – surface water, recycled water and groundwater
CWA Local – IID water transfers, canal lining transfers,
CWA MWD (Import) – Water sold to CWA by MWD (includes water from Bay-Delta and Colorado River)

Figure 3-1
City of San Diego Water Supply Planning

3.3.2 Water Conservation

In addition to the conservation-oriented inclining block water rate structure in use for residential customers, the City and the CWA have active water conservation programs. These programs provide customer education and financial incentives for the installation of water saving devises such as low flow toilets, water efficient clothes washers and weather-based sprinkler controllers for irrigating large landscapes, parks and green belts. Many of these programs provide permanent long-term benefits. In fact, water usage within the City is approximately the same today as it was in 1992, despite a 21% increase in population.

In response to recent water supply shortages announced by MWD and CWA, the City has recently declared a Stage 1 Voluntary Compliance Water Watch that asks citizens to voluntarily reduce water use. Programs such as the "Twenty-gallon Challenge" provide information to the public on ways residential water use can be reduced to help the area manage current and potential future additional reductions in the delivery of imported water. The City is currently updating a drought ordinance that outlines voluntary and mandatory actions that would be taken should further water supply restrictions occur.

3.3.3 Recycled Water

The Water Department distributes recycled water from two City reclamation plants (operated by Metropolitan Wastewater Department), and currently serves approximately 400 retail and 3 wholesale customers. Approximately 8,000 AF of recycled water was delivered in FY 07. A recycled water master plan was completed in 2007 that is the basis for recycled water distribution projects that are included in the CIP.

3.3.4 Facilities Planning

The Department's capital project planning has been based upon a combination of improvements based upon regulatory requirements and system requirements as defined in various strategic planning efforts. The Department has initiated efforts to begin an update to its Water Facilities Master Plan in the fall of 2008 that will outline the capital program and projects that will be needed during the FY10 through FY30 planning period.

3.3.5 Capital Project Execution

Capital Project Planning and Preliminary Design

The Water Department is responsible for capital project planning, prioritization, financing, program financial management and preliminary design. Section 3.6 discusses the project prioritization process and details the current capital program projects. Following the completion of preliminary design, project implementation is transferred to the City Engineering and Capital Projects Department. Services are provided via an annual service agreement, with all costs being paid from Water Department budgets.

Capital Project Design, Bid and Construction

The mayor's office has instituted an organizational review process referred to as Business Process Reengineering ("BPR"), which has been used to improve efficiencies, reduce the cost of City government and to enhance the services offered to City residents. In July 2006, a study related to the provision of engineering services to City departments (including the water and wastewater utilities) was initiated to assess and implement a revised organizational structure that would consolidate these services under a single operational unit. This study was completed in April 2007; implementation of the organizational change began during the FY08 budget planning.

The new Engineering and Capital Projects Department ("E&CP") has been structured to be an effective, streamlined, and centralized service department. It manages a varying workload by adjusting to the ebb and flow of capital project demands among all City departments with less disruption than had previously occurred within individual departments. In addition, the E&CP is designed along the following key recommendations of the BPR:

- Consolidate all CIP design and construction functions so that projects are delivered in accordance with annual execution plans
- Implement a uniform and objective ranking system to prioritize all CIP projects
- Improve coordination of projects within the right of way
- Enhance the City's asset management systems
- Operate E&CP as a matrix organization
- Enhance communications and coordinate by placing all staff within one location

In recognition of some of the unique needs of the utilities, the Water and Wastewater departments have retained responsibility for CIP development and project planning, program management, project financing, budget control and compliance with the rate case plan and revenue program. In addition, O&M engineering responsibilities have remained within the Water and Wastewater departments. As a result of this consolidation of the City engineering operations, 25 positions were transferred from the Water Department to the E&CP department, which has a total of 527 positions. Of that number, approximately 140 positions are identified as assigned to the water and wastewater service sections. In addition, the department provides environmental and permitting services for the City's capital program. Services that require a specific expertise, such as treatment plant and large diameter pipeline design, utilize outside contractors who will be managed by this department.

Each year the E&CP and Water Department develop a formal Service Level Agreement that defines the roles and responsibilities of each party, and establishes schedules and timelines for project implementation, communication protocols, performance measures and dispute resolution. As the E&CP was created recently, the performance of its service relationship with the Water Department has not yet been reviewed. However, given the number of defined water project positions, and E&CP's capability to shift work responsibilities within the large pool of engineers and construction specialists, the department has the ability to efficiently perform its prescribed services to the Water Department.

3.4 Regulatory Issues

3.4.1 Current Regulatory Issues

The City's water treatment and delivery system falls under federal, state, county, and municipal regulations. The general types of regulations which may be applied to capital project implementation and other department operations include those listed in Table 3-1.

Table 3-1
General Statutes, Laws, and Regulations Guiding the Water Department

Locality	Statute, Law, or Regulation
Federal	Energy Policy Act Clean Air Act Endangered Species Act National Environmental Policy Act National Historic Preservation Act Federal Insecticide, Fungicide, Rodenticide Act National Fire Protection Act1 Uniform Fire Code Toxic Substances Control Act Uniform Building Code Clean Water Act
State	California Prop 65 Emergency Planning Community Right to Know Act Hazardous Materials / Wastes Pesticides Pollution Prevention Above and Underground Fuel Storage Integrated Waste Management Act Safe Drinking Water Act State Drinking Water Standard Hydrostatic and Potable Water Discharge Permit Storm Water Code Compliance CARB Title 13 California Environmental Quality Act
County	Clean Air Act – local enforcement Recreational Use Permits in Domestic Supply Reservoirs

Table 3-1 (cont.) General Statutes, Laws, and Regulations Guiding the Water Department	
Locality	**Statute, Law, or Regulation**
Municipality	City of San Diego General Plan & Progress Guide City of San Diego Historical Resources Register Coastal Zone Development Permit Environmental Quality Ordinance Site Development Permit Hazardous Material Disclosure Noise Control Watershed Protection Energy Conservation Medical Waste Recycling of Construction Debris Storm Water Code Compliance

The Operations Division maintains a detailed inventory of regulations and requirements that relate to all aspects of the water utility operations. This data provides information on statutes, regulating agency, areas of impact (air, water, hazardous materials, release impacts, etc.), the functional areas that the regulation may effect, and the implementation documentation within the department. This information is used to monitor reporting or permitting activities as they are required during facility planning and operation. Compliance with regulations related to capital project design and construction is monitored by both Water Department and E&CP staff.

Other than the Department's ongoing work with the CDPH, no other outstanding regulatory issues were identified during this review.

The US EPA and State of California adopted new rulings related to surface water treatment and water quality in the late 1980's. In response to these regulatory requirements and to provide water quality management for the City water supplies, the Water Department initiated a Drinking Water Quality Improvement Program in the late 1980's. This program and its related studies led to the development of various capital projects at the water treatment facilities to optimize operations and to provide ozonation as a primary disinfectant system.

Since 1994, the Department has been working closely with the CDPH to ensure that the water treatment and distribution systems achieve compliance with CDPH requirements. Table 3-2 lists outstanding CDPH compliance order issues and the projects the Department is pursuing to address those issues. We have opined on whether or not the projects use proven and reliable technology and would adequately address the CDPH's issues.

The proposed CIP includes 20 projects that are planned to respond to regulatory concerns or requirements. These projects have a total cost of approximately $480 million over the five year capital planning period.

3.4.2 Potential Future Regulatory Issues

In the future there may be additional regulatory requirements related to other emerging contaminants, such as pharmaceuticals, and their potential impact on drinking water quality. The treatment processes being implemented at the City treatment facilities have the potential to provide effective treatment for many of these issues. Therefore, based upon the City's established working relationship with CDPH, the implementation of treatment plant improvements and the established regulatory monitoring program in the operations division, it appears that the City has practices in place that can properly respond to potential future regulatory issues.

Table 3-2
CDPH Compliance Related Projects

Compliance Order Issue	Project Name	Work Description	Proven & Adequate?	Compliance Status
Rancho Bernardo CCR: reservoir rehabilitation. Start by July 31, 2007 and complete by December 31, 2008	Rancho Bernardo Reservoir Upgrade	The project calls for the rehabilitation of the 10-million gallon, trapezoidal-shaped concrete reservoir. Work will include improvements of the beam connection, repairs of the roof slab and columns and a seismic retrofitting to bring the reservoir up to code compliance mandate by Water Department and State Department of Health Service standards.	Yes	Under Construction
Optimize Treatment of all WTP: effluent turbidity goal of 0.1 NTU	Upgrade projects at Alvarado, Miramar and Otay WTPs	See project specific descriptions.	Yes	See project descriptions
Water main replacement: award contracts annually for construction of at least 10 miles per year	AA Water Main Replacements	Annual allocation for the replacement of water mains throughout the City. The existing cast-iron system is either approaching or has exceeded its expected life of 40 years. As of 2008, breaks are occurring at the rate of approximately 100 annually.	Yes	On-going program in place, approximately $40 million planned each year in CIP
Rancho Penasquitos Pump Station (formerly called Rancho Bernardo). Begin construction by Jan 31, 2008 and complete construction by Jan 31, 2010.	Rancho Penasquitos Pump Station	Project calls for the design and construction of a new pump station and a new Del Mar pressure reducing station near the site of the existing stations. The new station will house 5 new vertical pumps each rated at 6000gpm and an additional pump can for future expansion. The Del Mar pressure reducing station will be replaced with a new facility.	Yes	Under Construction FY2009-FYy2010
Miramar WTP Contract B (construction of three flocculation and sedimentation basis, demolition of flocculation and sedimentation base no. 3 and rehabilitation of the operations building). Start construction by Mar 31, 2008 and complete by Mar 31, 2010.	Miramar WTP Contract B - Floc/Sed Basin	This project will expand the plant capacity from 140 mgd to 215 mgd to meet water demands through 2030. The construction scope of work will involve: Construction of 4 new Flocculation and Sedimentation basins 5, 6, 7 and 8 inclusive of associated piping - Demolition of the twelve existing filters - Demolition of the existing backwash water tank and associated piping - Demolition of the existing Flocculation and Sedimentation basins - Construction of 60 inch influent pipelines to New Flocculation Basins - Construction of 108 inch & 120 inch settled water pipelines	Yes	Under Construction FY2009-FY2010

Table 3-2 CDPH Compliance Related Projects				
Compliance Order Issue	**Project Name**	**Work Description**	**Proven & Adequate?**	**Compliance Status**
Miramar WTP Contract C (Ozone equipment). Start construction by June 30, 2008 and end construction by Mar 31, 2010.	Miramar WTP Contract C - Ozone Equip/Install	This project consists of installation of Ozone equipment and Liquid Oxygen delivery and storage facilities. Three Ozone generators will be provided to generate ozone for supply and distribution of ozonated feed gas to two pre-ozone and three settled water ozone contactors. Once this project is completed, ozone will replace chlorine as the primary disinfectant.	Yes	Under Construction FY2008-FY2010
Alvarado WTP Flocculation and Sedimentation Basins I & II - rehabilitation. Start construction by Dec 31, 2010 and complete by June 30, 2012.	Alvarado WTP Ph 3 Rehab Floc/Sed Basins	This project consists of rehabilitation of Flocculation/Sedimentation Basins 1 & 2, as well as installation of Ozone pipeline from Ozone Building through the exiting basins to the existing filter.	Yes	In-Design Construction to begin FY2011
Otay 2nd Pipeline I-15 to 54th street. Start construction by Mar 31, 2008 and complete by Mar 31, 2010.	Otay 2nd Pipeline - Cast Iron Replacement Phase	This project includes the installation of approximately 1.3 miles of new 42-inch welded steel pipe in 54th Street between El Cajon Blvd and Chollas Station Road which will provide a means to bypass 3.5 miles of the 36-inch cast iron pipeline, located west of 54th Street, abandonment of 1200 feet of existing 36-inch cast iron pipe. This segment includes flow meters, pressure control valves, and connections to the Trojan, Otay I and II and Mid City Pipelines. Also, this project consists of replacement of approximately 3000 feet of existing cast iron pipe in 54th Street with new 16-inch PVC distribution pipelines that will maintain the City's reliable source of potable water.	Yes	Under Construction FY2009-FY2010
Alvarado WTP Ozone equipment. Start construction by Jun 30, 2008 and complete by Dec 31, 2010.	Avarado WTP Ph 4 Ozone	Construction of ozone disinfection and pumping facilities to meet new Federal Safe Drinking Water requirements and State of California Department of Health Services compliance order, and the associated process changes to make ozone the primary water disinfectant and chlorine secondary.	Yes	Under Construction FY2009-FY2011
Otay WTP Phases I and II (construction of new flocculation and sedimentation basins, make improvements to filtration facilities, and install chlorine dioxide facilities). Start by Sept 30, 2008 and complete by Dec 31, 2010.	Otay WTP Upgrade Phase 1	The Otay WTP Upgrades Phase 1 project will construct a new flocculation and sedimentation basin and make improvements to the sixteen existing filters. The filters improvements include granular activated carbon (GAC) filtration media and providing a pumped backwash system, a filter to waste system, replacing the filter under drains and increasing the media depth.	Yes	Under Construction FY2009-FY2011

Table 3-2
CDPH Compliance Related Projects

Compliance Order Issue	Project Name	Work Description	Proven & Adequate?	Compliance Status
	Otay WTP Upgrade Phase 2	The Phase 2 upgrades to the Otay WTP include construction of a chlorine dioxide shaft contactor, ClO2 generation system, sodium chlorite tank, ferrous chloride (FeCl2) tanks and feed system, powder activated carbon (PAC) facilities, reservoir circulator units, yard piping, electrical support facilities, instrumentation and controls systems, and associated site work.	Yes	Under Construction FY2009-FY2011

3.5 Current Water System Facilities

The City's service area covers over 400 square miles, which includes 342 square miles in the City, and serves approximately 1.3 million customers. To assess the current condition of the water system, we performed a site evaluation of several of its key facilities. The site evaluations involved walking through the sites and visually observing the physical condition of several water treatment plants, water pump stations, and reservoirs.

The City owns and operates three main water treatment plants, 9 raw water reservoirs, 32 treated water reservoirs, and 49 pumping stations. Our inspections were limited to sites best representing the overall condition of the City's facilities, and a summary of the City's facilities is provided below. A rating system of 1 to 3 was applied to each facility visited. In conclusion, the overall ratings (detailed below) were: Treatment Plants -- 3.0; Pump Stations -- 2.5; and Reservoirs/Standpipes -- 2.0.

3.5.1 Rating System Definition

A grading system was used to evaluate the water facilities. This approach and methodology result in standardized definitions of condition regardless of the facility type (treatment plant, pump station or reservoir).

During the assessment we established a condition grade for each of the sites inspected. The grading system for the facilities is as follows:

Good Rating -- 3

A rating of 3 implied the facility was in operation, in good working order, with all or most of the equipment associated with the facility in good mechanical condition. A 3 rating was given if all maintenance was being performed in accordance with manufacturer's recommendations, and that backup equipment, where provided, was in good condition and ready for operation as required.

Fair Rating -- 2

A rating of 2 implied the facility/equipment was in operation and in fair mechanical condition. A rating of 2 was given if the equipment was nearing the end of its useful life, and in need of repair or replacement.

Poor/Out of Operation Rating -- 1

A rating of 1 implied the facility/equipment was in poor condition and/or out of service altogether.

3.5.2 Water Treatment Facilities

The City has three main water treatment plants: Alvarado, Miramar and Otay. Table 3-3 summarizes the capacity and demands of these treatment facilities. In general all three treatment facilities are in good working order.

Table 3-3 Capacity and Demand of the City's Water Treatment Plants						
Water Treatment Plant	**Original Design Capacity (mgd)**	**Current Rated Capacity (mgd)**	**Future Rated Capacity (mgd) (1)**	**Current Average Demand (mgd)**	**Current Peak/Max Demand (mgd)**	**Condition Rating**
Alvarado	66	150	200	89.5	116.8	3-Good
Miramar	100	140	215	88.1	135.3	3-Good
Otay	40	34.2	40	20.7	30.5	3-Good
Total	**206**	**324.2**	**455**	**198.3**	**282.6**	
1)Source: Water Department						

Alvarado Water Treatment Plant

The Alvarado Water Treatment Plant (WTP) began operation in January 1951 with a capacity 66 mgd. It is located adjacent to Lake Murray near the City's border with La Mesa. Plant capacity is 150 mgd and will be increased to 200 mgd by completion of the Upgrade /Expansion Project.

The Alvarado WTP is rated at 3. The plant is currently under construction to include additional treatment tanks and ozonation.

While some of the facility is older, including the flocculation tanks and filter control consoles (upgraded, but still housed in the original cabinets), overall the facility is very clean and well maintained. A total of five maintenance staff is responsible for maintaining the facility, with I&C and HVAC maintenance performed by others. This is a relatively small maintenance crew, so staffing may be inadequate for such a large facility. Once the construction project is completed, it is recommended that a staffing study be conducted to determine if additional maintenance staff is warranted. Based on discussion with plant operators, there seems to be adequate operations staff.

A computerized maintenance management system ("CMMS") is being implemented at Alvarado, but work orders continue to be manually generated. Maintenance staff perform daily walkthroughs of the facility, with a daily meeting held in the morning to review the previous day's operation's log. While this seems to be effective, as the facility expands, CMMS should be fully implemented. Currently, estimation of equipment run time is based on calendar days. In contrast, elapsed time meters are more effective tools for accurate scheduling of preventative maintenance.

In summary, the Alvarado WTP is in very good condition, is maintained well, and is rated at 3.

Miramar Water Treatment Plant

The Miramar WTP began operation in 1962. The WTP is located in the Scripps Miramar Ranch community adjacent to Miramar Reservoir, and provides drinking water to an estimated 500,000 customers. The WTP's current capacity is 140 mgd and will be increased to 215 mgd by completion of the Miramar Upgrade and Expansion Project.

The WTP is staffed with four maintenance staff plus a supervisor. The facility is currently under construction to expand its capabilities to provide ozonation disinfection treatment. The majority of the old facilities have been demolished and replaced. New facilities include a new administration building, filters and flocculation/sedimentation basins. The completion of the current construction contract will have replaced everything except the distribution pump station and clear wells. The facility is well maintained and in good working condition and has been in continuous operation throughout the construction period. Construction on the current expansion-upgrade project will be complete in 2011.

CDM staff is on site at the Miramar WTP providing design services during construction Based on our first-hand knowledge of the plant condition and operations, the condition of the facility is rated at 3.

Otay Water Treatment Plant

The Otay WTP supplies one of the City's three major water service areas, providing up to 34 mgd of potable water to customers primarily in the southern reaches of the City. The plant receives raw water from the Morena, Barrett and Lower Otay Reservoirs.

This facility is well-maintained and operated, but shows some wear with certain areas in need of painting. It is rated at 40 mgd, but regulated to 32.4 mgd. It has 16 existing filters, with construction underway to add an additional settling basin and to convert from chlorine to chlorine dioxide disinfection. Other capital improvement projects are scheduled to replace valves in the filter gallery and replace the ferric chloride tanks.

A total of four maintenance staff plus a supervisor are responsible for maintaining the Otay WTP, which seems to be adequate. Similar to the Alvarado WTP, the maintenance staff does not fully utilize the CMMS program. According to discussions with the Maintenance Supervisor, most of the equipment maintenance is performed on a repair basis. Five operators are assigned to the Otay facility, working on rotating shifts. This seems to be an adequate number of operations staff for the plant.

The Otay WTP condition is rated at 3.

3.5.3 Water Storage Facilities

The City's Water System includes 9 raw water reservoirs with a total capacity of 415,936 AF and 32 treated water reservoirs/standpipes, with 29 currently in operation. Three treated water reservoirs/standpipes were visited, and 2 additional standpipes were discussed with City staff to assess the condition of the reservoirs.

We did not have the opportunity to assess the level of staffing for the reservoir or hydraulics crews. According to City staff, there are two crews of 2 to 3 people, each responsible for checking and maintain the reservoir and standpipes. There is a four-person hydraulics crew responsible for checking and maintaining the pressure reducing stations and the altitude valves. Table 3-4 summarizes the capacity and condition of these storage facilities.

Table 3-4
Water Storage Facilities Inspected

Facility Name	Capacity MG	Rating
College Ranch Standpipe	1.5	3-Good
La Jolla Country Club Reservoir	0.5	2-Fair
San Carlos Reservoir	5.0	1-Poor (out of service)
Paradise Mesa Standpipe	2.53	3-Good
Redwood Village Standpipe	2.0	2-Fair

College Ranch Standpipe

The College Ranch Standpipe is rated at 3. The standpipe is currently in service, and in good operating condition.

The standpipe altitude valve is in good condition. The cathodic protection is also well maintained and in good working order. The standpipe has been drained and cleaned according to the City's inspection schedule. During routine inspection, the tank liners are inspected and coated as necessary. Due to low demand in this area, some operational problems occur due to stagnant water in the standpipe. Chlorine is routinely fed to the standpipe to mitigate this problem.

La Jolla Country Club Reservoir

The La Jolla Country Club Reservoir is rated at 2. The reservoir is old and the roof and liner need replacing. The overall condition of the reservoir is fair. Water quality issues require the reservoir to be chlorinated.

San Carlos Reservoir

The San Carlos Reservoir is rated at 1, as it is leaking and out of service. The reservoir was emptied, cleaned, and inspected for leakage. Upon refilling the reservoir, it was discovered to still be leaking, and has not been placed back into service. During the visit, evidence of leaking was apparent, and a bee infestation exists at the base of the reservoir. A project to repair this reservoir is included within the current CIP.

Paradise Mesa and Redwood Village Standpipes

We did not visit the Paradise Mesa Standpipe or the Redwood Village Standpipe, but discussed the condition of them with a City representative. According to the City representative, the Paradise Mesa Standpipe is in service, and in good working order. The altitude valve and cathodic protection are in good condition. Therefore, the

Paradise Mesa Standpipe is rated at 3. The City representative indicated that the Redwood Village Standpipe has some operational problems related to elevation grade variability in the zone which can cause pressure fluctuations. This facility requires some additional monitoring and managing by maintenance staff and is therefore rated at 2.

3.5.4 Pump Stations

Forty-nine pump stations deliver water throughout the City's system. The pump stations are divided into four pressure zone areas, where each area is assigned pump station crews to check the stations on a regular basis. As a general statement, some of the 49 pump stations are located at grade, and vandalism has been a recurring problem. To provide continuous operation during power outages, 20 pump stations have permanent emergency generators and an additional 15 mobile/portable generators are available for use at other pump stations, as needed.

We did not have the opportunity to assess the level of staffing for the pump station crews. According to Water Department staff, each pressure zone has two crews of four people that are responsible for checking and maintaining the pump stations. We visited four stations in one pressure zone area. According to the City, these stations fairly represented all pump stations within the four zones. Table 3-5 summarizes the capacity and condition of these pump station facilities.

Table 3-5
Water System Pump Stations

Facility Name	Max Capacity MGD	Rating
Climax Pump Station	6.5	2-Fair
College Ranch Hydro Pneumatic Pump Station	2.5	2.5-Fair Plus
Waring Road Pump Station	29.0	3-Good
Eagle Ridge Pump Station	3.4	3-Good

Climax Pump Station

The Climax Pump Station is rated at 2. The pump station is located in a residential area, and equipped with four VFD-driven pumps. The VFDs are older and "showing some wear." The piping is also leaking some water. The station itself is fairly cramped, and equipment access is difficult. The facility does not have an emergency standby generator. The station is located below grade, and there are no vandalism or security issues.

College Ranch Hydro Pneumatic Pump Station

The College Ranch Hydro Pneumatic Pump Station is rated at 2.5. Although not a typical water pump station, it is considered part of the 49 pump station network. One pump pressurizes a hydro pneumatic tank at the College Ranch Standpipe. The facility does not have an emergency standby generator. The below grade station is maintained adequately and is physically located within the fenced area of the College Ranch Standpipe. This station has one pump. Typical of all the pump stations visited, intrusion alarms are provided on the access doors and hatchways.

Waring Road Pump Station

The Waring Road Pump Station is rated at 3. The station is four years old and is in new condition. Five 200 horsepower vertical turbine pumps are manually operated remotely by the Alvarado WTP operators through the SCADA system. Due to low demand in the area, the pumps are operated intermittently, based on pressure. A trailer-mounted emergency standby generator is located onsite. Construction is currently underway to permanently tie in the generator to the pump station for automatic switchover operation. This station has been well maintained.

Eagle Ridge Pump Station

The Eagle Ridge Pump Station is rated at 3. The site is equipped with two hydrants; one for hooking up to the suction side of the reservoir, and one for the discharge side, providing redundancy to the system. The pump station is equipped with a total of four pumps; two large and two small pumps. The facility does not have an emergency standby generator. The pump station site is well-maintained.

3.6 Operations and Maintenance Activities

A review of budget and planning documents as well as interview information was used to prepare this evaluation of the Water Department operations and maintenance programs.

3.6.1 Staffing and Operations Plan

The Water Department Operations Division operates and maintains the Water System. This Division is currently authorized to have 460 positions. The division is divided into six major groupings to operate, manage and maintain the system facilities. A review of current operations and the planned CIP does not indicate that a significant increase in positions will be needed as projects are completed. The workforce is divided into the following units and sub-units:

- Public Information
- Administrative Support
- Safety, Security and Emergency Response Program
- Water Operations and Engineering
    - Production Engineering
    - Facility Information Management
    - Distribution System Operations/Optimization

- Optimization
- Distribution Operations
- Distribution Engineering
- Corrosion Engineering

- Water Production
  - Treatment Plants
  - Water Quality Laboratory

- Water Construction and Maintenance
  - North Council Districts 1,5,6,7
  - South Council Districts 2,3,4,8
  - Emergency Services
- Lakes and Recreation/ Reservoir Management

The Operations Division has ISO 14001 certification (International Organization for Standardization), which is a program that establishes a standard for performance that is designed to function on a plan, do, check, act systems approach. All members of the organization participate in the development and operation of this interactive system with the following goals:

- Cost Savings
- Reduced risk to the environment and the employee
- Increased operational efficiency
- Positive external relations and public image
- Improved communications

In addition, the Operations Division operates under a "Bid to Goal" program that establishes performance standards for employees that are set and reviewed monthly and annually for performance/pay reviews.

3.6.2 Maintenance Program

Interviews with the Operations Division maintenance program staff were performed to review the maintenance methodology and practices in use. Key areas reviewed were employee training and supervision, work order systems and documentation, and work planning and execution.

Training

The division has established a structured training program for all new employees. This program, the Water Academy, provides three weeks of training related to all the City systems and safety programs. In addition, the City provides ongoing classes that lead to water system operator certifications and the City training program is certified to grant continuing education credits. Programs are provided by both internal and external trainers, depending on the particular topic and skills needed. Training programs cover topics such as legal requirements, break repair practices, equipment operation, customer service issues, and ongoing safety practices. Staff members who pursue additional certifications receive compensation recognizing the level achieved even if it is beyond their position requirements. Generally, the department supervisory staff is promoted from within and supervisors take an active role in provision of regular training sessions.

Work Order Management

The operations maintenance staff is divided into teams assigned to specific zones within the City and at the major treatment facility sites. Maintenance work hours are linked to work orders on an average of about 90% of the time. Work orders are linked to a specific asset and are managed by the supervisor of each zone/facility team. Work orders are issued to work crews on a weekly or biweekly basis, depending on the supervisor. Emergency work orders are issued on a daily basis as they occur. According to operations staff, most work orders are related to planned maintenance and about 75% are completed within four weeks from the date requested.

The system is a combination of electronic and manually managed documents, with the work orders generated electronically, the documentation completed manually by field workers and then input by data processing operators on a daily basis. Consideration has been given to a fully automated system, but concerns related to equipment requirements, field conditions and worker computer skills has led to a preference for this hybrid system. There is no automated link between the time reporting and work orders, and the individual supervisors are responsible for auditing time and materials costs for work orders on an informal basis. Analysis of work order maintenance data is not regularly used to establish a predictive maintenance program.

Maintenance Planning

The water distribution system utilizes system redundancy to provide service reliability and emergency response. The system is mapped using GIS and the department engineering staff provides support for the implementation of maintenance/repair projects. Operations management reported that the system currently experiences about 100 breaks per year over the 3,420 miles of pipeline. The

Department's continuing cast iron main replacement program will help to prevent breaks related to aging and deteriorated pipeline sections.

3.7 Capital Improvement Program

The general objectives of the Water Department's CIP are to provide the facilities necessary to meet federal and state requirements, maintain the integrity of the system, and provided satisfactory service and performance to customers at a reasonable cost. To accomplish these objectives, the Water Department must have sufficient operating revenues and adequate funding for CIP projects.

The Water Department reviews the CIP on an ongoing basis to prioritize and plan for program implementation. In addition to projects that are driven by regulatory issues, several planning documents and studies have been developed to define potable and non-potable water demands, alternative supply options, and the infrastructure requirements related to these issues. These plans and studies have identified a number of potential projects for further evaluation at the master planning level. Additionally, the City has operational and short- to mid-term reliability projects compiled in "project summary sheets" as part of the CIP. Master Plans to determine long-term facility needs have been developed independently for the Miramar and Alvarado Service Areas. The City has established five-year periods for the development and integration of the information needed to establish a comprehensive, practical, and functional Master Plan, in part by utilizing the facility plans described above. The City is developing a long-range CIP with an outlook that will extend past the 2013 planning horizon.

The City has recently developed prioritization policies for CIP projects. In May 2008, the City Council approved a policy to establish an objective process for ranking CIP projects to have a basis for choosing the most compelling projects for implementation. The following prioritization factors are listed in order of importance:

1. Health and Safety Effects
2. Regulatory or Mandated Requirements
3. Implication of Deferring the Project
4. Annual Recurring Cost or Increased Longevity of the Capital Asset
5. Community Investment
6. Ease of Implementation
7. Project Cost and Grant Funding Opportunity
8. Project Readiness

3.7.1 Master Planned Facilities

Appendix A, Table A-1 presents the list of projects in the proposed CIP as of September 2008. The projects are scheduled for design and construction between FY09 and FY13; the table identifies the justification for each project and estimated then-current cost by fiscal year, using an inflation allowance of 4 percent. Some of the multi-year projects have already incurred considerable costs in the years before FY09, and other projects include construction expenditures after FY13. Table A-2 provides descriptions of each project.

3.7.2 Capital Program Implementation

An accurate construction cost estimate is essential to successful project management, fiscal budgeting, and project implementation. The Engineering and Capital Projects Department's Standard Operating Procedure (SOP) provides general guidelines for the preparation of reliable project construction cost estimates. The SOP is included in Appendix B. The development of the construction cost estimates begins with the Water Department at a planning level (10 percent design stage). The Engineering Department further refines the cost estimate at 30, 75, 90 and 100 percent design stages. Cost estimates are also updated if a project is delayed for more than 6 months, or if there are significant changes in the design. The City typically hires outside consultants for large projects. The City's cost estimating guidelines are provided to the consultant, but the consultant is ultimately responsible for their own methods.

The following are the general guidelines for preparation of construction cost estimates as stated in the SOP:

- Preparation of the Engineer's Estimate and associated construction costs
- Types of construction cost estimates
- Construction cost estimating approaches
- Available cost estimating resources
- Ranges of construction administration and contingency costs
- Cost estimate submittals and expected accuracies at various stages of design
- The roles and responsibilities of the participants in the cost estimating process

Table 3-6 lists the elements of a project's costs as identified by the SOP. The range in percentage values listed reflects the varying complexities of a project as well as the varying site conditions that may be encountered.

Table 3-6 Elements of Project Costs		
Project Phase and Components	**Range of Project Cost Share**	
A – Project Design Costs	20% to 40%	Of Total Budget*
1 – Administration		
2 - Engineering		
B – Project Construction Costs	60% to 80%	Of Total Budget*
1 – Engineer's Est (Const Contract)	30% to 60%	Of Total Budget*
a – Bid Item Quantities		
b – Mobilization	5% to 10% (1)	Of Construction
c – Traffic Control	5% to 10% (2,3)	Of Construction
d – Water Pollution Control	2% to 5% (1)	Of Construction
e – Bonds	2.5% (4)	Of Construction
f – Field Orders	2.5% to 10% (3)	Of Construction
2 – Contingencies	10% to 15%	Of Construction
3– Const Admin – Field Engineering	10% to 15%	Of Construction
**Total Project Budget (costs) = (Design Costs) + (Construction Costs)*		
(1) Depending on location (2) Depending on ADT (3) Depending on project complexity (4) Per specification		
Source: City of San Diego Standard Operating Procedure, CIP Construction Cost Estimates, Table 1		

The cost estimate at the 10 percent design stage is considered a conceptual level rough estimate. The cost estimate at the 30 percent design stage is based on quantities and unit process models further refined by investigation or revised assumptions from the design criteria, site layout, soils reports and completed design drawings. The cost estimate at the 75 percent design stage includes unit prices associated with environmental review, mitigation requirements, and discretionary permits. The cost estimate at the 90 percent design stage is updated with the most recent bidding unit prices. The cost estimate at the 100 percent design stage serves as the final project cost plan.

The following is the expected accuracy of the actual cost of construction for each design stage:

- 30 percent design stage: +30 to -15 percent
- 75 percent design stage: +20 to -10 percent
- 90 percent design stage: +10 to -10 percent

The City's approach for estimating project construction costs is consistent with industry standards and professional practices. Based on our review, we find the cost estimates presented in the CIP and the proposed schedule for completion of the projects to be reasonable.

Section 4
Water System Financing

The purpose of this section is to evaluate the financial feasibility of the proposed Water Department revenue bonds to support the funding of the City's proposed CIP of $724 million through FY 13. This evaluation is based on proforma sources and uses of funds cashflows for the Water Department Fund and evaluation of debt service coverage ratios. The analysis was made to confirm that the utility has sufficient net operating revenues to adequately fund the capital program and projected debt service with appropriate financial safety margins. The funding plan uses the proceeds of the 2009 Series A and B Bonds, and proposed additional bond sales over a projected five years.

4.1 Capital Improvement Program

The Water Department has a capital improvement program (CIP) that identifies the construction schedule and estimated costs of projects prioritized for completion. The Water Department reviews and updates its CIP annually. A detailed water system analysis is conducted periodically to identify and reprioritize needed capital improvements. The project costs and other details are modified annually to reflect current needs, priorities and costs. The Department Strategic Plan includes capital projects to remediate existing deficiencies and provide additional capacity in the City's water facilities. A long-term CIP evaluation that extends project definitions through 2020 is currently being prepared.

Table 4-1 presents a summary of the projected five-year CIP for FY 09 through FY 13, as provided by Water Department staff. The annual CIP varies between $113 and $178 million per year, with future costs based on a nominal inflationary escalation of 4 percent, to then-current dollars. For a detailed list of projects, see Table A-1 in Appendix A.

Table 4-1
Proposed Major Capital Improvement Program (Inflated)

Line No	Project Numbers (a)	Description	Fiscal Year Ending June 30 2009	2010	2011	2012	2013	Total
1	1 - 12	Water Treatment Plants	$86,756,020	$83,881,204	$31,310,409	$1,639,389	$3,905,061	$207,492,083
2	13 - 37	Pipelines	$57,705,209	$48,074,621	$53,410,139	$61,430,309	$59,022,991	$279,643,269
3	38 - 45	Pump Station	$9,550,000	$3,840,792	$831,375	$2,438,729	$3,523,976	$20,184,872
4	46 - 61	Storage Facility	$6,794,422	$942,589	$1,522,669	$4,208,908	$10,983,215	$24,451,803
5	62 - 69	Reclaimed Pipelines	$3,104,606	$7,106,101	$7,414,401	$2,980,224	$1,000,000	$21,605,332
6	70 - 74	Groundwater	$2,019,816	$7,643,634	$18,528,908	$20,127,520	$1,209,935	$49,529,813
7	75 - 77	Security	$3,796,050	$10,109,000	$7,592,776	$326,295	$0	$21,824,121
8	78 - 87	Miscellaneous	$7,897,506	$7,800,000	$21,178,596	$29,023,958	$33,762,636	$99,662,696
9		Total	$177,623,629	$169,397,941	$141,789,273	$122,175,332	$113,407,814	$724,393,989

(a) Project Numbers coincide with the project numbers listed in Appendix A, Table A-1.

All project costs are divided between facility upgrades (including existing facility rehabilitation and replacement) and expansion of capacity for the benefit of new customers. Municipal utility facilities are built with capacity to serve a decade or more of projected demands, in order to reduce the overall unit cost of facilities to all customers. The City maintains a capital facility connection fee schedule for assessing new development with the cost of system-wide capacity so that "growth pays for itself" without burdening existing customers. However, the up-front expenditures on new facility construction always precedes the collection of connection fees, so the proposed bonds are sized to fund the total CIP expenditures. The anticipated connection fee proceeds of approximately $14 million per year will be used to offset future Water Department capital expenditures, including the expansion-related portion of debt service. As such, the connection fee proceeds are recognized as non-operating revenue to the operating fund, and can be used for debt service and/or transferred to the capital program for "pay-go" project expenditures.

Detailed water system analyses are conducted periodically to identify and prioritize needed capital improvements. As a result, the finalized CIP schedule for FY 09 - 13 may differ slightly from Table 4-1 shown above for individual projects, but the overall difference in average annual CIP expenditures will be immaterial.

Some of the projects shown in Table 4-1 started before FY 09, and some projects will extend beyond FY 14. The proposed five-year CIP for FY 09 - 13 is $724 million, including $280 million for various pipeline projects to rehabilitate, replace, and expand distribution and transmission lines throughout the water system, and $207 million for water treatment plant projects. Based on Water Department planning practices, approximately 80 percent of the expenditures will be bond funded, with the remaining 20 percent funded from annual revenues on a pay-as-you-go (pay-go) basis. However, depending on the cash available after net operating revenues, the City may in the future apply additional cash to project funding, which would alter this mix.

CIP Financing Plan

Table 4-2 presents the flow of funds of the proposed capital financing plan, and summarizes the projected sources and uses of funds over the study period. This plan anticipates that proposed capital improvements will be financed from a combination of revenue bond proceeds, grants, transfers from net operating revenues, and interest income from the capital monies.

Table 4-2, line 19 provides an estimated beginning FY 09 balance of approximately $170 million. A policy-based reserve target exists for capital emergencies of $5 million, with the remaining funds available for capital project expenditures.

Table 4-2
Capital Project Sources and Uses, Flow of Funds

Line No	Description	2009 ($000s)	2010 ($000s)	2011 ($000s)	2012 ($000s)	2013 ($000s)
		Fiscal Year Ending June 30				
1	**Sources of Funds**					
2	New Bond Issues	400,435	0	123,535	205,765	0
3	Interest Earnings on Capital monies	4,638	4,067	2,489	4,827	5,042
4	Grant Receipts	8,000				
5	Policy-based Transfers in from Net Op Revs (a)	35,525	33,880	28,358	24,435	22,682
6	Total Source of Funds	448,598	37,946	154,382	235,027	27,724
7	**Use of Funds**					
8	Capital Improvement Program Project Expenditures	177,624	169,398	141,789	122,175	113,408
9	Transfer to Debt Service Reserve Fund (DSRF) (b)	29,091	0	8,975	14,949	0
10	Bond Issuance Costs	3,392	0	1,018	1,429	0
11	Capitalized Interest Cost for Deferred Debt Service	0				
12	Retire/Defease Existing Notes from Bond Proceeds (c)	207,000				
13	Total Use of Funds	417,106	169,398	151,782	138,553	113,408
14	**Net Sources and Uses of Funds**	31,492	(131,452)	2,601	96,474	(85,684)
15	**Cash Balance Detail**					
16	Beginning Fiscal Year Cash Balance					
17	Const Fund Balance (incld unrestricted funds, d)	164,786	196,278	64,826	67,427	163,901
18	Capital Emergency Reserve (set by City policy)	5,000	5,000	5,000	5,000	5,000
19	Total Beginning Balance	169,786	201,278	69,826	72,427	168,901
20	Net Sources and Uses of Funds	31,492	(131,452)	2,601	96,474	(85,684)
21	Ending Balance	201,278	69,826	72,427	168,901	83,217
22	**Debt Service Reserve Fund Held by Bond Trustees (DSRF)**					
23	Beginning Balance	47,312	76,403	76,403	85,378	100,326
24	Ending Balance	76,403	76,403	85,378	100,326	100,326
25	**DSRF Interest Earnings**	1,546	2,292	2,831	3,714	4,013
26	Planned CIP Cash Funding Percentage (e)	20%	20%	20%	20%	20%

(a) Transfers in are 20 percent of CIP expenditures.
(b) The DSRF is held by the trustee and is listed separate from the capital program. The DSRF is equal to the minimum of 1) 10 percent of the proceeds, 2) 125 percent of the average annual debt service, or 3) maximum annual debt service. Assumes a 30 yr term at 6% interest. Interest from the DSRF is transferred to non-operating revenues.
(c) Two private placement notes will be retired/defeased during FY 09. The exact timing is not incorporated into this fiscal year level model, which coincides with the level of detail in the City's rate model.
(d) Per discussion with City staff, beginning FY 09.
(e) Funded with cash transfers from operating monies.
Note: Debt service detail is shown in Table 4-8, and is presumed to start in the year following the year of issuance.
Source: Future bond issues, grant receipts, and beginning fund balances from City rate model, 9/12/08.

Bond Financed Projects

Line 2 of Table 4-2 shows a total Series 2009 Bond issue of $400 million. This series will comprise two issues: A) to refund the 2007 Notes and B) to refund the 2008 Notes and help fund CIP expenditures. The total note refunding of $207 million is shown on Line 12. Not shown herein is, that if economically feasible, the Series 2009 A Bond issue may be increased to refund a portion of or all of the outstanding 1998 Bonds. Additional bonds are projected to be issued in FY 11 ($124 million) and FY 12 ($206 million).

We project that cash available from current net operating revenues will finance $145 million of the CIP projects, or 20 percent of the total CIP. The Water Department targets funding 20 percent of the CIP with pay-go, with reserves, interest earnings and grants. Interest earnings are based on an estimated 2.5 percent earnings rate on average fund balances in FY 09; growing to 4.0 percent by FY 12. Interest earnings come from capital fund balances and reserves.

4.2 Water Service Revenues

This subsection identifies the annual rate-based revenues based on the City Council approved water service rates and the projected customer demand levels.

Customer Service Charges

City customers are grouped into basic residential, other domestic, commercial/industrial, and irrigation/temporary construction, interruptible agricultural and other classifications. Customers are charged a monthly fee based on meter size and a unique water commodity charge. Residential customers have an inclining block tiered commodity rate schedule to promote conservation awareness, while a uniform commodity rate is used with the other customer classes. The average commodity rate charged to each classification is based on the unique costs of serving their peak water demands, which vary both seasonally and diurnally. Current and projected water rates are shown in Table 4-3.

Projected Rate Increases

The City Council has approved service rate increases of 6.5 percent in FY 10 and 11. Table 4-3 presents a summary of current and projected water rates incorporated into the financial projections. The unit rates in the table incorporate the CWA water supply purchase cost pass through adjustment and Indirect Potable Reuse (IPR) project temporary rate increase projected for FY 09. Based on City policy, the approved rates are updated semiannually by Council with CWA pass-through costs to reflect minor adjustments for actual versus projected water purchase costs imposed on the City by CWA. The IPR temporary rate increase expires at the end of FY 10 with the completion of the IPR study. As such, the funding of this pilot study for an alternative water supply is a temporary charge on the customer bills.

Unlike the unit rates for other customer classifications, the rates for interruptible agricultural customers are a function of MWD and CWA rate schedule policies, and are not projected to materially change. The Water Department updates its financial plan annually to determine if the projected level of revenues from proposed rate increases is appropriate for cashflow requirements and for meeting current and projected debt service coverage requirements.

Table 4-3
Current and Projected Rates and Charges

Line No	Description	2009 Actual	2010 Approved	2011 Approved	2012 Projection	2013 Projection
		Fiscal Year Ending June 30				
1	**Rate Increase (a)**	6.50%	6.50%	6.50%	0.00%	0.00%
2	**Meter Base Fee ($/month)**					
3	Less than 1 inch	$16.52	$17.59	$18.73	$18.73	$18.73
4	1 Inch	$24.20	$25.78	$27.45	$27.45	$27.45
5	1 1/2 Inch	$41.76	$44.47	$47.37	$47.37	$47.37
6	2 Inch	$63.72	$67.86	$72.27	$72.27	$72.27
7	3 Inch	$115.29	$122.79	$130.77	$130.77	$130.77
8	4 Inch	$188.83	$201.10	$214.17	$214.17	$214.17
9	6 Inch	$371.02	$395.14	$420.82	$420.82	$420.82
10	8 Inch	$590.52	$628.91	$669.79	$669.79	$669.79
11	10 Inch	$847.35	$902.43	$961.08	$961.08	$961.08
12	**Commodity Charge ($/HCF)**					
13	Single Family Domestic Customer					
14	1-7 HCF per month	$2.80	$2.98	$3.07	$3.07	$3.07
15	8-14 HCF per month	$3.03	$3.23	$3.33	$3.33	$3.33
16	15 + HCF per month	$3.40	$3.63	$3.74	$3.74	$3.74
17	Other Domestic Customers	$3.03	$3.23	$3.33	$3.33	$3.33
18	Commercial/Industrial	$2.91	$3.10	$3.20	$3.20	$3.20
19	Irrigation/Temporary Construction	$3.11	$3.31	$3.42	$3.42	$3.42
20	Interruptible Agricultural Rate	$1.55	$1.52	$1.49	$1.50	$1.52
21	Other Utilities - Cal-American	$1.95	$2.08	$2.21	$2.21	$2.21

(a) Rate increases include pass-through known and approved CWA water supply purchase costs and IPR rate adjustment that will go in effect mid-year FY 09. The rate increases do not include unknown future CWA supply costs that would increase the average bill. The IPR rate adjustment expires at the end of FY 10.
Rate increases through FY 2011 have been approved by the City Council.
CWA pass-through charges have always been approved by the City Council, in the past.

Source: City rate model, 9/12/08.
HCF = hundred cubic feet

As shown in Table 4-4, the Water Department has approximately 273,000 retail accounts, plus an additional 10,000 other water service customers included in rate-based revenue projections. These accounts serve approximately 1.3 million residents, as well as businesses and citywide institutions. Based on a projected annual population growth of approximately 1 percent, by FY 13 approximately 294,000 water accounts will be served by the City's Water Department.

Table 4-4
Projected Potable Water Accounts

Line No	Meter Size	Fiscal Year Ending June 30 2009	2010	2011	2012	2013
1	Less than 1 Inch	234,762	237,307	239,687	242,068	244,449
2	1 Inch	23,109	23,360	23,594	23,829	24,063
3	1 1/2 Inch	10,908	11,026	11,136	11,247	11,358
4	2 Inch	12,670	12,807	12,936	13,064	13,193
5	3 Inch	421	426	430	434	439
6	4 Inch	474	479	484	488	493
7	6 Inch	224	226	228	231	233
8	8 Inch	104	105	106	107	108
9	10 Inch	41	41	42	42	42
10	Total Meters	282,712	285,777	288,643	291,510	294,377
11	Annual Growth	1.1%	1.1%	1.0%	1.0%	1.0%

Source: City rate model, 9/12/08

Table 4-5 summarizes the potable water consumption as projected by the City. The FY 09 and FY 10 estimated demands include a 7.5 percent and a 15 percent, respectively, voluntary reduction in response to a Stage 1 Voluntary Compliance Water Watch declaration by the City Council in July 2008. In FY 11 water consumption is expected to return to historical levels and remain stable. Interruptible agricultural demand is based on 5-year historical average consumption, and construction demands on 3-year historical consumption. Irrigation is forecasted to increase based on population growth and previous year usage. While the projected residential water demands are a function of population, the values also incorporate conservation in water use and a long-term reduction in average per capita water consumption. As such, although customer accounts are projected to increase about 1 percent per year, total consumption is limited to annual increases of about 0.8 percent. As shown, total potable water demand, estimated at 210,000 AF in FY 09, will increase to 234,000 AF by FY 13. These projected demands are the basis for water supply purchases from CWA, and exclude the six percent of water demand served by local water supply sources.

Table 4-5
Projected Water Demand

Line No	Customer Classification	2009 MCF	2010 MCF	2011 MCF	2012 MCF	2013 MCF
		Fiscal Year Ending June 30				
1	Single Family Domestic	3,216	2,971	3,525	3,553	3,582
2	1-7 HCF	1,608	1,486	1,762	1,777	1,791
3	8-14 HCF	900	832	987	995	1,003
4	15 + HCF	708	654	775	782	788
5	Other Domestic	1,904	1,759	2,086	2,103	2,120
6	Commercial	2,050	1,894	2,247	2,265	2,283
7	Industrial	93	86	101	101	101
8	Outside City Services	2	1	2	2	2
9	Other Utilities - Cal-Am	574	530	629	634	639
10	Interruptable Agricultural	15	14	19	19	17
11	Irrigation	1,264	1,174	1,395	1,409	1,423
12	Construction Meters	25	23	26	26	26
13	Total, Potable Water Sales (MCF)	9,143	8,453	10,030	10,113	10,194
14	Total Potable Water Sales (AF)	209,889	194,049	230,251	232,167	234,027
15	Total Water Sales less Cal-Am (AF)	196,712	181,874	215,810	217,607	219,350
16	Annual Increase in Demand (b)		-7.5%	18.7%	0.8%	0.8%

(a) Demands are for potable water supplies.
(b) FY 2009 water demands reflect a 7.5% reduction and 2010 water demands reflect a 15% reduction due to water shortage related conservation measures.
Source: City rate model, 9/12/08, as revised per 12/09/08 City email regarding conservation rates.
MCF = Million Cubic Feet; AF = acre feet

Table 4-6 presents the projected water revenues for the City. The base monthly fee revenue is based on the monthly meter fee (Table 4-3) times the number of accounts (Table 4-4). Consumption revenues are dependent on the projected demand (Table 4-5) and the commodity charge (Table 4-3). Estimated revenues for fire services and back flow fees are also included in the table, while reclaimed water sale revenues are provided in the following sections. Total annual rate-based revenues are expected to grow from $328 million in FY 09 to $416 million in FY 13, based on the approved rate increases, adoption of the FY 09 CWA pass-through and IPR adjustments, and the projected customer demands. The significant increase in FY 11 represents the increased post-drought water demand and the unit rate increase. If the drought continues and reduced demand extends beyond FY 10, revenues will be lower than projected. However, this will be offset to an extent by lower water purchase costs from CWA.

Table 4-6
Current and Projected Revenues

Line No	Description	2009 ($000s)	2010 ($000s)	2011 ($000s)	2012 ($000s)	2013 ($000s)
		Fiscal Year Ending June 30				
	Meter Base Revenues					
1	Less than 1 Inch	46,246	50,089	53,880	54,415	54,950
2	1 Inch	6,665	7,226	7,773	7,850	7,927
3	1 1/2 Inch	5,423	5,885	6,330	6,393	6,456
4	2 Inch	9,607	10,429	11,218	11,330	11,441
5	3 Inch	578	627	675	682	688
6	4 Inch	1,064	1,155	1,243	1,255	1,268
7	6 Inch	987	1,073	1,154	1,165	1,177
8	8 Inch	727	790	850	858	867
9	10 Inch	411	447	480	485	490
10	Subtotal Base Fee Revenues	71,708	77,720	83,602	84,433	85,263
	Commodity Charge Revenues					
	Single Family Domestic Customer					
11	1-7 HCF	44,583	44,228	54,155	54,597	55,037
12	8-14 HCF	25,676	26,864	32,893	33,161	33,429
13	15 + HCF	22,652	23,696	29,016	29,253	29,488
14	Other Domestic Customers	54,283	56,794	69,539	70,106	70,671
15	Commercial/Industrial	58,613	61,310	75,024	75,610	76,194
16	Irrigation/Temporary Construction/Outside	37,660	39,608	48,533	49,027	49,497
17	Interruptible Agricultural Rate	219	215	290	287	266
18	Other Utilities - Cal-American	11,108	11,019	13,920	14,033	14,146
19	Subtotal Commodity Revenues	254,793	263,736	323,370	326,075	328,728
20	**Fire Service/Backflow Fees**	1,974	1,973	1,972	1,973	1,972
21	Total Rate-based Revenues (a)	328,475	343,429	408,943	412,480	415,964
22	Unit Rate Increase		6.5%	6.5%	0.0%	0.0%
23	Annual Account Growth		1.1%	1.0%	1.0%	1.0%
24	Annual Change in Water Demand (c)		-7.5%	18.7%	0.8%	0.8%
25	Annual Increase in Rate-based Revenues		4.6%	19.1%	0.9%	0.8%

(a) Revenues are based on unit rates times demand. FY 09 revenues reflect CWA and IPR rate adjustments starting mid-year. FY 09 total revenues reflect data from the City 12/09/08. FY 11 revenues reflect elimination of IPR rate adjustment. Unit rates are shown in Table 4-3. Revenues for reclaimed water are shown in Table 4-9.
(c) The increase in water demand in FY 11 represents the return to normal demand after the voluntary conservation-based reductions in FY 09 and FY 10.
Source: Fire service/backflow fees from City rate model, 9/12/08. All remaining values calculated.
HCF = Hundred cubic feet

4.3 Water Department Expenditures

The Water Department revenues must be sufficient to meet the annual expenditures of ongoing operations and the capital program. Expenditures are funded on a prioritized basis as follows (1) total system operation and maintenance expenses; (2) debt service (consisting of principal and interest payments); (3) expenditures for major capital improvements met directly from revenues; and (4) provision for adequate reserves. Projections of the cash requirements to meet these System expenditures for the period of FY 09 through FY 13 are developed in this section.

Operation and Maintenance Expense

Operation and maintenance expense includes water purchases, total annual salaries and wages of personnel, and the costs of fringe benefits, materials and services, outlays (routine capital expenses) and transfers. Since these costs are essential for daily operations of the Water Department, they are funded on a priority basis from operating revenues as they are incurred. A summary of total projected operation and maintenance expense for the period FY 09 through FY 13 is presented in Table 4-7. Wages, salaries and fringe benefits are expected to remain flat through FY 12 and then increase by four percent per year, based on regional economic and employment trends.

Table 4-7
Projected Operation and Maintenance Expense

Line No	Expenditure	Fiscal Year Ending June 30 2009 ($000s)	2010 ($000s)	2011 ($000s)	2012 ($000s)	2013 ($000s)
1	Water Supply Purchase Costs (a, b)	136,567	123,794	137,265	138,122	138,954
2	Salary & Wages	44,576	44,576	44,576	44,576	46,360
3	Fringe Benefits	23,621	23,621	23,621	23,621	24,566
4	Supply/Services/Other NPE	43,467	45,206	47,014	48,895	50,851
5	Outlay	857	891	927	964	1,003
6	Miscellaneous & Other (c)	28,397	42,632	39,277	39,918	39,393
7	Transfers to General Government Services	6,084	6,084	6,084	6,084	6,327
8	Total O&M	283,570	286,805	298,765	302,181	307,453

(a) Water supply costs are based on FY 09 supply rates including pass-through cost escalations times projected demand.
(b) FY 09 water purchase cost is per City email 12/09/08, the FY 09 and 10 water costs reflect the drought-induced (7.5% and 15%, respectively) conservation-oriented demand level; and FY 11 costs are based on a return to normal water demand levels.
(c) Includes IPR costs.
Source: City rate model, 9/12/08.

The Water Department purchases the majority of its water needs from CWA with the remainder coming from local sources. CWA provides both raw and treated water based on operational considerations and long-term planning to minimize costs through an optimum use of regional facilities.

Costs for materials and supplies and outlays are conservatively expected to increase by four percent per year. Miscellaneous costs include the impact of new facilities on O&M activities, management information system (MIS) services and energy/utility expenditures. Energy/utility costs are forecasted to increase eight percent per year. The operation and maintenance expense is projected to increase from about $284 million in FY 09 to $307 million in FY 13, as shown in Table 4-7.

Routine Capital Improvements

Expenditures for routine capital improvements include minor capitalized assets with short depreciation periods. These include items routinely acquired each year, such as vehicles and office equipment, and minor improvements or repairs. An allowance for construction and engineering costs to be expensed is also included in this category. Since the costs of these improvements are a continuing expense to be met each year, the Water Department appropriately finances these expenditures from current water revenues. As shown in Table 4-7, routine capital outlay is estimated to be $857,000 in FY 09, and escalate at 4 percent per year through the projection period.

Existing and Projected Debt Service

The Water Department's existing debt service schedule includes both senior and subordinate debt, as shown in Table 4-8. Bond assumptions and indices are also shown in Table 4-8. The Series 1998 bond issue was a senior debt issue. The Series 2002 Bonds, 2007 Notes, and 2008 Notes are subordinate lien issues as is the SRF Loan.

Table 4-8
Existing and Projected Debt Service Schedule and Assumptions

Line No	Description	2009 ($000s)	2010 ($000s)	2011 ($000s)	2012 ($000s)	2013 ($000s)
		Fiscal Year Ending June 30				
	Debt Service Schedule					
1	Existing Senior Debt	21,354	12,089	12,089	12,089	12,089
2	Existing Subordinate Debt	24,895	30,128	27,293	27,296	27,299
3	Existing Subordinate SRF Debt	1,376	1,376	1,376	1,376	1,376
4	Proposed New Senior Debt		29,091	29,091	38,066	53,014
5	Total Existing & Proposed Debt	47,625	72,684	69,849	78,827	93,779
	Bond Cost of Issuance & Insurance					
6	New Bond Issue Par Value	400,435	0	123,535	205,765	0
7	Bond Issuance Costs	3,392	0	1,018	1,429	0
8	New Debt Service Reserve Requirements	29,091	0	8,975	14,949	0
	Bond Assumptions and Indices					
9	Debt term (all years)	30				
10	Cost of issuance					
11	Discount (% of bond size)	0.50%	0.50%	0.50%	0.50%	0.50%
12	Fixed Cost of Issuance ($1,000)	1,389	400	400	400	400
13	Earnings on Fund Balance	2.5%	3.0%	3.5%	4.0%	4.0%
14	Bond Interest Rate (a)	6.0%	6.0%	6.0%	6.0%	6.0%

(a) The bond interest rate is based on a projected market rate for municipal revenue bonds. DSRF interest earnings are not shown herein. Bond debt repayment starts in the year following bond issuance.

Source of Existing Debt: City schedules.

It is anticipated that the sale of the Series 2009 Bonds and additional bonds in FY 11 and FY 12 will be necessary to finance capital projects; the Series 2009 Bonds will refinance and/or defease $207 million in existing notes, as well as finance CIP expenditures. As previously shown in Table 4-2, it is assumed that the Series 2009 Bonds will total some $400 million, and additional bonds will be issued amounting to $124 million in FY 11 and $206 million in FY12. The projected bond terms are for 30-years at a 6 percent interest rate, plus typical costs of issuance. As shown in Table 4-8, the projected costs associated with issuing new bonds include an underwriter discount and a fixed cost of issuance as well as deposits to the Debt Service Reserve Fund. Table 4-8 shows the projected debt service schedule for existing and proposed revenue bonds throughout the study period.

4.4 Water Enterprise Revenues and Expenditures Proforma

Table 4-9 presents a proforma cashflow statement for the Water Department's projected revenues and expenditures during the study period. System revenues must be at least sufficient to fund the annual costs of operation and maintenance expense, debt service costs on existing and proposed bonds and routine annual capital improvements while maintaining adequate operating reserve funds and complying with all revenue bond debt service coverage requirements.

Table 4-9 identifies that the Water Fund has a FY 09 beginning year balance of $204 million. This balance is associated with the operations, and is in addition to the capital monies previously identified in Table 4-2. The current reserves include:

Reserve Type	Amount	Notes
Operating	$19,936,000	Currently 50 days, increasing to 70 days by FY 10
Secondary Purchase	$7,132,000	6 percent of water purchase costs
SRF Loan	$1,376,000	Fixed
Rate Stabilization Fund	$20,500,000	Fixed

The Water Department has a policy of maintaining operation reserves equal to 45 days of O&M expenditures, excluding water purchase costs. The operating reserve policy is increasing to 70 days with the increase in rate-based revenues.

The rate stabilization fund was originally established by the Master Installment Purchase Agreement of August 1998, and a balance of such amounts as the City shall determine (currently $20.5 million) is maintained in the fund. Transfers to or from the Rate Stabilization fund are treated as operating expenditures or operating revenues, respectively, and these transfers are included in the Pledged Revenues in the calculations of bond coverage ratios. The balance is available and pledged to augment funds available for annual debt service on the existing and proposed bonds.

Table 4-9
Water Utility Flow of Funds and Debt Service Coverage

Line No	Description	2009 ($000s)	2010 ($000s)	2011 ($000s)	2012 ($000s)	2013 ($000s)
		Fiscal Year Ending June 30				
	Operating Revenues					
1	Water Service Rate-based Revenues (Proposed)	328,475	343,429	408,943	412,480	415,964
2	Reclaimed Water Service Revenues	7,876	8,304	9,472	10,307	11,148
3	Miscellaneous Service Charges	1,227	1,251	1,275	1,299	1,323
4	Other Operating Revenue (a)	19,245	19,611	19,984	20,363	20,750
5	Other Revenues	1,865	1,385	1,390	1,395	1,400
6	Total Operating Revenues	358,688	373,980	441,064	445,844	450,586
7	**Operating Expense**					
8	Water Purchase Costs	136,567	123,794	137,265	138,122	138,954
9	O&M Expenses	147,003	163,011	161,500	164,059	168,499
10	Total Operating Expense	283,570	286,805	298,765	302,181	307,453
11	**Net Operating Revenues**	75,118	87,175	142,299	143,664	143,133
12	**Non-Operating Revenues (Expenses) & Transfers**					
13	Interest Income on Operating funds	5,139	6,183	8,394	12,382	14,990
14	Interest Income on DSRF	1,546	2,292	2,831	3,714	4,013
15	Projected Debt	(47,625)	(72,684)	(69,849)	(78,827)	(93,779)
16	Capacity Fee Proceeds	3,869	9,512	13,510	14,139	14,066
17	Pay-go Transfers to Capital Programs	(35,525)	(33,880)	(28,358)	(24,435)	(22,682)
18	Net Non-operating Revenues & Transfers	(72,596)	(88,577)	(73,472)	(73,027)	(83,392)
19	**Annual Change in Cash Balance**	2,523	(1,402)	68,827	70,637	59,741
20	**Cash Balance Detail (b)**					
21	Beginning Fiscal Year Cash					
22	Operating Reserves	19,936	31,262	30,973	31,463	32,315
23	Secondary Supply (water purchase reserve)	7,132	7,428	8,236	8,287	8,337
24	Rate Stabilization Fund	20,500	20,500	20,500	20,500	20,500
25	Subordinate SRF Loan Reserve	1,376	1,376	1,376	1,376	1,376
26	Unrestricted Cash	155,338	146,239	144,319	212,604	282,339
27	Total Beginning Fiscal Year Cash Balance	204,283	206,805	205,403	274,230	344,867
28	Net Annual Change in Cash Balance	2,523	(1,402)	68,827	70,637	59,741
29	Ending Fiscal Year Balance	206,805	205,403	274,230	344,867	404,608
30	**Operating Reserve Target per City Policy**					
31	Operations @ 70 days O&M excld water purchase	28,192	31,262	30,973	31,463	32,315
32	Secondary Water Supply (c)	8,194	7,428	8,236	8,287	8,337
33	SRF Loan Reserve	1,376	1,376	1,376	1,376	1,376

(a) Other operating revenue includes land and building rentals, new water services, services rendered on other funds, other revenue, and lakes recreation.
(b) Cash balances do not include Capital monies; refer to Table 4-2.
(c) The Secondary Supply water reserve is set by City policy at 6 percent of the cost of water purchases.
Source: Operating revenue (except water sales), capacity fee proceeds (FY 11- FY 13), and beginning fund balances from City rate model, 9/12/08. Capacity fee proceeds in FY 09 and FY 10 are per 12/09/08 City email. All remaining values calculated.

Table 4-9 presents the projected water service revenues incorporating both the existing and proposed rates. The proposed rates are part of the Water Department's long range financial plan developed by the financial planning model used by the Water Department.

The table shows that projected revenues are more than sufficient to meet the total revenue requirements of the system during the study period. Water service revenues represent the most significant source of revenues, averaging approximately 92 percent of total revenue; other operating revenues include reclaimed water service charges, miscellaneous revenues and interest income. Also included in revenues are the proceeds from land and building rentals, new water services and lakes recreation. Total operating expenses include water purchase costs and O&M expense, previously projected in Table 4-7.

Non-operating revenues include interest earned on operating fund balances, and system capacity charges. Capacity charges are expected to range between $3.9 million and $14.2 million per year over the study period. These revenues represent impact fee exactions from new customers who benefit from capacity created from expansion projects.

The primary non-operating expense is debt service. As previously discussed, we have projected that the Series 2009 A and B Bonds are sized at $400 million, with additional bond issues of $124 million in FY 11 and $206 million in FY 12 to help finance major capital program expenditures and refinance and/or defease the Series 2007 and 2008 private placement notes. This debt financing provides a mechanism to spread the costs of major capital improvements over a portion of the useful life of the funded project and to more equitably recover the asset costs from both current and future users.

4.5 Debt Service Coverage

The single most important measurement of the ability of a utility to repay loans such as revenue bonds is the debt service coverage ratio. This ratio is defined in the bond covenant requirements of the current and proposed revenue bonds. Table 4-10 shows the coverage ratio on both the Senior and Aggregate bond debt service.

The City is required by the Installment Purchase Agreement to maintain 120 percent debt service coverage from pledged revenues on all existing and proposed senior lien debt**.** The senior debt service coverage test equals adjusted net revenues (which excludes interest earnings on reserve funds held by the bond trustees for parity obligations) divided by existing and proposed senior debt less the interest on the senior debt reserve fund. The aggregate debt service coverage equals the adjusted net revenues (including interest on the debt reserve fund) divided by the total existing and proposed debt.

Table 4-10 shows that senior debt service coverage is projected to meet or exceed 272 percent during the study period (FY 09 – FY 13). Aggregate debt service coverage is projected to meet or exceed 150 percent during the study period. These findings indicate that the Water Department has approved future customer service rates that will satisfy all debt service coverage requirements during the study period.

Table 4-10
Water Utility Debt Service Coverage

Line No	Description	2008 ($000s)	2009 ($000s)	2010 ($000s)	2011 ($000s)	2012 ($000s)	2013 ($000s)
		Fiscal Year Ending June 30					
1	Senior Debt Service Coverage						
2	Net Operating Revenues (a)	43,862	75,118	87,175	142,299	143,664	143,133
3	Interest Income on Operating Funds	8,268	5,139	6,183	8,394	12,382	14,990
4	Interest Income on Capital Monies (b)	2,465	5,187	4,725	3,257	5,704	5,920
5	Capacity Fee Proceeds	8,459	3,869	9,512	13,510	14,139	14,066
6	Total Adjusted Net System Revenues (c)	63,053	89,312	107,594	167,460	175,889	178,108
7	Projected Senior Debt Service	21,354	21,354	41,180	41,180	50,155	65,104
8	Senior DSRF Interest (d)	1,370	998	1,634	2,063	2,837	3,136
9	Adjusted Debt Service	19,984	20,356	39,546	39,117	47,318	61,968
10	Senior Debt Service Coverage (c)	316%	439%	272%	428%	372%	287%
11	Aggregate Debt Service Coverage						
12	Net Operating Revenues	43,862	75,118	87,175	142,299	143,664	143,133
13	Interest Income on Operating Funds	8,268	5,139	6,183	8,394	12,382	14,990
14	Interest Income on Capital Monies	1,922	4,638	4,067	2,489	4,827	5,042
15	Capacity Fee Proceeds	8,459	3,869	9,512	13,510	14,139	14,066
16	Debt Service Reserve Fund Interest	2,435	1,546	2,292	2,831	3,714	4,013
17	Total Net System Revenues	64,945	90,310	109,228	169,523	178,726	181,244
18	Projected Senior Debt Service	21,354	21,354	41,180	41,180	50,155	65,104
19	Projected Subordinate Debt Service	21,728	26,271	31,504	28,668	28,672	28,675
20	Aggregate Debt Service (e)	43,082	47,625	72,684	69,849	78,827	93,779
21	Aggregate Debt Coverage (f)	151%	190%	150%	243%	227%	193%

(a) FY 09 & FY 10 figures reflect an anticipated 7.5% and 15%, respectively water conservation. Thereafter, figures reflect pre-water conservation levels. Includes service charges and reclaimed water sales. Includes revenues generated by purchase water cost increases that were affected as a result of rate increases implemented by CWA. Reflects treated water purchases, which do not include unknown future rate increases due to potentially increasing CWA supply costs.
(b) Includes interest income on Subordinate DSRF.
(c) As defined in the Installment Purchase Agreement.
(d) Includes anticipated bond issuances subsequent to FY 09.
(e) Includes Senior obligations, Subordinated obligations, and SRF debt service without adjustment for DSRF earnings.
(f) Ratio of total Net System Revenues to Aggregate Debt Service.

4.6 Operating Reserves

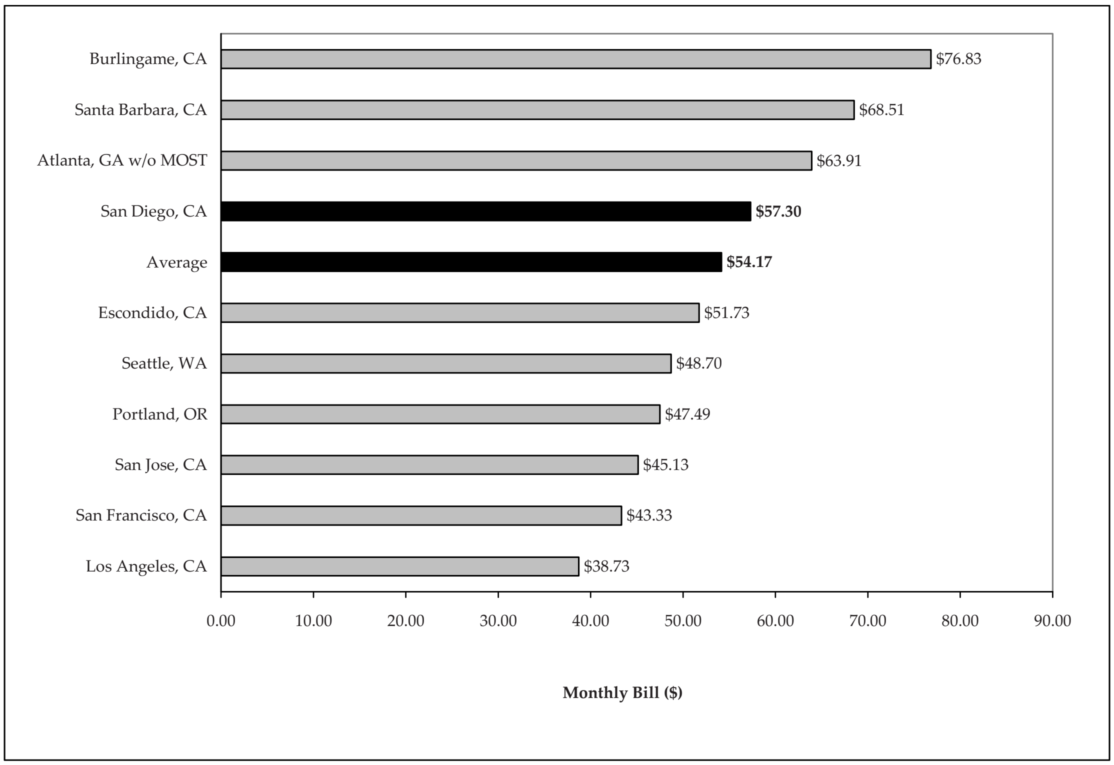
The Water Department currently maintains an operating reserve target equal to 45 days of O&M expenses, excluding water purchase costs. This target is scheduled to increase to 70 days with the increase in rate-based revenues. Currently, the water operating fund reserves equal 50 days of operating costs. The projected operating reserve will meet the 70 day target level by FY 10.

4.7 Affordability

A 2006 American Community Survey conducted by the US Census Bureau stated the median household income in San Diego County was almost $58,815. The typical monthly water bill of $57, based on January 1, 2009 effective rates, for an average single family residence represents 1.2 percent of this median household income. As such, the projected monthly bill is below the 2.0 percent median household income baseline used as a typical industry standard for affordability by the U.S. Environmental Protection Agency.

4.8 Water Bill Comparison

Figure 4-1 presents a comparison of typical water service bills for various water utilities. The comparison of water utilities represent either utilities serving high population cities or utilities serving large cities in California near or on the coast with imported supplies. The water bills are based on current rates (as of September 2008) assuming a water flow of 14 hundred cubic feet per month with a meter size of less than 1 inch. The monthly water bill for an average San Diego single family residential customer is estimated to be $57.30 per month, effective January 1, 2009.



(a) These bills are based on water use of 14 HCF per month and a meter size of less than 1 inch.

Figure 4-1
Comparison of Monthly Water Bills with Other Cities (a)

Section 5
Parity Obligation (Additional Bonds) Test

A condition for the issuance of the additional bonds projected in this analysis is a certification that the City complies with the Parity (or Subordinate) Obligations test, as provided in the Installment Purchase Agreement. As provided in the Agreement, the City is required to meet one of two Obligation tests. Both tests examine the coverage ratio of the Water Department's pledged revenues to the total existing and proposed bonded debt. The first test is a historical test, and is based on any 12 consecutive month period within the 18 consecutive months prior to the proposed bond issuance. The second (alternative) test is based on a five year forecast of the coverage ratio. The tests differ slightly for parity versus subordinated bonds.

As shown in Table 5-1 on the following page, the Water Department meets the historical coverage test.

The historical coverage test allows the Water Department to use data from any 12 month consecutive period within the 18 consecutive months ending immediately prior to the incurring of additional Parity Obligations. The Water Department can rely upon financial statements prepared by the City that have not been subject to audit by an independent certified public accountant if audited financial statements for the period are not available. The data used in the historical coverage test in Table 5-1 is derived from the unaudited financial statements of FY 08, which ended on June 30, 2008.

The historical coverage test requires that the Water Department demonstrate that during the 12-month period the Net System Revenues are 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 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.

All capitalized terms used in this Section 5 that are not otherwise defined herein have the meanings given such terms in the Installment Purchase Agreement.

Table 5-1
Historical Additional Bonds Test

Line No	Description	FY 2008 ($000s)
1	Operating Receipts	
2	Water Sales (a)	288,949
3	Other Services	9,564
4	Rentals	5,695
5	Other Revenue	2,992
6	Total Operating Receipts	307,200
7	Operating Expenditures	
8	Water Purchases	128,114
9	Operations and Maintenance	135,225
10	Total Operating Expenditures	263,339
11	Operating Income	43,862
12	Other Income	
13	Interest Earnings	12,625
14	Capacity Charges	8,459
15	Other Income (b)	2,746
16	Total Other Income	23,829
17	Net Income	67,691
18	Less: DSFR Earnings on Parity Obligations	1,370
19	Adjusted Net System Revenue	66,321
20	Maximum Annual Debt Service on all Parity Obligations	54,466
21	Test (c)	1.22

(a) Includes Service Charges and Reclaimed Water Sales
(b) Includes cancelled prior year encumbrances, recovered damages, land sales
(c) Ratio of Net System Revenue to Parity Obligations > = 1.20

Appendix A
Proposed Capital Improvement Plan Projects

Table A-1
Proposed Capital Improvement Plan Projects

Line #	PROJECT	PROJECT TYPE	Current Phase as of Sept. 2008	FY2009	FY2010	FY2011	FY2012	FY2013
1	Alvarado WTP Expansion Phase 2	Water Treatment Plant	close-out	$ 260,000	$ -	$ -	$ -	$ -
2	Alvarado WTP-SD12	Water Treatment Plant	planning	$ -	$ 119,444	$ 184,632	$ 221,311	$ 2,521,848
3	Alvarado WTP-Ozone Improv	Water Treatment Plant	construction	$ 21,981,620	$ 23,453,520	$ 9,790,666	$ 314,072	$ -
4	Alvarado WTP Rehab Floc/Sed Basin Ph3	Water Treatment Plant	design	$ 3,387,234	$ 21,622,888	$ 5,296,723	$ -	$ -
5	Miramar WTP SDFCF 24, 25, 26	Water Treatment Plant	planning	$ 463,865	$ 1,137,841	$ 3,618,022	$ 100,143	$ 12,326
6	Miramar WTP Contract B - Floc/Sed Basin	Water Treatment Plant	construction	$ 33,574,060	$ 14,954,826	$ -	$ -	$ -
7	Miramar WTP Contract D - Landscape & Site Impr	Water Treatment Plant	design	$ 75,679	$ 21,322	$ 3,868,217	$ 826,341	$ 501
8	Miramar WTP Contract C - Ozone Equip/Install	Water Treatment Plant	construction	$ 14,679,265	$ 9,841,329	$ -	$ -	$ -
9	Otay WTP Upgrade Phase 1 (Flocc/Sed Basin & Reh)	Water Treatment Plant	construction	$ 7,949,200	$ 7,978,478	$ 5,664,644	$ 171,099	$ -
10	Otay WTP Upgrade Phase 2	Water Treatment Plant	construction	$ 4,385,097	$ 4,751,556	$ 2,887,505	$ 6,423	$ -
11	Otay WTP Upgrade Phase 3	Water Treatment Plant	planning	$ -	$ -	$ -	$ -	$ 1,251,452
12	Miramar Clearwell Improvements	Water Treatment Plant	planning	$ -	$ -	$ -	$ -	$ 118,934
				$ 86,756,020	**$ 83,881,204**	**$ 31,310,409**	**$ 1,639,389**	**$ 3,905,061**
13	AA - Freeway Relocations	Pipelines	various	$ 35,569	$ 50,000	$ 50,000	$ 50,000	$ 50,000
14	AA - Water Main Replacements	Pipelines	various	$ 36,630,050	$ 43,264,000	$ 44,994,560	$ 46,794,344	$ 48,666,116
15	Miramar Pipeline Monitoring	Pipelines	planning	$ 67,576	$ 578,261	$ 649,106	$ 200,152	$ -
16	Torrey Pines Rd/La Jolla Blvd - Phase 2	Pipelines	completed	$ 14,695	$ -	$ -	$ -	$ -
17	La Jolla Shores Dr. 16" Water Main Repl.	Pipelines	planning	$ -	$ -	$ 259,158	$ 1,432,365	$ 518,077
18	Harbor Drive Pipeline	Pipelines	planning	$ 168,179	$ 254,395	$ 2,621,371	$ 6,500,955	$ 123,905
19	El Capitan Pipeline No. 2	Pipelines	planning	$ -	$ -	$ 1,049,917	$ 1,407,332	$ 1,975,936
20	El Monte Pipeline No. 2	Pipelines	planning	$ -	$ -	$ 2,449,693	$ 2,889,454	$ 4,943,735
21	Kearny Mesa Pipeline Upgrade	Pipelines	planning	$ -	$ -	$ 1,111,866	$ 1,308,380	$ 2,247,061
22	Caltrans Relocation Miramar	Pipelines	Construction	$ 568,000	$ 7,664	$ 333	$ -	$ -
23	CALTRANS-W.Bernardo Dr-I1	Pipelines	Close-out	$ 364	$ -	$ -	$ -	$ -
24	SR125 - Toll Road	Pipelines	Close-out	$ 56,678	$ -	$ -	$ -	$ -
25	CALTRANS - I905	Pipelines	Design	$ 9,765	$ 2,791	$ -	$ -	$ -
26	CALTRANS-El Monte-RTE 67	Pipelines	Construction	$ 42,872	$ 41,311	$ 4,198	$ -	$ -
27	Caltrans Carroll Canyon and I-15 Potable Water	Pipelines	Construction	$ 1,071,565	$ 3,742	$ -	$ -	$ -
28	Caltrans Carroll Canyon and I-15 Reclaimed Water	Pipelines	Construction	$ 1,868,025	$ 2,850	$ -	$ -	$ -
29	Pomerado Pipeline No. 2	Pipelines	planning	$ -	$ 11,669	$ -	$ -	$ -
30	Otay 2nd Pipeline - Isolate Service Sweetwater	Pipelines	planning	$ -	$ -	$ 99,716	$ 269,350	$ 453,352
31	Otay 2nd Pipeline - Cathodic Protect Otay Ranch	Pipelines	planning	$ -	$ -	$ -	$ 24,377	$ 40,231
32	Otay 2nd Pipeline - Cast Iron Replacement Phase	Pipelines	construction	$ 8,367,217	$ 2,782,752	$ -	$ -	$ -
33	Otay 2nd Pipeline - North Encanto Replacement	Pipelines	construction	$ 4,523,186	$ 523,098	$ -	$ -	$ -
34	Lindbergh Field 16in Cast Iron Replacement	Pipelines	planning	$ -	$ 107,061	$ 120,221	$ 553,600	$ 4,578
35	La Jolla/Pacific Beach-WTR	Pipelines	planning	$ 2,427	$ -	$ -	$ -	$ -
36	Fault Crossing Retrofits to Large Pipelines	Pipelines	design/construction	$ 1,413,234	$ 211,865	$ -	$ -	$ -
37	Landslide/Liquefaction Pipeline Mitigation	Pipelines	design/construction	$ 2,865,807	$ 233,162	$ -	$ -	$ -
				$ 57,705,209	**$ 48,074,621**	**$ 53,410,139**	**$ 61,430,309**	**$ 59,022,991**

Table A-1
Proposed Capital Improvement Plan Projects

Line #	PROJECT	PROJECT TYPE	Current Phase as of Sept. 2008	FY2009	FY2010	FY2011	FY2012	FY2013
38	AA - Water Pump Station Rehabilitations	Pump Station	various	$ -	$ -	$ 500,004	$ 500,004	$ 500,000
39	Tierrasanta (Via Dominique) Pump Station	Pump Station	planning	$ -	$ 90,346	$ 126,684	$ 132,365	$ 573,278
40	Soledad Pump Station Upgrade	Pump Station	planning	$ -	$ -	$ -	$ -	$ 101,911
41	Scripps Miramar Pump Station Upgrade	Pump Station	planning	$ -	$ -	$ 204,687	$ 108,476	$ 238,653
42	Tierrasanta Norte Water Pump Station	Pump Station	planning	$ -	$ -	$ -	$ 18,620	$ 36,396
43	Rancho Penasquitos Pump Station	Pump Station	construction	$ 9,550,000	$ 3,750,446	$ -	$ -	$ -
44	Serra Mesa Pump Station	Pump Station	planning	$ -	$ -	$ -	$ 115,848	$ 374,620
45	Parkland Pump Station	Pump Station	planning	$ -	$ -	$ -	$ 1,563,416	$ 1,699,118
				$ 9,550,000	**$ 3,840,792**	**$ 831,375**	**$ 2,438,729**	**$ 3,523,976**
46	AA - Standpipes and Reservoirs	Storage Facility	various	$ -	$ -	$ 500,004	$ 500,004	$ 500,000
47	AA - Dams and Reservoirs	Storage Facility	various	$ 146,847	$ 250,000	$ 250,000	$ 250,000	$ 250,000
48	Barrett Reservoir Outlet Tower Upgrade	Storage Facility	construction	$ 1,639,374	$ 3,333	$ -	$ -	$ -
49	El Capitan Reservoir Rd Improvements	Storage Facility	planning	$ -	$ -	$ -	$ 23,153	$ 3,327,049
50	Morena Reservoir Outlet Tower Upgrade	Storage Facility	planning	$ -	$ -	$ -	$ 1,013,343	$ 2,334,035
51	Rancho Bernardo Reservoir Upgrade	Storage Facility	construction	$ 4,461,387	$ -	$ -	$ -	$ -
52	Lower Otay Reservoir - Emergency Outlet Improvmt	Storage Facility	design	$ 447,628	$ 160,292	$ 589,037	$ 1,876,898	$ 1,894,959
53	Pomerado Park Reservoir Upgrade	Storage Facility	planning	$ -	$ -	$ 64,896	$ 167,044	$ 682,869
54	Paradise Mesa Standpipe Rehabilitation	Storage Facility	planning	$ -	$ -	$ -	$ -	$ 195,674
55	La Jolla View Reservoir	Storage Facility	planning	$ -	$ -	$ -	$ 101,064	$ 467,763
56	La Jolla Exchange Place Reservoir	Storage Facility	planning	$ -	$ -	$ -	$ -	$ 1,742
57	La Jolla Country Club Reservoir Seismic Upgrade	Storage Facility	planning	$ -	$ -	$ -	$ 149,185	$ 245,005
58	Murray Outlet Tower	Storage Facility	planning	$ -	$ -	$ -	$ 10,332	$ 148,029
59	San Carlos Reservoir Interior Enhancement	Storage Facility	planning	$ -	$ 493,575	$ 43,707	$ -	$ -
60	Lake Hodges Dam Modification	Storage Facility	planning	$ 99,186	$ 35,389	$ 75,025	$ 40,410	$ 483,557
61	Morena Dam Grotto	Storage Facility	planning	$ -	$ -	$ -	$ 77,475	$ 452,533
				$ 6,794,422	**$ 942,589**	**$ 1,522,669**	**$ 4,208,908**	**$ 10,983,215**
62	AA - Pooled Contingencies - RWDS	Reclaimed Pipelines	various	$ 250,000	$ 500,000	$ 500,000	$ 500,000	$ 500,000
63	AA - Reclaimed Water Extension	Reclaimed Pipelines	various	$ 1,000,000	$ 500,000	$ 500,000	$ 500,000	$ 500,000
64	Black Mountain Ranch Reclaimed Water Storage Tank	Reclaimed Pipelines	completed	$ 2,500	$ -	$ -	$ -	$ -
65	Carmel Valley Reclaimed Water Pipeline	Reclaimed Pipelines	design	$ 100,000	$ 1,096,060	$ 4,566,017	$ 1,872,039	$ -
66	Los Penasquitos Canyon RW Project	Reclaimed Pipelines	design	$ 140,000	$ 3,270,969	$ 973,308	$ 108,185	$ -
67	Pacific Highlands RWP - Participation Agreement	Reclaimed Pipelines	design	$ 1,023,508	$ 137,953	$ -	$ -	$ -
68	Camino Del Sur RWP - E&CP	Reclaimed Pipelines	design	$ 166,506	$ 631,509	$ 483,707	$ -	$ -
69	Camino del Sur Recycled Water P/L- Part Agmt	Reclaimed Pipelines	design	$ 422,092	$ 969,610	$ 391,369	$ -	$ -
				$ 3,104,606	**$ 7,106,101**	**$ 7,414,401**	**$ 2,980,224**	**$ 1,000,000**
70	Mission Valley Groundwater Desalination	Groundwater	planning	$ -	$ -	$ -	$ 1,020,814	$ 885,349
71	San Pasqual Brackish Groundwater Desalination Demo	Groundwater	design	$ 1,193,982	$ 1,463,612	$ -	$ -	$ -
72	San Pasqual Brackish Desalination	Groundwater	planning	$ -	$ 5,181,976	$ 18,352,782	$ 19,106,706	$ 74,129
73	San Diego Formation Desalination	Groundwater	planning	$ -	$ -	$ -	$ -	$ 250,457
74	Groundwater Pilot Production Wells	Groundwater	planning	$ 825,834	$ 998,046	$ 176,126	$ -	$ -
				$ 2,019,816	**$ 7,643,634**	**$ 18,528,908**	**$ 20,127,520**	**$ 1,209,935**

Table A-1 Proposed Capital Improvement Plan Projects													
Line #	**PROJECT**	**PROJECT TYPE**	**Current Phase as of Sept. 2008**		**FY2009**		**FY2010**		**FY2011**		**FY2012**		**FY2013**
75	SD 17 Flow Control Facility (Alvarado)	Security	design	$	3,180,180	$	9,602,958	$	5,674,242	$	230,042	$	-
76	Water Dept. Security Upgrades	Security	design	$	535,400	$	506,042	$	1,918,534	$	96,253	$	-
77	Water Dept. Security Upgrades - Miramar	Security	design	$	80,470	$	-	$	-	$	-	$	-
				$	**3,796,050**	**$**	**10,109,000**	**$**	**7,592,776**	**$**	**326,295**	**$**	**-**
78	AA - Corrosion Control	Miscellaneous	various	$	-	$	100,000	$	100,000	$	100,000	$	100,000
79	AA - Pooled Contingencies - Water	Miscellaneous	various	$	7,000,000	$	7,000,000	$	7,000,000	$	7,000,000	$	7,000,000
80	AA - Meter Boxes	Miscellaneous	various	$	500,000	$	500,000	$	500,000	$	500,000	$	500,000
81	AA-Pressure Reducing Stations	Miscellaneous	various	$	200,000	$	200,000	$	500,000	$	1,000,000	$	1,000,000
82	Miramar Service Area Improvements	Miscellaneous	planning	$	-	$	-	$	3,000,000	$	10,000,000	$	10,000,000
83	Alvarado Service Area Improvements	Miscellaneous	planning	$	-	$	-	$	10,000,000	$	10,000,000	$	10,000,000
84	Otay Service Area Improvements	Miscellaneous	planning	$	-	$	-	$	-	$	-	$	5,000,000
85	Kensington Pressure Regulator	Miscellaneous	planning	$	-	$	-	$	-	$	329,788	$	7,977
86	Alvarado Water Quality Lab Roof Replacement	Miscellaneous	close-out	$	197,506	$	-	$	-	$	-	$	-
87	Barrett Flume Cover	Miscellaneous	planning	$	-	$	-	$	78,596	$	94,170	$	154,659
				$	**7,897,506**	**$**	**7,800,000**	**$**	**21,178,596**	**$**	**29,023,958**	**$**	**33,762,636**
				$	**177,623,629**	**$**	**169,397,941**	**$**	**141,789,273**	**$**	**122,175,332**	**$**	**113,407,814**

Table A-2 Capital Improvement Plan Project Descriptions			
	CIP Project	**Project Type**	**Description**
1	Alvarado WTP Expansion Phase 2	Water Treatment Plants	This CIP item closes out the expansion phase of the Alvarado Water Treatment Plant project. The plan is to upgrade and expand the Alvarado WTP to its ultimate capacity of 200 mgd to meet the 2015 water demands in several phases. The first phase increased the capacity of the WTP to 150. Phase 2 increases the capacity to 200 mgd by providing additional flocculation and sedimentation basins and new controls for the original eight gravity filters.
2	Alvarado WTP SD12	Water Treatment Plants	Upgrade & expansion of CWA's flow control facility to 150 mgd. Another 50 mgd will be provided from San Vicente through El Monte pipeline and Lake Murray Reservoir to provide 200 mgd total plant capacity. Two (size to be determined) Pressure Sustaining Valves would be installed and used with two existing 16-inch Pressure Sustaining Valves within the existing Meter and Pressure Control Structure.
3	Alvarado WTP-Ozone Improv Ph 4 Ozone	Water Treatment Plants	Construction of ozone disinfection and pumping facilities to meet new Federal Safe Drinking Water requirements and State of California Department of Health Services compliance order, and the associated process changes to make ozone the primary water disinfectant and chlorine secondary.
4	Alvarado WTP Rehab Floc/Sed Basins Ph 3	Water Treatment Plants	This project consists of rehabilitation of Flocculation/Sedimentation Basins 1 & 2, as well as installation of Ozone pipeline from Ozone Building through the exiting basins to the existing filter.
5	Miramar WTP SDFCF 24, 25, 26	Water Treatment Plants	In order to meet capacity of the Miramar WTP Upgrade and Expansion (MWTP) project from 140 MGD to 215 MGD, it is necessary to upgrade CWA's existing flow control facility (5A/5B/5C) to increase capacity of raw water to MWTP.
6	Miramar WTP Contract B - Floc/Sed Basin	Water Treatment Plants	This project will expand the plant capacity from 140 mgd to 215 mgd to meet water demands through 2030. The construction scope of work will involve: Construction of 4 new Flocculation and Sedimentation basins 5, 6, 7 and 8 inclusive of associated piping - Demolition of the twelve existing filters - Demolition of the existing backwash water tank and associated piping - Demolition of the existing Flocculation and Sedimentation basins - Construction of 60 inch influent pipelines to New Flocculation Basins - Construction of 108 inch & 120 inch settled water pipelines
7	Miramar WTP Contract D - Landscape & Site Improvement	Water Treatment Plants	This project consists of final Water Treatment Plant site landscaping, irrigation, parking, paving and new Guard Shack and site entrance.

Table A-2 Capital Improvement Plan Project Descriptions			
	CIP Project	**Project Type**	**Description**
8	Miramar WTP Contract C - Ozone Equip/Install	Water Treatment Plants	This project consists of installation of Ozone equipment and Liquid Oxygen delivery and storage facilities. Three Ozone generators will be provided to generate ozone for supply and distribution of ozonated feed gas to four ozone contactors. Once this project is completed, ozone will replace chlorine as the primary disinfectant.
9	Otay WTP Upgrade Phase 1	Water Treatment Plants	The Otay WTP Upgrades Phase 1 project will construct a new flocculation and sedimentation basin and make improvements to the sixteen existing filters. The filters improvements include granular activated carbon (GAC) filtration media and providing a pumped backwash system, a filter to waste system, replacing the filter under drains and increasing the media depth.
10	Otay WTP Upgrade Phase 2	Water Treatment Plants	The Phase 2 upgrades to the Otay WTP include construction of a chlorine dioxide shaft contactor, ClO_2 generation system, sodium chlorite tank, ferrous chloride ($FeCl_2$) tanks and feed system, powder activated carbon (PAC) facilities, reservoir circulator units, yard piping, electrical support facilities, instrumentation and controls systems, and associated site work.
11	Otay WTP Upgrade Phase 3	Water Treatment Plants	The Otay WTP upgrades Phase 3 project will construct four new filters; rehabilitate the two existing flocculation and sedimentation basins by adding plate settlers, launders and a new sludge collection system; provide an additional ultraviolet disinfection system reactor; and construct the seismic improvements identified in the Seismic Vulnerability Assessment.
12	Miramar Clearwell Improvements	Water Treatment Plants	The project is based on the rehabilitation of the clearwell roof to address structural issues and upgrade overflow to pass the total flow from the plant (current overflows will only pass approximately 40 mgs before the water surface in the clearwells reaches the underside of the roof supports). The other option for this project would be to demolish the existing clearwells and construct new ones which require $30 million. We also want to evaluate the need to add clearwell storage. Roof and related: $6,500,000.
13	AA - Freeway Relocations	Pipelines	This project provides for relocation of water lines in conflict with California Department of Transportation highway construction program.
14	AA-Water Main Replacements	Pipelines	This project replaces aged cast iron water mains

Table A-2 Capital Improvement Plan Project Descriptions			
	CIP Project	**Project Type**	**Description**
15	Miramar Pipeline Monitoring	Pipelines	The condition of the Miramar Pipeline was originally assessed in 2005 under the Miramar Pipeline Rehabilitation Project (Phases III and IV), using an inspection technology known as the Remote Field Eddy Current/ Transformer Coupling (RFEC/TC) to identify and locate pre-stressing wire failures in the pipe wall. Miramar Pipeline Monitoring Project was created based on the results of the Miramar Pipeline Rehabilitation Project (phases III and IV), which recommended that the city perform RFEC/TC inspection of phases III and IV within approximately 5 years of the original inspection performed in early 2005. The Miramar Pipeline Monitoring project is scheduled to begin FY2009. Phase III will consist of inspecting approximately 17, 000 feet of 51-inch and 54-inch pipe along Mira Mesa Boulevard from Pacific Heights Blvd eastward to Westonhill Drive. While phase IV will consist of inspecting approximately 12,000 feet of pipe eastward from the intersection of Westonhill Drive and Mira Mesa Blvd to the Miramar Water Treatment Plant. Pipe diameters in this section range from 60 inches to 66-inches.
16	Torrey Pines Rd/La Jolla Blvd.-Phase 2	Pipelines	Replace ± 31,900 linear feet of 16-inch diameter Cast Iron Water Main. The construction will be done in multiple phases and at times to minimize the construction impact on the area, and in compliance with restrictions relating to when construction can be done in this area. Phase 2 replaces ± 21,200 linear feet of 16-inch Cast Iron Water Main in the La Jolla and Pacific Beach Area. The construction will be divided into three segments. Segment A starts from the intersection of Torrey Pines Road and Exchange Place and travels west on Torrey Pines Road, then turns south on Girard Avenue to Pearl Street (approximately 2,434 feet). Segment B continues from Girard Avenue on Pear Street, heads southwest to Fay Avenue to Westbourne Street, and back to La Jolla Blvd, then terminates at Mesa Way (approximately 6,936 feet).
17	La Jolla Shores Dr. 16" Water Main Repl.	Pipelines	This project is the 3rd phases of the Torrey Pines Blvd Pipeline. It proposes to replace ± 4,410 linear feet of 16-inch Cast Iron Water Main along La Jolla Shores Dr in the La Jolla Area.
18	Harbor Drive Pipeline	Pipelines	This project replaces the remaining portions of 16-inch cast iron water main located along Harbor Drive from Point Loma to San Diego Bay.
19	El Capitan Pipeline No. 2	Pipelines	Hydraulic analysis to determine if the size is adequate to meet the demandsCondition assessment with internal and external inspectionBased on the findings of the Condition assessment, if sections need to be replaced we will either parallel or replace in place

Table A-2
Capital Improvement Plan Project Descriptions

	CIP Project	Project Type	Description
20	El Monte Pipeline No. 2	Pipelines	This project would build a new 60-inch pipeline with capacity of 150 mgd between the Lakeside Pump Station and the Alvarado WTP.
21	Kearny Mesa Pipeline Upgrade	Pipelines	Replacement of the Kearny Mesa Pipeline. The existing pipeline was constructed in 1950 and has reached its useful service life. This is an upgrade and replacement of the 36-inch pipeline and will create interconnect for redundancy.
22	Caltrans Relocation Miramar	Pipelines	Caltrans is expanding the bridge crossing at Carroll Canyon and I-15, water lines on the bridge will need replaced with construction, pipeline will be relocated to Maya Linda.
23	CalTrans-W.Bernardo Dr-I1	Pipelines	The State of California (Caltrans) is demolishing and replacing the Highland Valley Rd (West Bernardo Drive) bridge to accommodate a four lane High Occupancy Vehicle Road. The City owns and maintains a 12-inch water main under the bridge. Caltrans will remove and replace the water main as part of its construction contract at City's expense.
24	CalTrans SR125 - Toll Road	Pipelines	Caltrans is constructing a portion of SR125 in San Diego County from SR905 to SR54. Construction of the highway requires the relocation of a portion of the Otay II and III potable water lines. Since the City has prior rights, Caltrans is required to relocate the lines at its expense. Pipelines will be relocated in the same aligned but further below the surface and will be upsized to 54".
25	CALTRANS - I905	Pipelines	Caltrans will relocate the existing 24 inch steel pipe crossing I-905 to Airway Rd. and connect back to Caliente Blvd.
26	CalTrans-EL Monte-Rte 67	Pipelines	Caltrans will be extending State Route 52 east from State Route 125 to State Route 67 in the City of Santee. The Water Department has an existing 68-inch pipeline known as the El Monte Pipeline that will require protection near Magnolia Avenue to facilitate work being constructed by Caltrans.
27	Caltrans Carroll Canyon and I-15 Potable Water	Pipelines	Caltrans is expanding the bridge crossing at Carroll Canyon and I-15, potable water lines on the bridge will need replaced with construction
28	Caltrans Carroll Canyon and I-15 Reclaimed Water	Pipelines	Caltrans is expanding the bridge crossing at Carroll Canyon and I-15, reclaimed water lines on the bridge will need replaced with construction
29	Pomerado Pipeline No. 2	Pipelines	This project provides for negotiating an agreement with the San Diego County Water for the disposition of the City's share of the Pomerado Pipeline.
30	Otay 2nd Pipeline - Isolate Service Sweetwater	Pipelines	Transfer 33 residential services for the Otay 2nd pipeline to the Sweetwater Authority. Project will involve construction of a small pump station to boost pressure from Sweetwater Authority.

Table A-2 Capital Improvement Plan Project Descriptions			
	CIP Project	**Project Type**	**Description**
31	Otay 2nd Pipeline - Cathodic Protect Otay Ranch	Pipelines	17,000 feet of existing pipeline between the South San Diego Reservoir and Olympic Parkway require installation of cathodic protection.
32	Otay 2nd Pipeline - Cast Iron Replacement Phase	Pipelines	This project includes the installation of approximately 1.3 miles of new 42-inch welded steel pipe in 54th Street between El Cajon Blvd and Chollas Station Road which will provide a means to bypass 3.5 miles of the 36-inch cast iron pipeline, located west of 54th Street, abandonment of 1200 feet of existing 36-inch cast iron pipe. This segment includes flow meters, pressure control valves, and connections to the Trojan, Otay I and II and Mid City Pipelines. Also, this project consists of replacement of approximately 3000 feet of existing cast iron pipe in 54th Street with new 16-inch PVC distribution pipelines that will maintain the City's reliable source of potable water.
33	Otay 2nd Pipeline - North Encanto Replacement	Pipelines	The North Encanto Replacement is one of the City of San Diego's most important treated water transmission mains because of its ability to move water between the Alvarado and Otay services, providing great operational flexibility and system reliability. It is also one of the City's oldest pipelines with sections of 36-inch diameter cast iron pipe that are more than 75 years old. The City has received a very good service life out of this pipeline but it is undoubtedly deteriorated due to age and corrosion. To provide the reliability needed in the City's water distribution system, the City has decided to replace approximately 7,000 feet of deteriorated or inaccessible pipe between State Route 94 and the 65th and Herrick Pump Station. The project alignment extends from the intersection of Tooley and 60th Streets, traversing south along 60th Street to Brooklyn Avenue, where it turns eastward and extends along Brooklyn Avenue to Otay Street, turning southeast and extending along Otay Street to the intersection of Herrick and 65th Streets.
34	Lindbergh Field 16in Cast Iron Replacement	Pipelines	This water main must be relocated from underneath the tarmac (landing strip) at Lindbergh Field to a location that is more accessible for operation and maintenance.
35	La Jolla/Pacific Beach - WTR	Pipelines	The installation of approximately 5595 linear feet of 16-inch Water Main Replacement between Camino de la Costa and Tourmaline Street along La Jolla BlvdThis project replaces old and deteriorated 16-inch cast iron mains.
36	Fault Crossing Retrofits to Large Pipelines	Pipelines	There are six large diameter pipelines that cross the Rose Canyon Fault that have been determined vulnerable. It is recommended to retrofit the pipelines using new fault tolerant pipelines and/or install manual isolation valves on either side of the fault. Currently, WD/CIP pursue the pipeline installation of valves and manifolds per FEMA grant for five pipelines (kearny Mesa, Alvarado 1, Upas Street, Thorn Street, and Laurel Street pipelines.

Table A-2 Capital Improvement Plan Project Descriptions			
	CIP Project	**Project Type**	**Description**
37	Landslide/Liquefaction Pipeline Mitigation	Pipelines	Install 40 pipeline manifold and isolation valve sets at critical backbone pipeline locations that traverse high liquefaction and high landslide zones. Currently, WD/CIP pursue the pipeline installation of valves and manifolds per FEMA grant for nine pipelines (kearny Mesa, Montgomery-2 sites, Clairemont Mesa, Alvarado 2, Miramar, Miramar Extention, Rancho Bernardo, and Commercial Street pipelines).
38	AA - Water Pump Station Rehabilitations	Pump Station	Many of the pump stations in the water transmission and distribution system have been in service for many years. Some are over 50 years old, and have not been upgraded with more efficient pumps and motors, have worn check and isolation valves and outdated electrical and central systems. This annual allocation CIP project is to upgrade some of these facilities to improve operational efficiency and reliability.
39	Tierrasanta (Via Dominique) Pump Station	Pump Station	Shifting of the water source from the CWA Aqueduct to the Miramar WTP via Pomerado pipeline will reduce suction pressures to this pump station. To compensate for lower suction pressures during summer peaking, the pump station will need to be upgraded.
40	Soledad Pump Station Upgrade	Pump Station	The efficiency, reliability and maintainability of this pump station has diminished over the past 40 years and it is now in need of upgrading.
41	Scripps Miramar Pump Station Upgrade	Pump Station	Rapid growth in the Scripps Miramar Pump Station service area, the lack of adequate redundancy and maintenance needs require immediate upgrade of this pumping station.
42	Tierrasanta Norte Water Pump Station	Pump Station	This project includes the installation of four end-suction centrifugal pumps inside the existing, unused SD #16 flow control facility. The existing building is 18-feet by 17-feet 8-inches by 10-feet 5.5-inches high. The pumps will be one 25 hp (1,200 gpm at 65 feet TDH) and three 50 hp (2,150 gpm at 65 feet TDH) pumps. Roof hatches will be added to the existing building for future installation and removal of the pumps and motors.
43	Rancho Penasquitos Pump Station	Pump Station	Project calls for the design and construction of a new pump station and a new Del Mar pressure reducing station near the site of the existing stations. The new station will house 5 new vertical pumps each rated at 6000gpm and an additional pump can for future expansion. The Del Mar pressure reducing station will be replaced with a new facility.
44	Serra Mesa Pump Station	Pump Station	This project consists of constructing a new water pump station with (5) five 5-mgd pumps. One pump will be a standby. Total pump station capacity will be 20-mgd. The pump plant will pump water from the Alvarado Zone (536) to the Northwest Mesa Zone (currently 559, that will be increased to 600). Emergency power will be provided by portable, engine-generator sets. The pump plant will connect to the existing 36-inch Kearny Mesa Pipeline.

Table A-2 Capital Improvement Plan Project Descriptions			
	CIP Project	**Project Type**	**Description**
45	Parkland Pump Station	Pump Station	This project entails replacing the Paradise Mesa Pump Station No. 1 and No. 2 with a new pump station (located at the Paradise Mesa No. 1 site), improving efficiency and reliability, and allowing for substitution of San Diego City water for San Diego County Water Authority (SDCWA) water now provided via the SDCWA #19 Paradise Mesa Crosstie.
46	AA - Standpipes and Reservoirs	Storage Facility	This project has identified 20 treated water reservoirs for upgrades and demolition.
47	AA - Dams and Reservoirs	Storage Facility	This project includes a broad range of improvements at various dams and raw water reservoirs throughout the system. These include resurfacing access roads, rehabilitation of berms, reservoir aeration systems, installing fencing and security systems, installing lighting around dams, sandblasting and shotcreting dam surfaces, installation of weather stations and water level sensors, rehabilitation or replacement of bridges, ladders and other access systems, installation of remote operators and or/valves, seismic upgrades to specific facilities, plus making other improvements.
48	Barrett Reservoir Outlet Tower Upgrade	Storage Facility	The Barrett Reservoir dam is a concrete gravity structure with a 120-foot high outlet tower with 26 automatic flash gates located on the spillway. The Design Report recommended the following upgrades: replacing piping, valves and bulkheads, replacing the roof, improving ventilation, repairing concrete surfaces and replacing 26 dam spillway gates. Due to WD budget constraint, the project scope of work has been revised to address the essential appurtenances as required by Water Operations Division and Department of Safety of Dams such as replacing piping, valves, replace platform structures and railings, install mechanical ventilation system, electrical and instrumentation system, including dredging.
49	El Capitan Reservoir Rd Improvements	Storage Facility	Upgrade 2.5 miles of access road to the reservoir, starting at the base of the dam and proceeding counterclockwise around the reservoir to the southern tip of the lake. The road will be repaired and portions widened in this project.
50	Morena Reservoir Outlet Tower Upgrade	Storage Facility	The existing Morena Dam is a rock embankment dam with a parapet wall creating a dam 171- feet high above the original stream bed. The outlet tower is 132 feet from the operating floor to the center line of the outlet tunnel. The piping and mechanical system of the outlet tower will be replaced or repaired. The project will include the construction of two sluice gates at the spillway to meet emergency Division of Dam Safety (DODS) drawdown requirements.

Table A-2
Capital Improvement Plan Project Descriptions

	CIP Project	Project Type	Description
51	Rancho Bernardo Reservoir Upgrade	Storage Facility	The project calls for the rehabilitation of the 10-million gallon, trapezoidal-shaped concrete reservoir. Work will include improvements of the beam connection, repairs of the roof slab and columns and a seismic retrofitting to bring the reservoir up to code compliance mandate by Water Department and State Department of Health Service standards.
52	Lower Otay Reservoir - Emergency Outlet Improvement	Storage Facility	The existing Savage Dam creates the Lower Otay Reservoir. At the present time, 56 days are required to achieve a 10% drawdown of the reservoir through the existing 40-inch (48-inch prior to slip lining) outlet pipe. State regulation requires 10% drawdown in a maximum of 10 days. This project will increase the drawdown rate by installing dual 48-inch drain pipes through the existing auxiliary spillway (in addition to existing 40-inch described above). Installation will include two 48-inch butterfly valves and 48-inch flap gates on the spillway bulkheads and intake screens on the upstream end. Length of each pipe will be 70-feet. Maximum existing grade over the pipes is approximately 10-feet above the intended drain pipe invert. This project will also include the seismic retrofit of the outlet tower.
53	Pomerado Park Reservoir Upgrade	Storage Facility	The Pomerado Park Reservoir has a capacity of 5.2 million gallons, and was constructed in 1969. This project includes safety, sanitation, appurtenance, exterior and interior surface restoration, seismic cathodic protection, and structural improvements.
54	Paradise Mesa Standpipe Rehabilitation	Storage Facility	The Paradise Mesa Standpipe was erected in 1979. It is 120-feet tall, with a diameter of 60-feet, and a capacity of 2.5 million gallons. This standpipe services the 610 Pressure Zone. Current seismic standards require that the standpipe be either retrofitted at the foundation to reduce the changes of failure in the event of an earthquake, or reconstructed. A detail analysis between rehabilitation and new installation indicated that two options are very comparable for costs while there are so many benefits in construction of new tank. Some of these benefits are minimal construction restriction and duration constraint, minimal environmental and health risks due to lead-containing primer and coal-tar coating, less operational risks, superior tank with higher life expectancy and less maintenance costs.

Table A-2 Capital Improvement Plan Project Descriptions			
	CIP Project	**Project Type**	**Description**
55	La Jolla View Reservoir	Storage Facility	The La Jolla View Reservoir is a steel tank measuring 70 feet in diameter by 25 feet in height, with a storage capacity of 0.72 million gallons and an overflow elevation of 525. It was built in 1949 to service the pressure system at the time, which was approximately 525 but subsequently increased to 610. The reservoir elevation is too low for the 610 system. This project includes demolition and removal of the old tank, and construction of a new 5.65 million-gallon concrete reservoir at an overflow elevation of approximately 570 feet. The tank will be constructed underground with a small deck above the ground access building.
56	La Jolla Exchange Place Reservoir	Storage Facility	The La Jolla Exchange Place Reservoir is a covered concrete reservoir with a storage capacity of 1.0 million gallons and an overflow elevation of 273. It was constructed in 1909 to operate in the 270 zone. It currently serves only as a forebay to the onsite Exchange Place Pump Station which pumps from 267 to 610. It is rarely used except to maintain the water quality within the reservoir. This project includes demolition of both the La Jolla Exchange Place Reservoir and Exchange Place Pump Station. The 1.0 million gallons of emergency storage will be consolidated into a new La Jolla View Reservoir at a higher location within the 610 zone, eliminating the need for pumping.
57	La Jolla Country Club Reservoir Seismic Upgrade	Storage Facility	This project will be necessary to perform a seismic study to make sure the reservoir meets current seismic standards.
58	Murray Outlet Tower	Storage Facility	Retrofit from interior. A planning study should analyze the outlet tower's current capacity and its ability to provide flow to Alvarado Treatment Plant if the CWA Aqueduct and El Monte Pipeline fail in a seismic event.
59	San Carlos Reservoir Interior Enhancement	Storage Facility	The San Carlos Reservoir Interior Enhancements Project will install a synthetic membrane lining system to prevent leakage from the 5.0 MG prestressed wire-wrapped concrete circular potable water tank located at the intersection of Wing Span Drive and Tommy Drive in the San Carlos community. The reservoir, originally built in 1965, was substantially rehabilitated in 2001. That work included a seismic retrofit plus valve, pipeline, and appurtenance upgrades to bring the facility up to code. This is the final step in the complete rehabilitation process.

Table A-2 Capital Improvement Plan Project Descriptions			
	CIP Project	**Project Type**	**Description**
60	Lake Hodges Dam Modification	Storage Facility	Construction of a parapet wall on top of the Hodges dam. The geotechnical study of the dam foundation determined that dam overtopping flows could potentially erode the left abutment of the dam during a Probable Maximum Flood event and compromise the stability of the dam. The parapet wall will protect the dam and mitigate the possible overtopping.
61	Morena Dam Grotto	Storage Facility	The grotto was formed before the Morena Dam was constructed, however the presence of the grotto was not known to the City Operations staff until 1992 when the members of the San Diego Grotto, National Speleological Society (grotto society) discovered the grotto. The DSOD has shown concern for the affect the grotto has on dam stability.
62	AA - Pooled Contingencies - RWDS	Reclaimed Water	This CIP item provides contingency funds for expenditures incurred that are greater than the contracted amounts to install service connections of the reclaimed water distribution system to consumers.
63	AA - Reclaimed Water Extension	Reclaimed Water	Extensions of the North City reclaimed water distribution pipeline network beyond the sphere of influence of the existing North City Reclaimed Water distribution pipelines and improving the reclaimed water distribution system as the demands for reclaimed water increase.
64	Black Mountain Ranch Reclaimed Water Storage Tank	Reclaimed Water	The reservoir is a circular, above grade, metallic tank with a capacity of 3 MGD to storage recycled water. The design cost is $384,106 with an estimated total project cost of 4.7 million. Construction of the tank began in January of 2005 and it was com
65	Carmel Valley Reclaimed Water Pipeline	Reclaimed Water	This project is designed to expand the reclaimed water system into the North county. This project will install approximately 9000 LF of 12" and 8" plastic pipe. It will provide future service to the Del Mar National Golf Course and the Pacio HOA.
66	Los Penasquitos Canyon RWP Part Agmt	Reclaimed Water	Part of the North City Reclamation System. The project wall facilitates moving recycled water from the North City Water Reclamation Plant to service areas in the northern region of the City of San Diego. The 9000 LF - 24" pipeline project will begin by connecting to the suction line of the Canyonside pump station, goes through the Canyonside Parkland, along Park Village Road and Camino Del Sur.
67	Pacific Highlands RWP - Participation Agreement	Reclaimed Water	This project proposes to construct 11,770 linear feet of new 12-inch and 16-inch diameter PVC pipe, beginning East of Santa Fe Farms Road moving westerly along Carmel Valley Rd to the intersection of SR 56.

Table A-2
Capital Improvement Plan Project Descriptions

	CIP Project	Project Type	Description
68	Camino Del Sur RWP - E&CP	Reclaimed Water	This proposed recycled water pipeline is part of the Camino Del Sur Road extension project. This pipeline includes the construction of approximately 3,300 linear feet of 24-inch diameter steel recycled water pipeline to be constructed concurrently with the road extension. This will provide a vital connection to serve recycled water to the Rhodes Crossing Development, Torrey Highlands (Subarea IV), Fairbanks Highlands, Pacific Highlands, Carmel Valley and future customers in the 500 Zone. This proposed project is an integral part of the City's reclaimed distribution network since it is the piece needed to charge the system to serve SR-56 and customers in Pacific Highlands.
69	Camino del Sur Recycled Water P/L- Participation Agreement	Reclaimed Water	The Camino Del Sur RWP (Participation Agreement) is located in the Rancho Penasquitos /Torrey Highlands area of the City of San Diego. A portion of which lies within the North City Planned Urbanizing Area (NCPUA) Subarea IV and along the State Route 56 as it crosses the southern extensions of Carmel Mountain Road and Camino del Sur within Subarea IV. The proposed project is a 24-inch recycled water transmission main on Camino del Sur. The City will enter into a participation agreement with the developer to construct the pipeline concurrently with the construction of Camino del Sur
70	Mission Valley Groundwater Desalination	Groundwater	This concept project proposes to extract and desalinate 2,000 AFY from the western portion of the basin for potable use. Two extraction wells, with an average yield of 1,000 gpm, would be necessary. Approximately 1,700 AFY (1.5 mgd) of desalinated water and 300 AFY (0.27 mgd) of brine would be produced.
71	San Pasqual Brackish Groundwater Desalination Demo	Groundwater	This project component entails extracting 5,800 AFY of groundwater from the western portion of the basin and desalinating it by means of a RO water treatment plant. The water supply produced will be approximately 5,000 AFY.
72	San Pasqual Brackish GRD Demo	Groundwater	The project entails extracting and desalinating groundwater, resulting in the production of 250 AFY of desalinated water.
73	San Diego Formation Desalination	Groundwater	Based on available information, it is recommended that the City consider the implementation of a two-phased project. The first phase will consist of the extraction of 3,300 AFY of brackish groundwater, to produce 2,800 AFY (2.5 MGD) of desalinated water. Based on the results of additional investigations and on observations of the aquifer during the operation of the first phase, the City could consider the implementation of a second phase, for a total capacity of 5.0 MGD.

	Table A-2 Capital Improvement Plan Project Descriptions		
	CIP Project	**Project Type**	**Description**
74	Groundwater Pilot Production Wells	Groundwater	Construct a pilot production well at up to four sites, perform Aquifer tests and hydrogeological analyses of basins in which wells are installed to determine feasibility of further development, conduct environmental studies, water quality assessments and economic feasibility analysis.
75	SD 17 Flow Control Facility (Alvarado)	Security	This project is the construction of a pump plant to feed the Mid-City Pipeline from the Alvarado Water Treatment Plant. This pump plant and the Mid-City Pipeline provide required redundancy for, and relieve the capacity load on, the existing Trojan Pipeline, which is the "backbone" transmission facility of the Alvarado water supply system. To avoid the high cost of crossing Interstate 8 (I-8), the pump plant discharge pipe will be connected to the San Diego County Water Authority's (SDCWA's) Pipeline 4B at a location north of I-8. Water is taken out of Pipeline 4B south of I-8 at the Mid-City Pipeline connection. The pump plant will have a total capacity of 93 cubic feet per second (cfs). Approximately 200 feet of 72-inch diameter steel pipe will be installed to transmit water from the Alvarado Water Treatment Plant into the SDCWA's Pipeline 4B. This project will also include a Flow Control Facility to allow the City to draw water from Pipeline 4B.
76	Water Dept. Security Upgrades	Security	This CIP project was created in compliance with the Vulnerability Assessment Report (VA), dated December 31, 2002. Thus, it will design and install miscellaneous security systems at various facilities to improve security, control entry and reduce opportunities for intrusion of unauthorized persons. The VA recommended $20,430,000 in upgrades on existing water facilities. Individual sub-projects may be created, as required.
77	Water Dept. Security Upgrades - Miramar	Security	This CIP project was created in compliance with the Vulnerability Assessment Report (VA), dated December 31, 2002. Thus, it will design and install security systems at various Regulators to improve security, control entry and reduce opportunities for intr.
78	AA - Corrosion Control	Miscellaneous	This Annual Allocation will fund the installation of corrosion protection (such as “anode beds” and “deep well anodes”) to extend the service life of existing facilities. Individual sub-projects will be created as required.
79	AA - Pooled Contingencies - Water	Miscellaneous	This CIP item provides for contingency costs, as required, for all water projects that are greater than the contracted amounts.

	Table A-2 Capital Improvement Plan Project Descriptions		
	CIP Project	**Project Type**	**Description**
80	AA - Meter Boxes	Miscellaneous	Annual Allocation for Replacement of Meter Boxes as needed.
81	AA-Pressure Reducing Stations	Miscellaneous	This annual allocation will install new pressure reduction facilities, and replace of upgrade existing pressure reduction facilities to meet present and future water demands. Individual sub-projects will be created as required.
82	Miramar Service Area Improvements	Miscellaneous	Unidentified projects that require funding per master planning study.
83	Alvarado Service Area Improvements	Miscellaneous	Unidentified projects that require funding per master planning study.
84	Otay Service Area Improvements	Miscellaneous	Unidentified projects that require funding per master planning study.
85	Kensington Pressure Regulator	Miscellaneous	The completion of Mid City Pipeline Project and it operation at the design pressure level will enable to increase the pressure throughout the Normal Heights areas. The Kensington Park Villas community is located at the lowest elevation within Normal Heights; this pressure increase will result in over pressurizing of the Community's water distribution system. The pressure Regulating Stations (PRS) provides more consistent water pressure throughout the Community and would serve to avoid pipe ruptures or other problems due to over pressurizing.
86	Alvarado Water Quality Lab Roof Replacement	Miscellaneous	This project replaces the roof on the water Quality Lab located at the Alvarado Water Treatment Plant.
87	Barrett Flume Cover	Miscellaneous	Each year, golden eagles, deer and other wildlife drown in the open channel section of the Barrett Flume. This 10 - 12 mile open channel section is also causing an excessive maintenance burden to keep out soil, sediment and sunlight-caused algae build-up. Covering of the open flume sections is necessary to preempt fines and sanction from the resource agencies, to maintain water quality, and to reduce maintenance and down time.

Appendix B
CIP Construction Cost Estimates
City of San Diego SOP

CITY OF SAN DIEGO, CALIFORNIA **Standard Operating Procedure**	NUMBER SOP – xxx MRN	DEPARTMENT **Engineering & Capital Projects**
SUBJECT **CIP Construction Cost Estimates**	PAGE OF	EFFECTIVE DATE
	SUPERCEDES DI- PAGES	DATED

1.0 PURPOSE:

This Standard Operating Procedure (SOP) provides the following general guidelines in the preparation of reliable construction cost estimates of Capital Improvement Projects (CIP):

- Preparation of the Engineer's Estimate and associated construction costs
- Types of construction cost estimates
- Construction cost estimating approaches
- Available cost estimating resources
- Ranges of construction administration & contingency costs
- Cost estimate submittals & expected accuracies at various stages of design
- The roles & responsibilities of the participants in the cost estimating process

2.0 SCOPE:

This SOP provides the information and approaches for the preparation of CIP construction cost estimates and related administration costs. Project Managers (PM) should determine the best construction cost estimating approach and level of effort suitable for the specific CIP project.

This SOP focuses on the construction cost estimation of in-house designed CIP projects rather than those prepared by design consultants. This SOP specifically covers the construction administration and contingency cost estimates associated with both in-house and consultant designed projects.

3.0 BACKGROUND:

An accurate construction cost estimate is essential to successful project management and a requirement for the service provider's and client's sound fiscal budgeting. Large variances between the engineering estimate and actual contractors' construction bids can delay the award of projects and creates additional activities (e.g. 1472, re-advertise, reduction in scope, etc) that the PM must perform to ensure the successful construction-award of the project.

4.0 RESPONSIBILITY:

The PM is ultimately responsible for the construction cost estimate's completeness and accuracy. It is also the PM's responsibility to ensure this SOP is adhered to and that the Section Head reviews the estimates. The Project Engineer (PE) applies this SOP during the preparation of project cost estimates to maintain uniformity in the development of the estimates and to facilitate review by various project participants.

5.0 PROCEDURE:

CIP Cost Categories - At a high level, a CIP's cost is made up of design and construction costs, each of which include contractual and City labor charges. City labor charges are incurred as part of design, administration, and processing activities. Table 1 below lists the high level elements that make up a project's costs. The SOP addressing Total Project Cost Estimation will address Design (item A). Administration and Engineering is estimated and accounted for under the Design Cost Estimate. Administration and Engineering includes the preparation of the construction drawings (specifications and plans) as well as the project management/design staff's administration of the project as a whole, from start of design until project close-out.

This SOP addresses the Construction Cost Estimate element (Table 1, item B), and all sub-elements (e.g. Engineer's Estimate, Contingencies, and Field Engineering). The Engineer's Estimate is the Project Engineer's estimate of the Construction Contract that will be bid and awarded for construction.

Of the elements listed in Table 1, item B1a (Bid Item Quantities) is one of the most complex estimating methodologies presented in this SOP.

Table 1 – Cost Categories (Elements of a CIP's Total Budget/Costs)		
A - Project Design Costs	20% to 40%	Of Total Budget *
1 – Administration		
2 – Engineering		
B - Project Construction Costs	60% to 80%	Of Total Budget *
1 - Engineer's Est (Constr Contract)	30% to 60%	Of Total Budget *
a – Bid Item Quantities		
b – Mobilization	5% to 10% (1)	Of Construction
c – Traffic Control	5% to 10% (2,3)	Of Construction
d – Water Pollution Control	2% to 5% (1)	Of Construction
e – Bonds	2.5% (4)	Of Construction
f – Field Orders	2.5% to 10% (3)	Of Construction
2 – Contingencies	10% to 15%	Of Construction
3 – Constr Admin – Field Engineering	10% to 15%	Of Construction
** Total Project Budget (costs) = (Design Costs) + (Construction Costs)*		
(1) Depending on location (2) Depending on ADT (3) Depending on project complexity (4) Per specification		

The range in percentage values listed in Table 1 reflect the varying complexities of a project as well as the varying site conditions that may be encountered (e.g. roadway vs. building, pipeline vs. bike path). It is not in the scope of this SOP to provide values for each of the asset and project types encountered, but instead to provide a guideline for achieving the standard industry values.

Note that construction "**contingencies"** (item B2 in Table 1, page 2) is an amount other than the Engineer's Estimate (construction contract cost) that is set aside as a reserve for unforeseen construction conditions. The Engineer's Estimate does not contain the contingency amount. This amount is applied to in-scope activities only and not to be used for out of scope items or activities.

Cost Estimate at 10% (Conceptual) Design (Planning Package): The operating division or asset planning group prepares this cost estimate once the project is identified and resources for implementing the project are being determined. This cost estimate accompanies the preliminary engineering package and is considered a rough estimate that requires field and technical validation by the assigned PM.

Cost Estimate at 30% (Preliminary) Design: This cost estimate is developed once the Project Manager receives the planning (pre-design) package (10% Design) from the client department or the Preliminary Engineering Section. This estimate is the first construction budget developed from project specific design criteria. This estimate is submitted with the 30% design. The framework of this estimate is based on quantities and unit price models developed from the design criteria, site layout, soils reports and the completed 30% Design Plans. This cost estimate has an expected accuracy of +30% to -15% of the actual cost of construction.

Cost Estimate at 75% Design: This cost estimate is an extension of the Cost Estimate at 30% Design. It is the interim budget cost estimate developed to conform to the latest project-specific design criteria. This estimate is submitted with the 75% design. The framework of this estimate is based on quantities and unit price models further refined by field investigation or revised assumptions from the design criteria, site layout, soils reports and the completed 30% Design. This estimate includes unit prices associated with environmental review, mitigation requirements, and discretionary permits. This cost estimate has an expected accuracy of +20% to -10% of the actual cost of construction.

Cost Estimate at 90% Design: This cost estimate is an extension of the Cost Estimate at 75% Design. This is a semi-final cost estimate which is sent to Field Engineering Division along with 90% design plans for Constructability Review. This is the most detailed estimate of all the previous estimates, where the project scope is close to being completely defined. Given that this project is close to design completion and near-ready to advertise and award, cost figures should reflect the most recent bidding updates. This construction cost estimate has an expected accuracy of +10% to -10% of the actual cost of construction.

Cost Estimate at 100% (Final) Design: This cost estimate is referred to as the "Final Engineer's Estimate". This estimate is prepared once all plan check comments have been incorporated into plans and Constructability Review is completed. The estimate is intended to serve as the final project cost plan, a comparison to the interim budget level cost estimate, and the Analysis of Construction Bids.

Cost Estimation Approaches and Methods - There are two approaches to cost estimating, under each of which there are several methods (techniques) available:

Cost Estimating Approaches

- **Top Down -** Relates to total costs, or costs of major elements, of similar projects. Under this approach, the estimate begins with a total figure and is then broken down into smaller parts, progressively detailing the estimate until all project elements are accounted for. The PM/PE should be cautious when using this approach since certain project details may be overlooked and would result in an undervalued total project cost. The Top Down approach utilizes a **Work Breakdown Structure** (WBS) method. This involves stating the work at a high level (top-down) and then breaking the work (e.g. products or tasks) into smaller components called activities. Each of the WBS activities identifies the associated dollar (labor and material) and scheduling (duration, start and end times) details. Other additional costs, not included in these items, are allocated as a percentage of the total cost components. These components appear as separate line items in the cost estimate summary as follows: Field Engineering, Bonds, Mobilization, Traffic Control, and Water Pollution Control. While this approach requires more effort than other methods, if the PE understands the work well and ensures that the required work is included in the work breakdown structure, an accurate estimate may be achieved.
- **Bottom Up** – Breaks the product into smaller elements and estimates each individually. The individual elements are then grouped back together to come up with an overall cost estimate. The PM/PE should use caution when using this approach because the risk associated with this approach is in being overly conservative on each of the individual elements to where the total cost estimate is inflated.

Cost Estimating Methods

- **Ratio** – Applies *fixed ratios* to costs of major elements based on previous similar projects. While all projects are considered to be unique, some projects are similar in scope to others. Using the Ratio cost estimating method, the PE looks for similar projects previously (and most recently) completed and then estimates work based on the actual cost required for the completed project. This is a reliable method for estimating work since it utilizes actual historical data; however, the projects must be similar in scope and the completed project must have detailed and accurate accounting.
- **Parametric** - This approach follows, in principle, that of the Ratio Method but instead of a fixed ratio, the Parametric Method uses a more complex correlation of smaller element costs to larger ones (e.g. based on size, quantity, complexity, technique, etc…).
- **Standards** – Estimates every project element using published or in-house standard cost for that element. Standard estimates may be ratio-based or parametric, but the data used is a compilation and the source of the projects is unknown.

Construction Cost Estimate Submittals & Updates - Construction Cost Estimates are prepared at each stage of design (identified in Table 2). Additionally, in between any of the above stages of design, construction cost estimates are updated at a minimum of every 6 months, or when there is a change or new information on the project or the project is being re-initiated (removed from the shelf). These changes/ new information include:

- change in scope (reduction or additions)
- change in site conditions (recent construction activity or discovered utilities)
- recent spike or dip in material prices
- change in construction phasing

Anytime a project is shelved for more than 6 months, cost figures should be updated to match the latest unit price data. Where projects have been shelved for more than 1 year, a site visit and a redefinition of all the project scope elements is necessary to reflect changes in existing field conditions.

Table 2 – Design Submittals

Design Stage	Type of Submittal	Expected Accuracy	Submitted To
10%	Conceptual		Stakeholders/ Project Manager
30%	Preliminary	+30% to -15%	Stakeholders/ Client/ Permit Applications
75%	Intermediary	+20% to -10%	Client
90%	Substantial	+10% to -10%	Citywide
100%	Final	+10% to -10%	Advertise

The PE provides the following types of construction cost estimates (in current dollars) to the Project Manager for review and comments during design (see Table 2).

Each cost estimate is titled to correspond with the design completion stage and the type of estimate. The cost estimate includes an assessment of the difficulties inherent in the construction work and documents the price determinations and the assumptions for preparing the cost estimates. This may include factors such as labor conditions, construction equipment, construction supervision, material costs, and equipment installation costs. All reasonable costs a Construction Contractor can expect to incur are also included.

The construction cost estimate includes the line items listed in Table 1.

Following completion of the 90% Design, the PE participates in cost estimate review meetings with the PM and QA/QC Group to reconcile cost estimates and discuss each party's respective cost estimate.

Construction Cost Estimation Accuracies - The accuracy of the estimate is dependent upon what is known, what is assumed, and what is unforeseen at the time the estimate is prepared.

Furthermore, it should be noted that, while the Engineer's Estimate attempts to forecast the cost of the proposed work, the estimate may not always closely correlate to the low bid. Variances are expected because of the nature of Public Works contracting. Items that contribute to these variances include:

- Errors by contractors in preparing bids (i.e. both quantity takeoff & pricing errors).
- Competitive nature of bidding as a result of market conditions, number of contractors submitting bids, importance of the project to a particular contract or contractors.
- The level of refinement of the scope of the project and/or the project construction documents. (i.e., completeness and accuracy of the drawings and subsequent interpretation of the drawings by the bidders).
- Significant fluctuations in the cost of materials, labor, and equipment.
- Recent experience with similar projects.
- The complexity of the project, type of construction, and age of existing facilities.

City Forces Work - All City furnished equipment or materials and all labor costs (e.g. those associated with Water Department system shutdowns, connections, and water service highlining) are excluded from the construction cost estimates submitted by the PE unless otherwise required by the Project Manager. Installation costs for these items incurred by the Construction Contractor are included in the cost estimate. Note that non-contractor expenditures that would be incurred as part of constructing the project (e.g. environmental mitigation) should be identified and noted in the overall project budget.

Special Benefits and Maintenance Costs - The costs associated with special benefits and long term maintenance (irrigation, landscaping, non-standard elements such as streetlights, color concretes, etc), are not included in the construction cost estimate. However, the PM is responsible for ensuring that the funds are available for these activities (i.e. Maintenance Assessment District, Service Level Agreement, etc.).

Cost Estimates for Projects Receiving Federal and State Grants - For projects funded with Federal/State monies, the PM must take into account increases per unit item for costs associated with increased wage rates (prevailing wages) that the contractors are required to pay their employees.

Cost Estimating Spreadsheets – While the use of computerized cost estimating software is preferred if available, spreadsheets are considered equally dependable tools for generating cost estimates provided they have the most recent unit prices and most accurate quantities inputted. Spreadsheets must clearly label the item, quantity, and unit price applied and the construction item must be clearly identified on the associated construction plans and construction specifications' bid list.

Cost Estimates Documentation - The PE maintains a file documenting justification for the cost estimations prepared at all stages of design. The documentation file includes, at a minimum, the sources, methods, quantities, and prices used in developing the cost estimates (as applicable) such as:

- A reference of the source of unit prices used
- Quotations with estimated installation costs
- Completed project title(s) & CIP number(s) used for cost comparisons
- Details, sections, and sketches used to perform typical quantity takeoffs

6.0 DEFINITIONS:

***Bid**: The offer or proposal of the Bidder submitted on the prescribed form setting forth the prices for the Work.*

***Bond**: Bid, performance, and payment bond or other instrument of security.*

***Consultant:** One who provides a specialized service based on their special qualifications, education, or experience.*

***Contingency**: An amount other than the Engineer's Estimate that is set aside as a reserve for unforeseen construction conditions – this amount is to be used on in-scope items only and not to be used for scope creep items.*

***Engineer's Estimate:** The projected cost of construction based on completed design and detailed cost estimates.*

***Mobilization**: Process of activating resources including labor, equipment, and supplies. The process includes setup at or near location of work to attain full or partial readiness to commence construction activities.*

***PE (Project Engineer)**: Assistant to the PM responsible for close oversight of project design details.*

***PM (Project Manager)**: Ultimate responsible individual for the management of all project resources and project overall quality.*

***Prevailing Wages**: Higher wages imposed on federal and state funded projects.*

***Shelved Project**: A project where no active processing or review has been conducted.*

***SWPPP**: Storm Water Pollution Prevention Plan for permit compliance during construction activities.*

***Unit Price**: The amount stated for a single unit of an item of work.*

WBS (Work Breakdown Structure): *The list of tasks and subtasks defined for a project. This list is done in a hierarchical fashion, grouping sets of related tasks under a common parent task.*

7.0 REFERENCES and/or RELATED DOCUMENTS:

8.0 ATTACHMENTS:

9.0 P3 ACTIVITIES:

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APPENDIX C

INFORMATION CONCERNING THE SAN DIEGO COUNTY WATER AUTHORITY AND METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA

The following information concerning the San Diego County Water Authority (the "CWA") and the Metropolitan Water District of Southern California (the "MWD") has been excerpted from publicly available sources, which the City believes to be accurate, or otherwise obtained from the CWA and the MWD. The CWA and the MWD are not obligated in any manner for payment of debt service on the Series 2009A Bonds, and they did not review and will not provide any certifications regarding this Appendix. The City of San Diego (the "City"), the Public Facilities Financing Authority of the City of San Diego (the "Authority"), the San Diego Facilities and Equipment Leasing Corporation (the "Corporation") and the Underwriters take no responsibility for the completeness or accuracy thereof.

San Diego County Water Authority

Organization and Authorization. CWA was organized on June 9, 1944, under the County Water Authority Act for the primary purpose of providing a supply of imported water to its member agencies for domestic, municipal, and agricultural uses. CWA has 24 member agencies, consisting of the City, the Carlsbad Metropolitan Water District, the City of Del Mar, the City of Escondido, the Fallbrook Public Utility District, the Helix Water District, the Lakeside Water District, National City, the City of Oceanside, the Olivenhain Metropolitan Water District, the Otay Water District, the Padre Dam Metropolitan Water District, the Camp Pendleton Marine Corps Base, the City of Poway, the Rainbow Metropolitan Water District, the Ramona Metropolitan Water District, the Rincon del Diablo Metropolitan Water District, the San Dieguito Water District, the Santa Fe Irrigation District, the South Bay Irrigation District, the Vallecitos Water District, the Valley Center Metropolitan Water District, the Vista Irrigation District and the Yuima Metropolitan Water District. CWA obtains water from MWD, which derives its supply from the Colorado River and the State of California Water Project, and also from the Imperial Irrigation District ("IID"), which derives its supply from the Colorado River. CWA delivers water to its member agencies through five large-diameter pipelines located in two right-of-way corridors known as the First and Second San Diego Aqueducts.

The decision-making body of CWA is its 35-member Board of Directors (the "CWA Board"). Each of the member agencies of CWA has at least one representative on the CWA Board. Any member agency may appoint one additional representative for each full 5% of total assessed value of property taxable for CWA purposes that is within the public agency's boundaries. As a result, the City is entitled to representation by 10 directors, the Helix Water District is entitled to representation by two directors and the Otay Water District is entitled to representation by two directors. Under the County Water Authority Act, California Statutes 1943, Chapter 545, as amended (the "CWA Act"), a member agency's vote is based on its "total financial contribution" to CWA since CWA was organized 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 Board 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 the foregoing formula, as of January 1, 2008, the City is entitled to 618.826 of the aggregate 1,431.208 votes, which accounts for 40.42% of all votes. The member agency with the next highest number of voting entitlements, for comparison purposes, is the Helix Water District, which has 111.732 votes or 7.30% of the aggregate votes. The City of San Diego has adopted an ordinance pursuant to which its directors vote as a block, as determined by a majority of the City's representatives. Another provision of the CWA Act states that, except as otherwise provided in the CWA Act, a 55% vote is required for CWA Board action. Whenever the City proportion of financial contribution equals 38% or less, however, all CWA Board actions will be required to receive only a majority of the vote.

Over the last five fiscal years, the City has purchased an average of 90% of its water from CWA, with the remainder from local surface and groundwater sources and the use of reclaimed water for irrigation. The City projects that with increases in the sale of reclaimed water and consistent use of local surface water, city purchases of water from the CWA could drop to approximately 83% in Fiscal Year ended June 30, 2015. In calendar year 2007, approximately 230,000 AF of water from CWA was delivered to the City. The City estimates that a seven percent increase in the demand for water from the CWA will occur between calendar year 2007 and 2020. The City attributes the increase to a projected 14% increase in the City's population.

As of Fiscal Year ended June 30, 2007, CWA member agencies' combined imported and local water use totaled 741,893 AF. Of the 222,496 AF sold to the City by CWA in Fiscal Year 2006-07, 632 AF was for agricultural use and 221,864 AF was for non-agricultural consumptive use. Table C-1 below sets forth the City's local water production and CWA supplied water for Fiscal Years ended June 30, 2003 through 2007.

TABLE C-1
CWA WATER SUPPLIES TO THE CITY OF SAN DIEGO[(1)]
Fiscal Years 2002-03 through 2006-07
(In AF)

Fiscal Year	Local Production[(2)]	CWA Water Supplies[(3)]	Total
2002-03	22,914	192,641	215,555
2003-04	11,119	227,220	238,339
2004-05	22,866	204,039	226,906
2005-06	35,959	196,940	232,898
2006-07	17,770	222,496	240,266

Source: San Diego County Water Authority.
(1) Excludes local surface water use by the City outside of CWA service area.
(2) Includes surface, recycled and groundwater supplies; does not reflect conserved water.
(3) Water use in a given year may differ from CWA sales due to storage.

CWA water rates are established by the CWA Board and are not subject to regulation by the California Public Utilities Commission or by any other local, state or federal agency. Effective January 1, 2003, the CWA's Board implemented a rate structure that included fixed storage and customer service charges, and variable transportation, melded municipal and industrial ("M&I") treatment and melded M&I supply rates. Agricultural customers pay the transportation rate and the customer service charge while M&I customers pay the transportation rate, the customer service charge, and the storage charge, which funds CWA's Emergency Storage Project. See " – Water Storage" herein. Agricultural water users have elected to receive a reduced level of service during an emergency, in return for excluding the cost of the Emergency Storage Project from their water rate, and pay MWD's Interim Agricultural Water Program rate instead of the CWA's melded supply rate. The customer service and storage charges are fixed charges that enable the CWA to increase its coverage of fixed expenditures by fixed revenues. Water rates are set on a calendar year basis. Other Water Authority rates and charges include the Infrastructure Access Charge ("IAC"), the Water Standby Availability Charge, the System Capacity Charge and the Treatment Capacity Charge. Certain of these charges are passed through to the City's customers.

The City Council of the City (the "City Council") approved service rate increases of 6.5% in Fiscal Year 2009-10 and 2010-2011. Based on City policy, the approved rates are updated semi-annually by the City Council with pass-through surcharges to reflect minor adjustments for actual versus projected water purchase costs imposed on the City by CWA. The Water Department's calculation of increased rates in future Fiscal Years is based on, among other things, the CWA increase in the cost of water and the cost of its planned Indirect Potable Reuse and Reservoir Augmentation Demonstration Project. Unlike unit water rates for other customer classifications, the rates paid by interruptible agriculture customers are a function of MWD and CWA rate schedule policies, and are not projected to change in any material aspect.

CWA Water Supply. CWA imports most of its water from MWD and smaller portions from the San Diego County Water Authority/Imperial Irrigation District Conserved Water Transfer Agreement and the Coachella Canal Lining Project. MWD obtains its water supply from two primary sources: the Colorado River via the Colorado River Aqueduct and the State Water Project ("SWP") via the Edmund G. Brown California Aqueduct. See "METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA" herein. Water that the CWA receives from the IID is also derived from the Colorado River and is conveyed through the Colorado River Aqueduct pursuant to an exchange agreement with MWD. Recently, the CWA has received approximately 50-65% of its imported water supply from the Colorado River and the remaining 35-50% from the SWP. The CWA began receiving transfer water from IID in December 2003. Starting with the initial delivery of 10,000 AF, the amount of water to be delivered is increasing according to an agreed-upon schedule until the maximum transfer yield of 200,000 AFY is achieved. In addition, the CWA will receive approximately 77,700 AF of imported water per year from the All-American Canal Lining Project and the Coachella Canal Lining Project. See "– Quantification Settlement Agreement" herein. The CWA began receiving water from the Coachella Canal Lining Project in January 2007. Water from the All-American Canal Lining Project will be available on a reach-by-reach basis as each reach of the relining project is completed. San Diego Creek Reach 2 and San Diego Creek Reach 3 were completed this year and San Diego Creek Reach 1 is expected to be completed in Spring 2010.

The CWA is a member agency of MWD, which was created in 1928 by vote of the electorates of eleven Southern California cities, to provide a supplemental supply of wholesale water for domestic and municipal uses to its constituent agencies. The MWD service area comprises approximately 5,200 square miles and includes portions of the six counties of Los Angeles, Orange, Riverside, San Bernardino, San Diego and Ventura. There are 26 member agencies of MWD, consisting of 14 cities, 11 municipal water districts and the CWA. A Board of Directors (the "MWD Board"), currently numbering 37 members, governs MWD. Each constituent agency has at least one representative on the MWD Board. Representation and voting rights are based upon the assessed valuation of property within each constituent agency. The CWA has four members on the MWD Board. The CWA is the largest purchaser of water from MWD. In the Fiscal Year ended June 30, 2007, the CWA's estimated water purchases from MWD represented approximately 26% of MWD's total deliveries.

In the Fiscal Year ended June 30, 2007, MWD supplied approximately 2.24 million AF of water to its member agencies. During years of normal precipitation, existing water supplies of MWD are sufficient to meet demands within the service area of MWD. In the future, several variables could impact to some extent the availability of both existing and future supplies in normal years. Supply deficiencies can occur during periods of drought. Increased demand on MWD water due to population growth, coupled with a reduction of MWD's existing water supplies could reduce the amount of water available to MWD to supply the CWA, which could affect the supply of water to the City. The Metropolitan Water District Act, California Statutes 1969, Chapter 209, as amended (the "MWD Act") provides a preferential entitlement for the purchase of water by each of the MWD constituent agencies. This preferential right is based upon a ratio of all payments made to MWD by each constituent agency on tax assessments and other payments toward the capital cost and operating expense of MWD, except purchases of water, to all such payments made by all constituent agencies. Based upon the formula as applied by MWD, as of June 30, 2007, the CWA has a statutory preferential right to 16.73% of MWD's total supply. It is MWD's declared policy to meet all the supplemental needs of each of its member agencies, including the CWA. However, MWD's Board adopted a shortage allocation method in February 2008 (the "Water Supply Allocation Plan"). See "METROPOLITAN WATER DISTRICT SUPPLY MANAGEMENT STRATEGIES" herein. 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 of a member agency's dependence on MWD for its total water supply, as well as other water supply related factors. Any extended curtailment could be accompanied by an increase in MWD water charges to its member agencies including, among others, the CWA, and consequently could necessitate an increase in water rates to the member agencies of the CWA including, among others, the City. The City has taken into account the effect of the drought on operations in its Fiscal Year 2008-09 and Fiscal Year 2009-10 budgets by assuming a 15% reduction in water sales and deliveries, which is expected to result in reduced revenues which are offset by reductions in both its operating budget and its capital improvement budget. See "WATER SYSTEM CAPITAL IMPROVEMENT PROGRAM" and "WATER SYSTEM FINANCIAL OPERATIONS – Operation and Maintenance Expenses" in the forepart of this Official Statement.

CWA Current Water Supply Outlook. CWA's water supply portfolio is comprised of seven programs: MWD water supplies, San Francisco Bay/Sacramento-San Joaquin Delta Estuary ("Bay-Delta") water supplies, Colorado River water supplies, reclaimed water, water conservation, local surface water and groundwater. The primary sources from which the CWA receives its water supplies are being impacted by adverse supply conditions as a result of recent multiple dry year events and judicial delivery constraints. The Colorado River basin, which on average provides over 60% of the CWA's supply, has experienced significant drought events over the last several years resulting in diminished reservoir storage levels along the river. Locally, conditions within the County watershed are below normal as well, with the region in the midst of its third consecutive year of below normal rainfall. As a result of these conditions and certain SWP environmental issues described herein, the CWA faces near-term supply challenges. Due to these supply challenges, the CWA became the first major California water agency to adopt a shortage allocation plan.

In late 2007, MWD notified its member agencies that it expected considerable supply challenges for the 2008 water year (October 2007 – September 2008), which would result in insufficient core supplies from the Colorado River and SWP to meet demand. As a result, MWD announced that it would cease replenishment deliveries and implement a 30% cutback in agricultural deliveries to customers participating in the MWD sponsored Interim Agricultural Water Program ("IAWP"). On November 28, 2007 the CWA Board adopted a Regional IAWP Reduction Plan which outlined an array of potential actions available to local farmers to ensure compliance with the 30% IAWP cutback starting January 1, 2008. In addition to the IAWP reduction, MWD also announced that it would need to draw from its Water Surplus and Drought Management ("WSDM") supplemental supplies to meet expected demands in the 2008 water year. See "METROPOLITAN WATER DISTRICT SUPPLY MANAGEMENT STRATEGIES" herein.

MWD estimated in April 2008 that it will need to draw upon 665,000 AF of WSDM supplies under the current 35% SWP allocation to balance 2008 water year supply and demand. MWD's announcement in calendar year 2007 that it would draw from WSDM storage supplies triggered implementation of the CWA's Drought Management Plan ("DMP"). Developed with member agency input and adopted by the CWA Board in March 2006, the DMP contains a list of water management actions available to the CWA during drought conditions. These actions are organized into three stages that include: voluntary supply management, supply enhancement, and mandatory cutbacks. As part of the mandatory cutback stage, the DMP includes a supply allocation methodology. See "METROPOLITAN WATER DISTRICT SUPPLY MANAGEMENT STRATEGIES" herein. Currently, the CWA does not expect to implement mandatory cutbacks during the current calendar year. The CWA expects to authorize a modification to its water conservation ordinance in order to facilitate mandatory cutbacks in future years.

Consistent with actions listed in the DMP Drought Response Matrix, in calendar year 2007 the CWA implemented several drought response measures to avoid or reduce impacts due to supply shortages. These actions included, among other things, a call for increased voluntary conservation in its service area, increased delivery of imported water into local reservoirs for carryover purposes, and spot transfer opportunities with rural water districts. See "FUTURE CWA WATER SUPPLY – CWA Water Transfer Agreements" herein. In April 2008, the CWA Board approved approximately $1.8 million to launch a comprehensive advertising and marketing campaign to promote voluntary water conservation during the summer months of calendar year 2008. The CWA will continue to implement DMP action as necessary and work closely with its member agencies and MWD to monitor supply conditions and storage levels. See "RISK FACTORS – Risks Relating to Water Supply – *Drought Risks*" in the forepart of this Official Statement.

Despite the above-mentioned actions to balance supply and demand, there is no guarantee that the short-term water supply outlook will improve. Although the CWA maintains financial reserves, it is possible that additional costs associated with demand reduction and supply enhancement could negatively affect the Water Authority's short-term financial situation. The CWA may compensate for increased costs or reduced water sales by adjusting water rates in succeeding years. See "WATER SYSTEM FINANCIAL OPERATIONS – Establishment of Water Service Charges" in the forepart of this Official Statement.

In September 2008, the Governor signed legislation, S.B. No. 1 (2nd Ex. Sess.), which authorizes the Integrated Regional Water Management Planning Act. The legislation is designed to facilitate the development of integrated regional water management plans, which are expected to further the improvement of water supply reliability, water quality and environmental stewardship of each region within the State in order to meet current and future needs. The legislation appropriates $842 million in funding from two voter initiatives, which were approved in calendar year 2006. The legislation includes $200 million to help stabilize the Sacramento-San Joaquin Bay Delta, help prevent catastrophic failures of levees in the Delta and accommodate pumping restrictions mandated by a federal court ruling. See "METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA – Endangered Species Act Considerations" herein.

In October 2008, the State's Department of Water Resources ("DWR") issued a report titled "Managing an Uncertain Future: Climate Change Adaptation Strategies for California's Water", which detailed the impact of climate change upon the State's water supplies. The report stated warmer temperatures, altered patterns of precipitation and runoff and rising sea levels presented challenges to the State's ability to manage water supplies, floods and natural resources. The report proposed ten strategies to help the State avoid or reduce climate change impacts to water resources including, among other things, providing sustainable funding for Statewide and integrated regional water management, increasing water use efficiency and expanding water storage and management of surface and groundwater resources. The report also encouraged regional and local entities to implement diverse water management techniques to address uncertainties of changing water patterns.

Water Storage. The Olivenhain Reservoir is part of the first phase of the CWA's Emergency Storage Project, described below. The Olivenhain Reservoir has a storage capacity of 24,000 AF of water. Of the available supply, approximately 3,400 AF of water is dedicated to the Olivenhain Municipal Water District's operational use, and the remaining water is available for emergency use. The Olivenhain Reservoir is complete and is in full operational service.

Agreements with the City regarding the CWA's Emergency Storage Project have extended the CWA's contractual rights for up to 60,000 AF of storage in City-owned reservoirs. The CWA has the right to store up to 40,000 AF in San Vicente Reservoir at the terminus of the First Aqueduct and up to 20,000 AF at other City-owned reservoirs. In anticipation of construction to raise the San Vicente Dam by 117 feet from its current 220 feet (the "San Vicente Dam Raise"), the San Vicente Reservoir was closed to all public uses in September 2008. Water from the San Vicente Dam was partially drawn down to facilitate construction and diverted to other reservoirs. Upon completion of construction, the San Vicente Reservoir will store an additional 152,000 AF of water for two different purposes. The first 54 feet of the dam raise will provide 52,000 AF that will be held in reserve for the Emergency Storage Project in the event the region's imported water supply is interrupted during an emergency. The remaining 63 feet of the dam raise, bringing the raise to a total of 117 feet, will provide an additional 100,000 AF of water to be allocated to the CWA's Carryover Storage Project. The Carryover Storage Project will allow the CWA to store surplus water during wet years for use during dry years. The CWA's payment to the City is in the amount of $2.20 per AF for the maximum amount of water in storage each year. The City receives a credit of $4.00 per AF for CWA water delivered to the City from the CWA's storage account in San Vicente Reservoir. In the event water delivered from CWA to the City is lost, the first water that may be lost over the spillway is the portion which is stored by the CWA. Although water was lost over the spillway in Fiscal Year 1997-98, which was a very wet year by historical standards, this is an infrequent occurrence. The CWA does have contractual rights to make a paper transfer of a specified amount of water from reservoirs with high spillage risks to reservoirs with a lower risk of spill in order to minimize potential losses.

Future CWA Water Supply

MWD and Bay-Delta. MWD has traditionally been the largest supplier of water to CWA. But in the aftermath of a six-year drought that ended in 1992 and a 31% mandatory cutback at the height of that drought, CWA's Board decided to gradually diversify its supply away from its heavy reliance on MWD, which, including water from the SWP and Colorado River delivered by the MWD, provided more than 95% of the CWA's water at that time. The Bay-Delta, a region of northern California that is the source of supply for the SWP and a major supplier to MWD, is primarily managed through a consortium of 130 state and federal agencies called CALFED Bay-Delta. A major effort of this consortium focuses on balancing delivery of water to the SWP with satisfying ecological concerns and mitigating degradation of the levee system that has been built up around the Bay-Delta over the decades. CALFED Bay-Delta's actions directly affect MWD's supply, which in turn affect CWA's supply of imported water not received from the Colorado River. The MWD and Bay-Delta program encompasses 12 goals in CWA's current business plan, many of which aim to increase CWA's scope of influence with financial and infrastructure decisions made by CALFED Bay-Delta and MWD that directly or indirectly affect water deliveries and costs to CWA. For Fiscal Years 2007-08 and 2008-09, the CWA has budgeted MWD and Bay-Delta program expenditures, which include among other things, monitoring, evaluating, and preparing recommendations relative to regional, state and federal issues affecting imported water quality and availability, serving as a liaison with local and non-local water agencies, and state and federal officials to promote CWA positions, planning programs and services, conducting studies, preparing administrative reports, and supporting the CWA's representatives at MWD, in the amount of $2.99 million.

Based upon reports from the City and from CWA, the City expects its reliance on water imported from MWD to reduce from the current levels of approximately 90% to less than 40% by Fiscal Year 2019-20, provided that planned local CWA and City projects are implemented. The City expects that such water, which continues to be imported from MWD, will originate from a higher priority water right.

Due to drought conditions and court-ordered restrictions throughout the State, on June 4, 2008, California Governor Arnold Schwarzenegger issued an Executive Order proclaiming a condition of statewide drought (the "Executive Order"). The Executive Order directs DWR to expedite existing conservation grant programs, facilitate water transfers, conduct a water conservation and outreach campaign in cooperation with local water agencies and organizations, and take additional drought response and water conservation actions. On October 30, 2008, DWR announced its initial allocation to SWP contractors for 2009 of 15% of their contracted amounts for water delivery. The announcement is a component of DWR's efforts to implement the Executive Order. The announced allocation for calendar year 2009 reflects the impact of ongoing drought conditions and, among other things, low carryover storage levels in the State's major reservoirs and court ordered restrictions on water deliveries from the Bay-Delta. See "METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA – State Water Project" herein. CWA is preparing for decreased water supplies by working with local retail member agencies to adopt drought ordinances that establish use restrictions corresponding to escalating water supply shortages.

Colorado River Water Supplies. The cornerstone of the Colorado River Programs is the QSA among IID, MWD, and Coachella Valley Water District. In accordance with the terms of the agreement, the IID will transfer 60,000 AF to CWA in 2008, increasing that volume by 10,000 AF a year until calendar year 2020, when the transfer reaches 200,000 AFY. Another component of the QSA is the canal lining projects for the Coachella and All-American Canals. The Coachella Canal Lining Project has been completed and is currently delivering 21,500 AFY. The All-American Canal Lining Project is expected to deliver 56,200 AFY to CWA when complete in late 2010. Together, these two canal linings will supply 77,700 AFY when fully complete, enough to meet the needs of about 150,000 households. Combined with the implementation of the QSA, this program will considerably aid CWA's efforts at supply diversification. By calendar year 2020, the City estimates that the IID transfer, the All-American Canal Lining Project and the Coachella Canal lining will provide 277,000 AF to CWA and reduce CWA's reliance on water from MWD by at least one-half. By 2011, water transfers from the IID agreement and canal lining projects are expected to provide 20% of the region's water demands. The Colorado River Water Supplies program includes the major goals of completing construction of the All-American Canal, implementation of a public outreach campaign in the affected Imperial Valley communities and determination of the feasibility of a water transfer price-reset provision of the QSA, in which each of the participating agencies has the opportunity to request a new pricing formula for the transferred water. See "QUANTIFICATION SETTLEMENT AGREEMENT – All-American Canal and Coachella Canal Lining Projects" herein.

Seawater Desalination. CWA continues to regard desalination as a key means in achieving water supply diversification. CWA has developed and adopted a desalination action plan that provides the strategy for achieving intermediate and long-range targets.

Seawater desalination is a key component of the CWA's supply diversification strategy. As such, the CWA is assisting its member agencies in pursuing the development of a local, privately owned, desalination project located adjacent to the Encina Power Station. The project will consist of a reverse osmosis desalination treatment facility as well as ancillary intake, discharge, and product water distribution pipelines and facilities. To date, nine CWA member agencies have entered into water purchase agreements with the private developer. Total demands from these agreements fully subscribe the plant's 50-million-gallon-per-day capacity. The plant could come on-line as early as 2011. Major planning milestones completed thus far include: certification of an environmental impact report by the City of Carlsbad, approval of a concentrate discharge permit by the San Diego Regional Water Control Board, and approval of a conditional Coastal Development Permit by the California Coastal Commission.

Several contingencies related to member agency agreements must be satisfied before implementation of the desalination project and its ultimate yield can be determined. These contingencies include obtaining legal entitlements for construction of the project, determination of a mutually acceptable delivery interconnection point and delivery charge, and engagement of a third party exchange agreement where physical delivery to the contracting agency is not practical. The CWA has also significantly improved its imported supply diversification through the implementation of the All-American Canal Lining Project and the Coachella Canal Lining Project. These projects are expected to provide conserved water for delivery to the CWA member agencies for 110 years, and are more reliable during droughts due to their higher Colorado River priority.

The primary focus is on CWA facilitation of the implementation of a local project in the City of Carlsbad that will provide desalinated water directly to member agencies and will account for up to 7% of the region's water supply by 2012. CWA will be evaluating other potential sources of desalinated seawater, as well as additional opportunities for brackish groundwater desalination. In 2009, CWA will complete a detailed feasibility study for a seawater desalination project adjacent to Marine Corps Base Camp Pendleton in northern San Diego County and will initiate work on a regional brine line to convey concentrate from desalination facilities proposed to be located in south San Diego County to the South Bay Ocean Outfall near the international boundary.

CWA Water Transfer Agreements. Core water transfers have emerged as one of the CWA's greatest alternatives to continued purchases from MWD, thus helping accomplish the CWA supply diversification goal. In general, water transfers typically involve purchasing water for a specified period of time from an agency or district that then reduces its water use by the equivalent amount. The principle behind water transfers is that market forces will work to reallocate water. The CWA/IID core water transfer, included in the QSA, is an example of this principle and will ultimately provide the CWA with 200,000 AFY by 2021. See "QUANTIFICATION SETTLEMENT AGREEMENT – Water Authority/Imperial Irrigation District Water Transfer" herein.

The cost of CWA transfers can be divided into two general components: the acquisition cost from the transferring agency and the cost to convey the water to the CWA. Conveyance cost typically introduces a third party into any transfer agreement because virtually all potential transfers to the CWA's service area rely upon using MWD, SWP, and/or U.S. Bureau of Reclamation Central Valley Project facilities to transport (or "wheel") the water. Under current State law, these public agencies are required to provide 70% of unused capacity in their distribution systems to wheel transferred water, provided that compensation at the lawful rate is made to cover the costs and that no harm is done to other legal water users.

Transfers originating from the Colorado River and SWP Bay-Delta supplies involve significant environmental considerations. The primary environmental focus for both sources has been declining fisheries and aquatic ecosystems. This has resulted in greater restrictions being placed on facility operations and has created additional challenges in securing viable transfer options. See "QUANTIFICATION SETTLEMENT AGREEMENT – Quantification Settlement Agreement Litigation" and "METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA – Environmental Considerations" and "– Endangered Species Act Considerations" herein.

The CWA is also pursuing spot water transfers to provide supplemental supplies to the region during times of supply shortages. Spot transfers are short-term transfers or leases, typically agreed to and completed within one to three years. Consistent with the CWA Board of Directors' declaration in December 2007 implementing Stage 2 - Supply Enhancement actions of Drought Management Plan, staff sought to develop short-term transfer agreements with agencies north and south of the Bay-Delta region. In February 2008, the CWA Board executed one-year transfer option agreements with the Butte Water District ("BWD") and the Sutter Extension Water District ("SEWD") for 10,006 AF and 13,071 AF respectively. As of March 2008, these measures have resulted in the following achievements: over 20,000 AF of carryover storage in local reservoirs, the CWA exercising the water transfer purchase option agreements that were entered into with the BWD and SEWD, for 10,006 and 13,071 AF respectively. In addition, the CWA paid a $10 per acre-foot non-refundable option payment following the execution of agreements with BWD and SEWD. A second non-refundable option payment of $40 per acre-foot was paid to BWD and SEWD on April 2, 2008 to extend the option period April 15, 2008. The CWA is negotiating wheeling and related agreements with DWR and MWD necessary to convey the transfer water through SWP and MWD facilities into the CWA's service territory.

Reclaimed Water. CWA's reclaimed water program seeks to treat reclaimed wastewater for urban irrigation and other non-potable purposes. This program is expected to yield 5% of the region's water demand by 2011. Currently, the program conserves about 11,500 AFY. Since CWA does not own and operate a wastewater treatment plant, its reclaimed water program will continue to be implemented entirely by member agencies via public relations and educational outreach programs. A primary incentive for the existing reclaimed water program is a $200 per AF water reclamation credit paid from CWA's local water supply development program, up to $700,000. Additionally, CWA staff provides technical assistance to member agencies on marketing, regulatory compliance and grant applications. A majority of the goals set forth in the CWA's reclaimed water program are projected to be completed during this budget period. Those focus on partnering with member agencies, securing additional grant funding and implementing a regional public information program. MWD also offers a variable recycling credit, based on project financial need, of up to $250 per acre-foot.

Groundwater Storage. In January 2008, the CWA Board approved a term sheet for groundwater storage with the Semitropic Rosamond Water Bank Authority (the "Bank Authority"). The Bank Authority is a Joint Powers Authority among the Semitropic Water Storage District, Rosamond Community Services District and Valley Mutual Water Company. The Bank Authority is developing and will operate two groundwater banks in Kern County, the Stored Water Recovery Unit adjacent to the original Semitropic Groundwater Storage bank in Kern County, and the Rosamond Water Bank in the Antelope Valley area of Kern County. In total, the Stored Water Recovery Unit and the Rosamond Water Bank will have the ability to store up to 800,000 AF of groundwater supplies.

The term sheet for groundwater storage with the Bank Authority allows the CWA to purchase 20,000 "units" from the Bank Authority, with the option to purchase an additional 10,000 "units" within two years from the first purchase. Each "unit" allows for 3 AF of storage in the Stored Water Recovery Unit or 5 AF in the Rosamond Water Bank. The purchase price for the units would be $30,000,000. The option purchase price would be $1,550 per "unit" or $15,500,000 if fully exercised. The term sheet also includes fees for "puts" and "takes" from storage, power costs, and annual management, operations, and maintenance fees. Members of the CWA staff and Bank Authority staff are currently negotiating a contract based on the term sheet.

The CWA has a contract with DWR to reimburse the CWA for expenses incurred to develop groundwater conjunctive use projects that benefit the San Diego region. Purchases of shares, or "units" in groundwater banking projects are eligible expenses for reimbursement. The CWA estimates that $26.7 million will be available for this purpose, plus an additional $3.8 million for local groundwater studies. The State's reimbursement is contingent upon appropriation by the State Legislature, which to date has appropriated approximately $15.5 million.

By 2011, CWA's groundwater program is projected to triple its production to 6% of the region's water demand. Nearly 30,000 AFY, or all of the projected additional supply, is expected to come from the following projects: three brackish-water groundwater recovery projects previously identified by the City, expansion of existing brackish-water groundwater recovery projects operated by two member agencies, the City of Oceanside and Sweetwater Authority and the development of a conjunctive-use project in the Santa Margarita River Basin with two member agencies, the Marine Corps Base at Camp Pendleton and the Fallbrook Public Utility District. In April 2007, the CWA Board approved an increase to the budget of $487,000 to design, construct, and test two production wells in the City of Oceanside. The additional work is reimbursable from the City of Oceanside. A major goal of CWA's groundwater program is the expansion of the local water supply incentive program to groundwater projects to assist member agencies in reaching their groundwater production goals.

Water Conservation. The City and the CWA have active water conservation programs. In previous years, these programs have provided customer education and financial incentives for the installation of water saving devices such as low-flow toilets, water efficient washers and weather-based sprinkler controllers for irrigating large landscapes, parks and greenbelts. The CWA's adopted budget for Fiscal Years 2008-09 and Fiscal Year 2009-10, seeks to increase water savings to more than 81,000 AFY by 2011 by shifting its focus on ultra low flush toilet and high efficiency washer voucher programs to commercial users of landscape irrigation. The annual savings from increased conservation measures is projected to make up 10% of the region's water demand in 2011.

In response to recent water supply shortages by MWD and CWA, the City declared a Stage 1 Voluntary Compliance Water Watch, which requests voluntary water use reduction. City's participation in programs such as the CWA's "Twenty Gallon Challenge" provide information to the public on the methods in which residential water use can be reduced to help the area manage potential reductions in the delivery of imported water to the area. The City expects that the success of these voluntary programs will help the area manage potential reductions in the delivery of imported water. The success of these voluntary programs will help the area manage water deliveries in the event that the MWD is required to further cut deliveries to the CWA. The City is currently updating a drought ordinance that will outline voluntary and mandatory actions that would be taken should further water supply restrictions occur.

Local Surface Water. 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. An integral part of CWA's local surface water program is a surface storage operating agreement that CWA has executed with MWD. This agreement coordinates local surface water supplies and maximizes the efficient use of storage to provide supplies during peak demand periods. During the off-peak demand months of November through May, when most of the County's annual rainfall occurs, MWD delivers up to 70,000 AF to nine reservoirs in San Diego County. In peak demand months of June through October, reservoirs release water based on a formula that is agreed upon between CWA, MWD and participating member agencies in the agreement. Expansion of CWA's carryover storage capacity is also 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. Among the major goals that the CWA's local surface water program expects to achieve include updating a database of regional hydrological information with the assistance of member agencies and issuing recommendations to the CWA Board based on the conclusions of a working group that focuses on local surface supply issues.

Seismic Considerations. Water conveyance facilities are designed to withstand earthquakes with minimal damage. Earthquake loads have been taken into consideration in the design of project structures such as pumping plants and hydroelectric plants. All known faults are crossed by pipelines at very shallow depths to facilitate repair in case of damage from movement along a fault. To date, no CWA facilities have suffered any material earthquake damage. The CWA's Emergency Storage Project is being designed to allow continued water service to its member agencies at a 75% level of service or better in the event of a complete interruption of water deliveries from MWD, such as might result from a severe earthquake along a fault traversing pipelines connecting with MWD, for a period of up to two months while pipelines are being repaired. On October 16, 1999, a magnitude 7.1 earthquake centered 45 miles from the Colorado River Aqueduct occurred. When it occurred, the Colorado River Aqueduct was running at capacity. Inspections following the earthquake revealed no structural damage. There were no interruptions in operations. No assurance can be made that a significant seismic event would not cause damage to project structures, which could thereby interrupt the supply of water from the Colorado River

Aqueduct. See "RISK FACTORS – Risks Relating to the Water Supply – *Earthquakes, Wildfires and Other Natural Disasters*" in the forepart of this Official Statement.

Metropolitan Water District of Southern California

MWD obtains its water supply from two primary sources: the Colorado River via the Colorado River Aqueduct and the SWP via the Edmund G. Brown California Aqueduct. Of the MWD water supply to CWA, more than 60% flows from the Colorado River and nearly 40% from the Bay-Delta through the SWP. MWD expects to face a number of challenges in providing a reliable and high quality water supply for Southern California. These challenges include, among others, population growth within the service area, increased competition for low-cost water supplies, variable weather conditions, and increased environmental regulations for clean and safe drinking water. MWD's resources and strategies for meeting these long-term challenges are set forth in its Integrated Resources Plan, as updated from time to time (defined hereinafter). See "METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA – Integrated Resources Plan" herein.

Colorado River Water. Under applicable laws, agreements and treaties governing the use of water from the Colorado River, California is entitled to use 4.4 million AF of Colorado River water annually, plus 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. The MWD's fourth priority right is within California's basic 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. In addition, because of MWD's junior fourth priority right to other California contractors, under the 1931 California Seven-Party Agreement, diversions could further be restricted by certain California Indian reservations and other California users holding "present perfected rights". Since 1985, however, these entities have used less than 20,000 AF annually of their rights to approximately 49,000 AF of California's 4.4 million AF apportionment.

The Colorado River Aqueduct, which is owned and operated by MWD, transports water from the Colorado River approximately 242 miles to its terminus at Lake Mathews in Riverside County. After deducting evaporation and seepage losses in transporting and storing the water and considering maintenance requirements, up to 1.2 million AFY may be conveyed through the Colorado River Aqueduct to MWD's member agencies, subject to availability of Colorado River water for delivery to MWD as described below.

Other MWD Colorado River Supply Programs. MWD has taken steps to enhance its share of Colorado River water through agreements with other agencies that have rights to use such water, including agreements with IID, the Central Arizona Water Conservation District and the Palo Verde Irrigation District.

California's Colorado River Water Use Plan. Until 2002, 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 increased their use of water from the Colorado River, leaving no unused apportionment available for California in 2002. The State of Arizona's demand has been substantially increased by deliveries to an in-state groundwater banking program. The State of Nevada is banking water under an interstate water banking rule established by the Department of Interior in 1999, which allows Nevada to bank water in Arizona for Nevada's future use. In addition, a severe drought in the Colorado River Basin has reduced storage in system reservoirs. Prior to 2003, MWD could divert over 1.2 million AF in any year, but since that time, MWD's deliveries of Colorado River water varied from a low of 633,000 AF in 2006 to a high of approximately 905,000 AF in 2008. Average annual net deliveries, from 2003 through 2008, were approximately 762,000 AF with annual volumes dependent on the availability of unused higher priority agricultural water and increasing transfers of conserved water. See "QUANTIFICATION SETTLEMENT AGREEMENT" and "METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA—Colorado River Operations, Shortage, and Surplus Guidelines" below.

In response to Arizona and Nevada increasing use of their respective apportionments and the uncertainty of continued surpluses on the Colorado River, the Colorado River Board of California, in consultation with MWD, IID, Coachella Valley Water District ("CVWD"), and the CWA, has developed and released a plan for reducing California's use of Colorado River water to its basic apportionment of 4.4 million AF when necessary (the "California Plan"). In 1999, IID, CVWD, MWD and the State of California agreed to the "Key Terms for Quantification Settlement among the State of California, Imperial Irrigation District, Coachella Irrigation District, and Metropolitan Water District of Southern California" (the "QSA Key Terms"), as the basis for obtaining public input regarding Colorado River use in California aimed at managing California's Colorado River supply. The QSA Key Terms were incorporated into the Colorado River Board's May 2000 California Plan that proposed to optimize the use of the available Colorado River supply through water conservation, transfers from higher priority agricultural users to MWD's service area and storage programs. In March 2000, California voters approved Proposition 13, which authorized the State to issue $1.97 billion of its general obligation bonds for water projects. Additionally, California voters approved Proposition 50 in November 2002 and Proposition 84 in November 2006, which authorized the issuance by the State of $3.4 billion and $5.4 billion, respectively, of its general obligation bonds for water projects. Types of water projects eligible for funding under Propositions 13, 50, and 84 include water conservation, groundwater storage, water treatment, water quality, water security and Colorado River water management projects, many of which are within the scope of the California Plan. The California Plan optimizes the use of the available Colorado River supply through water conservation, transfers from higher priority agricultural users to the CWA's and MWD's service area, and storage programs. Beginning in 2003, California's use of Colorado River water has been limited to its basic apportionment of 4.4 million AFY.

Colorado River Operations, Shortage, and Surplus Guidelines. In December 2007, the Secretary of the Interior executed a Record of Decision ("ROD") for guidelines that determine potential shortage allocations among the Lower Basin states and revise reservoir operations (Colorado River Interim Guidelines for Lower Basin Shortages and the Coordinated Operations for Lake Powell and Lake Mead). Under these guidelines, California would not have to share in any of the potential annual shortages identified by the Secretary (up to 500,000 AF). The ROD extended existing Interim Surplus Guidelines ("ISG") until 2026, which determine when surplus water is available for California, Arizona and Nevada. ISG surplus supplies are not projected to be available in 2008. Availability of ISG surplus water in future years will depend upon whether drought conditions continue and how fast storage in the Colorado River Basin can recover from present conditions. The ROD also provided a way for Lower Basin Colorado River water contractors and others to create a storage account (the "Intentionally Created Surplus"), pursuant to which surplus water may be stored for use in time of shortages. Under the Intentionally Created Surplus provisions, MWD can implement water conservation programs to create a storage account in Lake Mead of up to 375,000 AFY, for a total at any given time of no more than 1,450,000 AF. When other surplus is not available and the Colorado River is not in shortage condition, MWD could call for the delivery of 375,000 AF of this stored water in any year. If water were needed to avoid shortages within the MWD service area, MWD would be able to call 400,000 AF.

Environmental Considerations. Several fish species and other wildlife species either directly or indirectly have the potential to affect Colorado River operations, thus changing power operations and the amount of water deliveries to the Colorado River Aqueduct. A number of species that are on either "endangered" or "threatened" lists under the federal or California endangered species acts (respectively, the "Federal ESA" and the "California ESA" and, collectively, the "ESAs") are present in the area of the Lower Colorado River. To address this issue, a broad-based state/federal/tribal/private regional partnership, which includes water, hydroelectric power and wildlife management agencies in Arizona, California and Nevada developed a multi-species conservation plan for the main stem of the Lower Colorado River (the Lower Colorado River Multi- Species Conservation Program or "MSCP"). The MSCP allows MWD to obtain federal and state permits for any incidental take of protected species resulting from current and future water and power operations and diversions on the Colorado River. The MSCP also covers operations of federal dams and power plants on the Colorado River.

State Water Project. Since 2003, following the execution of the QSA (defined herein) on the Colorado River, the CWA has received about 35-50% of its supply from MWD's other major source of water - the SWP. The SWP is owned by the State of California and operated by 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. 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, but is the largest agency in terms of the number of people it serves (more than 18 million), the share of SWP water for which it contracted to receive (approximately 1.9 million AF, or 46% of total SWP entitlement), and the total amount of annual payments made to DWR. MWD signed a contract with DWR, which, as modified, results in MWD having 1,911,400 AF of contract amount and a "call" to a block of transferred water, if needed, so long as it pays for the financial obligations associated with the water during the call period.

At this time, MWD is unable to assess all of the impacts of the Governor's Executive Order on its SWP supplies, although MWD expects DWR to deliver all of MWD's allocation from the SWP (35% of MWD's contracted-for amount, or 669,000 AF) for the 2008 water year. Drought impacts increase with the length of a drought, as carry-over supplies in reservoirs are depleted and water levels in groundwater basins decline. Further, MWD does not expect any short-term relief with respect to its decreased water supply in the event of increased precipitation in Southern California, Northern California or the Colorado River in the present water year, being October 1, 2008 through September 30, 2009. See "SAN DIEGO COUNTY WATER AUTHORITY – CWA Current Water Supply Outlook" herein. Under DWR's announced initial allocation of 15% of the contracted amount for agencies such as MWD, MWD would receive 287,000 AF of water from the SWP. According to DWR, the allocation for 2009 will be the second lowest in the history of SWP. Actual delivery amounts may increase from the initial allocation depending on hydrologic and water supply conditions, fish abundance, weather, flow conditions in the Bay-Delta, numbers of fish salvaged at the project pumps, and how curtailments are divided between the SWP and CVP in calendar year 2009. However, the final amount of water allocated may result in reduced revenues and the need to offset such reduced revenues by reductions in both MWD operating budget and its capital improvement budget. DWR will revisit the initial allocation as conditions change during the winter and spring, and may increase the allocation as precipitation occurs.

Updated projections for the 2004 IRP (hereinafter defined), show that MWD expects to receive more than 650,000 AF of dry-year supply from the SWP by the year 2025. The ability to receive these supplies depends upon the relative success of implementing programs that improve the Bay-Delta, and the result of lawsuit challenges, which are described below. The success of these programs could also affect the amount of transfer water from the Central Valley that MWD projects it will need to fully implement the 2004 IRP and the corresponding amount of transfer water to be received by the CWA and the City. See "METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA – Integrated Resources Plan" herein.

Bay-Delta Regulatory and Planning Activities. The supply and reliability issues affecting the SWP are largely a result of longstanding environmental problems in the Bay-Delta estuary, which provides at least a portion of the drinking water used by two-thirds of all Californians, including San Diego County residents. In addition to its importance to urban and agricultural water users, the Bay-Delta is of critical ecological importance. The Bay-Delta is the largest estuary on the West Coast of the United States and provides habitat for more than 750 plant and animal species. Human activity has contributed to the destruction of habitat, the decline of several estuarine and anadromous fish species, and the deterioration of water quality. These activities include increasing water demands from urban and agricultural uses, the dredging and filling of tidal marshes, the construction of levees, urban runoff, agricultural drainage, runoff from abandoned mines, and the introduction of non-native species. See "SAN DIEGO COUNTY WATER AUTHORITY – CWA Water Supply" herein.

The State Water Resources Control Board ("SWRCB") is the agency responsible for setting water quality standards and administering water rights throughout California. Decisions of SWRCB can affect the availability of water to MWD and other users of SWP water, including end-users such as the CWA and the City. The SWRCB exercises its regulatory authority over the Bay-Delta by means of public proceedings leading to regulations and decisions. These include the Bay/Delta Water Quality Control Plan (the "WQCP"), which establishes the water quality standards and proposed flow regime of the estuary, and water rights decisions, which assign responsibility for implementing the objectives of the WQCP to users throughout the system by adjusting their respective water rights. SWRCB is required by law to periodically review its WQCP to ensure that it meets the changing needs of this complex system.

Since 2000, SWRCB's Water Rights Decision 1641 ("D-1641") has governed the SWP's ability to export water from the Bay-Delta for delivery to MWD and other SWP contractors. D-1641 was challenged in a dozen lawsuits, filed primarily by Bay-Delta interests and environmental groups. These cases were consolidated in a single action. D-1641, for the most part, was affirmed by the California Court of Appeal in the State Water Resources Control Board Cases in February 2006. The Court of Appeal decision stated that the "public trust doctrine" does not mandate a preference for environmental purposes, but requires a balancing of competing interests; recognized the dual importance of the SWP to provide adequate supply and water quality for the Bay-Delta as well as export supplies; and held that determining the appropriate levels of water supply and Bay-Delta water quality requires a "balancing of all relevant factors and all of the competing interests in the water that flows through the Delta." The Court of Appeal held that SWRCB appropriately weighed that balance in adopting D-1641, although it returned D-1641 to SWRCB to reconsider its allocation of responsibility for implementation of two of the water quality objectives under the WQCP. The California Supreme Court denied petitions for review of the Court of Appeal's decision. In December 2006, SWRCB adopted limited amendments to D-1641 to cure the two issues identified by the Court of Appeal (the flow regime for salmon and deferral of a salinity objective to protect Bay-Delta agriculture). SWRCB also identified additional issues to review, which could result in future changes in water quality objectives and flows that could affect exports of water from the SWP. The California Supreme Court denied petitions for review of the Court of Appeal's decision. In December 2006, SWRCB adopted limited amendments to D-1641 to cure the two issues identified by the Court of Appeal. SWRCB also identified additional issues to review beginning in 2007, which could result in future changes in water quality objectives and flows that could affect SWP water exports. D-1641 includes a salinity objective established in the Bay-Delta to protect local agriculture.

Plaintiffs California Water Impact Network (C-WIN) and California Sportfishing Protection Alliance filed a complaint in Sacramento Superior Court on December 1, 2008, that appears to raise several of the claims that were unsuccessfully asserted in the State Water Resources Control Board Cases. This action, *California Water Impact Network et al. v. Department of Water Resources, State Water Resources Control Board and U.S. Bureau of Reclamation*, alleges that SWP and CVP operations violate the "public trust doctrine" because increased exports have resulted in decreased fish populations; are unreasonable methods of diversions and use of water; violate the California Fish and Game Code requirement to leave sufficient water in the rivers below project dams; and have not complied with water quality objectives. The C-WIN complaint seeks an order enjoining DWR and the Bureau of Reclamation from exporting water from the Bay-Delta and enjoining SWRCB from allowing the projects to export water until project operations comply with state law. MWD is reviewing the complaint to determine how best to respond to this litigation in order to protect MWD's SWP supply.

The CALFED Bay-Delta Program is a collaborative effort among 25 State and federal agencies to improve water supplies in the State and the health of the Bay-Delta watershed. On August 28, 2000, the federal government and the State issued a Record of Decision and related documents approving the final programmatic environmental documentation for the CALFED Bay-Delta Program. The Record of Decision includes, among other things, pledges to restore the Bay-Delta ecosystem, improve water quality, enhance water supply reliability, and assure long-term protection for Bay-Delta levees.

Implementation of the CALFED Bay-Delta Program has resulted in an investment of $3 billion on a variety of projects and programs to begin addressing the Bay-Delta's water supply, water quality, ecosystem, and levee stability problems. To guide future development of the CALFED Program and identify a strategy for managing the Delta as a sustainable resource, in September 2006 Governor Schwarzenegger established the Delta Vision process by Executive Order. The Delta Vision process relates to legislation that created a cabinet-level committee tasked with developing a strategic vision for the Delta. The 41-member Delta Vision Blue Ribbon Task Force issued its Delta Vision Strategic Plan on October 17, 2008 (the "Strategic Plan") which set forth its recommendations for long-term sustainable management of the Bay-Delta. The Delta Vision Committee, chaired by the State Secretary of Resources, will review the Strategic Plan and provide recommendations for the development of implementing legislation to the Governor by the end of calendar year 2008. A draft discussion document summarizing potential Delta Vision Committee recommendations was released on November 25, 2008. These recommendations include completing the Bay-Delta Conservation Plan and associated environmental assessments to permit ecosystem revitalization and conveyance water improvements, identifying and reducing stressors to the Bay-Delta ecosystem, strengthening levees, increasing emergency preparedness, continuing funding for the CALFED ecosystem restoration program, updating Bay-Delta regulatory flow and water quality standards to protect beneficial uses of water and continuing to work with the State Legislature on a comprehensive water bond package to fund Bay-Delta infrastructure projects. The Bay-Delta Conservation Plan is scheduled for completion during the third quarter of 2009, with acquisition of appropriate permits and completion of the associated environmental impact statement/impact report commencing thereafter.

Three lawsuits were filed in the fall of 2000 challenging the sufficiency of the CALFED Bay-Delta Program Environmental Impact Report ("EIR") under the California Environmental Quality Act ("CEQA"). The EIR was upheld by the trial court, but invalidated by the Court of Appeal largely because the CALFED agencies failed to include a project alternative of reducing exports from the Bay-Delta that, in the Court of Appeal's view, was feasible because it would curb population growth in Southern California. MWD, along with the State and certain other interested parties, petitioned the Supreme Court for review of the Court of Appeal's decision, and in January 2006, the California Supreme Court granted review of these coordinated cases. On June 5, 2008, the California Supreme Court found that an EIR is not required to consider an alternative which does not meet the basic project objectives and held that the CALFED EIR fully complied with the CEQA. The Supreme Court also found that the Court of Appeal erred in not distinguishing between pre-existing environmental problems in the Bay-Delta and the environmental effects of the CALFED Program.

Four SWP contractors located north of the SWP's Bay-Delta pumping plant filed litigation against DWR on July 17, 2008, asserting that since they are located in the "area of origin" of SWP water they are entitled to receive their entire contract amount before any water is delivered to contractors south of the Bay-Delta. If the plaintiffs are successful in this litigation, SWP water available to MWD in a drought period could be reduced by approximately 25,000 AFY or by as much as 40,000 AF in an exceedingly dry year. MWD other SWP contractors located south of the Bay-Delta expect to move to intervene in this litigation.

Endangered Species Act Considerations. The listing of several fish species as threatened or endangered under the ESAs have impacted SWP operations and limited the flexibility of the SWP. An annual environmental water account established under the CALFED Bay-Delta Program as a means of meeting environmental flow requirements and export limitations has helped to mitigate these impacts. 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, in February 2008, the California Fish and Game Commission listed the longfin smelt for protection under the California ESA. The San Francisco Bay Institute, the Center for Biological Diversity and the Natural Resources Defense Council have also petitioned to list the longfin smelt for protection under the Federal ESA. The United States Fish and Wildlife Service announced in May 2008 that it will consider the Delta's longfin smelt population for such listing.

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.

Under the Federal ESA, critical habitat also must be designated for each listed species. Critical habitat has been designated for each of the listed species except for the green sturgeon. On September 8, 2008, the National Marine Fisheries Service issued its proposed rule designating habitat for the green sturgeon. The proposal includes as part of the designated habitat the lower Feather River, which could have an impact on SWP operations. MWD cannot determine the extent of any such impacts at this time.

On February 14, 2008, the California Fish and Game Commission, pursuant to its authority under the California ESA, adopted an emergency regulation authorizing the incidental take of longfin smelt by certain activities, including operation of the SWP. The longfin smelt is listed as a candidate species for protection under the California ESA. The Fish and Game Commission's emergency regulation includes measures for the protection of adult, larval and juvenile longfin smelt, which will be in effect until the Fish and Game Commission makes a final listing decision on the longfin smelt, which is expected in March 2009. The protective measures for longfin smelt may affect the operation of the SWP, and will be in effect from December 2008 through February 2009. Under the regulation, the Director of the Department of Fish and Game has ultimate authority to decide what protective measures to impose based upon real-time evidence of various conditions that exist during the effective dates of the regulation. The impact of the protective measures on project exports are unknown at this time, and depend upon future conditions and the exercise of discretion by the Director of the Department of Fish and Game. Assuming the imposition of the most protective of the possible measures during the maximum period of time that those measures may be imposed, the DWR estimates that the protective measures could reduce SWP exports by 310,000 AF to 700,000 AF depending upon water-year conditions. DWR had asked the California Fish and Game Commission to extend incidental take authority of the longfin smelt adopted under the California ESA and include proposed revisions to help assure that DWR would only be required to mitigate impacts caused by the SWP. The California Fish and Game Commission rejected this proposal in favor of adopting the Section 2084 regulation. DWR estimates these regulations have the potential to reduce SWP and federal water project deliveries up to 1.1 million AF, or an additional 17% in an average water year. Such reductions are in addition to the existing export restrictions currently in place as a result of the federal court decision to protect Delta smelt described above Petitions for writs of mandate challenging the longfin smelt take regulation were filed on December 8, 2008 in Los Angeles County Superior Court by the State Water Contractors, federal CVP contractors and the Kern County Water Agency. Motions for preliminary injunctions to enjoin enforcement of the longfin regulation were filed on December 29, 2008 and are currently set for hearing on January 28, 2009.

Litigation filed by several environmental interest groups *(NRDC v. Kempthorne; Pacific Coast Federation of Fishermen's Associations v. Gutierrez)* in the United States District Court for the Eastern District of California alleges that these biological opinions and incidental take statements inadequately analyzed impacts on listed species under the Federal ESA. On May 25, 2007, Federal District Judge Wanger issued a decision on summary judgment in *NRDC v. Kempthorne*, finding the United States Fish and Wildlife Service's biological opinion for Delta smelt to be invalid. On December 14, 2007, Judge Wanger issued his Interim Remedial Order and Findings of Fact and Conclusions of Law requiring that the SWP and Central Valley Project operate according to certain specified criteria until a new biological opinion for the Delta smelt is issued. Under the Interim Remedial Order, SWP operations were constrained in the winter and spring of 2007-08 by prevailing conditions and the status of the Delta smelt. Export restrictions during the winter and spring of 2007-08 reduced SWP deliveries to MWD by approximately 250,000 acre-feet. The United States Fish and Wildlife Service released the new biological opinion on December 15, 2008 setting forth its determination that the coordinated operations of the Central Valley Project ("CVP") and the SWP, as proposed, are likely to jeopardize the continued existence of the Delta smelt and adversely modify Delta smelt critical habitat. The biological opinion includes various alternative actions to address protection of the adult Delta smelt life stage, protection of larval and juvenile Delta smelt, improvement of habitat for Delta smelt growth and rearing, habitat restoration and monitoring and reporting and specifies "take" thresholds to address jeopardy to the species or destruction or adverse modification of critical habitat when the alternative actions are implemented. 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 under median hydrologic conditions could impact deliveries to MWD in the range of 300,000 to 700,000 acre-feet for 2009. In addition, issuance of the new biological opinion will render any pending claims with respect the renewal of federal CVP contracts set forth in the *NRDC v. Kempthorne* litigation moot. The City is monitoring these developments but cannot predict at this time their ultimate impact on the City.

The plaintiffs' motion for summary judgment in *Pacific Coast Federation of Fishermen's Associations v. Gutierrez*, which challenges the National Marine Fisheries Service's Biological Opinion for the salmon and other fish species that spawn in rivers flowing into the Bay-Delta, was argued before Judge Wanger on October 3, 2007. On April 16, 2008, Judge Wanger issued his summary judgment ruling invalidating the biological opinion for these salmonid species. Among other things, the court's summary judgment found that the no-jeopardy conclusions in the biological opinion were inconsistent with some of the factual findings in the biological opinion; that the biological opinion failed to adequately address the impacts of SWP and Central Valley Project operations on critical habitat and that there was a failure to consider how climate change and global warming might affect the impacts of the projects on salmonid species. Judge Wanger began a multi-day hearing on June 6, 2008 to evaluate the status of the salmonid species, and determine if a more extensive proceeding on interim remedies should be commenced. In July 2008, Judge Wanger issued a decision on the interim remedy proceeding, denying plaintiffs' requests for immediate modifications to certain Central Valley Project operations. However, the judge found that the project operators had failed to demonstrate that interim operation of the projects would not threaten irreparable harm, and thus continued the interim remedy proceeding on this issue. The court has indicated that it will consider the plaintiffs' requests for project operational changes, including restrictions on project exports from the delta, if the plaintiffs file a motion seeking that relief. To date, the plaintiffs have not filed such a motion. If there are project operational changes as a result of such a motion, it may affect the volume and timing of exports from the SWP. Currently, the new biological opinion for salmonid species is due for release on March 2, 2009. MWD expects any interim remedy for salmonids that might include export restrictions would probably be in effect only until the new salmonid biological opinion is issued on March 2, 2009.

In addition to the litigation under the Federal ESA, other environmental groups sued DWR on October 4, 2006 in the Superior Court of the State of California for Alameda County alleging that DWR was taking listed species without authorization under the California ESA. This litigation (Watershed Enforcers, a project of the *California Sportfishing Protection Alliance v. California Department of Water Resources*) requests that DWR be mandated to either cease operation of the SWP pumps, which deliver water to the California Aqueduct, in a manner that results in such "taking" of listed species or obtain authorization for such "taking" under the California ESA. On April 18, 2007, the Alameda County Superior Court issued its Statement of Decision in *Watershed Enforcers v. California Department of Water Resources*. The Statement of Decision finds that DWR is illegally "taking" listed fish through operation of the SWP export facilities. The Court ordered DWR to "cease and desist from further operation" of those facilities within 60 days unless it obtains take authorization from the California Department of Fish and Game.

DWR appealed the Alameda County Superior Court's order on May 7, 2007. This appeal automatically stays the order pending the outcome of the appeal, unless the plaintiff obtains an order from the trial or appellate court that the appeal not act as a stay based on a showing of irreparable injury. Watershed Enforcers filed a notice that it would not oppose a stay of the Court's order pending appeal with the Alameda County Superior Court on May 2, 2007. Also on May 7, 2007, DWR withdrew its application, which was filed on April 9, 2007, to the Department of Fish and Game for a determination that the existing federal biological opinions are consistent with requirements for incidental take under the California ESA and executed a memorandum of understanding ("MOU") with the California Department of Fish and Game to assist in reinitiated consultations with the United States Fish and Wildlife Service and National Marine Fisheries Service for new biological opinions on the coordinated operations of the SWP and CVP as they relate to the listed species of fish. In the MOU, DWR and the California Department of Fish and Game agree that the biological assessment and resulting biological opinions under the Federal ESA should be developed to include SWP operations that are consistent with the California ESA. After the new biological opinions and incidental take statements for the listed species of fish are completed, DWR will apply to the Department of Fish and Game for a consistency determination under the California ESA based on the new biological opinions and incidental take statements. On January 15, 2008, all parties in the *Watershed Enforcers* appeal filed a motion asking the Court of Appeal to stay the appeal until January 1, 2009. On motion of all parties, the Court of Appeal has stayed the appeal until January 1, 2009. The MWD expects such stay of appeal to provide additional time, during which DWR may obtain a consistency determination under the California ESA before the Court of Appeal rules on the appeal in *Watershed Enforcers*.

Other issues such as the recent decline of some fisheries in the Delta and surrounding region and certain operational actions in the Delta may significantly impact MWD's water supply from the Delta and the amount of water received therefrom by the CWA and the City. SWP operational requirements may be further modified through the consultation process for new biological opinions for listed species under the Federal ESA or from the California Fish and Game's actions regarding a consistency determination under the California ESA. No assurances can be given whether or when a consistency determination will be issued under the California ESA, what the content of those opinions and determinations might be and how they may affect the SWP and CVP operations. In addition, success by plaintiffs in the recently-filed C-WIN litigation could result in additional restrictions on SWP and Central Valley Project operations. Decisions in cases referenced here or future litigation, listings of additional species (such as the longfin smelt) or new regulatory requirements could adversely affect SWP operations in the future by requiring additional export reductions, releases of additional water from storage or other operational changes impacting water supply operations. The City cannot predict the ultimate outcome of any of the litigation or regulatory processes described above at this time or whether such outcome will result in any materially adverse impact on the operation of the SWP pumps, MWD's SWP supplies, MWD's water reserves or their impact on the City's water supplies.

MWD's current approach to managing water shortages has evolved from its experiences during the droughts of 1976-77 and 1987-92 into the Water Surplus and Drought Management Plan ("WSDM Plan"). The WSDM Plan, which was adopted by MWD's Board of Directors in April 1999, establishes broad resource management strategies to meet full service demands. These measures include calling for extraordinary conservation, cutting groundwater replenishment and agricultural water deliveries, maximizing groundwater production, acquiring additional supplies and drawing from dry-year storage. Although the Water Surplus and Drought Management Plan provides principles for imported supply allocation in the event the need should arise, the Water Surplus and Drought Management Plan did not provide a detailed allocation plan. Beginning in 2007, MWD staff, working with member agency staff, prepared its Water Supply Allocation Plan based on the principles contained in MWD's Water Surplus and Drought Management Plan. The Water Supply Allocation Plan was approved by the Board of the MWD in February 2008. The Water Supply Allocation Plan provides a formula for equitable distribution of available supplies in case of extreme water shortages within MWD's service area. A separate action of the Board of the MWD will be required to impose the Water Supply Allocation Plan and subject water deliveries to its allocation formula.

Based on DWR estimates of SWP deliveries under the Interim Remedial Order in *NRDC v. Kempthorne* and assuming an equal division of curtailments between the SWP and CVP, MWD believes that its diversified supply portfolio together with the resources actions could provide sufficient supplies for MWD to meet firm demands in calendar years 2008, 2009 and 2010, even assuming drought in the Colorado River Basin and average to dry conditions in Northern California and MWD's service area. By the end of 2010, MWD estimates that even with the resources actions, water storage would be seriously depleted. To stretch supplies, MWD ceased replenishment deliveries in May 2007 and reduced deliveries to its IAWP by 30% on January 2008. In addition, MWD is pursuing water transfers, including negotiations with water agencies in the Sacramento and San Joaquin Valleys for transfers. MWD called for maximum fallowing in MWD's agricultural land management program within the Palo Verde Irrigation District ("PVID") starting in August 2008 and is working with the State of Arizona to withdraw water previously stored in Arizona.

Integrated Resources Plan. MWD, its member agencies, sub-agencies and groundwater basin managers developed an Integrated Water Resources Plan that was adopted by MWD's Board of Directors in January 1996 (the "1996 IRP") as a long-term planning guideline for resources and capital investments. The purpose of the 1996 IRP was the development of a preferred resource mix to meet the water supply reliability and water quality needs for the region in a cost-effective and environmentally sound manner.

In 2004, MWD adopted an updated Integrated Resources Plan (the "2004 IRP") that reviewed the goals and achievements of the 1996 IRP, identified changed conditions for water resource development and updated the resource targets through 2025. A key component of the 2004 IRP was the addition of a planning buffer. The planning buffer provided for the identification of additional supplies, both imported and locally developed, to address uncertainty in future supplies and demands from factors such as the level of population and economic growth which directly drive water demands, water quality regulations, new chemicals found to be unhealthful, endangered species affecting sources of supplies, and periodic and new changes in climate and hydrology. MWD is currently in the process of working on an update to the 2004 IRP, to evaluate supply reliability while incorporating changed conditions and new trends and managing uncertainties. MWD expects to complete the update to the 2004 IRP in calendar year 2009.

Additional Activities. Management of SWP supplies through water marketing and groundwater banking is expected to play an important role in meeting State water needs. MWD is currently pursuing voluntary water transfer and storage and exchange programs with the State, federal, public and private water districts and individuals.

Quantification Settlement Agreement

In October 2003, the Quantification Settlement Agreement ("QSA") and its related water transfer and other agreements were signed by the US Secretary of the Interior and representatives of various Indian tribes, the US Bureau of Reclamation, CVWD, IID, MWD and CWA. The QSA outlines how California will reduce its overuse of Colorado River water over a 15- year period. The CWA's Colorado River Program manages the implementation of the CWA's agreements under the QSA including the water transfer agreement with IID and the concrete lining of portions of the All-American and Coachella canals. The linchpin of the QSA is the CWA/IID water transfer agreement described below. Under the QSA, the CWA will receive 30% of its water supply from the water transfer and canal lining projects by 2020.

Water Authority/Imperial Irrigation District Water Transfer. Water transfers have emerged as one of the CWA's greatest alternative resources to continued purchases from MWD. Water transfers typically involve purchasing water for a specified period from an agency or district that then reduces its water use by that amount. The principle behind transfers is that market forces may reallocate water. See "FUTURE CWA WATER SUPPLY – CWA Water Transfer Agreements" herein.

In September 1995, the CWA approved a Memorandum of Understanding with IID to negotiate a long-term transfer of conserved agricultural water. In July 1996, the CWA and IID agreed to draft terms for a Cooperative Water Conservation and Transfer Program. On April 29, 1998, the CWA and IID approved an Agreement for the Transfer of Conserved Water. Concurrently with its approval of the QSA on October 10, 2003, the CWA executed a Revised Fourth Amendment to the agreement and commenced implementation of the water transfer. The agreement provides that water saved through conservation measures in Imperial Valley will be transferred to the CWA. This water is highly reliable because it comes from IID's priority of use of the first 3.85 million AFY of the State's 4.4 million AF normal year allocation. 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. Implementation of the water transfer began in calendar year 2003 with a transfer of 10,000 AF of water. Total calendar year 2009 exchange deliveries are projected to reach nearly 120,000 AF. The quantities will increase according to an agreed-upon delivery schedule, ultimately providing up to 205,000 AF of water in calendar year 2021 and declining to 200,000 AFY beginning in calendar year 2023. This amount will continue to be transferred between calendar year 2021 and as late as calendar year 2077. In calendar year 2008, the CWA will receive 60,000 AF of conserved water from this program.

All-American Canal and Coachella Canal Lining Projects. As part of the QSA and related contracts, the CWA was assigned MWD's rights to approximately 77,700 AFY of conserved water from the All-American Canal Lining Project and the Coachella Canal Lining Project pursuant to an Allocation Agreement among various parties to the QSA (the "Allocation Agreement"). The All-American Canal Lining Project will yield approximately 56,200 AF of Colorado River water per year and the Coachella Canal Lining Project will yield approximately 21,500 AFY. Under the Allocation Agreement, 16,000 AFY of conserved canal lining water is projected to be available to the San Luis Rey Settlement Parties. The remaining approximately 77,700 AFY is projected to be available to the CWA. Under the Allocation Agreement, 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 the CWA. These projects will reduce the loss of water that currently occurs through seepage and that conserved water will be delivered to the CWA. This will provide the CWA's service area with an additional 8.5 million AF of water over the 110-year life of the agreement. IID and the CVWD are responsible for managing the design, permitting, contracting, and construction of the two projects. Each of the canal lining projects is subject to the completion of necessary environmental documentation and permits. See "FUTURE CWA WATER SUPPLY – Colorado River Water Supplies" herein.

Most of the construction work on the Coachella Canal Lining Project has been completed. The significant items of remaining work are focused on environmental mitigation and providing secondary electric power to two of the canals' six check structures. Water was first turned into the newly lined canal on December 4, 2006 and the facility was taking full flow by December 21, 2006. In December 2007, the CWA and CVWD executed an agreement that will allow up to an additional 4,850 AF of conserved water that was previously considered necessary for environmental mitigation to be available for delivery to the CWA. Upon the Bureau of Reclamation issuing a final "secretarial determination" it is anticipated that the total project yield will increase to approximately 30,850 AF. The terms of the agreement provide that the CWA will receive up to an additional 1,850 AF in calendar years 2007 and 2008, and up to 4,850 AFY thereafter. Although the actual total net supply available in any year will depend upon how much of the additional water may be necessary for environmental mitigation, the CWA expects to receive 2,500 AFY on average from the project.

IID issued notices-to-proceed to two construction contractors in May and June of 2007 for the All-American Canal Lining Project. The lining project consists of constructing a concrete-lined canal parallel to 23 miles of the existing All-American Canal from Pilot Knob to Drop 3. National Environmental Policy Act ("NEPA") and CEQA documentation is complete, environmental mitigation measures have been identified and Endangered Species Act consultations are pending. Under the current schedule, the project is expected to be completed in calendar year 2010. The CWA will receive 56,200 AF of water per year in equal monthly installments after adjusting for water allocated to the San Luis Rey Indian parties. The IID expects Kiweit Pacific Company, the contractor for Reach 1-A, to complete the Reach 1-A portion of the project by winter 2008. Ames Construction, the contractor for Reach 2 and Reach 3 of the All-American Canal Lining Project has completed approximately one-half of the lining work necessary to complete Reach 3. The IID expects Ames Construction to complete repairs to Reach 2 and the remainder of its contract by the end of summer 2008.

The calendar year 2003 Exchange Agreement between the CWA and MWD provides for the delivery of the conserved water from the canal lining projects. Pursuant to the calendar year 2003 Exchange Agreement, MWD will deliver the canal lining water for the term of the Allocation Agreement (110 years) and the CWA will pay MWD's applicable wheeling rate for each acre-foot of exchange water delivered.

Quantification Settlement Agreement Litigation. On November 5, 2003, IID filed a validation action in Imperial County Superior Court seeking a judicial declaration of the validity of the QSA and its related water transfer and other agreements. Other lawsuits, including an action brought by the County of Imperial ("Imperial County"), were also filed challenging the execution, approval and subsequent implementation of the QSA on various grounds including failure to comply with CEQA, violations of the Water Code, breach of trust and fiduciary duties, unconstitutional taking of property rights, and deprivation of federal civil rights under 42 U.S.C. section 1983. The CWA has been named as a defendant/respondent/cross-defendant in certain cases pertaining to the QSA and its related agreements. All of the QSA cases have been coordinated in the Sacramento Superior Court. Two rounds of pleading challenges that ended in January 2005 narrowed the cases and claims in the coordinated proceedings. In calendar year 2005 the Third District Court of Appeal granted Imperial County's petition for review of rulings dismissing one County case and dismissing the CEQA causes of action from another. The Court of Appeal then stayed all lower court proceedings pending appellate review. On June 14, 2007, the Court of Appeal affirmed the Superior Court's decision. The Court of Appeal denied a petition for rehearing in July 2007, and the time to petition the California Supreme Court expired. The QSA litigation then resumed in the Superior Court where motions were filed to dismiss some of the other QSA lawsuits and for a preliminary injunction. On January 31, 2008, the court denied the motion for a preliminary injunction, and on February 5, 2008, the court dismissed one of the lawsuits challenging the State Water Resources Control Board's decision to approve the IID-CWA transfer. The court also dismissed most of the parties, including all the water agencies, from a cross-complaint in the validation action, leaving state agencies as the only defendants to that cross-complaint. If one or more of the lawsuits is successful, the court could enjoin transfers anticipated to be made to CWA under the QSA totaling over 80,000 AF for the year. Such action would represent an additional demand from CWA upon MWD.

A complaint filed July 19, 2005, in U.S. District Court, District of Nevada, in the matter of *Consejo de Desarrollo Economico de Mexicali, A.C. v. United States*, alleges that the Federal government and federal officials ("Federal Defendants") violated NEPA, the Endangered Species Act and other environmental laws in approving and carrying out the All-American Canal Lining Project, and that Mexican landowners are entitled to receive seepage water from the All-American Canal that will be conserved by the lining project and conveyed to water users in California under certain QSA agreements. The court granted summary judgment to the Federal Defendants on July 3, 2006. The plaintiffs appealed, and the Ninth Circuit Court of Appeals issued an injunction against work on the All-American Canal Lining Project pending its decision on the legal challenges of the project. In April 2007 the Ninth Circuit Court of Appeals upheld the lower court decision, lifting its injunction and ordering that the case be dismissed.

An action challenging the All-American Canal lining project, *Protect Our Water and Environmental Rights v. Imperial Irrigation District* ("POWER III"), was filed in California state court in 2008, challenging IID's water conservation and transfer project and the habitat conservation plan under CEQA. The action was third such action filed by Protect Our Water and Environmental Rights against IID regarding the All-American Canal Lining project since 2006. The petition named IID as a respondent and named CWA, MWD, and CVWD as real parties in interest. The court granted the defendants' demurrer and dismissed the action. The plaintiffs appealed this dismissal. In November 2008. The appellate court held that the trial court properly determined that the United States was both a necessary and indispensable party to the litigation and that the demurrers were properly sustained.

Success by plaintiffs in the lawsuits described above could further delay the implementation of programs authorized under the QSA or result in increased costs or other adverse impacts. Such litigation is in its early stages and MWD has stated that any adverse impact on it or its water supplies from the Colorado River cannot be determined at this time.

The Navajo Nation has filed litigation against the Department of the Interior, specifically the Bureau of Reclamation and the Bureau of Indian Affairs, alleging that the Bureau of Reclamation has failed to determine the extent and quantity of the water rights of the Navajo Nation in the Colorado River and that the Bureau of Indian Affairs has failed to otherwise protect the interests of the Navajo Nation. The complaint challenges the adequacy of the environmental review for the Interim Surplus Guidelines and seeks to prohibit the Department of the Interior from allocating any "surplus" water until such time as a determination of the rights of the Navajo Nation is completed. MWD filed a motion to intervene in this action. In October 2004, the court granted the motions to intervene and stayed the litigation to allow negotiations among the Navajo Nation, federal defendants and Arizona parties. The stay has been extended until April 2009. The intervening parties may observe, but may not participate in the negotiations. Negotiations are continuing. This litigation has not delayed implementation of the QSA. Any adverse impact of this litigation on MWD or its Colorado River supplies, if settlement negotiations are not successful, cannot be adequately determined at this time.

Salton Sea Environmental Issues. A further complicating factor in the implementation of the QSA has been the fate of the Salton Sea. The Salton Sea is an important habitat for a wide variety of fish-eating birds as a stopover spot along the Pacific flyway. Some of these birds are listed as threatened or endangered species under the California and federal endangered species acts. Located at the lowest elevations of an inland basin and fed primarily by agricultural drainage with no outflows other than evaporation, the Salton Sea is on a trend towards hyper-salinity, which has already impacted the Salton Sea's fishery. This fishery has historically been suitable habitat for the fish-eating birds. The transfer of water from IID to the CWA will reduce the volume of agricultural run-off from IID into the Salton Sea, which in turn may accelerate the natural trend of the Salton Sea to hyper-salinity. The appropriate mitigation for impacts to the Salton Sea from the transfer of water from IID to the CWA and the larger issue of Salton Sea restoration have been addressed by State legislation implementing the QSA. In passing that legislation, the Legislature committed the State to undertake restoration of the Salton Sea ecosystem. Restoration of the Salton Sea is subject to selection and approval of an alternative by the Legislature and funding of the associated capital improvements and operating costs. The Secretary for Resources recommended an $8.9 billion preferred alternative for restoration of the Salton Sea to the Legislature in May 2007. On January 24, 2008, the State's Legislative Analyst's Office (the "LAO") issued a report describing current state of the Salton Sea and the California Secretary for Resources' preferred alternative for the Salton Sea's restoration. Further, the LAO, presented its own recommendations for the State Legislature to consider with respect to the restoration. These recommendations include, among other things, protecting air quality and preserving wildlife habitat as the highest of expenditure priorities, formally adopting a restoration plan, and adopting interim measures to address priority impacts such as mitigating immediate air quality impacts and habitat loss while the Legislature deliberates on the restoration issues with respect to the Salton Sea.

On September 27, 2008, the Governor approved SB 187 – "Salton Sea Restoration Implementation - Funds for Proposition 84", which authorized funds to be appropriated pursuant to a five-year restoration plan. Pursuant to SB 187, expenditures of funds from Proposition 84, upon appropriation by the Legislature, will be limited to those activities to be completed in the first five years (Phase 1) as identified in the Secretary of Resource's preferred alternative. These activities include additional data collection and analysis along with completion of project-level environmental documentation, permitting, and design work. Additional coordination with local stakeholders, local Tribal interests and other interested parties would also occur during this period. The QSA implementing legislation also established the Salton Sea Restoration Fund, which will be funded in part by payments made by the parties to the QSA and fees on certain water transfers among the parties to the QSA. Under the QSA agreements MWD will pay $20 per acre-foot into the Salton Sea Restoration Fund for any special surplus Colorado River water that MWD elects to take under the Interim Surplus Guidelines. MWD also agreed to acquire up to 1.6 million AF of water conserved by IID, excluding water transferred from IID to CWA, if such water can be transferred consistent with plans for Salton Sea restoration, at an acquisition price of $250 per acre-foot (in calendar year 2003 dollars), with net proceeds to be deposited into the Salton Sea Restoration Fund. No conserved water has been made available to MWD under this program. MWD may receive credit for the special surplus water payments against future contributions for the Lower Colorado River Multi-Species Conservation Program (see "—Environmental Considerations" below). In consideration of these agreements, MWD will not have or incur any liability for restoration of the Salton Sea. As part of an effort to mitigate the effects of the drought in the Colorado River Basin that began in calendar year 2000, MWD elected not to take delivery of special surplus Colorado River water that was available from October 2003 through 2004 and from 2006 through 2007. No special surplus will be available to MWD in calendar year 2008.

QSA Joint Powers Authority. The Quantification Settlement Agreement Joint Powers Authority Creation and Funding Agreement (the "QSA Funding Agreement"), which was executed in October 2003 by and among the State, acting by and through the California Department of Fish and Game ("DFG"), the CVWD, the IID and the CWA, established the Quantification Settlement Agreement Joint Powers Authority ("QSA JPA"). The QSA JPA is comprised of representatives from the DFG, CVWD, IID, and the CWA. The QSA JPA collects, holds, invests, and disburses funds needed for mitigation projects. The purpose of the QSA JPA is to administer the funding of environmental mitigation requirements related to

QSA water transfers, make certain and limit the financial liability of the CVWD, the IID and the CWA for environmental mitigation costs, make certain and limit the financial liability of the CVWD, the IID and the CWA for Salton Sea restoration costs and allocates and the remaining financial and other risks associated with the environmental mitigation and Salton Sea restoration to the State. CVWD, IID, and the CWA are required to provide up to $133 million (in calendar year 2003 dollars, discounted at 6% per annum) to pay for the QSA mitigation program. Under terms of the QSA Funding Agreement, the collective financial obligation of the three water agencies is capped at $133 million, of which the CWA is responsible for $52.2 million (in calendar year 2003 dollars). Certain of such costs will affect the water rates payable by the City and its water customers.

Future MWD Water Supply

MWD Colorado River water supply expansion programs include the 1988 water conservation agreement between MWD and IID (the "1988 Conservation Agreement") as extended by the 1989 Approval Agreement, which allows MWD to construct and operate conservation projects. Currently, under the 1988 Conservation Agreement, IID's efforts are conserving more than 105,000 AF of water per year. Under the terms of the 1988 Conservation Agreement, MWD paid for capital costs and continues to pay annual costs for specific conservation projects within IID. In return through 2003, MWD diverted from the Colorado River a quantity of water equal to the amount of water conserved by the conservation projects, which totaled between 104,940 and 109,460 AF annually from 1998 to 2003. In calendar year 2008, the conserved water augmented the amount of water available to MWD by 89,000 AF. Under an amendment to the 1988 Conservation Agreement in October 2003, 20,000 AF of the total conserved volume was to be made available to CVWD. As a result, annually, between 81,160 and 81,940 AF were made available to MWD from 2004 through 2006. Under the amendment to the 1988 Conservation Agreement in May 2007, 85,000 AF was made available to MWD during 2007. The water provided under the 1988 Conservation Agreement, as amended, must be used in the calendar year the water is conserved, unless stored in a Colorado River reservoir pursuant to a separate water banking agreement.

In 1992, MWD entered into an agreement with the Central Arizona Water Conservation District ("CAWCD") for storing Colorado River water in central Arizona for the benefit of any entity outside of Arizona. Pursuant to this agreement, CAWCD created 80,900 AF of long-term storage credits that may be recovered by CAWCD for MWD. MWD, the Arizona Water Banking Authority, and CAWCD executed an amended agreement for recovery of these storage credits in December 2007. In calendar year 2007, 16,804 AF were recovered. MWD anticipates recovery of as much as 28,000 AF in 2008 and has requested the balance of the storage credits in 2010. Water recovered by CAWCD under the terms of the 1992 agreement allows CAWCD to reduce its use of Colorado River water, resulting in Arizona having an unused apportionment. The Secretary of the Interior is making this unused apportionment available to MWD under its Colorado River water delivery contract.

MWD and PVID signed a program agreement for a Land Management, Crop Rotation and Water Supply Program in August 2004. This program provides up to 118,000 AF of water available to MWD in certain years. The term of the program is 35 years. Fallowing of approximately 20,000 acres of land began on January 1, 2005. In calendar years 2005, 2006 and 2007, approximately 108,700 AF, 105,500, and 72,300 AF, respectively, of water were saved. MWD's fallowing call is estimated to save 82,000 AF in 2008 and 118,000 AF in 2009.

In April 2008, MWD's Board authorized the expenditure of $28.7 million to join the CAWCD and the Southern Nevada Water Authority ("SNWA") in funding the construction of a new 8,000 acre-foot off-stream regulating reservoir near Drop 2 of the All-American Canal in Imperial County. The reservoir is under construction by the Bureau of Reclamation and is anticipated to be completed in late calendar year 2010. The Drop 2 Reservoir is expected to save up to 70,000 AF of water per year by capturing and storing water that would otherwise be lost. In return for its funding, MWD received

100,000 AF of water that is stored in Lake Mead until recovered, with annual delivery of up to 34,000 AF of water through calendar year 2010 and up to 25,000 AF between calendar years 2011 and 2036. Besides the additional water supply, the new reservoir will add to the flexibility of Colorado River operations.

MWD has agreements with the CVWD and the Desert Water Agency ("Desert") that require MWD to exchange its Colorado River water for those agencies' SWP entitlement water on an annual basis. Because Desert and Coachella do not have a physical connection to the SWP, MWD takes delivery of Desert's and CVWD's SWP supplies and delivers a like amount of Colorado River water to the agencies. In accordance with an advance delivery agreement executed by MWD, CVWD and Desert, MWD delivers Colorado River water in advance to these agencies for storage in the Upper Coachella Valley groundwater basin. In years when supplies are needed to meet local demands, MWD has the option to receive the water supply and must pay the associated SWP transportation costs and CVWD and Desert may use the stored water.

Arvin-Edison/Metropolitan Water Management Program. In December 1997, MWD entered into an agreement with the Arvin-Edison Water Storage District ("Arvin-Edison"), an irrigation agency located southeast of Bakersfield, California. Under the program, Arvin-Edison stores water on behalf of MWD. In January 2008, MWD amended the agreement to enhance the program's capabilities and to increase the delivery of water to the California Aqueduct. The agreement includes a "Regulation Program" and a "Transportation Program". Under the terms of the Regulation Program, Arvin-Edison will regulate the storage and delivery for MWD of up to 350,000 AF of water and currently has 209,251 AF in the program. Arvin-Edison is obligated to return up to 75,000 AF of water in any year to MWD, upon request. The minimum estimated return capability for the Arvin-Edison program varies from 40,000 AF per year to 75,000 AFY per year depending on hydrologic/groundwater conditions. As a result of the operational history, the long-term return capability for the program during dry years has been estimated to be 90,000 AFY. Return water will be delivered to MWD upon request through a new intertie pipeline to the California Aqueduct and by exchange of existing Arvin-Edison supplies in the California Aqueduct. The agreement terminates on December 31, 2022 with provisions for automatic extension if all stored water has not been returned.

The agreement also provides a Transportation Program pursuant to which the MWD is provided priority rights to convey water acquired by MWD from third parties through the Arvin-Edison facilities to the California Aqueduct for ultimate delivery to MWD. The agreement will terminate on November 4, 2035 unless extended. To facilitate the program, new wells, spreading basins and a return conveyance facility connecting Arvin-Edison's existing facilities to the California Aqueduct have been constructed.

MWD California Aqueduct Dry-Year Transfer Program. MWD has entered into agreements with the Kern Delta Water District, the Mojave Water Agency (Demonstration Water Exchange Program) and the San Bernardino Valley Municipal Water District to insure against regulatory and operational uncertainties in the SWP system that could impact the reliability of existing supplies. The total potential yield for the three agreements is approximately 115,000 AFY. MWD entered into an agreement with San Bernardino Valley Municipal Water District in April 2001 to coordinate the use of facilities and SWP water supplies. The agreement allows for the minimum purchase of 20,000 AF on an annual basis with the option to purchase additional water when available. Also, the program includes 50,000 AF of carryover storage. In addition to water being supplied using the SWP, the previously stored water can be returned using an interconnection between the San Bernardino Central Feeder and MWD's Inland Feeder. In Fiscal Year 2006-07, MWD took delivery of 30,000 AF from San Bernardino Valley Municipal Water District under the agreement. MWD did not take any deliveries under this agreement in Fiscal Year 2007-08. This program terminates on December 31, 2014. MWD entered into an agreement with Kern Delta Water District on May 27, 2003, for a groundwater banking and exchange transfer program to allow MWD to store up to 250,000 AF of State Water Contract water in wet years and permit MWD, at MWD's option, a return of up to 50,000 AF of water annually during hydrologic and regulatory droughts.

Additionally, MWD entered into a groundwater banking and exchange transfer agreement with Mojave Water Agency on October 29, 2003. The agreement allows for MWD to store water in an exchange account for later return.

Storage Capacity and Water in Storage. MWD's storage capacity, which includes reservoirs, conjunctive use and other groundwater storage programs within MWD's service area and groundwater and surface storage accounts delivered through the SWP or Colorado River Aqueduct, has increased to 5.0 million AF. Approximately 674,000 AF of stored water is emergency storage that is reserved for use in the event of supply interruptions from earthquakes or similar emergencies, as well as extended drought.

MWD's ability to replenish water storage, both in the local groundwater basins and in surface storage and banking programs, is likely to be limited by Bay-Delta pumping restrictions under the Interim Remedial Order in *NRDC v. Kempthorne*. MWD replenishes its storage accounts when imported supplies exceed demands. Effective storage management is dependent on having sufficient years of excess supplies to store water so that it can be used during times of shortage. Historically, excess supplies have been available in about seven of every ten years. MWD forecasts that, with anticipated supply reductions from the State Water Project, it will need to draw down on storage in about seven of ten years and will be able to replenish storage in about three years out of ten. This extends the time required for regional storage to recover from drawdowns of stored water supplies and could require MWD to implement its water supply allocation plan during extended dry periods.

In 1994, MWD entered into a water banking and exchange program with the Semitropic Water Storage District and its improvement districts ("Semitropic"), located adjacent to the California Aqueduct north of Bakersfield, to store water in the groundwater basin underlying land within Semitropic. The program also entitles MWD to withdrawal and exchange rights for Semitropic's SWP supplies. The agreement terminates in November 2035.

In 1999, MWD became fully vested for 35 percent of the 1,000,000 acre-foot banking project. MWD has a storage allocation of 350,000 AF and currently has 343,327 AF in the program. MWD is entitled to 31,500 AFY (minimum) of pump back capacity and 46,550 AFY (minimum) of entitlement exchange rights. Additionally, MWD has the ability to use other banking partner's rights when they are not being used. As a result, the estimated minimum return capability for MWD is 107,000 AFY.

Over the past two years MWD has drawn down approximately half of its water in storage to meet demands. At its highest in July 2006, MWD's storage was 2.74 million AF. As of December 1, 2008, MWD had approximately 1.7 million AF of water in storage. Groundwater storage and other storage programs may have physical or contractual conditions that affect withdrawal capacity or limit the maximum amount that may be withdrawn each year.

Water Conservation. The central object of MWD's water conservation activities is to help ensure adequate, reliable and affordable water supplies for Southern California by actively promoting efficient water use. The importance of conservation to the region has increased in calendar year 2008 because of drought conditions in the SWP watershed and court-ordered restrictions on Bay-Delta pumping.

MWD's conservation activities have largely been developed to assist its member agencies in meeting the "best management practices" ("BMP") of the California Urban Water Conservation Council's Memorandum of Understanding Regarding Urban Water Conservation in California ("CUWCC MOU") and to meet the conservation goals of the 2004 IRP. Under the terms of the CUWCC MOU and MWD's Conservation Credits Program, MWD co-funds member agency conservation programs designed to achieve greater water use efficiency in residential, commercial, industrial, institutional and landscape applications. Direct spending by MWD on active conservation incentives from Fiscal Year 1989-90 through Fiscal Year 2006-07 was $205 million. The 2004 IRP estimates that 1,100,000 AF of water will be conserved annually in Southern California by calendar year 2025.

In August 2007, MWD launched a significant public outreach campaign to urge consumers and businesses to voluntarily save water during current record dry conditions. The campaign combines radio, print and on-line advertising with media and community outreach efforts. Along with the message to save water, the campaign is intended to educate the public about the uncertainties of future water supplies. MWD's Board also authorized agreements with public agencies to provide financial incentives for water saving measures, ranging from $195 to $500 per acre-foot of potable water saved, up to a maximum of $15 million for the Public Sector Water Efficiency Partnership Demonstration Program. This program aims to continue public support for conservation through public agency accomplishments and efforts. MWD estimated total water savings from this program of 40,000 AF. The campaign was intensified following MWD's declaration of a regional Water Supply Alert on June 10, 2008. MWD urged cities, counties and water districts in its service area to achieve extraordinary conservation by adopting and enforcing drought ordinances, accelerating public outreach and conservation messaging, and developing additional local supplies. MWD estimates that conservation resulting from these measures could reduce the demand for imported water supplies by about 200,000 AF over the twelve months following this declaration. If necessary, MWD could implement its Water Supply Allocation Plan, resulting in mandatory water allocations, prior to calendar year 2010 to reduce water use and drawdowns from water storage reserves.

Metropolitan Water District Supply Management Strategies

MWD's current measures to address potential water supply shortages and interruptions include calling for extraordinary conservation, cutting groundwater replenishment and agricultural water deliveries, maximizing groundwater production, acquiring additional supplies and drawing from storage accounts. MWD suspended groundwater replenishment deliveries on May 1, 2007, and cut deliveries under the IAWP by 30% on January 1, 2008. In addition, MWD is pursuing water transfers, including negotiations with water agencies in the Sacramento and San Joaquin Valleys for transfers. MWD is calling for maximum fallowing in MWD's agricultural land management program within PVID starting in August 2008 and is working with the State of Arizona to withdraw water previously stored in Arizona.

MWD's forecast of water supplies over the next three years, following reductions of SWP deliveries under the Interim Remedial Order in *NRDC v. Kempthorne* and considering dry conditions in the SWP watershed in calendar year 2008 (see "METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA — State Water Project" herein), includes the impact of these and similar anticipated resources actions. Based on DWR estimates of SWP deliveries under the preliminary ruling, assuming an equal division of curtailments between the SWP and Central Valley Project, MWD is planning to meet firm demands in calendar years 2008, 2009 and 2010. However, MWD is withdrawing supplies from surface and groundwater storage to meet current demands. Anticipating that storage could be seriously depleted by the end of calendar year 2010, MWD and its member agencies are calling for voluntary water conservation to lower demands and reduce drawdowns from water storage.

The Central Basin Municipal Water District ("Central Basin") filed a complaint against MWD in Los Angeles Superior Court, Central District, on April 16, 2008 challenging MWD's adoption of the Water Supply Allocation Plan. The complaint alleges that the Water Supply Allocation Plan violates Central Basin's preferential right to purchase of water and, if implemented, will be a breach of Central Basin's member agency purchase; that MWD inappropriately relied on exemptions under CEQA to avoid CEQA compliance; that the MWD Board's adoption of the Water Supply Allocation Plan failed to address "environmental justice"; that the Water Supply Allocation Plan's penalty rate is unfair, unreasonably discriminates against Central Basin and is an unauthorized "special tax" enacted without voter approval; and that adoption of the Water Supply Allocation Plan violated California and United

States constitutional rights regarding impairment of contract, due process and equal protection. The complaint seeks a writ of mandate setting aside adoption of the Water Supply Allocation Plan and seeks recovery of attorney's fees and other litigation costs. The Los Angeles Superior Court held two hearings on the issue and ordered the case transferred to the San Francisco Superior Court on June 24, 2008. MWD staff is assembling the record and preparing to file appropriate responses.

DWR established the State Drought Water Bank (the "Drought Water Bank") for transfers in 2009 from willing sellers located upstream of the Bay-Delta to water-short buyers through the SWP and CVP. Prospective buyers were required to give expressions of interest to the DWR by October 15, 2008. MWD anticipates purchasing up to 300,000 AF from the Drought Water Bank. Purchases from the Drought Water Bank will be contingent on acquisition by DWR of supplies from willing sellers. Delivery of Drought Water Bank transfers will be contingent on sufficient capacity for export of this water from the Bay-Delta. According to DWR, if precipitation during the winter of 2008-09 is average to relatively wet, capacity for export of the transfer water may become unavailable.

The Supply Plan also includes additional transfers with entities within the Bay-Delta and investigations into the feasibility of crop rotation demonstration projects with Kern County agencies, as well as the return of existing transfers stored in Shasta Lake. In addition, MWD may benefit from a water transfer between North Kern Water Storage District and Desert by taking up to 27,500 AF of SWP water over the next three years and returning this water to Desert in small increments over the next 30 years. MWD's member agencies and retail water suppliers in MWD's service area also may implement water conservation and allocation programs within their respective service territories.

APPENDIX D

EXCERPTS FROM THE COMPREHENSIVE ANNUAL FINANCIAL REPORT OF THE CITY OF SAN DIEGO FOR FISCAL YEAR 2006-07

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CITY OF SAN DIEGO
STATE OF CALIFORNIA

COMPREHENSIVE ANNUAL FINANCIAL REPORT

FOR THE FISCAL YEAR ENDED JUNE 30, 2007

Prepared Under the Supervision of
Gregory Levin, CPA
Comptroller

JERRY SANDERS
MAYOR

October 17, 2008

Citizens and Interested Parties,

The City of San Diego has faced significant financial challenges over the last several years and has made a determined effort to improve its overall financial condition, as well as the quality of its financial disclosures, including its financial statements, its internal controls and its disclosure controls and procedures. The City continues to operate under a cease and desist order ("Order") with the Securities and Exchange Commission as a result of the Commission finding in 2006 that the City had misstated or omitted material information in connection with five bond offerings in 2002 and 2003, and contemporaneous continuing disclosure filings and rating agency presentations, all related to the pension system and retiree health care. City financial disclosures have been improved through the work of the Disclosure Practices Working Group and improvements to the financial reporting processes employed by City financial management.

A few of the City's achievements since the Order include (1) the release within the last eighteen months of audited financial statements for fiscal years 2003-2007; (2) the implementation of an annual five-year financial outlook as a prudent planning tool; (3) the strengthening of the City's General Fund reserves; (4) increased funding of the City's pension system; (5) renegotiating a new pension plan for non-public safety employees hired on or after July 1, 2009; (6) participation in a California Public Employees' Retirement System (CALPERs) trust for pre-funding of post-retirement healthcare benefits for retired City employees and (7) rating upgrades from the national rating agencies, including, in the case of one agency, the reinstatement of the City's credit rating.

The City continues to work through the consequences of many years of financial mismanagement. The City's pension deficit, while significantly smaller than it was just three years ago, is still sizeable at approximately $1.184 billion (as of June 30, 2007). This deficit is the product of a number of factors, including improvements in benefits to members without corresponding funding, and previously selling service credits at less than the cost to the pension system. In addition, the City has a postemployment healthcare actuarial accrued liability of approximately $1.028 billion (as of June 30, 2007).

City management and the City's Independent Budget Analyst have identified structural budget deficits for the foreseeable future. These deficits, coupled with the deteriorating national economy, have affected the City's revenues, placing strain on the City's ability to fund all of its spending priorities. Areas of funding priorities include deferred maintenance, retiree healthcare costs, self insurance claims, and various state and federal regulatory requirements.

At the present time, the City is experiencing, as are other state and local governments across the country, extraordinary conditions in both the equity and debt markets and revised negative economic forecasts for the local, national and world economies. The City is responding to a possible prolonged economic downturn by revising downward its General Fund revenue projections that were utilized in developing the fiscal year 2009 budget. The City is reviewing preliminary first quarter data and is forecasting a General Fund budget deficit of approximately $43 million for fiscal year 2009. This deficit is primarily the result of reduced revenues in the areas of sales tax, property tax, transient occupancy tax, franchise fees, and interest earnings, as well as higher expenditures in booking fees and property tax administrative fees paid to the County. It also reflects approximately $8 million of projected expenditures in excess of the adopted budget. The $43 million represents roughly 3% of the General Fund. Management intends to propose a revised fiscal year 2009 budget to City Council in November that will present reductions in discretionary spending to offset the expected decline in revenues and maintain a balanced budget in fiscal year 2009.

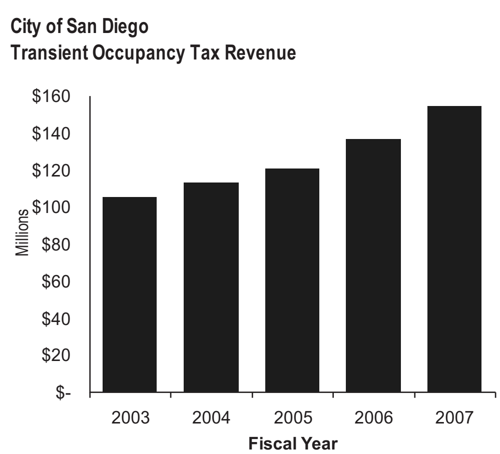
Unlike many municipal and state issuers, San Diego has no variable rate or auction rate debt outstanding. The City does not foresee the need to issue additional debt or revenue anticipation notes to meet any General Fund liquidity needs in fiscal year 2009. The City treasury holds approximately $2 billion that is invested primarily in US Treasuries and agencies, and consistent with the City's investment policy, has sufficient liquidity to meet all currently foreseeable cash demands. The General Fund reserves are approximately $75 million, which includes $55 million set aside in an Emergency Reserve Fund that can be accessed by a majority vote of City Council.

Readers of these financial statements should pay particular attention to Notes 12, 13, 18, and 22, concerning Pension Plans, Other Post Employment Benefits, Contingencies, and Subsequent Events, respectively. These notes address certain issues underlying the City's ongoing financial difficulties, including the under funding of the City's pension system and the November 2006 settlement with the Securities and Exchange Commission for violations of federal securities laws that stemmed from inadequate disclosures of pension liabilities, as well as various investigative reports regarding those matters. 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, 2007.

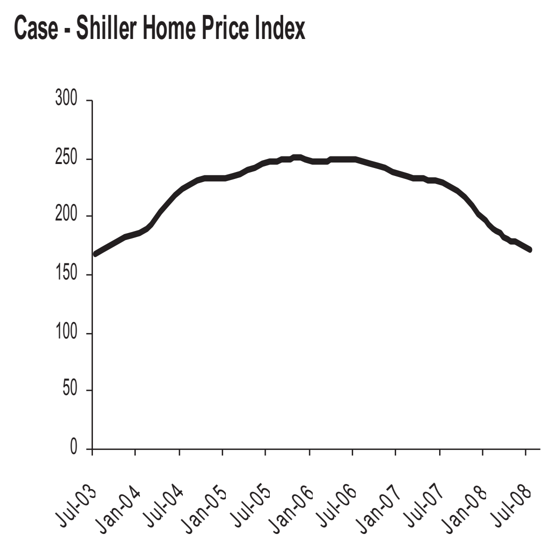
Our Underlying Fundamentals

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

The hospitality industry remains strong and the City projects continued growth in hotel taxes ("Transient Occupancy Tax" or "TOT"). The City's TOT is currently 10.5% and is allocated according to the Municipal Code. As such, the General Fund receives 52% of these revenues to be used for general governmental purposes, and the TOT fund receives the remaining 48% for the purpose of promoting the City as a tourism destination. The General Fund portion of TOT represents approximately 8% of General Fund revenue. In 2007, a total of 31.6 million visitors spent approximately $7.9 billion in San



Diego, resulting in a 10.7% increase in transient occupancy tax revenue over calendar year 2006. The fiscal year 2009 TOT budget is $173 million, which represents an approximate 6% growth rate over the fiscal year 2008 budget of $162.6 million.

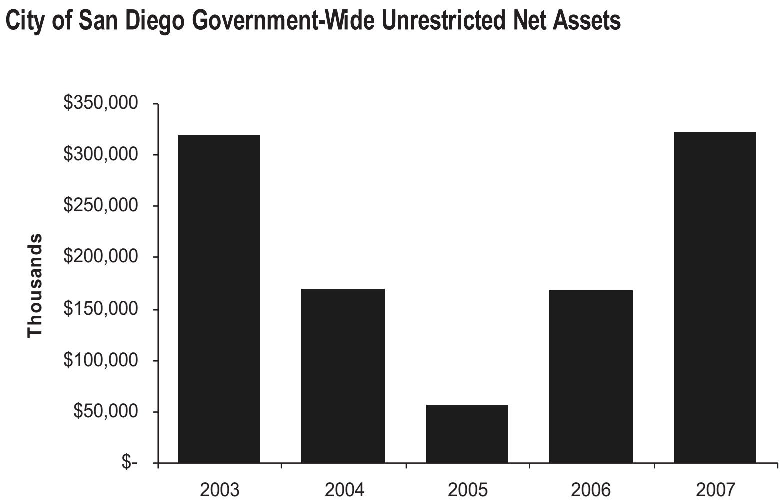


The median home price in San Diego increased by 125% from calendar years 2000 to 2005, which also increased City property tax revenues. However, the San Diego market has been one of the hardest hit during the recent national decline in home prices. The Case-Shiller Home Price Index for July 2008 shows the County of San Diego (County) median home price is down 31.2% from its peak in November 2005. There have been 9,275 foreclosures so far in the first half of calendar 2008 (through June). Annualized, this would be approximately double the 8,417 foreclosures in the County during calendar 2007, which was a significant increase when compared to 2,065 foreclosures in 2006 and 559 in 2005. The total number of housing units through June 2008 is 1,140,349; which means foreclosures represent approximately .81% of the total units. In 2007, the total number of housing units was 1,131,749, representing a .74% foreclosure rate. The impact of the deteriorating housing market is widespread, affecting the construction sector, consumer spending on retail goods and automobiles, home improvement purchases and furnishings. The City has reduced property tax growth projections from 6% to 5.75% in the fiscal year 2009 Annual Budget to account for these economic conditions, resulting in a budget of $411.1 million. Similarly, the City's projected growth in sales tax revenue has been reduced from 1.25% to .75%, which is projected to be $222.1 million.

As of August 2008, the unemployment rate for the City was 6.4%, and was 6.4%, 7.6% and 6.1% for the County, State of California (State), and nation, respectively. For the period from 2003 to 2007, the City and County have experienced an unemployment rate less than or equal to the national average. For example, for calendar year ended December 31, 2007, the unemployment rates for the City, County and nation were all 4.6%. However, a large decrease in County and City school jobs, approximately 8,000, has caused an increase locally, as compared to the nation.

Our Financial Health

The City's total government-wide revenues, which are generated through a combination of governmental and business-type activities, have increased over the past five years by approximately 28%. This increase was primarily driven by the consistent growth of general revenues such as property taxes and transient occupancy taxes. Over the last five years, the City's expenditures have grown approximately 18%. These expenditures were for providing public services, as well as addressing the significant fiscal challenges of the City, including funding of the City's pension system, post-employment healthcare benefits, and deferred maintenance.



Government-wide revenues have consistently exceeded expenditures over the past five years and this has had a positive impact on the City's Total Net Assets, which have increased by approximately $676 million since fiscal year 2003. Total Net Assets (assets minus liabilities) are presented in three separate components: (1) Net Assets Invested in Capital Assets, net of Related Debt, (2) Restricted Net Assets, and (3) Unrestricted Net Assets. The increase has been almost entirely in the Invested in Capital Assets category; however, because the City has not been able to access the public bond markets, a large part of our capital improvements have been funded from cash. This has resulted in a deficit in our Governmental Activities' Unrestricted Net Assets. The City has been able to improve the Governmental Activities' Unrestricted Net Asset balances in fiscal year 2007, primarily due to expenditure savings in the General Fund and increased property tax revenues.

Public safety is a primary government responsibility and the provision of public safety services is the largest component of governmental expenses. During 2007, approximately 37% of total governmental activities expenses were for Public Safety. Spending on the remaining functions is as follows: General Government and Support expenses were 17%; Transportation expenses were 17%; Parks, Recreation, Culture and Leisure were 15%; Neighborhood Services expenses were 6%; Debt Service Interest expense was 5%; and lastly, Sanitation and Health expenses represented 3% of total governmental activities expenses in fiscal year 2007.

Pension Funding Progress (Thousands)

Actuarial Valuation Date	UAAL	Funded Ratio
6/30/2005	$ 1,452,937	67.30%
6/30/2006	1,000,768	79.90%
6/30/2007	1,184,242	78.80%

The City's unfunded pension liability remains a significant obligation of the City. This liability resulted from the under funding of the pension system, diversion of pension fund investment earnings to pay for contingent benefits and retiree healthcare, and poor investment returns, particularly between 2000 and 2003. At its highest level, the unfunded pension liability was projected at $1.453 billion in fiscal year 2005. The City has aggressively confronted this deficit, fully funding the City's annual required contribution ("ARC") beginning in fiscal year 2006, as well as making significant additional payments in excess of the ARC into the pension fund. The June 30, 2007 valuation estimated the unfunded pension liability to be approximately $1.184 billion and the City's net pension obligation has been reduced to $195 million from a high of $290 million (fiscal year 2005) on a government-wide basis.

Presently, the global financial markets have experienced significant declines. The effects of the market declines have been wide ranging and impact even the most diversified investment portfolios. The San Diego City Employee Retirement System (SDCERS) investment portfolio is no exception. Upon request of the City, SDCERS has recently reported that as of September 30, 2008 the portfolio had an estimated approximate asset value of $4.32 billion (unaudited). SDCERS has not yet completed its routine quarterly reporting process and this report did not include the most recent data on real estate valuations which are delayed by one fiscal quarter. Additionally, SDCERS indicates that plan sponsor contributions and benefit payments result in significant cash flows into and out of the fund. SDCERS indicates that making comparison to June 30, 2007 or June 30, 2008 asset valuations may not accurately reflect the performance of the portfolio. However, for the benefit of the reader, SDCERS reported an actuarial valuation of assets of $4.41 billion for fiscal year ended June 30, 2007. SDCERS Financial Statements for Fiscal Year ended June 30, 2008 have not been completed yet; however, the June 30, 2008 unaudited investment report reported a total portfolio asset valuation of approximately $4.69 billion.

SDCERS employs a long-term investment strategy. The City's Annual Required Contribution is determined using an asset smoothing technique that spreads the effects of market trends over a period of 4 years. As of the issuance of this report, the extent of the impact of the current market downturn on the City's Annual Required Contribution for fiscal year 2010 and 2011 is unknown.

The City has ceased past practices that resulted in the current pension deficit, and SDCERS is in the process of incorporating more conservative actuarial assumptions and methodology changes into the pension plan. Governance of the pension system has been overhauled and the system has settled all outstanding issues with the Internal Revenue Services regarding retirement system practices that did not comply with the Internal Revenue Code.

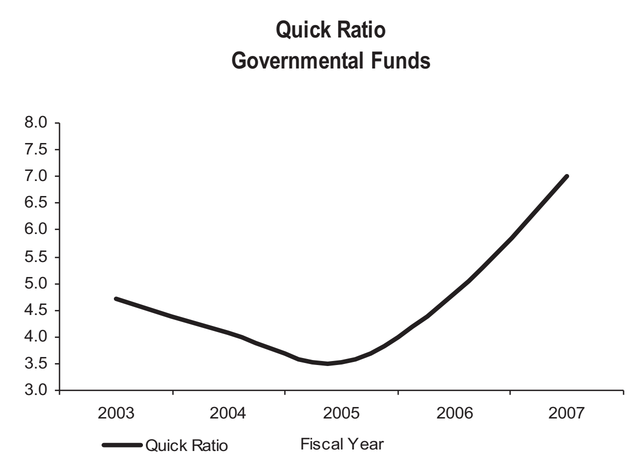
In fiscal year 2008, Governmental Accounting Standards Board Statement 45 ("GASB 45"), went into effect requiring all municipal governments to report on Other Post Employment Benefits (retiree healthcare costs) in a manner similar to reporting on pension benefits. The City's actuarial valuation for retiree healthcare costs estimated an unfunded actuarial accrued liability of $1.03 billion as of June 30, 2007, which is the basis for the fiscal year 2009 budget. The City is participating in a trust administered by CalPERS to begin advance-funding this liability and, to date, has contributed $54 million to the CalPERS trust. The City is not currently fully funding the ARC for retiree healthcare, which is estimated to be $104 million for fiscal year 2009, the amount budgeted in fiscal year 2009 is $50 million.

Retiree Healthcare Liabilities (Thousands)

Valuation fiscal year ended 6/30/2007	Full Funding Method (7.75% Earnings Assumption)	UAAL Partial Funding (blended 6.69% rate)
Actuarial Accrued Liability	$ 819,900	$ 1,027,918
Annual Required Contribution	$ 87,597	$ 104,475

Governmental Funds
(Tax Supported Operations)

The City established a Reserve Policy in November 2007 to improve the condition of the City's cash reserves. Due to higher than expected revenue and curbed expenditures, the City's liquidity position has improved since 2003. The City's liquid assets (cash + investments + receivables), relative to its current liabilities (governmental quick ratio) have improved from a ratio of 4.81 in 2006 to 7.00 at the end of fiscal year 2007.



The City's General Fund finished fiscal year 2007 with unrestricted cash and investments of approximately $97 million. In fiscal year 2008, the City established an emergency reserve fund and set aside $55 million from the General Fund to protect the City against natural disasters or unforeseen events. The General Fund Reserve Policy set a funding goal of 6% of General Fund revenue by the end of fiscal year 2008. Unaudited financials for June 30, 2008 report a General Fund reserve of 6.6% of General Fund revenue, resulting in a total reserve balance of $72.5 million. This amount is comprised of $55 million in the emergency reserve, and $17.5 million in unrestricted General Fund reserves. The emergency reserve can only be accessed for qualifying emergencies as declared by the Mayor and/or City Council and ultimately approved by at least a 2/3 vote of the City Council. The reserves are currently cash funded within the City Treasury's pooled cash portfolio. The goal is to establish General Fund reserves at 8% of revenues by fiscal year 2012.

Strong revenue growth and constrained spending have resulted in an increasing fund balance over the last five years. However, deteriorating regional economic conditions, a continued commitment to addressing structural budget deficit reform, and revenue shortfalls for fiscal year 2008 resulted in an estimated reduction of our General Fund Unreserved, Undesignated Fund Balance of approximately $20 million (not including the $55 million transfer to the emergency reserve fund) for the fiscal year ended June 30, 2008. The reduction in Unreserved, Undesignated Fund Balance for fiscal year 2008 was partially related to expenses incurred as a result of recent natural disasters, including landslides and wildfires. Considered in total, the unaudited financial statements for fiscal year 2008 report a reduction in General Fund equity of approximately $63 million, which is primarily the result of the $55 million transfer to the emergency reserve fund mentioned above.

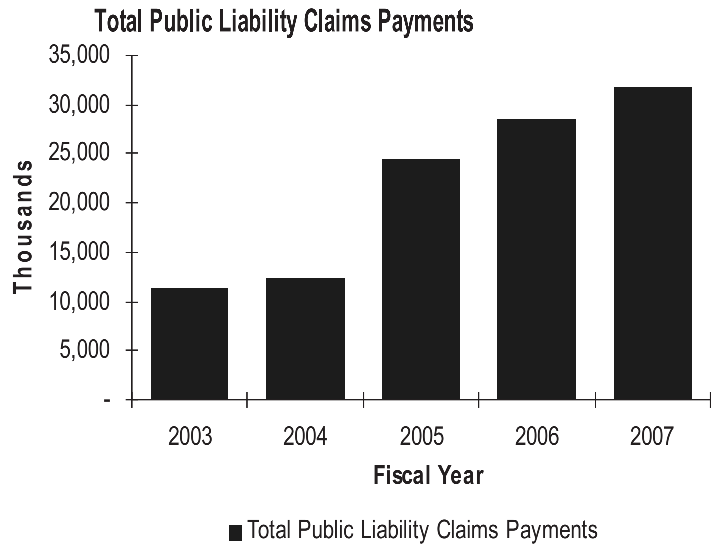
The Fiscal Year 2009 Budget reflects a reduction of personnel expense growth by eliminating budgeted positions and reducing program expenditures. We intend to address the City's budgetary pressures by reducing spending on current services, while mitigating service level reductions when possible. However, the slowing growth of the local economy will test our ability to continue balancing the budget and may require tough decisions. Certain service level reductions may be unavoidable absent increased revenues or significant efficiency gains.

During fiscal year 2007, total liabilities of the City's governmental activities increased by $112 million. This is largely the result of the decision to extend, beyond the end of the fiscal year, the holding of assets and the associated liability for repayment of Tax Revenue Anticipation Notes. Overall, our annual interest costs for governmental activities were approximately $85 million in fiscal year 2007, which represents approximately 5% of our total governmental activities revenue (including transfers).

The City's capital assets are essential to providing services to our residents and maintaining the quality of our environment. In recent years, the primary source of capital asset increases has been developer contributions, rather than City funded capital improvements. During 2007, our governmental activities infrastructure balances declined by approximately $41 million. The decline resulted primarily from a write down of $40 million in capital asset balances due to internal control weaknesses in operating departments. Specifically, the write down is associated with the administration of the City's Facilities Benefit Assessment Credit program, which is an unusual method of financing infrastructure. The program allows for the City's share of the cost of capital assets jointly financed by the City and private developers to be funded by offering credits to developers for future permit fees. This write down did not result in a restatement of the fiscal year 2006 capital asset balances as it is not material when compared to the total governmental assets of approximately $5.8 billion in fiscal year 2006.

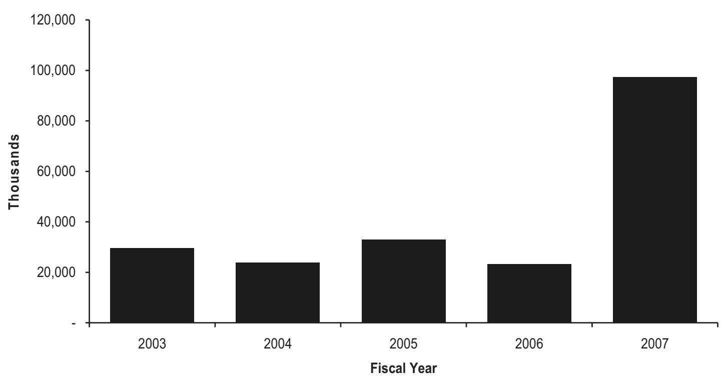
The City's deferred maintenance backlog is estimated to be approximately $800 to $900 million, according to the most recent Five Year Financial Outlook. This includes the cost of repairs of City streets, sidewalks, and facilities that have been deferred because the City does not have necessary funding resources. An assessment of facilities maintenance needs is still ongoing and the results may increase this estimate. That assessment is scheduled to be completed by December 2008.

The City's Public Liability Fund has a deficit of approximately $30 million as of June 30, 2007. This fund has seen significantly higher claims since fiscal year 2005, largely as a result of the legal claims and investigations stemming from the pension fund underpayment and related financial disclosure issues. The Workers' Compensation Fund has a deficit of $138 million as of June 30, 2007. This is primarily the result of increased healthcare costs. Per the City Reserve Policy, the City intends to establish dedicated cash reserves in both funds equal to 50% of the outstanding claims in each fund. This is expected to be achieved by no later than fiscal year 2014.



Governmental Activities Key Indicators

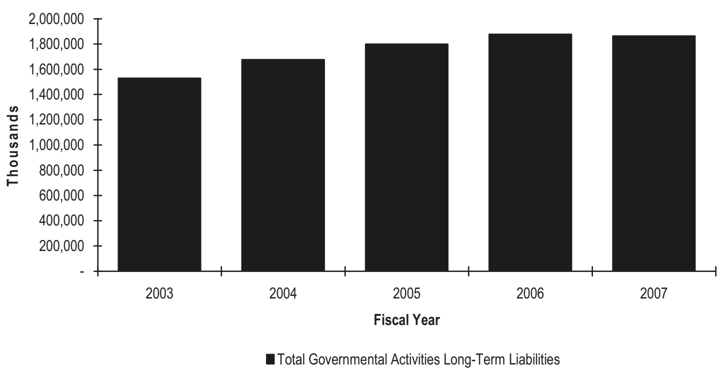
General Fund Cash and Investments



General Fund Cash

Realized expenditure savings and higher than anticipated revenues improved the City's liquidity position.

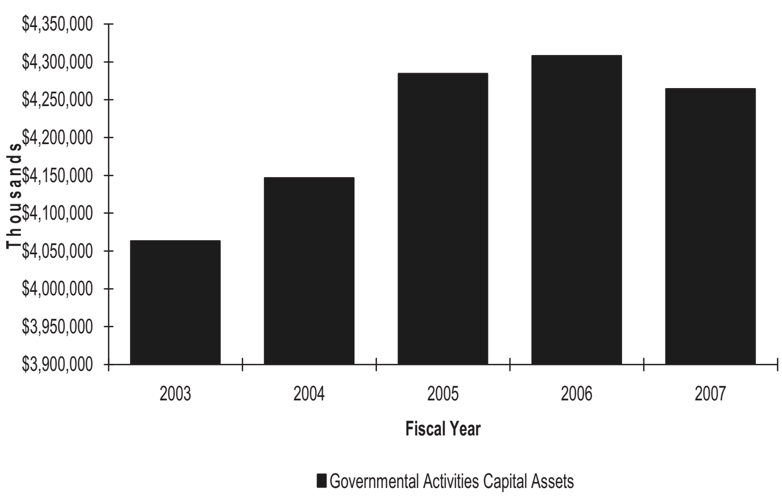
Total Governmental Activities Long-Term Liabilities



Long-term Liabilities

Paying down the outstanding principal on existing debt, and constraints on the City's ability to issue new debt is the reason for a reduction of long-term liabilities in Fiscal Year 2007.

Governmental Activities Capital Assets



Capital Assets

Without proceeds from bond financings, our capital expenditures have been primarily funded by operating budgets and developer contributions. This reduced funding for capital projects has caused depreciation to exceed depreciable asset additions. This has caused a decline in capital asset balances in Fiscal Year 2007.

Business-Type Activities

The majority of the City's business-type activities are related to utilities that provide water and wastewater services to City residents. Both the Water and Sewer Utility Departments serve several regional agencies outside of the City's boundaries.

The operations of both utilities are supported by fees charged to customers. On May 18, 2007, the San Diego County Superior Court approved the settlement of a class action lawsuit affecting sewer rates for the City. The lawsuit alleged that the City had overcharged single family residential customers, while undercharging other customers, for sewer service up until rates were revised in October 2004. A new rate structure was put into place in November 2007 to satisfy the terms of the settlement, with rate reversals and credits to eligible residential customers to correct past overcharges. Once the settlement amount has been raised and distributed (on or about October 30, 2011); the rate reversals and monthly credits will cease. Additionally, the Independent Rate Oversight Committee was created to monitor utility rates and expenditures.

The City's utilities have been unable to access public financial markets because of the City's suspended bond rating. To compensate, the City has completed several private financing transactions for both the Water and Sewer Utilities. This has resulted in an increase to our Invested in Capital Assets, Net of Related Debt component of Net Assets. We intend to return to the public market in the near future in an effort to meet our infrastructure demands.

For the year ended June 30, 2007, the City's business-type activities closed with restricted and unrestricted cash and investment balances totaling $719 million. The City's fiscal year 2007 ratio of liquid assets to current liabilities for business-type activities is 3.61, an improvement over the fiscal year 2006 ratio of 2.76.

The City's liabilities for business-type activities have increased by $96 million since fiscal year 2006. This increase is related to the issuance of notes payable, offset partially by a decrease in outstanding revenue bonds. On June 30, 2007 the City's business-type activities reported total liabilities of $2.072 billion. While the City's capital assets for business-type activities have continued to increase in value, deferred maintenance remains a challenge, as does compliance with environmental regulations.

Engineering standards have changed over time and part of the City's water distribution system consists of outdated cast iron pipes. Aging water pipes can lead to infrastructure failures, and the City has addressed this challenge by replacing water pipes funded through a variety of methods including private placement debt, and loans from state and federal agencies. Future infrastructure projects are expected to be funded by a combination of financing and cash.

Compliance with environmental regulations generally requires infrastructure construction, including the replacement of water distribution systems, the construction of new wastewater collection systems, and improving sewage treatment capacity. The City has agreed to significant infrastructure upgrades and continues to work with regulatory authorities. This includes a December 2007 waiver application to the Environmental Protection Agency to renew a modified permit for the Point Loma Wastewater Treatment Plant.

The City is also facing challenges to the future of its water supplies. A persistent regional drought and judicial decisions regarding management of the State Water Project has put significant pressure on San Diego's regional water supplies. The City of San Diego imports as much as 90% of its water supply. That supply may be reduced in the near future as the impact of court decisions, the diminishing availability of stored water, and dwindling supplies of new water are addressed by the City's water wholesalers.

The availability of water has legal implications and could potentially affect City Council findings regarding state mandated water supply assessments for future development. These assessments must demonstrate the long-term availability of water for large projects before those projects can be approved by local jurisdictions. At this time, it is unclear what effect limitations to water supplies would have on the City's economy and its revenues.

In an effort to address concerns regarding the City's water supplies, the City has taken a leadership position in advocating water conservation, general water awareness, and efforts to develop a bond measure necessary to fund improvements to the State's water infrastructure. To that extent, the Mayor declared a local water emergency and implemented a Stage 1 Water Watch for the City. The Water Watch is the first formal step under the City's Municipal Code and may lead to increasingly stringent controls on water use in San Diego. Also, at the direction of the City Council, the City is exploring water recycling systems that may reduce the City's reliance on imported water.

Focus on Governance

In November 2006, the City entered a cease and desist order with the SEC, settling all claims by that agency against the City. Since then, the City has released audited financial statements for fiscal years 2003-2007 and implemented a number of reforms regarding disclosure and internal controls and governance with the intent of establishing best practices in these areas.

Internal controls requiring improvement were identified in early reports from the City and in management letters received from its independent auditors. Additionally, various consultants hired to investigate the City's financial reporting and sewer rate setting practices recommended actions to ensure greater accuracy in financial reporting. As of June 1, 2008, the City has implemented approximately 82% of the recommendations contained in various investigative reports and we have established a plan to address the remainder. This includes the acquisition of an enterprise resource planning (ERP) system to improve the way the City manages finances and the processes and internal controls involved in the City's accounting, financial reporting and human resources functions.

In 2005, the City changed its structure to a Strong-Mayor form of government. Under this structure, the Mayor has executive and administrative responsibility for the City's day to day operations, and the City Council, as the legislative body of the City, sets policy including approving the City's budget. The transition also created the position of Independent Budget Analyst whose role is to provide budget oversight to the City Council on legislative initiatives that have policy and financial impacts.

The City also changed its financial management structure to enhance accountability. The position of Chief Financial Officer was created and placed in charge of all City financial operations. By voter referendum, the City Charter was amended to split the Office of the Auditor and Comptroller, effective July 2008. The City Comptroller now reports to the Chief Financial Officer and a newly-created position of City Auditor reports to a new, independent Audit Committee composed of two City Council members and three outside members with expertise in audit and accounting practices. The City Comptroller is responsible for financial reporting, and the City Auditor oversees the City's internal audit function with the oversight and direction of the new Audit Committee.

A Financial Vision for the Future

On January 11, 2008, the City released an updated Five-Year Financial Outlook for fiscal years 2009 through 2013. This document is an examination of the City's long range fiscal condition and financial challenges. The City intends to update the Five-Year Outlook periodically to account for changed circumstances. In addition to other issues, the financial outlook concentrates on eight significant areas that must be addressed in order to restore and preserve the fiscal integrity and/or meet the legal obligations of the City. These eight significant areas are discussed below.

General Fund -Funding for Eight Areas of Focus

(Thousands)

	2009*	2010	2011	2012	2013
Pension Plan: Annual Required Contribution 1	$ 161,700	$ 172,000	$ 179,300	$ 186,900	$ 187,300
Reserve Contributions	3,700	8,600	9,300	9,900	3,900
Deferred Maintenance	31,600	53,000	67,100	75,400	69,900
Post Employment Retiree Health	50,000	75,000	75,000	75,000	75,000
Storm Water Compliance	27,500	36,600	36,600	36,600	36,600
ADA Compliance	10,000	10,000	10,000	10,000	10,000
Workers' Compensation Fund	4,000	10,000	10,000	10,000	10,000
Public Liability Fund	10,000	5,000	10,000	10,000	10,000
Totals	$ 298,500	$ 370,200	$ 397,300	$ 413,800	$ 402,700

1 The Annual Required Contribution assumes a 20 year time horizon to eliminate the unfunded pension liability with no negative amortization

* FY 2009 reflects FY 2009 Annual Budget; FY 2010-2013 reflect the Five Year Financial Outlook projections.

Pension Plan

In 2005, the City only funded 68% of its annual required contribution (ARC). Commencing in fiscal year 2006, the City has funded 100% of the ARC and our financial forecast assumes the full funding of the ARC into the future. For fiscal year 2009, our Annual Required Contribution is $161.7 million. We currently anticipate an annual growth rate of 4.25% in our pension costs over the next five years. Current projections indicate that in fiscal year 2013 our annual required contribution will be approximately $187 million. The City is also currently evaluating financing options as a means to fund our pension liability.

General Fund Reserves

The establishment of reserves is essential to minimize service level impacts as a result of emergencies and changes in the local economy. It is the City's goal to achieve a General Fund reserve of 8% of budgeted General Fund revenues by fiscal year 2012.

Deferred Maintenance Backlog

As previously discussed, the City's deferred maintenance/capital needs are approximately $800 to $900 million excluding those related to the City's Water and Sewer Utilities. Since that estimate was produced, the State passed a bond initiative to fund street and road improvements, which has aided the City's efforts to improve infrastructure. However, our goal is to supplement this funding by contributing $297 million in funding for deferred maintenance over the five year period ending in fiscal year 2013 through a combination of financing and cash funding.

Post Employment Retiree Health

In 2008, the City contracted with the CalPERS Employer Trust Fund to pre-fund the retiree health liability and has contributed approximately $54 million, to date, toward advance funding of the benefits. In addition, the City covered the annual (cash basis) cost out of the City's treasury. The City's unfunded actuarial accrued liability for retiree health is estimated to be $1.03 billion in fiscal year 2009. The City's intent is to pay approximately 50% of the ARC over the next 5 years and to fully fund the ARC thereafter. The June 30, 2007 valuation estimates the ARC to be $104 million for fiscal year ending June 30, 2009.

Obligations Related to Storm Water Runoff Permits
Efforts to comply with storm water runoff regulations, including public education, maintenance, and monitoring, has had a significant impact on the City's budget. In fiscal year 2008, $18 million was budgeted. The 2009-2013 Outlook includes $27.5 million for fiscal year 2009 and $36.6 million annually for fiscal years 2010-2013 for street sweeping, public education, and monitoring requirements.

Americans with Disabilities Act (ADA) Obligations
The Americans with Disabilities Act (ADA) requires public agencies and private companies to make facilities and infrastructure accessible. In fiscal year 2008, a total of $2.3 million in Community Development Block Grant (CDBG) funds were allocated for ADA improvements and the total citywide allocation for ADA-related purposes was $12.3 million. The Five-Year Financial Outlook includes $10 million dollars in ADA improvements annually.

Workers' Compensation Fund
The City had approximately $161 million in outstanding workers' compensation claims, and $24 million in cash reserves at June 30, 2007. The City's Reserve Policy targets a reserve that is 50% of the value of outstanding claims by fiscal year 2014. While the fiscal year 2008 Annual Budget included $26.1 million to cover the regular projected annual cash payments, we have allocated an additional $4 million in the fiscal year 2009 budget. In order to build reserves, we plan on contributing $10 million for each year thereafter, in addition to the expected annual cash payments.

Public Liability Fund
The City has approximately $38 million in outstanding public liability claims and $9 million in reserves. Similar to the Workers' Compensation Fund reserve, the City's new Reserve Policy targets a reserve equivalent to 50% of the value of outstanding claims by fiscal year 2014. $10 million has been allocated to this reserve in fiscal year 2009 and an additional $5 million will be allocated in 2010. Beginning in fiscal year 2011, our plan is to increase annual allocations to $10 million per year. All amounts referenced are in addition to the annual budgeted amount to cover the projected annual claims.

Future Challenges

These are difficult economic times, and we have set challenging goals for the City's future. We believe these goals are achievable with continued fiscal discipline and greater government efficiency. San Diego has relatively low taxes and fees compared to most other large municipalities in the United States. The necessity of correcting past decisions and creating a more fiscally sound city may require tradeoffs. We expect the cumulative annual cost of our future goals to be $210 million by fiscal year 2010 and rise to $227 million by fiscal year 2013. When balanced against our expectations of future revenues and expenses, the Outlook currently projects annual budget deficits that range from $50 million to $85 million over the next five years, and accordingly, the Mayor and City Council will need to work together to balance the budget of each year.

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, 2007, 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. Our objective is to provide you with reasonable, rather than absolute, assurance that the financial statements are free of any material misstatements. Additionally, the City continues to construct and improve a comprehensive internal control framework in order to ensure acceptable management of taxpayer funds.

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

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

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

- The financial section is prepared in accordance with governmental accounting standards. It includes the MD&A (unaudited), the independent auditor's report, the audited basic financial statements, notes to the basic financial statements, required supplementary information, and supporting statements and schedules.

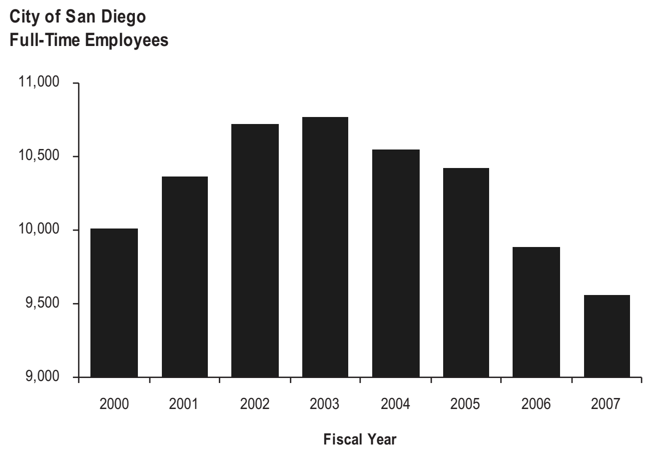
- The statistical section contains historical statistical data on the City's financial data and debt statistics, as well as miscellaneous physical, demographic, economic, and social data of the City. This section of the CAFR is unaudited.

Profile of the City of San Diego

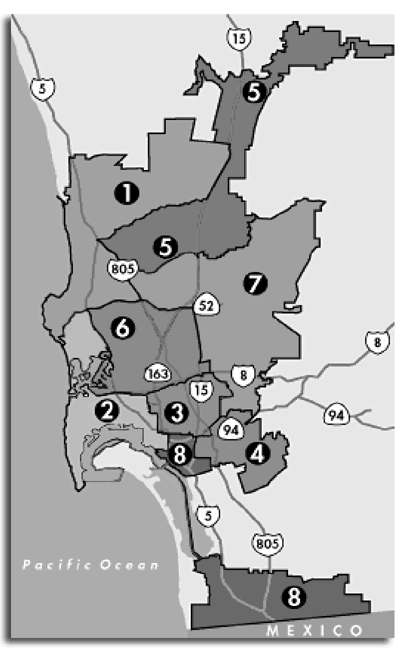
The City of San Diego was incorporated in 1850. The City is comprised of 403 square miles and, as of January 1, 2008, the California Department of Finance estimates the population to be 1,336,865. The City, with approximately 9,600 full-time employees, provides a full range of governmental services which 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.

Governing Structure

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



City of San Diego Council District Map



The charter amendment adopting the Strong-Mayor form of government is in effect for five years, and pending a voter approved extension or modification, sunsets on December 31, 2010. Under the Strong-Mayor form of government, the Mayor is the Chief Executive Officer of the City and has direct oversight over all City functions and services except for the City Council, Personnel, City Clerk, Independent Budget Analyst (IBA), City Attorney, and City Auditor's departments. Under this form of government, the Council is composed of eight members and is presided over by the Council President, who is selected by a majority vote of the Council. The Mayor presides over Council in closed session meetings of the Council. The Council retains its legislative authority; however, all City Council resolutions and ordinances are subject to a veto of the Mayor except for certain ordinances including emergency declarations and the City's annual Salary and Appropriations Ordinances. The City Council may override a Mayoral veto with five votes. The City Attorney, who is elected for a four-year term, serves as the chief legal advisor of and attorney for the City and all departments.

During the County's primary election held on June 3, 2008, voters approved Proposition B which requires Council to place a measure on the June 2010 ballot to allow voters to decide whether the Strong-Mayor form of government should become permanent effective January 1, 2011. Additionally, Proposition B provides for the public to decide whether the number of Council districts should increase from eight to nine, and therefore, a corresponding increase of Council votes required to override the Mayor's veto from five to six. Additionally, voters approved Proposition C which separated the City Auditor's Office from the Comptroller's Office and made the Office of the IBA permanent. Under this amendment, the City Auditor serves a 10 year term and is supervised by an Audit Committee consisting of two Councilmembers and three members of the public, with auditing expertise who are appointed by the City Council. This amendment also provides that the Mayor will appoint, with Council confirmation, the Chief Financial Officer. In addition, the Mayor's appointment of the City Treasurer no longer requires Council confirmation.

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

Mayor Jerry Sanders

District 1
Council President Scott Peters

District 5
Councilmember Brian Maienschein

District 2
Councilmember Kevin Faulconer

District 6
Councilmember Donna Frye

District 3
Councilmember Toni Atkins

District 7
Councilmember Jim Madaffer

District 4
Council President Pro Tem
Tony Young

District 8
Councilmember Ben Hueso

City Attorney
Michael Aguirre

Other City Officials

Jay M. Goldstone, Chief Operating Officer

Mary Lewis, Chief Financial Officer

Greg Levin, Comptroller

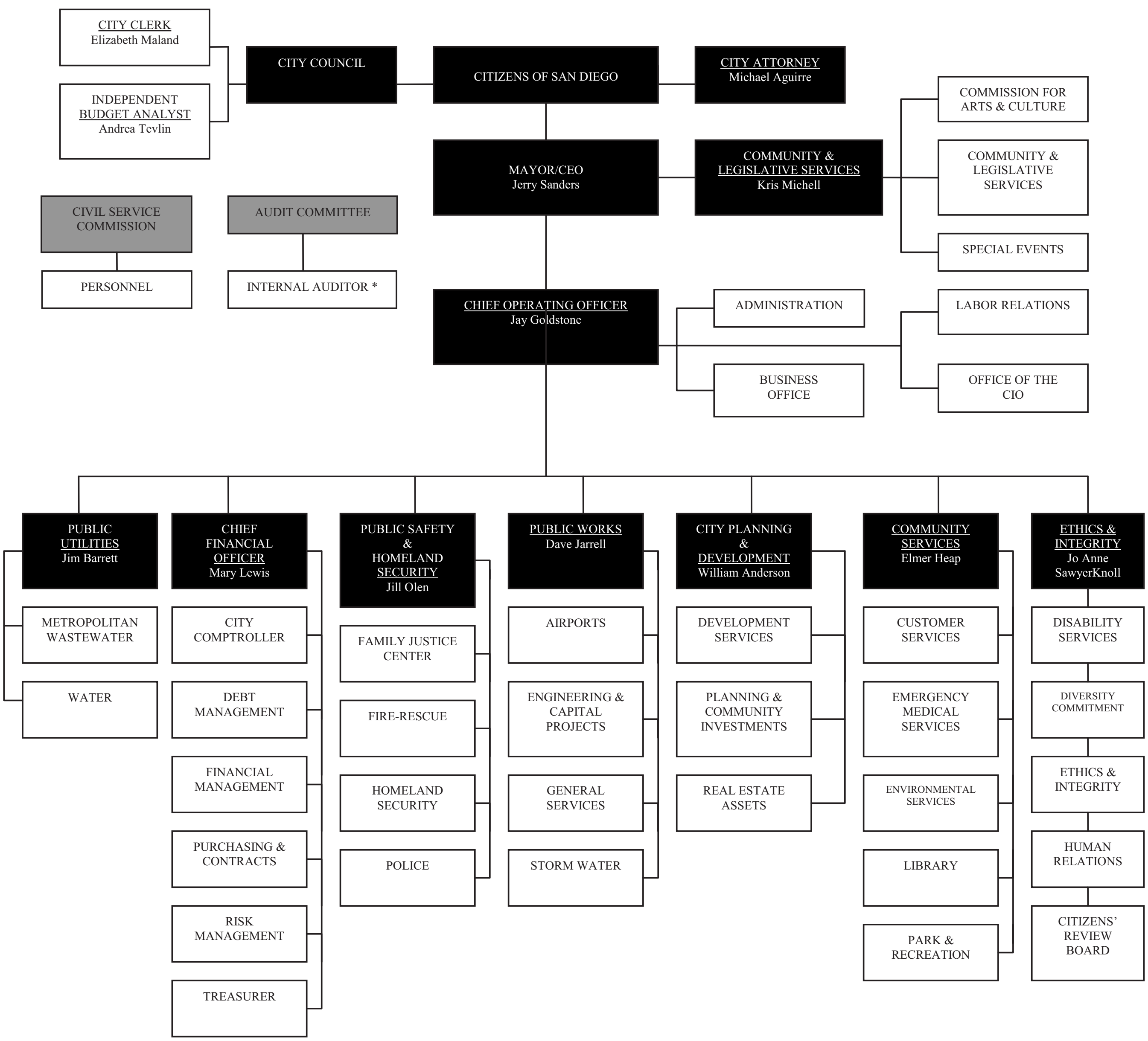
Gail Granewich, City Treasurer

Elizabeth Maland, City Clerk

Andrea Tevlin, Independent Budget Analyst

Eduardo Luna, Internal Auditor

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



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

Financial Reporting Entity

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

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

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

Budgetary Process

Pursuant to the City Charter, an annual budget is presented by the Mayor to the City Council for consideration. Set forth in this budget are the anticipated revenues and expenditures of the General Fund, certain special revenue funds, enterprise funds, and certain debt service funds for the ensuing fiscal year. Additionally, project-length financial plans are presented to and adopted by council for the capital projects funds. The level of budgetary control (the level at which expenditures cannot legally exceed the appropriated amount) is maintained at the fund, department, and object class level. Object classes are defined as salaries and non–personnel expense (including employee benefits). Copies of the City's Budgets are available at the Financial Management Office located at 202 C Street, MS8A, San Diego, CA 92101.

The City also maintains an encumbrance accounting system as one technique of accomplishing budgetary control. Encumbered amounts are reported as reservations of fund balances since the commitments are expected to be honored in subsequent periods.

We continue to look for ways to improve the effectiveness and efficiency of our operations. Our focus now is on crafting policy that will ensure a continued commitment to strong financial stewardship.

Sincerely,

Jerry Sanders
Mayor

Jay M. Goldstone
Chief Operating Officer

Mary Lewis
Chief Financial Officer

Greg Levin, CPA
Comptroller

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Financial Section

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Independent Auditor's Report

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

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the City of San Diego, California (City), as of and for the year ended June 30, 2007, which collectively comprise the City's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the City's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of the San Diego Housing Commission, a discretely presented component unit, which statements reflect 90%, 94% and 83% of total assets, total net assets and total revenues, respectively, of the aggregate discretely presented component unit totals. Those financial statements were audited by other auditors whose report thereon has been furnished to us, and our opinion, insofar as it relates to the amounts included for the San Diego Housing Commission, is based solely on the report of the other auditors.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the 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. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the report of other auditors provide a reasonable basis for our opinions.

In our opinion, based on our audit and the report 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, 2007, 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.

The management's discussion and analysis, analysis of funding progress and general fund budgetary information on pages 33 through 47, 159 and 163 through 166, respectively, are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Macias Gini & O'Connell LLP

Certified Public Accountants

Los Angeles, California
October 17, 2008, except for paragraphs 21, 24 and 25 of Note 22 as to which the date is December 16, 2008, and paragraphs 24, 26, 27, and 28 of Note 18 as to which date is January 21, 2009

MANAGEMENT'S DISCUSSION AND ANALYSIS
(Unaudited)
(In Thousands)
June 30, 2007

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, 2007.

OVERVIEW OF THE FINANCIAL STATEMENTS

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

GOVERNMENT-WIDE FINANCIAL STATEMENTS

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

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

The statement of activities presents information showing changes in the City's net assets during the fiscal year 2007. 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; Parks, Recreation, Culture and Leisure; Transportation; Sanitation and Health; and Neighborhood Services. The business-type activities of the City include: Airports; City Store; Development Services; Environmental Services; Golf Course; Recycling; Sewer Utility; and Water Utility.

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

Included within the primary government as blended component units:

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

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

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

FUND FINANCIAL STATEMENTS

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

GOVERNMENTAL FUNDS

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

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the governmental funds balance sheet and the governmental funds statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

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

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

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

PROPRIETARY FUNDS

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

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

FIDUCIARY FUNDS

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

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

NOTES TO THE FINANCIAL STATEMENTS

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

OTHER INFORMATION

In addition to the basic financial statements and accompanying notes, this report also presents certain required supplementary information concerning the City's progress in funding its obligation to provide pension benefits to its employees. Required supplementary information can be found beginning on page 159 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 statement, beginning on page 191 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	
	2007	2006	2007	2006	2007	2006
Capital Assets	$ 4,264,170	$ 4,307,640	$ 4,605,284	$ 4,536,313	$ 8,869,454	$ 8,843,953
Other Assets	1,824,547	1,511,124	846,103	650,350	2,670,650	2,161,474
Total Assets	6,088,717	5,818,764	5,451,387	5,186,663	11,540,104	11,005,427
Net Long-Term Liabilities	1,863,185	1,876,763	1,967,826	1,866,411	3,831,011	3,743,174
Other Liabilities	285,709	160,423	103,724	109,123	389,433	269,546
Total Liabilities	2,148,894	2,037,186	2,071,550	1,975,534	4,220,444	4,012,720
Net Assets:						
Invested in Capital Assets,						
Net of Related Debt	3,461,127	3,472,531	2,998,848	2,867,469	6,459,975	6,340,000
Restricted	498,695	449,173	37,709	35,085	536,404	484,258
Unrestricted	(19,999)	(140,126)	343,280	308,575	323,281	168,449
Total Net Assets	$ 3,939,823	$ 3,781,578	$ 3,379,837	$ 3,211,129	$ 7,319,660	$ 6,992,707

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. In the case of the City, assets exceeded liabilities by $7,319,660 at June 30, 2007, an increase of $326,953 over fiscal year 2006.

$6,459,975, or approximately 88%, 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.

$536,404, or approximately 7%, of total Net Assets represent resources that are subject to external restrictions on how they may be used. The remaining balance of $323,281, or approximately 5%, is available to finance ongoing services and obligations to the City's citizens and creditors.

Unrestricted Net Assets increased by $154,832, or approximately 92%, which was caused by several factors. General Fund appropriation savings were approximately $50,000, as a result of vacant positions in the Police, Parks and Recreation, Engineering, and other General Government departments, including Auditor and Comptroller, City Treasurer, and Purchasing and Contracts. Property taxes increased by approximately $67,000 due to higher assessed property valuations ($15,000 of this increase was attributed to RDA tax increment revenue generated from the Centre City project area). Business-type Activities comprised approximately $35,000 of the increase in Unrestricted Net Assets, which was primarily due to vacant positions and rate increases for both Water and Sewer Utilities.

The deficit balance of ($19,999) in Unrestricted Net Assets for Governmental Activities reflects the fact that governmental activities raise resources based on when liabilities are expected to be paid, rather than when they are incurred. Most governments normally do not have sufficient current resources on hand to cover current and long-term liabilities. This deficit in and of itself should not be considered an economic or financial difficulty; however, it does measure how far the City has committed the government's future tax revenues for purposes other than capital acquisition.

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

	Governmental Activities		Business-Type Activities		Total Primary Government	
	2007	2006	2007	2006	2007	2006
Revenues:						
Program Revenues						
Charges for Current Services	$ 303,866	$ 278,881	$ 742,640	$ 705,682	$ 1,046,506	$ 984,563
Operating Grants and Contributions	84,745	101,723	1,203	1,909	85,948	103,632
Capital Grants and Contributions	81,169	100,564	141,419	77,602	222,588	178,166
General Revenues						
Property Taxes	526,722	459,777	-	-	526,722	459,777
Transient Occupancy Taxes	154,810	136,803	-	-	154,810	136,803
Other Local Taxes	157,941	148,001	-	-	157,941	148,001
Grants and Contributions not Restricted to						
Specific Programs	5,339	64,039	-	-	5,339	64,039
Sales Taxes	263,399	227,017	-	-	263,399	227,017
Investment Income	76,292	40,108	30,713	16,938	107,005	57,046
Other	94,910	75,943	5,384	6,502	100,294	82,445
Total Revenues	1,749,193	1,632,856	921,359	808,633	2,670,552	2,441,489
Expenses:						
General Government and Support	270,190	252,295	-	-	270,190	252,295
Public Safety-Police	376,581	370,990	-	-	376,581	370,990
Public Safety-Fire, Life Safety, Homeland Security	209,902	194,074	-	-	209,902	194,074
Parks, Recreation, Culture and Leisure	229,500	237,375	-	-	229,500	237,375
Transportation	272,780	200,883	-	-	272,780	200,883
Sanitation and Health	43,780	48,774	-	-	43,780	48,774
Neighborhood Services	99,870	111,886	-	-	99,870	111,886
Debt Service:						
Interest on Long-Term Debt	84,920	71,109	-	-	84,920	71,109
Airports	-	-	3,755	4,100	3,755	4,100
City Store	-	-	843	810	843	810
Development Services	-	-	53,924	57,893	53,924	57,893
Environmental Services	-	-	40,138	44,493	40,138	44,493
Golf Course	-	-	10,690	9,563	10,690	9,563
Recycling	-	-	19,754	21,853	19,754	21,853
Sewer Utility	-	-	313,716	319,274	313,716	319,274
Water Utility	-	-	313,256	302,996	313,256	302,996
Total Expenses	1,587,523	1,487,386	756,076	760,982	2,343,599	2,248,368
Change in Net Assets Before Transfers:	161,670	145,470	165,283	47,651	326,953	193,121
Transfers	(3,425)	4,530	3,425	(4,530)	-	-
Net Change in Net Assets	158,245	150,000	168,708	43,121	326,953	193,121
Net Assets - July 1	3,781,578	3,631,578	3,211,129	3,168,008	6,992,707	6,799,586
Net Assets - June 30	$ 3,939,823	$ 3,781,578	$ 3,379,837	$ 3,211,129	$ 7,319,660	$ 6,992,707

GOVERNMENTAL ACTIVITIES

Governmental activities increased the City's net assets by $158,245 during fiscal year 2007. Variances from fiscal year 2006 of more than 10% are discussed below.

- Operating Grants and Contributions decreased by $16,978, or approximately 17%. The administration of the "6 to 6" Extended School Day program was transferred to the San Diego Unified School District as of January 1, 2007, which resulted in a decrease of approximately $9,000. Special Assessments revenues for the Maintenance Assessment Districts (MAD's) were reclassified from "Operating Grants and Contributions" to "Charges for Services," which caused a decrease of approximately $13,000, and a similar reclassification of CCDC's services to RDA from "Operating Grants and Contributions" to "Charges for Services" resulted in a decrease of approximately $7,000. These decreases were partially offset by an increase in tobacco revenues of approximately $10,000. Effective in fiscal year 2007, all tobacco revenues due to the City were paid directly to the TSRFC, in order to make debt service payments on the outstanding tobacco settlement bonds.

- Capital Grants and Contributions decreased by $19,395, or approximately 19%. The San Diego Padres advanced money to RDA in prior years, for the purpose of acquiring land surrounding Petco Park. The City recorded these advances as land acquisition credits to be used by the developer against the sales price of the land. In fiscal year 2006, the conveyance of these parcels was substantially completed, which resulted in the recognition of approximately $35,000 in Capital Grants and Contributions revenue. In fiscal year 2007, the last remaining credits were used, for which only $1,000 in revenue was recognized, resulting in a revenue decrease of approximately $34,000. Offsetting this large decrease was approximately $18,000 due to increases in developer contributed assets in several communities, including Otay Mesa, San Ysidro, Black Mountain Ranch, and Carmel Valley.

- Property Tax revenue increased by $66,945, or approximately 15%, primarily due to increases in assessed property values, both in the City and Redevelopment project areas, including approximately $15,000 attributable to the Centre City redevelopment project area.

- Transient Occupancy Tax revenues increased by $18,007, or approximately 13%, primarily due to continued growth in San Diego's tourism industry. According to data from the San Diego Convention & Visitors Bureau, average occupancy rates remained unchanged at approximately 73%, however, average daily room rates increased by approximately 7.9% over fiscal year 2006.

- Grants and Contributions not Restricted to Specific Programs decreased by $58,700, or approximately 92%, primarily due to the current year reclassification of In-Lieu Sales Tax, from Grants and Contributions not Restricted, to Sales Taxes.

- Sales Taxes increased by $36,382, or approximately 16%, primarily due to the reclassification of In-Lieu Sales Tax mentioned above.

- Investment Income increased by $36,184, or approximately 90%, primarily due to changes in market values of all investments. This was primarily attributed to increases in the City's investment pool, due to higher market values and an increase in the overall size of the investment pool from fiscal year 2006 to 2007.

- Other Revenue increased by $18,967, or approximately 25%. Approximately $15,000 of the increase resulted from the government-wide adjustment reclassifying current year Facilities Benefit Assessment (FBA) credit additions as Developer Contributions revenue, rather than a reduction of expenses as was recorded in previous years. This was partially offset by a net decrease in Developer Contributions revenue at the fund level of approximately $5,800, which included a $6,000 increase related to the Torrey Hills Developer Agreement for the Carmel Mountain Road I-5 Interchange project and a $13,000 decrease caused by declining development within the North University City and Torrey Highlands communities.

  A gain of approximately $5,600 resulted from the sale of several parcels of land. As part of an overall portfolio management plan for the City, the Real Estate Assets department is continuing to review the City's property inventory to determine which properties are no longer needed and may be designated for disposition. In addition, approximately $6,400 of the increase was attributed to RDA's sale of land held for resale.

- Transportation expense increased by $71,897, or approximately 36%, primarily due to adjustments for donated capital assets related to FBA credit projects. FBA credit projects are not capitalized until final inspections have taken place, which often occurs after substantial completion. During fiscal year 2007 the adjustment for completed projects funded by FBA credits in prior years resulted in an increase of approximately $41,000 in transportation expenses. There was also a write off of capital improvement project costs related to the State Route 905 project. The State Route 905 project was originally anticipated to be a City project but was later turned over to the State. When turned over, the write-off of previously capitalized costs resulted in an expense of almost $5,000. There was an additional increase of approximately $15,000 as a result of current year FBA additions being reclassified as Developer Contributions revenue, rather than a reduction of expenses as was recorded in previous years.

- Sanitation and Health expense decreased by $4,994, or approximately 10%, due to the reclassification of the City's Animal Regulation program. Effective in fiscal year 2007, the Animal Regulation Program was taken over by the Police Department. It had previously been included with Citywide Programs and reported as Sanitation and Health.

- Neighborhood Services expense decreased by $12,016, or approximately 11%, partially due to write-downs in the value of property held for resale in redevelopment project areas of approximately $8,000 during fiscal year 2006. The amount of write-downs varies from year to year depending on real estate market conditions and disposition and development agreements entered into during the fiscal year. RDA expenses decreased by an additional $5,300 as a result of a fiscal year 2006 expense for the construction of low and moderate income residential units in the Crossroads project area. The administration of the "6 to 6" Extended School Day program was transferred to the San Diego Unified School District as of January 1, 2007, which resulted in a $6,500 decrease in expenditures for the City's Grants Funds. These decreases were offset by a $12,990 liability accrued to reflect the potential reimbursement of federal funds related to ongoing audits.

- Interest expense increased by $13,811, or approximately 19%, due to Centre City Redevelopment Project Tax Allocation Bonds, Series 2006 A and B, and Tobacco Settlement Asset-Backed Bonds, Series 2006, which were issued in fiscal year 2006 and began paying debt service in fiscal year 2007. There was also an additional TRANs interest payment made in fiscal year 2007.

BUSINESS-TYPE ACTIVITIES

Business-type activities increased the City's net assets by $168,708 during fiscal year 2007. Variances from fiscal year 2006 of more than 10% are discussed below.

- Operating Grants and Contributions decreased by $706, or approximately 37%, primarily due to fewer Water and Sewer Utility revenues received during fiscal year 2007 compared to 2006, associated with grant reimbursement projects, particularly water desalination studies and disaster assistance recoveries.

- Capital Grants and Contributions increased by $63,817, or approximately 82%, primarily due to additional water and sewer main installations by developers.

- Investment Income increased by $13,775, or approximately 81%, primarily due to changes in market values of all investments. This was primarily attributed to increases in the City's investment pool, due to higher market values and an increase in the overall size of the investment pool from fiscal year 2006 to 2007.

- Other revenues decreased by $1,118, or approximately 17%, primarily due to fewer receipts of permits and fees for the Sewer Utility department.

- Environmental Services expense decreased by $4,355, or approximately 10%, as a result of a Business Process Reengineering process undergone by the department during fiscal year 2007. Operating inefficiencies were corrected, and it was discovered that the Environmental Services Fund paid for expenditures that should have been charged to the General Fund. As a result, the Environmental Services Fund was reimbursed approximately $2,000 from the General Fund during fiscal year 2007.

- Golf Course expense increased by $1,127, or approximately 12%, primarily due to preparation for the U.S. Open held at the Torrey Pines municipal golf course during fiscal year 2008.

FINANCIAL ANALYSIS OF THE GOVERNMENT'S FUNDS

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

GOVERNMENTAL FUNDS

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

As of the end of fiscal year 2007, the City's governmental funds reported combined ending fund balances of $1,365,763, an increase of $228,524 from fiscal year 2006. Approximately $825,212 constitutes unreserved fund balance, which is available for spending at the government's direction. The remainder of fund balance is reserved to indicate that it is not available for new spending because it has already been committed (1) to liquidate contracts and purchase orders of the period, (2) to pay debt service, (3) to generate income to pay for the perpetual funding of various programs, or (4) for a variety of other purposes.

The General Fund is the principal operating fund of the City. At the end of fiscal year 2007, undesignated fund balance of the General Fund was $95,031, while total fund balance was $132,048. This represents a $70,407 increase from the fiscal year 2006 total fund balance.

PROPRIETARY FUNDS

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

As of the end of fiscal year 2007, Unrestricted Net Assets of the Sewer Utility Fund are $152,060. Unrestricted Net Assets increased approximately $36,457, or approximately 32%, mainly due to decreased administration costs and vacant positions, combined with sewer rate increases and a transfer from the Central Garage and Machine Shop Fund of $7,000 for savings accumulated in the Sewer vehicle replacement funds.

As of the end of fiscal year 2007, Unrestricted Net Assets of the Water Utility Fund are $137,704. Unrestricted Net Assets decreased by $10,473, or approximately 7%.

GENERAL FUND BUDGETARY HIGHLIGHTS

The original budget for expenditures and transfers out was $36,466 lower than the final budget due to increases (decreases) in appropriations primarily attributed to the following:

- $4,745 for General Government. This was due to increased Public Liability costs, as well as the addition of Parking Management positions and related costs to the City Treasurer's department. Effective in fiscal year 2007, the Parking Management Department was dissolved and the parking management functions and related positions were split between the Police and City Treasurer's Departments. This change required increases in the Police and General Government budgets, and an offsetting decrease in the Transportation budget.

- $5,126 for Public Safety-Police. This increase was related to the reclassification of Parking Management mentioned above, in addition to higher than anticipated data processing and energy costs for the Police department.

- $2,868 for Public Safety-Fire and Life Safety and Homeland Security. This increase was mainly due to retirement contributions, energy, and fuel costs which exceeded anticipated amounts.

- ($6,521) for Transportation. This decrease is related to the reclassification of Parking Management mentioned in the General Government explanation above.

- $2,038 for Sanitation and Health. This increase was related to repayments made to the Recycling and Environmental Services Funds for activities that were budgeted and charged to the Enterprise Funds in error.

- $2,604 for Principal Retirement. This was due to capital lease payments for Police and Parking Enforcement vehicles, as well as equipment, vehicles, and helicopters for the Fire and Life Safety department.

- $4,529 for Debt Service Interest. The amount of interest expense for the Tax Revenue Anticipation Notes was unknown at the time the original budget was developed.

- $19,350 for Transfers to Other Funds. This increase was primarily due to a $10,000 transfer to the Other Construction capital improvements fund for streets resurfacing contracts and roof replacements in Balboa Park. There was an additional increase of approximately $9,000 for a transfer to the Police Decentralization special revenue fund. In prior years this fund received sales tax revenues directly, but effective in fiscal year 2007, all sales tax was reported in the General Fund and then transferred out to the other funds supported by sales tax revenues.

Actual revenues received for the General Fund were $15,348 less than budgeted. Property Taxes and Transient Occupancy Taxes were over budget by $5,714 and $7,840, respectively, as a result of higher than anticipated growth. Sales Taxes were under budget by $9,685, which was a result of slower than anticipated growth in local retail sales. Other Local Taxes were under budget by $5,587 primarily due to decreased Property Transfer Tax revenues, as a result of a downturn in the real estate market. Fines, Forfeitures, and Penalties were over budget by $2,396, primarily due to litigation awards received related to prior year audits and actuarial valuations. Revenue from Other Agencies was $8,862 under budget. This was the result of Securitized Tobacco Revenue being budgeted as part of Revenue from Other Agencies, when in fact the actual receipts were recorded as a Transfer from Other Funds. Charges for Current Services were also under budget by $9,548, primarily due to reductions in service level agreements with other funds.

Actual expenditures for the General Fund were $52,017 less than budgeted, primarily due to vacant positions in the Police, Parks & Recreation, Engineering, and other General Government departments, including Auditor and Comptroller, City Treasurer, and Purchasing and Contracts.

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	
	2007	2006	2007	2006	2007	2006
Land, Easements, Rights of Way	$ 1,731,003	$ 1,711,064	$ 90,011	$ 89,769	$ 1,821,014	$ 1,800,833
Construction-in-Progress	210,084	223,903	290,161	399,422	500,245	623,325
Structures and Improvements	781,799	785,158	1,332,843	1,272,150	2,114,642	2,057,308
Equipment	106,132	110,971	103,807	115,865	209,939	226,836
Distribution and Collection Systems	-	-	2,788,462	2,659,107	2,788,462	2,659,107
Infrastructure	1,435,152	1,476,544	-	-	1,435,152	1,476,544
Totals	$ 4,264,170	$ 4,307,640	$ 4,605,284	$ 4,536,313	$ 8,869,454	$ 8,843,953

CAPITAL ASSETS

In accordance with GASB Statement No. 34, all major infrastructure assets (such as streets, signals, bridges, and drains) are capitalized by the City in the government-wide statements. While capital assets of both governmental and proprietary funds are capitalized at the government-wide level, only proprietary assets are reported at the fund level. Governmental funds will continue to be reported on a modified accrual basis at the fund level. Differences between the fund and government-wide statements reporting 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, 2007 was $8,869,454 (net of accumulated depreciation). There was an overall increase in the City's investment in Capital Assets over fiscal year 2006 of approximately $25,501.

HIGHLIGHTS OF FISCAL YEAR 2007 CAPITAL IMPROVEMENT ACTIVITIES

Governmental Activities

- Construction continues on the Northwestern Area Station. This project will provide for the land development, design, and construction of a new Police Command and Light Vehicle Maintenance Facility. The facility will serve the Northwestern area of the City in the Carmel Valley and adjacent communities. The project is fully funded by Developer Impact Fees and Facilities Benefit Assessments. The City's fiscal year 2007 capital expenditures for this project were $7,838.

- Construction began on Carmel Valley Road, 300 feet East of Portofino Drive to the Del Mar city limits. This project will provide for improvements to curbs, gutters, sidewalks, and drainage, as well as the construction of a class II bicycle lane on both sides of Carmel Valley Road. This project is funded by TransNet funds. The City's fiscal year 2007 capital expenditures for this project were $4,551.

- Construction continues on the Mira Sorrento Place project. This project will provide for widening and extending Mira Sorrento Place to a four-lane collector street. Traffic flow on Scranton Road and Vista Sorrento Parkway will improve upon project completion. This project is funded by Facilities Benefit Assessments. The City's fiscal year 2007 capital expenditures for this project were $1,577.

- Construction continues on Judicial Drive from Golden Haven to Eastgate Mall. This project will provide a new four lane major street and under-crossing at La Jolla Village Drive. The project is funded by the North University City Facilities Benefit Assessment. The City's fiscal year 2007 capital expenditures for this project were $2,056.

- Construction began on the Nobel Athletic Area. Upon completion, this project will provide an additional twenty-four acres of developed park land. Improvements will include a 10,300 square foot recreation center, sports fields, comfort stations, an off-leash dog area, play, and parking areas in the University City area. The City's fiscal year 2007 capital expenditures for this project were $5,538. The project is entirely funded by the North University City Facilities Benefit Assessment.

- Construction continues on the Carmel Mountain Road-Interstate 5 Interchange project. This project provides for a diamond interchange at Interstate 5 and Carmel Mountain Road. This interchange will accommodate the increase in vehicular traffic created by development in the communities of Carmel Valley and Sorrento Hills. The City's fiscal year 2007 capital expenditures for this project were $5,110. This project is funded by Facilities Benefit Assessments.

- Construction began on the Pacific Highlands Ranch Fire Station #47. This project will provide for a new 10,500 square foot fire station to serve the Pacific Highlands Ranch community. The project is part of the Pacific Highlands Ranch Facilities Financing Plan. The City's fiscal year 2007 capital expenditures for this project were $2,832.

- Construction continues on the North University Community Branch Library. This project will provide for the construction of a 15,000 square-foot library on a City owned park site at Nobel Drive and Judicial Drive to serve the community in North University City. This project is funded by Facilities Benefit Assessments. The City's fiscal year 2007 capital expenditures for this project were $3,581.

- Construction was completed on Phase 1 of the Black Mountain Ranch Community Park. This first phase of the project provided for the acquisition and development of 13 acres of useable park land including athletic fields and a parking lot. Phase 2 will provide for the development of an additional 17 acres of park land. This project is funded by Facilities Benefit Assessments. The City's fiscal year 2007 capital expenditures for this project were $2,950.

- Construction continues on the Serra Mesa/Kearny Mesa Branch Library. This project will provide for the construction of a new 15,000 square-foot library on the 8900 Block of Aero Drive. Upon completion the new facility will include additional meeting rooms, computer lab, separate children's area and quiet study areas. Additional parking has also been incorporated into the design of the new facility. Serra Mesa and Kearny Mesa Developer Impact fees are the primary funding sources for this project. The City's fiscal year 2007 capital expenditures for this project were $1,566.

Business-Type Activities

During fiscal year 2007, the Water Utility Fund added approximately $35,300 in capital improvement projects (CIP). Upgrades and expansion of the Miramar Water Treatment Plant and the Alvarado Water Treatment Plant continued, along with Water Main Replacements. Capital asset write-offs for fiscal year 2007 were approximately $5,900, and were primarily related to losses on abandoned projects, and retirements of developer contributed assets.

During fiscal year 2007, the Sewer Utility Fund added approximately $30,900 in CIP, of which the Metropolitan system CIP increased approximately $2,200 and included the Point Loma Grit Processing Improvements. Municipal system CIP increased approximately $28,700 and included the following major projects: Pipeline Rehabilitation Phase C-1, Sorrento Valley Trunk Sewer Relocation, Pump Station Upgrades, and the continued replacement of sewer mains and upgrades to the sewer infrastructure. Capital asset write-offs for fiscal year 2007 were approximately $9,000, and were primarily related to losses on abandoned projects, and retirements of developer contributed assets.

HIGHLIGHTS OF APPROVED FISCAL YEAR 2008 CAPITAL IMPROVEMENT PROJECTS (CIP) BUDGET

The Annual Approved Capital Improvements Budget for Fiscal Year 2008 is $491,600 which is an increase of $197,900, or approximately 67% over the fiscal year 2007 budget of $293,700. The increase in the Fiscal Year 2008 budget is primarily due to an increase in Water and Sewer projects. Water and Sewer projects comprise over 50% of the total CIP budget. Engineering & Capital Projects and General Services projects comprise 27%, and 9% of the total CIP budget, respectively. Funding for governmental projects include TransNet funds, Facilities Benefit Assessments, Developer Impact Fees, developer contributions, and Federal, State, local, and private contributions. Highlights of the key budgets by department are as follows:

Governmental Activities

- Engineering and Capital Projects: $134,500 (27% of total CIP budget). Key projects include the undergrounding of City utilities to augment the California Public Utilities Commission (CPUC) Rule 20A funds. Funding is also allocated for conversion of City-owned street lighting and resurfacing of roadways associated with the undergrounding of utilities. The $58,600 annual allocation for these projects is entirely funded by the Underground Surcharge Fund. Other significant projects include: $7,700 for Palm Avenue/I-805 Improvements, $6,000 for Camino del Sur–Carmel Mountain Road, and $4,500 for Carroll Canyon Road–Sorrento Valley to Scranton Road.

- General Services: $44,000 (9% of total CIP budget). Key budgets include: $27,400 for deferred maintenance including street resurfacing, storm drain repair, and sidewalk repair; $12,300 for ADA improvements; and $5,300 for City facilities improvements which include roof replacements and air conditioning and heating upgrade replacements.

- Parks and Recreation: $30,700 (6% of total CIP budget). Planned project types for fiscal year 2008 include play area upgrades, joint use fields, roof reconstruction, accessibility improvements, comfort stations, picnic shelters, sports field and security lighting, and new park development.

- Chief Information Officer: $19,600 (4% of total CIP budget). This allocation includes $16,300 for the Enterprise Resource Planning (ERP) System and $3,300 for public safety communication upgrade projects.

Business-Type Activities

The fiscal year 2008 Water Utility CIP budget is $145,600. There are no phase funded projects budgeted for fiscal year 2008. Significant projects include: $31,200 for replacing water mains citywide; $44,600 for the Miramar Water Treatment Plant; $19,200 for the Otay Water Treatment Plant; and $13,200 for the Alvarado Water Treatment Plant Expansion.

The fiscal year 2008 Sewer Utility CIP budget is $100,700. There are no phase funded projects budgeted for fiscal year 2008. Significant projects include: $42,400 for continued sewer main replacements and upgrades to sewer infrastructure; $19,800 for repair and upgrade of pump stations; $18,600 for replacement of trunk sewers; and $7,600 for repair and upgrade of treatment plants.

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

	Governmental Activities		Business-Type Activities		Total Primary Government	
	2007	2006	2007	2006	2007	2006
Capital Lease Obligations	$ 39,130	$ 40,541	$ 1,006	$ 2,051	$ 40,136	$ 42,592
Contracts Payable	2,615	2,615	-	-	2,615	2,615
Notes Payable	8,555	7,294	280,830	-	289,385	7,294
Loans Payable	18,775	14,345	101,316	91,247	120,091	105,592
Section 108 Loans	39,431	42,499	-	-	39,431	42,499
SANDAG Loans	2,287	7,355	-	-	2,287	7,355
General Obligation Bonds	10,705	12,690	-	-	10,705	12,690
Revenue Bonds/COP's/ Lease Revenue Bonds	521,210	549,850	1,469,060	1,662,705	1,990,270	2,212,555
Special Assessment/ Special Tax Bonds	145,625	133,605	-	-	145,625	133,605
Tax Allocation Bonds	502,804	514,845	-	-	502,804	514,845
Tobacco Settlement Asset-Backed Bonds	102,700	105,400	-	-	102,700	105,400
Totals	$ 1,393,837	$ 1,431,039	$ 1,852,212	$ 1,756,003	$ 3,246,049	$ 3,187,042

LONG-TERM DEBT

At the end of fiscal year 2007, the City, including blended component units, had total debt outstanding of approximately $3,246,049. Of this amount, $10,705 is comprised of debt backed by the full faith and credit of the City. The remainder of the City's debt represents revenue bonds, lease revenue bonds, certificates of participation (COPs), special assessment bonds, tax allocation bonds, contracts payable, notes payable, loans payable, Section 108 loans, SRF loans, capital lease obligations, and San Diego Association of Governments (SANDAG) loans.

Governmental Activities

- The Community Facilities District No. 3 (The District) sold, on a private placement basis, $16,000 of Communities Facilities District No. 3 (Liberty Station) Special Tax Bonds, Series 2006 A, to finance public improvements required in connection with the district. The 2006 A bonds were issued pursuant to the Mello-Roos Community Facilities Act of 1982 and are limited obligations of the district.

- The Public Facilities Financing Authority of the City of San Diego (PFFA) sold, on a private placement basis, $156,560 of Lease Revenue Refunding Bonds, Series 2007A (Ballpark Refunding) to refund the Ballpark Lease Revenue Bonds, Series 2002. The Series 2007 A bonds are secured by and payable solely from base rental payments payable under the Ballpark Facility Lease. Such base rental payments are a general fund obligation of the City.

- The Redevelopment Agency of the City of San Diego executed a non-revolving line of credit with Bank of America, N.A. in the amount of $8,530. The line of credit is to be used to refinance the North Park Theatre, to pay settlements on eminent domain actions related to the North Park Redevelopment Area, and for other redevelopment activities in the North Park Redevelopment Area.

- Total principal payments for long-term debt were $72,690. $48,176 of this amount was for outstanding bonds, including $7,555 recorded as a principal payment for the amount transferred to escrow from resources other than the new debt proceeds issued for the purpose of refunding the PFFA Lease Revenue Bonds, Series 2002 (Ballpark Project). Payments on loans payable were $14,529, payments on notes payable were $919, and payments on capital leases were $9,066.

Business-Type Activities

- Sewer loans from the State Water Resources Control Board for $3,858 and $11,068 were executed in order to construct capital improvement projects.

- PFFA sold, on a private placement basis, $57,000 of Non-Transferable Subordinated Water Revenue Notes, Series 2007A to finance upgrades to and expansion of the City's water system and to reimburse for costs previously incurred. The Series 2007A Notes are secured by and payable solely from net system revenues of the Water Utility Fund and the final maturity date is January 30, 2009. The 2007A Notes carried a six month call provision with no prepayment penalty after the call date and had no provisions for an extension beyond the final maturity date.

- PFFA sold, on a private placement basis, $223,830 of Subordinate Sewer Revenue Notes, Series 2007 to finance and reimburse for costs previously incurred from upgrades to the City's sewer system and to refund $144,400 of outstanding principal balance on the Sewer Revenue Bonds, Series 2004. The Series 2007 Notes are secured by and payable solely from net system revenues of the Sewer Utility Fund and the final maturity date is May 15, 2009. The 2007 Notes carried a one year call provision with no prepayment penalty after the call date and had no provisions for an extension beyond the final maturity date.

- Total principal payments for long-term debt were $55,147 which includes $49,245 for outstanding bonds, $4,857 for loans payable and $1,045 for capital leases.

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

	Moody's Investors Service	**Fitch Ratings**	**Standard & Poor's**
General Obligation Bonds	A2	BBB+	A
General Fund Backed Lease Revenue Obligations	Baa1/Baa2	BBB-	A-
Outlook	Stable	Positive	Positive
Wastewater System Obligations	A3	BBB+	A+
Outlook	Stable	Positive	Stable
Water System Obligations	A2/A3	BBB+/BBB	AA-/A+
Outlook	Stable	Positive	Stable

Standard & Poor's suspended the City's credit rating on September 20, 2004. The rating was reinstated on May 15, 2008. Fitch Ratings placed the City on positive Rating Watch as of March 27, 2008. On August 26, 2008, Moody's upgraded the underlying ratings on the City's general obligation bonds from A3 to A2. Also upgraded from Baa2 to Baa1 were the City's General Fund lease revenue bonds and certificates of participation. The underlying rating on the taxable Lease Revenue Bonds, Series 1996A (San Diego Jack Murphy Stadium) was upgraded from Baa3 to Baa2.

As of January 2008, the City of San Diego Tobacco Settlement Revenue Funding Corporation Tobacco Settlement Asset-Backed Bonds, Series 2006, were upgraded by Fitch Ratings from BBB to BBB plus. MBIA Insurance Corporation, AMBAC Assurance Corporation, and FGIC Insurance Company bond insurance policies and surety debt reserve policies support ratings and certain of the City's debt obligations issued on a long term fixed rate basis. As of the date of this report, Fitch has withdrawn its ratings for MBIA and Ambac, and downgraded its rating on FGIC to CCC. Standard & Poor's has lowered its ratings on MBIA and Ambac to AA. Moody's has lowered its ratings on MBIA and Ambac to A2 and Aa3, respectively. None of the underlying ratings, as shown in the tables above, have been changed as a result of the rating agency actions on the insurers.

Section 90 of the City Charter provides that the general obligation bonded indebtedness for the development, conservation and furnishings of water shall not exceed 15% of the last preceding assessed valuation of all real and personal property of the City subject to direct taxation, and that the bonded indebtedness for other municipal improvements shall not exceed 10% of such valuation. The City's current outstanding general obligation balances as of June 30, 2007 are significantly less than the current debt limitations for water and other purposes, which are $5,218,175 and $3,478,783, respectively (see Statistical Section, Table 12).

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

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

REQUESTS FOR INFORMATION

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

BASIC FINANCIAL STATEMENTS

STATEMENT OF NET ASSETS
June 30, 2007
(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	$ 1,223,834	$ 505,384	$ 1,729,218	$ 15,779	$ 74,499
Receivables:					
Taxes - Net	88,809	-	88,809	-	-
Accounts - Net of Allowance for Uncollectibles					
(Governmental $7,251, Business-Type $1,819)	31,707	79,331	111,038	3,003	8,371
Claims - Net	116	-	116	-	-
Contributions	251	-	251	-	-
Special Assessments - Net	1,353	-	1,353	-	-
Notes	69,999	-	69,999	-	136,673
Accrued Interest	11,836	6,571	18,407	-	15,105
Grants	33,569	1,944	35,513	-	-
Investment in Joint Venture	2,097	-	2,097	-	-
Advances to Other Agencies	3,458	-	3,458	-	-
Internal Balances	245	(245)	-	-	-
Inventories of Water in Storage	-	27,556	27,556	-	-
Inventories	2,081	527	2,608	16	67
Land Held for Resale	47,619	-	47,619	-	-
Prepaid Expenses	4,476	751	5,227	968	46
Restricted Cash and Investments	285,801	213,144	498,945	-	1,723
Deferred Charges	17,296	11,140	28,436	-	-
Capital Assets - Non-Depreciable	1,941,087	380,172	2,321,259	-	40,044
Capital Assets - Depreciable	2,323,083	4,225,112	6,548,195	16,559	61,063
TOTAL ASSETS	6,088,717	5,451,387	11,540,104	36,325	337,591

STATEMENT OF NET ASSETS
June 30, 2007
(In Thousands)

	Primary Government			Component Units	
	Governmental Activities	Business - Type Activities	Total	San Diego Convention Center Corporation	San Diego Housing Commission
LIABILITIES					
Accounts Payable	$ 58,228	$ 44,120	$ 102,348	$ 513	$ 3,938
Accrued Wages and Benefits	27,102	8,647	35,749	-	365
Other Accrued Liabilities	53	-	53	1,898	588
Interest Accrued on Long-Term Debt	21,339	19,800	41,139	-	95
Long-Term Liabilities Due Within One Year	125,002	61,446	186,448	2,849	1,787
Due to Other Agencies	1,561	10,013	11,574	-	-
Unearned Revenue	32,515	7,304	39,819	7,363	283
Contract Deposits	-	9,550	9,550	-	-
Sundry Trust Liabilities	2,911	-	2,911	-	-
Short-Term Notes Payable	142,000	-	142,000	-	-
Liabilities Payable from Restricted Assets:					
Customer Deposits Payable	-	4,265	4,265	-	-
Deposits/Advances from Others	-	25	25	-	991
Long-Term Liabilities Due After One Year:					
Arbitrage Liability	-	224	224	-	-
Compensated Absences	43,142	7,849	50,991	-	-
Liability Claims	190,374	49,257	239,631	-	-
Capital Lease Obligations	30,949	166	31,115	2,201	-
Contracts Payable	2,615	-	2,615	-	-
Notes Payable	8,555	280,830	289,385	2,500	32,052
Loans Payable	18,714	95,875	114,589	-	-
Section 108 Loans Payable	35,896	-	35,896	-	-
Net Bonds Payable	1,249,776	1,418,826	2,668,602	-	-
Estimated Landfill Closure and Postclosure Care	-	16,935	16,935	-	-
Net Pension Obligation	158,162	36,418	194,580	-	-
TOTAL LIABILITIES	2,148,894	2,071,550	4,220,444	17,324	40,099
NET ASSETS					
Invested in Capital Assets, Net of Related Debt	3,461,127	2,998,848	6,459,975	10,102	67,893
Restricted for:					
Capital Projects	300,288	-	300,288	2,118	-
Debt Service	-	2,977	2,977	-	-
Low-Moderate Income Housing	81,739	-	81,739	-	-
Nonexpendable Permanent Endowments	16,509	-	16,509	-	-
Other	100,159	34,732	134,891	-	86,944
Unrestricted	(19,999)	343,280	323,281	6,781	142,655
TOTAL NET ASSETS	$ 3,939,823	$ 3,379,837	$ 7,319,660	$ 19,001	$ 297,492

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

STATEMENT OF ACTIVITIES
Year Ended June 30, 2007
(In Thousands)

		Program Revenues		
Functions/Programs	**Expenses**	**Charges for Services**	**Operating Grants and Contributions**	**Capital Grants and Contributions**
Primary Government:				
Governmental Activities:				
General Government and Support	$ 270,190	$ 107,257	$ 13,764	$ 3,760
Public Safety - Police	376,581	27,960	2,227	500
Public Safety - Fire and Life Safety and Homeland Security	209,902	16,548	39,709	-
Parks, Recreation, Culture and Leisure	229,500	52,656	4,567	13,733
Transportation	272,780	49,809	765	51,633
Sanitation and Health	43,780	10,224	791	119
Neighborhood Services	99,870	39,412	22,922	11,424
Debt Service:				
Interest	84,920	-	-	-
TOTAL GOVERNMENTAL ACTIVITIES	1,587,523	303,866	84,745	81,169
Business-Type Activities:				
Airports	3,755	5,635	-	775
City Store	843	827	-	-
Development Services	53,924	48,746	-	-
Environmental Services	40,138	36,143	7	-
Golf Course	10,690	15,772	-	-
Recycling	19,754	20,476	564	-
Sewer Utility	313,716	304,749	65	59,785
Water Utility	313,256	310,292	567	80,859
TOTAL BUSINESS-TYPE ACTIVITIES	756,076	742,640	1,203	141,419
TOTAL PRIMARY GOVERNMENT	$ 2,343,599	$ 1,046,506	$ 85,948	$ 222,588
Component Units:				
San Diego Convention Center Corporation	$ 33,499	$ 32,849	$ 4,339	$ -
San Diego Housing Commission	155,770	14,653	156,165	1,348
TOTAL COMPONENT UNITS	$ 189,269	$ 47,502	$ 160,504	$ 1,348

General Revenues:
- Property Taxes
- Transient Occupancy Taxes
- Other Local Taxes
- Developer Contributions and Fees
- Grants and Contributions not Restricted to Specific Programs
  - Sales Taxes
- Investment Income
- Gain on Sale of Capital Assets
- Miscellaneous

Transfers

TOTAL GENERAL REVENUES AND TRANSFERS

CHANGE IN NET ASSETS

Net Assets at Beginning of Year

NET ASSETS AT END OF YEAR

Net Revenue/(Expense) and Changes in Net Assets

Primary Government			Component Units	
Governmental Activities	Business-Type Activities	Total	San Diego Convention Center Corporation	San Diego Housing Commission
$ (145,409)	$ -	$ (145,409)	$ -	$ -
(345,894)	-	(345,894)	-	-
(153,645)	-	(153,645)	-	-
(158,544)	-	(158,544)	-	-
(170,573)	-	(170,573)	-	-
(32,646)	-	(32,646)	-	-
(26,112)	-	(26,112)	-	-
(84,920)	-	(84,920)	-	-
(1,117,743)	-	(1,117,743)	-	-
-	2,655	2,655	-	-
-	(16)	(16)	-	-
-	(5,178)	(5,178)	-	-
-	(3,988)	(3,988)	-	-
-	5,082	5,082	-	-
-	1,286	1,286	-	-
-	50,883	50,883	-	-
-	78,462	78,462	-	-
-	129,186	129,186	-	-
(1,117,743)	129,186	(988,557)	-	-
-	-	-	3,689	-
-	-	-	-	16,396
-	-	-	3,689	16,396
526,722	-	526,722	-	-
154,810	-	154,810	-	-
157,941	-	157,941	-	-
62,693	-	62,693	-	-
5,339	-	5,339	-	-
263,399	-	263,399	-	-
76,292	30,713	107,005	754	7,340
6,546	-	6,546	-	3,560
25,671	5,384	31,055	124	-
(3,425)	3,425	-	-	-
1,275,988	39,522	1,315,510	878	10,900
158,245	168,708	326,953	4,567	27,296
3,781,578	3,211,129	6,992,707	14,434	270,196
$ 3,939,823	$ 3,379,837	$ 7,319,660	$ 19,001	$ 297,492

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

GOVERNMENTAL FUNDS
BALANCE SHEET
JUNE 30, 2007
(In Thousands)

	General Fund	Other Governmental Funds	Total Governmental Funds
ASSETS			
Cash and Investments	$ 97,347	$ 1,017,656	$ 1,115,003
Receivables:			
Taxes - Net	73,296	15,513	88,809
Accounts - Net of Allowance for Uncollectibles (General Fund $6,302)	11,103	13,868	24,971
Claims - Net	88	18	106
Special Assessments - Net	-	1,353	1,353
Notes	-	69,999	69,999
Accrued Interest	3,466	8,319	11,785
Grants	-	33,569	33,569
From Other Funds	1,475	6,563	8,038
Advances to Other Funds	300	8,252	8,552
Advances to Other Agencies	9	3,449	3,458
Land Held for Resale	-	47,619	47,619
Prepaid Items	81	1,799	1,880
Investment in Joint Venture	2,097	-	2,097
Restricted Cash and Investments	142,000	143,661	285,661
TOTAL ASSETS	$ 331,262	$ 1,371,638	$ 1,702,900
LIABILITIES			
Accounts Payable	$ 9,112	$ 35,282	$ 44,394
Accrued Wages and Benefits	23,881	616	24,497
Other Accrued Liabilities	-	53	53
Due to Other Funds	-	9,964	9,964
Due to Other Agencies	-	1,561	1,561
Unearned Revenue	903	31,530	32,433
Deferred Revenue	23,318	43,967	67,285
Sundry Trust Liabilities	-	2,911	2,911
Advances from Other Funds	-	8,552	8,552
Interfund Loan Payable	-	3,487	3,487
Short-Term Notes Payable	142,000	-	142,000
TOTAL LIABILITIES	199,214	137,923	337,137

GOVERNMENTAL FUNDS
BALANCE SHEET
JUNE 30, 2007
(In Thousands)

	General Fund	Other Governmental Funds	Total Governmental Funds
FUND EQUITY:			
Fund Balances:			
Reserved for Land Held for Resale	-	47,619	47,619
Reserved for Notes Receivable	-	69,013	69,013
Reserved for Encumbrances	33,452	217,907	251,359
Reserved for Advances	309	11,701	12,010
Reserved for Low and Moderate Income Housing	-	14,718	14,718
Reserved for Permanent Endowments	-	16,509	16,509
Reserved for Debt Service	-	127,226	127,226
Reserved for Minority Interest in Joint Venture	2,097	-	2,097
Unreserved, Reported in General Fund:			
Designated for Subsequent Years' Expenditures	1,159	-	1,159
Undesignated	95,031	-	95,031
Unreserved, Reported in:			
Special Revenue Funds	-	350,096	350,096
Debt Service Funds	-	29	29
Capital Projects Funds	-	377,648	377,648
Permanent Funds	-	1,249	1,249
TOTAL FUND EQUITY	132,048	1,233,715	1,365,763
TOTAL LIABILITIES AND FUND EQUITY	$ 331,262	$ 1,371,638	

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.	4,196,903
Other assets and liabilities used in governmental activities are not financial resources, and therefore, are either deferred or not reported in the funds.	84,581
Internal Service funds are used by management to charge the costs of activities such as Central Garage and Machine Shop, Publishing Services, Self Insurance, Central Stores and others to individual funds. The assets and liabilities of Internal Service Funds are included in governmental activities in the Statement of Net Assets.	(55,003)
Certain liabilities, including bonds payable, are not due and payable in the current period, and therefore, are not reported in the funds.	(1,652,421)
Net Assets of governmental activities	$ 3,939,823

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, 2007
(In Thousands)

	General Fund	Other Governmental Funds	Total Governmental Funds
REVENUES			
Property Taxes	$ 361,062	$ 160,672	$ 521,734
Special Assessments	-	36,585	36,585
Sales Taxes	233,385	31,202	264,587
Transient Occupancy Taxes	80,703	72,871	153,574
Other Local Taxes	74,069	83,977	158,046
Licenses and Permits	31,475	9,950	41,425
Fines, Forfeitures and Penalties	40,346	2,586	42,932
Revenue from Use of Money and Property	42,157	75,395	117,552
Revenue from Federal Agencies	5,066	74,669	79,735
Revenue from Other Agencies	16,644	45,333	61,977
Revenue from Private Sources	-	59,549	59,549
Charges for Current Services	85,026	74,851	159,877
Other Revenue	2,730	28,297	31,027
TOTAL REVENUES	972,663	755,937	1,728,600
EXPENDITURES			
Current:			
General Government and Support	189,203	78,258	267,461
Public Safety - Police	346,405	30,357	376,762
Public Safety - Fire and Life Safety and Homeland Security	171,117	30,914	202,031
Parks, Recreation, Culture and Leisure	112,967	69,230	182,197
Transportation	59,516	79,833	139,349
Sanitation and Health	39,391	5,338	44,729
Neighborhood Services	18,339	67,205	85,544
Capital Projects	-	106,518	106,518
Debt Service:			
Principal Retirement	2,604	65,556	68,160
Interest	6,519	76,409	82,928
Cost of Issuance	-	5,145	5,145
TOTAL EXPENDITURES	946,061	614,763	1,560,824
EXCESS OF REVENUES OVER EXPENDITURES	26,602	141,174	167,776
OTHER FINANCING SOURCES (USES)			
Transfers from Proprietary Funds	4,181	5,328	9,509
Transfers from Other Funds	86,980	204,554	291,534
Transfers to Proprietary Funds	(1,373)	(2,173)	(3,546)
Transfers to Other Funds	(46,018)	(245,516)	(291,534)
Transfers to Escrow Agent for Refunding Bonds	-	(159,690)	(159,690)
Net Income from Joint Venture	35	-	35
Capital Leases	-	6,167	6,167
Notes Issued	-	2,180	2,180
Loans Issued	-	10,823	10,823
Proceeds from Land Sales	-	12,942	12,942
Special Assessment Bonds Issued	-	16,000	16,000
Revenue Refunding Bonds Issued	-	156,560	156,560
Premium on Bonds Issued	-	9,768	9,768
TOTAL OTHER FINANCING SOURCES (USES)	43,805	16,943	60,748
NET CHANGE IN FUND BALANCES	70,407	158,117	228,524
Fund Balances at Beginning of Year	61,641	1,075,598	1,137,239
FUND BALANCES AT END OF YEAR	$ 132,048	$ 1,233,715	$ 1,365,763

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

City of San Diego
Reconciliation of the Statement of Revenues, Expenditures, and Changes in Fund Balances of Governmental Funds to the Statement of Activities
Year Ended June 30, 2007
(In Thousands)

Net change in fund balances - total governmental funds (page 58)	$ 228,524
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.	15,668
The net effect of various miscellaneous transactions involving capital assets (i.e., donations, retirements, and transfers) is to decrease net assets.	(66,961)
Revenues in the Statement of Activities that do not provide current financial resources are not reported as revenues in the funds.	(31,428)
Revenues in the Statement of Activities for the reduction of land acquisition credits do not provide current financial resources and are not reported in the funds.	1,480
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.	34,161
Some expenses reported in the Statement of Activities do not require the use of current financial resources (i.e., compensated absenses, net pension obligation), and therefore are not accrued as expenses in governmental funds.	(18,546)
Internal Service funds are used by management to charge the costs of activities such as Central Garage and Machine Shop, Publishing Services, Central Stores, Self Insurance, and others to individual funds. The net expense of certain activities of internal service funds is reported with governmental activities.	(4,653)
Change in net assets of governmental activities (page 55)	$ 158,245

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

PROPRIETARY FUNDS
STATEMENT OF NET ASSETS
JUNE 30, 2007
(In Thousands)

	Business-Type Activities - Enterprise Funds				
	Sewer Utility	Water Utility	Other Enterprise Funds	Total	Internal Service Funds
ASSETS					
Current Assets:					
Cash and Investments	$ 205,229	$ 196,510	$ 100,397	$ 502,136	$ 112,079
Receivables:					
Accounts - Net of Allowance for Uncollectibles (Sewer $832, Water $709, Other Enterprise $278, Internal Service $949)	35,746	42,697	888	79,331	6,736
Claims - Net	-	-	-	-	10
Contributions	-	-	-	-	251
Accrued Interest	2,733	2,291	1,524	6,548	74
Grants	26	1,202	716	1,944	-
From Other Funds	-	-	3,326	3,326	-
Inventories of Water in Storage	-	27,556	-	27,556	-
Inventories	-	414	113	527	2,081
Prepaid Expenses	1	737	13	751	2,596
Total Current Assets	243,735	271,407	106,977	622,119	123,827
Non-Current Assets:					
Restricted Cash and Investments	101,168	77,587	34,389	213,144	140
Deferred Charges	6,436	4,704	-	11,140	-
Interfund Loan Receivable	3,487	-	-	3,487	-
Capital Assets - Non-Depreciable	140,261	216,124	23,787	380,172	1,984
Capital Assets - Depreciable	2,712,387	1,452,843	59,646	4,224,876	65,519
Total Non-Current Assets	2,963,739	1,751,258	117,822	4,832,819	67,643
TOTAL ASSETS	3,207,474	2,022,665	224,799	5,454,938	191,470
LIABILITIES					
Current Liabilities:					
Accounts Payable	10,800	30,125	2,836	43,761	14,193
Accrued Wages and Benefits	4,101	1,925	2,198	8,224	3,028
Interest Accrued on Long-Term Debt	8,010	11,772	18	19,800	84
Long-Term Liabilities Due Within One Year	39,061	18,776	3,178	61,015	42,985
Due to Other Funds	-	-	-	-	1,400
Due to Other Agencies	5,511	4,502	-	10,013	-
Unearned Revenue	-	1,004	6,300	7,304	82
Contract Deposits	3,828	5,569	153	9,550	-
Current Liabilities Payable from Restricted Assets:					
Customer Deposits Payable	-	4,265	-	4,265	-
Total Current Liabilities	71,311	77,938	14,683	163,932	61,772
Non-Current Liabilities:					
Deposits/Advances from Others	-	-	25	25	-
Arbitrage Liability	31	193	-	224	-
Compensated Absences	2,673	2,202	2,511	7,386	4,404
Liability Claims	43,917	5,340	-	49,257	177,384
Capital Lease Obligations	-	-	166	166	4,660
Loans Payable	76,490	19,385	-	95,875	-
Notes Payable	223,830	57,000	-	280,830	-
Net Revenue Bonds Payable	883,356	535,470	-	1,418,826	-
Estimated Landfill Closure and Postclosure Care	-	-	16,935	16,935	-
Net Pension Obligation	12,288	9,789	11,505	33,582	6,316
Total Non-Current Liabilities	1,242,585	629,379	31,142	1,903,106	192,764
TOTAL LIABILITIES	1,313,896	707,317	45,825	2,067,038	254,536
NET ASSETS					
Invested in Capital Assets, Net of Related Debt	1,740,801	1,175,384	82,427	2,998,612	59,969
Restricted for Debt Service	717	2,260	-	2,977	-
Restricted for Closure/Postclosure Maintenance	-	-	34,732	34,732	-
Unrestricted	152,060	137,704	61,815	351,579	(123,035)
TOTAL NET ASSETS	$ 1,893,578	$ 1,315,348	$ 178,974	3,387,900	$ (63,066)
Adjustment to reflect the consolidation of internal service fund activities related to Enterprise Funds.				(8,063)	
Net assets of Business-Type activities				$ 3,379,837	

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, 2007
(In Thousands)

	Business-Type Activities - Enterprise Funds				
	Sewer Utility	Water Utility	Other Enterprise Funds	Total	Internal Service Funds
OPERATING REVENUES					
Sales of Water	$ -	$ 289,127	$ -	$ 289,127	$ -
Charges for Services	299,736	1,147	69,979	370,862	165,197
Revenue from Use of Property	-	6,162	-	6,162	-
Usage Fees	-	1,594	55,547	57,141	46,442
Other	5,013	12,262	2,073	19,348	3,616
TOTAL OPERATING REVENUES	304,749	310,292	127,599	742,640	215,255
OPERATING EXPENSES					
Benefit and Claim Payments	-	-	-	-	68,843
Maintenance and Operations	111,086	97,821	83,529	292,436	46,160
Cost of Materials Issued	-	-	351	351	28,355
Cost of Purchased Water Used	-	124,880	-	124,880	-
Taxes	-	163	-	163	-
Administration	79,164	30,964	34,482	144,610	56,022
Depreciation	69,696	27,644	9,712	107,052	16,645
TOTAL OPERATING EXPENSES	259,946	281,472	128,074	669,492	216,025
OPERATING INCOME (LOSS)	44,803	28,820	(475)	73,148	(770)
NONOPERATING REVENUES (EXPENSES)					
Earnings on Investments	12,505	11,461	6,617	30,583	4,848
Federal Grant Assistance	65	283	-	348	-
Other Agency Grant Assistance	-	284	571	855	-
Gain (Loss) on Sale/Retirement of Capital Assets	(9,004)	(5,076)	(1,263)	(15,343)	943
Debt Service Interest Expense	(44,735)	(26,370)	(69)	(71,174)	(306)
Other	3,093	175	2,114	5,382	49
TOTAL NONOPERATING REVENUES (EXPENSES)	(38,076)	(19,243)	7,970	(49,349)	5,534
INCOME (LOSS) BEFORE CONTRIBUTIONS AND TRANSFERS	6,727	9,577	7,495	23,799	4,764
Capital Contributions	59,785	80,859	775	141,419	-
Transfers from Other Funds	7,738	352	666	8,756	463
Transfers from Governmental Funds	80	84	1,634	1,798	2,144
Transfers to Other Funds	(220)	(234)	-	(454)	(8,765)
Transfers to Governmental Funds	(2,162)	(1,713)	(2,420)	(6,295)	(3,574)
CHANGE IN NET ASSETS	71,948	88,925	8,150	169,023	(4,968)
Net Assets at Beginning of Year	1,821,630	1,226,423	170,824		(58,098)
NET ASSETS AT END OF YEAR	$ 1,893,578	$ 1,315,348	$ 178,974		$ (63,066)
Adjustment to reflect the consolidation of internal service fund activities related to Enterprise Funds.				(315)	
Change in net assets of Business-Type activities				$ 168,708	

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

PROPRIETARY FUNDS
STATEMENT OF CASH FLOWS
YEAR ENDED JUNE 30, 2007
(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	$ 298,238	$ 299,676	$ 110,112	$ 708,026	$ 196,677
Receipts from Interfund Services Provided	3,717	2,612	20,840	27,169	17,155
Payments to Suppliers	(103,109)	(169,450)	(34,686)	(307,245)	(85,233)
Payments to Employees	(68,533)	(68,219)	(75,340)	(212,092)	(103,041)
Payments for Interfund Services Used	(18,041)	(12,807)	(8,188)	(39,036)	(1,225)
NET CASH PROVIDED BY OPERATING ACTIVITIES	112,272	51,812	12,738	176,822	24,333
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES					
Transfers from Other Funds	7,738	352	666	8,756	463
Transfers from Governmental Funds	80	84	1,239	1,403	2,143
Transfers to Other Funds	(220)	(234)	-	(454)	(8,765)
Transfers to Governmental Funds	(2,162)	(1,365)	(2,409)	(5,936)	(3,574)
Operating Grants Received	39	1,020	561	1,620	-
Proceeds from Advances and Deposits	341	1,060	-	1,401	-
Payments for Advances and Deposits	-	-	(5)	(5)	-
NET CASH PROVIDED BY (USED FOR) NONCAPITAL FINANCING ACTIVITIES	5,816	917	52	6,785	(9,733)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES					
Proceeds from Contracts, Notes and Loans	94,806	57,024	-	151,830	1,488
Proceeds from Capital Contributions	16,628	21,295	735	38,658	-
Acquisition of Capital Assets	(50,751)	(40,527)	(4,957)	(96,235)	(11,735)
Proceeds from the Sale of Capital Assets	-	861	-	861	1,571
Principal Payments on Capital Leases	-	-	(1,045)	(1,045)	(4,529)
Principal Payments on Contracts, Notes and Loans	(4,006)	(851)	-	(4,857)	-
Principal Payments on Revenue Bonds	(36,360)	(12,885)	-	(49,245)	-
Interest Paid on Long-Term Debt	(42,388)	(25,730)	(71)	(68,189)	(360)
NET CASH USED FOR CAPITAL AND RELATED FINANCING ACTIVITIES	(22,071)	(813)	(5,338)	(28,222)	(13,565)
CASH FLOWS FROM INVESTING ACTIVITIES					
Sales of Investments	320,588	146,799	-	467,387	-
Purchases of Investments	(400,677)	(145,515)	-	(546,192)	-
Interest Received on Investments	11,806	13,400	6,447	31,653	4,860
NET CASH PROVIDED BY (USED FOR) INVESTING ACTIVITIES	(68,283)	14,684	6,447	(47,152)	4,860
Net Increase in Cash and Cash Equivalents	27,734	66,600	13,899	108,233	5,895
Cash and Cash Equivalents at Beginning of Year	177,495	158,738	120,887	457,120	106,324
CASH AND CASH EQUIVALENTS AT END OF YEAR	$ 205,229	$ 225,338	$ 134,786	$ 565,353	$ 112,219
Reconciliation of Cash and Cash Equivalents at End of Year to the Statement of Net Assets:					
Cash and Investments	$ 205,229	$ 196,510	$ 100,397	$ 502,136	$ 112,079
Restricted Cash and Investments	101,168	77,587	34,389	213,144	140
Less Investments not meeting the definition of cash equivalents	(101,168)	(48,759)	-	(149,927)	-
Total Cash and Cash Equivalents at End of Year	$ 205,229	$ 225,338	$ 134,786	$ 565,353	$ 112,219
Reconciliation of Operating Income (Loss) to Net Cash Provided by (Used For) Operating Activities:					
Operating Income (Loss)	$ 44,803	$ 28,820	$ (475)	$ 73,148	$ (770)
Adjustments to Reconcile Operating Income (Loss) to Net Cash Provided By (Used For) Operating Activities:					
Depreciation	69,696	27,644	9,712	107,052	16,645
Changes in Assets and Liabilities:					
(Increase) Decrease in Receivables:					
Accounts - Net	(5,706)	(6,312)	1,005	(11,013)	(1,390)
Claims - Net	-	-	-	-	7
Contributions	-	-	-	-	(66)
From Other Funds	-	-	73	73	-
(Increase) Decrease in Inventories	-	(996)	(22)	(1,018)	688
(Increase) Decrease in Prepaid Expenses	2	(47)	14	(31)	(963)
Increase (Decrease) in Accounts Payable	2,925	1,629	(917)	3,637	(2,392)
Increase (Decrease) in Accrued Wages and Benefits	(124)	2	(344)	(466)	(781)
Increase (Decrease) in Other Accrued Liabilities	-	-	(60)	(60)	-
Increase (Decrease) in Due to Other Funds	-	-	-	-	1,400
Increase (Decrease) in Due to Other Agencies	(2,752)	565	-	(2,187)	-
Increase (Decrease) in Unearned Revenue	-	(2,285)	313	(1,972)	(23)
Increase (Decrease) in Contract Deposits	(181)	418	(152)	85	-
Increase (Decrease) in Arbitrage Liability	14	17	-	31	-
Increase (Decrease) in Compensated Absences	(370)	(137)	(654)	(1,161)	959
Increase (Decrease) in Liability Claims	864	2,312	-	3,176	11,015
Increase (Decrease) in Estimated Landfill Closure and Postclosure Care	-	-	2,124	2,124	-
Increase (Decrease) in Net Pension Obligation	8	7	7	22	(45)
Other Nonoperating Revenue (Expenses)	3,093	175	2,114	5,382	49
Total Adjustments	67,469	22,992	13,213	103,674	25,103
NET CASH PROVIDED BY OPERATING ACTIVITIES	$ 112,272	$ 51,812	$ 12,738	$ 176,822	$ 24,333
Noncash Investing, Capital, and Financing Activites:					
Developer Contributed Assets	$ 43,157	$ 59,564	$ -	$ 102,721	$ -
Increase (Decrease) in Capital Assets related Accounts Payable	(3,953)	(3,898)	1,129	(6,722)	51
Noncash Retirement of Capital Assets	(9,004)	(5,937)	-	(14,941)	-
Proceeds of Refunding Notes Issued	144,400	-	-	144,400	-
Repayment of Refunding Bonds to Escrow	(144,400)	-	-	(144,400)	-
Change in Fair Value of Investments	-	(652)	-	(652)	-

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

FIDUCIARY FUNDS
STATEMENT OF FIDUCIARY NET ASSETS
June 30, 2007
(In Thousands)

	Pension & Employee Savings Trust	Investment Trust	Agency
ASSETS			
Cash or Equity in Pooled Cash and Investments	$ 6,497	$ 2,323	$ 32,459
Cash with Custodian/Fiscal Agent	527,795	-	-
Investments at Fair Value:			
Short Term Investments	52,999	-	-
Domestic Fixed Income Securities (Bonds)	810,554	-	-
International Fixed Income Securities (Bonds)	176,388	-	-
Domestic Equity Securities (Stocks)	2,021,800	-	-
International Equity Securities (Stocks)	900,229	-	-
Mortgages	3	-	-
Real Estate Equity and Real Estate Securities	440,972	-	-
Defined Contribution Investments	745,461	-	-
Receivables:			
Accounts - Net	-	-	76
Contributions	28,092	-	-
Accrued Interest	13,742	39	26
Loans	29,417	-	-
Securities Sold	79,154	-	-
Prepaid Expenses	63	-	-
Securities Lending Collateral	854,631	-	-
Restricted Cash and Investments	-	-	8,312
Capital Assets - Depreciable	201	-	-
TOTAL ASSETS	6,687,998	2,362	$ 40,873
LIABILITIES			
Accounts Payable	7,965	-	$ 1,523
Accrued Wages and Benefits	572	-	-
Deposits/Advances from Others	-	-	13,300
Trust Liabilities	-	-	26,050
DROP Liability	271,596	-	-
Net Pension Obligation	776	-	-
Securities Lending Obligations	854,631	-	-
Securities Purchased	88,022	-	-
TOTAL LIABILITIES	1,223,562	-	$ 40,873
NET ASSETS			
Held in Trust for Pension Benefits and Other Purposes	$ 5,464,436	$ 2,362	

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

FIDUCIARY FUNDS
STATEMENT OF CHANGES IN FIDUCIARY NET ASSETS
Year Ended June 30, 2007
(In Thousands)

	Pension & Employee Savings Trust	Investment Trust	Total
ADDITIONS			
Employer Contributions	$ 253,271	$ -	$ 253,271
Employee Contributions	101,708	-	101,708
Retiree Contributions	6,727	-	6,727
Contributions to Pooled Investments	-	4,296	4,296
Earnings on Investments:			
Investment Income	799,542	261	799,803
Investment Expense	(21,682)	-	(21,682)
Net Investment Income	777,860	261	778,121
Securities Lending Income:			
Gross Earnings	35,580	-	35,580
Borrower Rebates	(33,216)	-	(33,216)
Administrative Expenses (Lending Agent)	(633)	-	(633)
Net Securities Lending Income	1,731	-	1,731
Other Income:			
Litigation Proceeds	619	-	619
TOTAL OPERATING ADDITIONS	1,141,916	4,557	1,146,473
DEDUCTIONS			
DROP Interest Expense	20,263	-	20,263
Benefit and Claim Payments	327,401	-	327,401
Distributions from Pooled Investments	-	8,866	8,866
Administration	18,730	-	18,730
TOTAL OPERATING DEDUCTIONS	366,394	8,866	375,260
CHANGE IN NET ASSETS	775,522	(4,309)	771,213
Net Assets at Beginning of Year	4,688,914	6,671	4,695,585
NET ASSETS AT END OF YEAR	$ 5,464,436	$ 2,362	$ 5,466,798

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

NOTES TO THE FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2007

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (In Thousands)

The City of San Diego (the "City") adopted its current charter on April 7, 1931 and operates as a municipality in accordance with State laws. Since adoption, the City Charter has been amended several times. The most recent amendments were added with voter approval of Propositions A, B and C during the June 3, 2008 election. Some of the amendments, which have taken effect immediately, include a more clear separation of the City's internal auditing function from supervision of the Manager (Mayor) by creating the new office of the City Auditor, which is supervised by a restructured Audit Committee. The Audit Committee will be restructured to consist of two Councilmembers, one being chair, and three public members. The public members must have at least 10 years of professional finance experience, and would be appointed from candidates recommended from a screening committee comprised of the Chief Financial Officer (CFO), the Independent Budget Analyst (IBA), a Councilmember, and two outside experts. Proposition C also provides that the Manager (Mayor) would appoint, with Council confirmation, the CFO who would assume the City's accounting responsibilities and oversee the City Treasurer. The measure also makes the Office of the IBA permanent, which would otherwise expire if the strong-mayor form of government does not get approved permanently in the year 2010.

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

a. Financial Reporting Entity

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

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

i. The component unit's governing body is substantively the same as the governing body of the primary government (the City).

ii. The component unit provides services entirely, or almost entirely, to the primary government or otherwise exclusively, or almost exclusively, benefits the primary government even though it does not provide services directly to it.

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

- Centre City Development Corporation
- City of San Diego/Metropolitan Transit Development Board Authority
- Community Facility and Other Special Assessment Districts
- Convention Center Expansion Financing Authority
- Public Facilities Financing Authority
- Redevelopment Agency of the City of San Diego
- San Diego Data Processing Corporation
- San Diego Facilities and Equipment Leasing Corporation

- San Diego Industrial Development Authority
- San Diego Open Space Park Facilities District #1
- Southeastern Economic Development Corporation
- San Diego City Employees' Retirement System
- Tobacco Settlement Revenue Funding Corporation

A brief description of each blended component unit follows:

- Centre City Development Corporation, Inc. (CCDC) is a not-for-profit public benefit corporation established in 1975 to administer certain redevelopment projects in downtown San Diego and to provide redevelopment advisory services to the Redevelopment Agency of the City of San Diego. CCDC's budget and governing board are approved by the City Council and services are provided exclusively to the primary government. CCDC is reported as a governmental fund. Financial statements can be requested from Centre City Development Corporation, 225 Broadway, Suite 1100, San Diego, California 92101.

- The City of San Diego/Metropolitan Transit Development Board Authority (MTDB Authority) is a financing authority which was established in 1988 and acquires and constructs mass transit guide ways, public transit systems, and related transportation facilities primarily benefiting the residents of the City of San Diego. The City appoints two Council members to the governing board and the MTDB Authority appoints one. The MTDB Authority primarily provides services to the primary government. The MTDB Authority is reported as a governmental fund. Financial statements can be requested from the Office of the City Comptroller, 202 C Street, San Diego, California 92101.

- The City maintains various Community Facility, Maintenance Assessment and Business Improvement Districts to pay for the construction, maintenance and improvement of community facilities and infrastructure. The governing body of Special Assessment Districts and Community Facilities Districts (special districts) is the City Council. Among its duties, it approves the budgets of special districts, parcel fees, special assessments, and special taxes. The special districts are reported in governmental fund types.

- The Convention Center Expansion Financing Authority (CCEFA) was established in 1996 to acquire and construct the expansion to the existing convention center. During the period reported, the governing board was administered by the Mayor, the Port of San Diego Director, and a member of the Board of Commissioners for the Port of San Diego. The CCEFA provides services which primarily benefit the primary government. CCEFA is reported as a governmental fund. Financial statements can be requested from the Office of the City Comptroller, 202 C Street, San Diego, California 92101.

- The Public Facilities Financing Authority (PFFA) was established in 1991 and currently acquires and constructs public capital improvements. PFFA is governed by a five member board appointed by the primary government. PFFA provides services exclusively to the primary government. Financing for governmental funds is reported as a governmental activity and financing for enterprise funds is reported as a business-type activity. Financial statements can be requested from the Office of the City Comptroller, 202 C Street, San Diego, California 92101.

- The Redevelopment Agency of the City of San Diego (RDA) was established in 1958 in order to provide a method for revitalizing deteriorating and blighted areas of the City and began functioning in 1969 under the authority granted by the community redevelopment law. The City Council is the governing board and the RDA is reported as a governmental fund. Complete stand-alone financial statements can be requested from the Office of the City Comptroller, 202 C Street, San Diego, California 92101.

- San Diego Data Processing Corporation (SDDPC) was formed in 1979 as a not-for-profit public benefit corporation for the purpose of providing data processing services. SDDPC's budget and governing board are approved by the City Council. SDDPC provides services almost exclusively to the primary government. SDDPC is reported as an Internal Service Fund. Financial statements can be requested from San Diego Data Processing Corporation, 5975 Santa Fe Street, San Diego, California 92109.

- The San Diego Facilities and Equipment Leasing Corporation (SDFELC) is a not-for-profit public benefit corporation established in 1987 for the purpose of acquiring and leasing to the City real and personal property to be used in the municipal operations of the City. The City Council appoints two of the three members of the governing board and services are exclusively to the primary government. Financing for governmental funds is reported as a governmental activity and financing for enterprise funds is reported as a business-type activity. Financial statements can be requested from the Office of the City Comptroller, 202 C Street, San Diego, California 92101.

- The San Diego Industrial Development Authority (SDIDA) was established in 1983 by the City for the purpose of providing an alternate method of financing to participating parties for economic development purposes. The City Council is the governing board. SDIDA is reported as a governmental fund. Financial statements can be requested from the Office of the City Comptroller, 202 C Street, San Diego, California 92101.

- The San Diego Open Space Park Facilities District #1 (SDOSPFD) was established in 1978 by the City for the purpose of acquiring open space properties to implement the Open Space Element of the City's General Plan. The boundaries are contiguous with those of the City. The City Council is the governing board. SDOSPFD is reported as a governmental fund. Financial statements can be requested from the Office of the City Comptroller, 202 C Street, San Diego, California 92101.

- Southeastern Economic Development Corporation (SEDC) is a not-for-profit public benefit corporation organized in 1980 by the City to administer certain redevelopment projects in southeast San Diego and to provide redevelopment advisory services to RDA. SEDC's budget and governing board are approved by the City Council and services are provided exclusively to the primary government. SEDC is reported as a governmental fund. Financial statements can be requested from the Southeastern Economic Development Corporation, 995 Gateway Center Way, Suite 300, San Diego, California 92102.

- San Diego City Employees' Retirement System (SDCERS) was established in 1927 by the City and provides retirement, health insurance, disability, and death benefits. Currently, SDCERS also administers the Port of San Diego and the San Diego County Regional Airport Authority defined benefit plans.

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

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

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

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. On August 1, 1993, SDCCC assumed similar responsibility for the Civic Theatre. The City is the sole member of SDCCC and acts through the San Diego City Council in accordance with the City Charter and the City's Municipal Code. The City appoints seven voting members out of the nine-member Board of Directors of SDCCC. The City is liable for any operating deficits and would be secondarily liable for any debt issuances of SDCCC. SDCCC is discretely presented because it provides services directly to the citizens. Complete stand-alone financial statements can be requested from San Diego Convention Center Corporation, 111 West Harbor Drive, San Diego, California 92101.

- San Diego Housing Commission (SDHC)

  SDHC is a government agency which was formed by the City under Ordinance No. 2515 on December 5, 1978 in accordance with the Housing Authority Law of the State of California. SDHC primarily serves low-income families by providing rental assistance payments, rental housing, loans and grants to individuals and not-for-profit organizations and other services. Members of the Board of Commissioners are appointed by the Mayor and confirmed by the City Council. SDHC is discretely presented because it provides services directly to the citizens. Complete stand-alone financial statements can be requested from San Diego Housing Commission, 1122 Broadway, Suite 300, San Diego, California 92101.

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

b. <u>Government-Wide and Fund Financial Statements</u>

The government-wide financial statements (i.e., the Statement of Net Assets and the Statement of Activities) report information on all of the non-fiduciary activities of the primary government and its component units. Governmental activities, which normally are supported by taxes and intergovernmental revenues, are reported separately from business-type activities, which rely to a significant extent on fees and charges for support. Likewise, the primary government is reported discretely from certain legally separate component units for which the primary government is financially accountable.

The Statement of Activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. Direct expenses are those that are clearly identifiable as to a specific function or segment. Direct expenses reported include administrative and overhead charges. Program revenues include (1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment and (2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items not properly included among program revenues are reported instead as general revenues and contributions.

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

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

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

The business-type activities and proprietary funds financial statements apply all effective pronouncements of the Governmental Accounting Standards Board ("GASB"). In addition, these statements apply all Accounting Principles Board Opinions ("APBO") and Financial Accounting Standards Board ("FASB") Statements and Interpretations issued on or before November 30, 1989, except those that conflict with GASB pronouncements.

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

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

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

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

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

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

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

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

Proprietary funds distinguish operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of the City's proprietary funds are charges to customers for sales and services. Operating expenses for proprietary funds include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

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

The following is the City's major governmental fund:

<u>General Fund</u> - 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:

<u>Sewer Utility Fund</u> - 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.

<u>Water Utility Fund</u> - 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:

<u>Internal Service Funds</u> - 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.

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

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

<u>Agency Funds</u> - 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, and certain employee benefit plans.

d. Property Taxes

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

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

At the government-wide level, property tax revenue is recognized in the fiscal year for which the taxes have been levied. Property taxes received after the fiscal year in which they were levied are not considered available as a resource that can be used to finance the current year operations of the City and, therefore, are recorded as deferred revenue in the governmental funds. The City provides an allowance for uncollected property taxes of 3% of the outstanding balance which reflects historical collections.

As a result of the recent decline in median residential home prices in the City, property owners can appeal the assessment value of their property to the County Assessment Appeals Board. In the event of a successful appeal, 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 market value. Cash equivalents reported in the Statement of Cash Flows for the Water and Sewer Utilities do not include restricted investments represented as Restricted Cash and Investments with a maturity date greater than ninety days.

The City's cash resources are combined to form a cash and investment pool managed by the City Treasurer (the pool). The pool is not registered as an investment company with the Securities and Exchange Commission (SEC) nor is it a 2a7–like pool. The investment activities of the Treasurer in managing the pool are governed by California Government Code § 53601 and the City's Investment Policy, which is reviewed by the Investment Advisory Committee and approved annually by the City Council. Interest earned on pooled investments is allocated to participating funds and entities based upon their average daily cash balance during the allocation month. Fair market 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 is equal to the fair market 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 expressly stated in the resolutions creating individual funds. During the fiscal year ended June 30, 2007, approximately $4,714 interest was assigned from various funds to the General Fund. These transactions caused an increase in the "transfers from" amount for the General Fund and a corresponding increase in the "transfer to" amount for the fund disbursing the interest. In the case of negative interest, these transactions caused an increase in the "transfers from" amount for the fund transferring the negative interest and a corresponding increase in the "transfer to" amount for the General Fund.

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

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

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

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

f. <u>Inventories</u>

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

g. <u>Land Held for Resale</u>

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

h. Deferred Charges

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

i. Capital Assets

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

Depreciable Capital Assets, which include structures and improvements, equipment, distribution and collection systems, and infrastructure, are reported net of accumulated depreciation in the applicable governmental or business-type activities column in the government-wide financial statements, as well as in the Proprietary Fund's 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 2007, $14,866 of interest expense incurred was capitalized, which is calculated net of related interest revenue of $1,132.

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

Assets	Years
Structures and Improvements	
Buildings	40 - 50
Building Improvements	15 - 40
Equipment	
Automobiles and Light Trucks	5 - 10
Construction and Maintenance Vehicles	5 - 20
General Machinery and Office Equipment	3 - 25
Distribution and Collection Systems	
Sewer Pipes and Water Mains	15 - 150
Reservoirs	100 - 150
Infrastructure	
Pavement and Traffic Signals	12 - 50
Bridges	75
Hardscape	20 - 50
Flood Control Assets	40 - 75

j. <u>Disposition and Development Agreements</u>

RDA and McMillin-NTC, LLC entered into a Disposition and Development Agreement, dated June 26, 2000, and a Third Implementation Agreement, dated May 6, 2003, which were executed for the purpose of effectuating the Redevelopment Plan at the Naval Training Center Redevelopment Project, in addition to constructing and installing additional infrastructure improvements as required by the City. The developer has agreed to advance the funds needed to pay for infrastructure costs. RDA has consistently reimbursed McMillin-NTC, LLC for eligible costs as they are billed, therefore, this agreement is not treated as a loan, and instead expenditures are recognized as payments are made to the developer and a corresponding capital asset is recorded in the government-wide financial statements.

On March 30, 2004 RDA entered into a Disposition and Development Agreement with Western Pacific Housing for a condominium development project in the North Park Redevelopment Project Area. Under the agreement, RDA promised to pay the maximum aggregate principal amount of $3,000, of which $2,100 represents the Affordability component of RDA's Payment Obligation, and $900 represents the Public Improvement component. The Affordability component is subject to an adjustment based on the actual project sales revenue proceeds received by the Developer. This adjustment amount cannot be computed until all 45 affordable units are sold. The principal amount outstanding bears simple interest at a rate equal to 5% per annum. Solely for the purposes of calculating the amount of interest payable, the developer shall be deemed to have paid an amount equal to 25% of RDA's Payment Obligation as of the date which is 195 days after closing of escrow, 50% as of the date which is 390 days after closing of escrow, 75% as of the date which is 585 days after closing of escrow, and 100% at the completion date, which is the date on which the release of construction covenants under the agreement have been recorded in the official records of the San Diego County. For purposes of calculating the amount of interest payable, the principal amounts stated above will be reduced by a 10% per annum applied on a pro rata basis for the period of time the Developer is not in compliance with the schedule of performance dates stated in the agreement for commencement and completion of construction. All payments shall be made from the site-generated property tax increment. To date, only the $900, representing the Public Improvement component of RDA's Payment Obligation, has been recognized as a liability since the remaining $2,100, representing the Affordability component of RDA's Payment Obligation, is subject to adjustment upon final sales of all 45 affordable units, which has yet to occur.

k. <u>Unearned/Deferred Revenue</u>

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

l. <u>Interfund Transactions</u>

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

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

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

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

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, and bond refunding gains and losses are amortized over the life of the bonds using a method which approximates the effective yield method. Net bonds payable reflects amortized bond accretion and unamortized bond discounts, premiums and refunding gains and losses. Bond accretion is not offset against capital assets as are discounts, premiums and refunding gains and losses.

n. Sundry Trust Liabilities

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

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

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 fund 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, 2007 the amount of restricted net assets due to enabling legislation was approximately $277,000.
- 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 Balance

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

Designated fund balance indicates that portion of fund equity for which the City has made tentative plans.

Undesignated fund balance indicates that portion of fund equity which is available for appropriation in future periods.

t. Reserves

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

On February 28, 1984, the City Attorney's Office issued Opinion No. 84-3 which addresses issues in regards to the City's compliance with the funding requirements of Charter Section 91. In the opinion of the City Attorney, "To the extent that the legislative body approves the issuance of short term notes, commonly referred to as Tax or Revenue Anticipation

Notes, pursuant to Section 92 titled “Borrowing Money on Short Term Notes”; or authorizes temporary loans to any tax-supported fund from any other funds in the treasury pursuant to Section 93 titled “Loans and Advances”, the General Reserve Fund required under section 91 can be reduced.” Therefore, the funding requirements of Charter Section 91 have been satisfied through a combination of the General Fund management reserve of $95,031 reported within the General Fund column of the Governmental Funds Balance Sheet in Undesignated Fund Balance, and the provisions set forth in Charter Sections 92 and 93 for the fiscal year ended June 30, 2007.

In September 2007, the City Attorney’s Office issued a new opinion that supersedes, in part, the opinion issued on February 28, 1984. The revised opinion states that the Charter Section 91 General Reserve must be a separate, legal fund. This fund, separate from the General Fund, must be funded if not at a “four month operating expenditure” level then at a level of such “other necessary funding.” The City Attorney’s Opinion referenced the guidance of the Government Finance Officer’s Association, which recommends a level between 5% and 15% of operating expenditures as the benchmark for interpreting the required funding level that meets the intent of the City’s voters. Per the City Attorney’s opinion, the City has created a separate General Reserve Fund in fiscal year 2008, and the General Fund reserve monies were transferred to that separate fund and reported therein in all future financial statements. The City Council also approved the Mayor’s “City Reserve Policy” with Ordinance 19679 on November 13, 2007. This is a formal fiscal reserve policy that establishes a General Fund Reserve that will be set at a minimum of 8% of annual General Fund Revenues. This adopted policy sets the goal for the City to reach this level of funding by fiscal year 2012.

The City also has an internal reserve policy in relation to certain governmental long term liabilities which are repaid with Transient Occupancy Tax revenues. When the liabilities are incurred by the City, the City creates policy reserves equal to one half of the annually required lease payments in the form of a rate stabilization reserve for each liability. The purpose of the internal reserve is to make the lease payments when they are due; even if there are unanticipated fluctuations in the Transient Occupancy Tax receipts that could potentially impact the timely payment of lease payments for such liabilities. In addition to the internal rate stabilization reserve, the City may also maintain cash funded debt service reserve funds or surety guarantees with trustees in accordance with the bond indentures that exist for these liabilities. As of June 30, 2007, the following is a schedule of all such rate stabilization reserves (in whole dollars) by fund:

Rate Stabilization Reserve	CAFR Section	CAFR Column		Amount
Convention Center Expansion	Special Revenue	Transient Occupancy Tax	$	6,850,531
Petco Park (PFFA-Ballpark)	Special Revenue	Transient Occupancy Tax		7,520,345
Balboa Park (SDFELC)	Special Revenue	Transient Occupancy Tax		3,286,878
Trolley (MTDB)	Special Revenue	Public Transportation		2,043,591
			$	19,701,345

u. Estimates

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

2. RECONCILIATION OF GOVERNMENT-WIDE AND FUND FINANCIAL STATEMENTS (In Thousands)

Certain adjustments are necessary to reconcile governmental funds to governmental activities (which includes all internal service funds except the Special Engineering Fund). The reconciliation of these adjustments are 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, and therefore, are either deferred or not reported in the funds." The details of this $84,581 difference are as follows:

Deferred Charges, net, July 1, 2006	$	24,585
Issuance Costs		5,145
Amortization Expense		(12,434)
Deferred Charges, net, June 30, 2007		17,296
Deferred Revenue:		
Taxes Receivable		17,388
Sales Taxes Receivable		4,523
Motor Vehicle License Receivable		93
Special Assessments Receivable		1,398
Grants and Other Receivables		43,883
Deferred Revenue, net, June 30, 2007		67,285
Net Adjustment to increase Total Fund Balances - Governmental Funds to arrive at Total Net Assets of Governmental Activities	$	84,581

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 ($1,652,421) difference are as follows:

Interest Accrued on Long-Term Debt	$	(21,255)
Compensated Absenses		(65,542)
Liability Claims		(12,990)
Capital Leases Payable		(31,596)
Contracts Payable		(2,615)
Notes Payable		(8,555)
Loans Payable		(18,775)
Section 108 Loans Payable		(39,431)
SANDAG Loans Payable		(2,287)
Net Bonds Payable		(1,283,678)
Accretion of Interest on Capital Appreciation Bonds		(11,015)
Net Pension Obligation		(154,682)
Net adjustment to decrease Total Fund Balances - Governmental Funds to arrive at Total Net Assets - Governmental Activities	$	(1,652,421)

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 $15,668 difference are as follows:

Capital Projects	$	106,518
Other Capital Activities		36,430
Depreciation Expense		(127,280)
Net Adjustment to increase Net Changes in Fund Balances - Total Governmental Funds to arrive at Changes in Net Assets of Governmental Activities	$	15,668

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 ($66,961) 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 land sold/retired.	$	(7,339)
Donations and transfers of capital assets decrease net assets in the Statement of Activities, but do not appear in the governmental funds because they are not financial resources.		(36)
The Statement of Activities reports losses arising from the retirement of depreciable capital assets. Conversely, governmental funds do not report any gain or loss on retirements of capital assets. Also included in this entry is a write off of approximately $40,000 for FBA credit project completions from prior years.		(59,586)
Net adjustment to decrease Net Change in Fund Balances - Total Governmental Funds to arrive at Changes in Net Assets of Governmental Activities	$	(66,961)

Another element of the reconciliation states "The issuance of long-term debt (i.e., bonds, leases) provides current financial resources to governmental funds, while the repayment of the principal consumes the current financial resources of governmental funds. Neither transaction, however, has any effect on net assets." The details of this $34,161 difference are as follows:

Debt Issued or Incurred:	
Capital Leases	$ (6,167)
Loans Payable	(10,823)
Notes Payable	(2,180)
Revenue Bonds	(156,560)
Special Assessment/Special Tax Bonds	(16,000)
Principal Repayments:	
Capital Leases	4,537
Notes Payable	919
Loans Payable	6,393
Section 108 Loans	3,068
SANDAG Loans	5,068
G.O. Bonds	1,985
Revenue Bonds	19,915
Special Assessment Bonds/Special Tax Bonds	3,980
Tax Allocation Bonds	12,041
Tobacco Settlement Asset-Backed Bonds	2,700
Refundings:	
Revenue Bonds	165,285
Net adjustment to increase Net Changes in Fund Balances - Total Governmental Funds to arrive at Changes in Net Assets of Governmental Activities	$ 34,161

Another element of the reconciliation states that "Some expenses reported in the Statement of Activities do not require the use of current financial resources (i.e., compensated absences, net pension obligation) and therefore are not accrued as expenses in governmental funds." The details of this ($18,546) difference are as follows:

Compensated Absences	$ (197)
Liability Claims	(12,990)
Net Pension Obligation	(129)
Accrued Interest	373
Current Year Premiums/Discounts and Interest Accretion Less Amortization of Bond Premiums	1,686
Issuance Costs Less Current Year Amortization	(7,289)
Net adjustment to decrease Net Changes in Fund Balances - Total Governmental Funds to arrive at Changes in Net Assets of Governmental Activities	$ (18,546)

3. CASH AND INVESTMENTS (In Thousands)

The following is a summary of the carrying amount of cash and investments:

	Governmental Activities	Business-Type Activities	Fiduciary Statement of Net Assets other than SDCERS	Subtotal	SDCERS Fiduciary Statement of Net Assets	Grand Total
Cash and Cash or Equity in Pooled Cash and Investments	$ 1,220,942	$ 545,302	$ 49,101	$ 1,815,345	$ 490	$ 1,815,835
Cash and Investments with Fiscal Agent	140,272	70,877	-	211,149	527,795	738,944
Investments at Fair Value	148,421	102,349	745,461	996,231	4,402,945	5,399,176
Securities Lending Collateral	-	-	-	-	854,631	854,631
TOTAL	$ 1,509,635	$ 718,528	$ 794,562	$ 3,022,725	$ 5,785,861	$ 8,808,586

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	$ 204
Deposit - Held in Escrow Accounts	8,312
Deposit - Cash and Cash Equivalents (Not Pooled)	86
Deposit Overdraft - Cash and Cash Equivalents (Pooled)	(9,358)
Pooled Investments in the City Treasury	1,816,591
Total Cash and Cash or Equity in Pooled Cash and Investments	$ 1,815,835

A summary of the investments held by the City Treasurer's investment pool as of June 30, 2007 is presented in the table below:

Investment	Fair Value	Cost	Interest Rate % Range		Maturity Range
U.S. Treasury Bills	$ 61,630	$ 61,539	3.39%		12/13/2007
U.S. Treasury Notes & Bonds	399,363	401,415	3.25-4.875%		8/15/2008 - 4/30/2012
U.S. Agency Discount Notes	303,599	300,947	4.92-5.11%	*	7/13/2007 - 5/27/2008
U.S. Agency Notes & Bonds	704,180	707,263	3.1-7.25%		7/2/2007 - 9/2/2011
Commercial Paper	139,594	138,877	5.14-5.35%		7/2/2007 - 9/17/2007
Corporate Notes & Bonds	155,350	155,682	3.125-6.875%		7/2/2007 - 10/27/2009
Local Agency Investment Fund (LAIF)	22,889	22,899	5.17%	**	7/1/2007 - 11/16/2007
Repurchase Agreement	29,986	29,986	5.20%		7/2/2007
	$ 1,816,591	$ 1,818,608			

* Discount Rates

** LAIF - Fair Value is adjusted to account for LAIF factor. Maturity range is based on weighted average maturity of 138 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, 2007:

Statement of Net Assets	
Deposit Overdraft - Cash and Cash Equivalents (Pooled)	$ (9,358)
Investments of Pool Participants	1,816,591
Accrued Interest Receivable of Internal Pool Participants	17,153
Accrued Interest Receivable of External Pool Participants	39
Total Cash, Investments, and Interest Receivable	1,824,425
Equity of Internal Pool Participants	$ 1,822,063
Equity of External Pool Participants (SanGIS, ARJIS & AVA) **	2,362
Total Equity	$ 1,824,425

**Voluntary Participation

Statement of Changes in Net Assets	
Net Assets Held for Pool Participants at July 1, 2006	$ 1,411,211
Net Change in Investments by Pool Participants	413,214
Total Net Assets Held for Pool Participants at June 30, 2007	$ 1,824,425

b. Cash and Investments with Fiscal Agents

Cash and Investments with Fiscal Agents represents cash and investments held by fiscal agents resulting from bond issuances. More specifically, these funds represent reserves held by fiscal agents or trustees as legally required by bond issuances and liquid investments held by fiscal agents or trustees which are used to pay debt service. The San Diego City Employees' Retirement System (SDCERS) portion of Cash and Investments with Fiscal Agents represents funds held as cash collateral from market neutral portfolios (domestic fixed income investment strategy). Furthermore, it represents transaction settlements, held in each investment manager's portfolio, which are invested overnight by SDCERS' custodial bank.

c. Investments at Fair Value

Investments at Fair Value represents investments of the City's Supplemental Pension Savings Plan, 401(k) Plan, San Diego City Employees' Retirement System (SDCERS), investments managed by the City Treasurer (which are not part of the pool), investments reported by San Diego Data Processing Corporation (SDDPC), and investments managed by the Funds Commission (e.g. Cemetery Perpetuity, Effie Sergeant, Gladys Edna Peters, Los Penasquitos Canyon, and the Edwin A. Benjamin Library Fund).

d. Investment Policy

In accordance with City Charter Section 45 and under authority annually approved by the City Council, the City Treasurer is responsible for the safekeeping and investment of the unexpended cash in the City Treasury according to the City's Investment Policy (the "Policy"). This Policy applies to all of the investment activities of the City except for the pension trust funds, the proceeds of certain debt issues, which are managed and invested at the direction of the City Treasurer in accordance with the applicable indenture or by Trustees appointed under indenture agreements or by fiscal agents, and the assets of trust funds, which are placed in the custody of the Funds Commission by Council ordinance.

City staff reviews the Policy annually and may make revisions based upon changes to the California Government Code and the investment environment. These suggested revisions are presented to the Investment Advisory Committee (IAC) for review and comments. The IAC consists of two City representatives and three outside financial professionals with market and portfolio expertise not working for the City of San Diego. The City Council reviews the Policy and considers approval on an annual basis.

The IAC evaluates the horizon returns, risk parameters, security selection, and market assumptions the City's investment staff is using when explaining the City's investment returns. The IAC also meets semi-annually to review the previous two quarters' investment returns and make recommendations to the City Treasurer on proposals presented to the IAC by the Treasurer's staff.

The Policy is governed by the California Government Code (CGC), Sections 53600 et seq. The following table presents the authorized investments, requirements, and restrictions per the CGC and the City Policy:

Investment Type	Maximum Maturity (1)		Maximum % of Portfolio		Maximum % with One Issuer		Minimum Rating	
	CGC	City Policy	CGC	City Policy	CGC	City Policy	CGC	City Policy
U.S. Treasury Obligations (bills, bonds, or notes)	5 years	5 years	None	None	None	None	None	None
U.S. Agencies	5 years	5 years	None	(2)	None	(2)	None	None
Bankers' Acceptances (6)	180 days	180 days	40%	40%	30%	10%	None	(3)
Commercial Paper (6)	270 days	270 days	25%	25%	10%	10%	P1	P1
Negotiable Certificates (6)	5 years	5 years	30%	30%	None	10%	None	(3)
Repurchase Agreements	1 year	1 year	None	None	None	None	None	None
Reverse Repurchase Agreements (4)	92 days	92 days	20%	20%	None	None	None	None
Local Agency Investment Fund	N/A	N/A	None	None	None	None	None	None
Non-Negotiable Time Deposits (6)	5 years	5 years	None	25%	None	10%	None	(3)
Medium Term Notes/Bonds (6)	5 years	5 years	30%	30%	None	10%	A	A
Municipal Securities of California Local Agencies (6)	5 years	5 years	None	20%	None	10%	None	A
Mutual Funds	N/A	N/A	20%	5%	10%	None	AAA	AAA
Notes, Bonds, or Other Obligations	5 years	5 years	None	None	None	None	None	AA
Mortgage Pass-Through Securities	5 years	5 years	20%	20%	None	None	AA	AAA
Financial Futures (5)	N/A	None	None	None	None	None	None	None

Footnotes:

(1) In the absence of a specified maximum, the maximum is 5 years.

(2) No more than one-third of the cost value of the total portfolio at time of purchase can be invested in the unsecured debt of any one agency.

(3) Credit and maturity criteria must be in accordance per Section X of the City's Investment Policy.

(4) Maximum % of portfolio for Reverse Repurchase Agreements is 20% of base value.

(5) Financial futures transactions would be purchased only to hedge against changes in market conditions for the reinvestment of bond proceeds.

(6) Investment types with a 10% maximum with one issuer are further restricted per the City's Investment Policy: 5% per issuer and an additional 5% with authorization by City Treasurer.

According to the Policy, the City may enter into repurchase and reverse repurchase agreements only with primary dealers of the Federal Reserve Bank of New York with which the City has entered into a master repurchase agreement.

Additionally, the Policy authorizes investment in other specific types of securities. The City may invest in floating rate notes with coupon resets based upon a single fixed income index (which would be representative of an eligible investment), provided that security is not leveraged. Structured notes issued by U.S. government agencies that contain imbedded calls or options are authorized as long as those securities are not inverse floaters, range notes, or interest only strips derived from a pool of mortgages. A maximum of 8% of the "cost value" of the pooled portfolio may be invested in structured notes.

Ineligible investments prohibited from use in the portfolio include, but are not limited to, common stocks and long-term corporate notes/bonds. A copy of the investment Policy can be requested from the City Treasurer, 1200 3rd Avenue, Suite 1624, San Diego, CA 92101.

Other Investment Policies

The City currently has a Funds Commission whose role is to supervise and control all trust, perpetuity, and investment funds of the City and such pension funds as shall be placed in its custody. The statutory authority for the Funds Commission is created in the City Charter Article V, Section 41(a). While the duties described in the creation document form broad authority for the Funds Commission, in practice, the Funds Commission only oversees investments related to a small number of permanent endowments. The allowable investments for these funds are different than those as prescribed in the City Treasurer's investment policy. Each permanent endowment fund has its own separate investment policy. Copies of the individual investment policies can be requested from the City Treasurer, 1200 3rd Avenue, Suite 1624, San Diego, CA 92101. Additionally, the City and its component units have funds invested in accordance with various bond indenture and trustee agreements.

City of San Diego – Disclosures for Specific Risks

e. Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. Market or interest-rate risk for the City's pooled investments is intended to be mitigated by establishing two portfolios, a liquidity portfolio and a core portfolio. Target durations are based upon the expected short and long-term cash needs of the City. The liquidity portfolio is structured with an adequate mix of highly liquid securities and maturities to meet major cash outflow requirements for at least six months (per CGC Section 53646). The liquidity portfolio uses the Merrill Lynch 3-6 month Treasury Index as a benchmark with a duration of plus or minus 20% of the duration of that benchmark.

The core portfolio uses the Merrill Lynch 1-3 year Treasury Index as a benchmark with a duration of plus or minus 20% of the duration of that benchmark. It consists of high quality liquid securities with a maximum maturity of 5 years and is structured to meet the longer-term cash needs of the City. Information about the sensitivity of the fair value of the City's investments to market interest rate fluctuations is presented in the table on the next page.

As of June 30, 2007, 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 Bills	$ 61,630	$ -	$ -	$ -	$ 61,630
U.S. Treasury Notes	-	350,346	49,017	-	399,363
U.S. Agencies - Federal Farm Credit Bank	20,000	14,889	-	-	34,889
U.S. Agencies - Federal Home Loan Bank	228,191	91,490	19,569	-	339,250
U.S. Agencies - Federal Home Loan Mortgage Corporation	143,419	89,994	45,183	-	278,596
U.S. Agencies - Federal National Mortgage Association	209,482	145,562	-	-	355,044
Commercial Paper	139,594	-	-	-	139,594
Corporate Notes	74,873	80,477	-	-	155,350
Repurchase Agreement	29,986	-	-	-	29,986
State Local Agency Investment Fund	22,889	-	-	-	22,889
	930,064	772,758	113,769	-	1,816,591
Non-Pooled Investments with City Treasurer:					
U.S. Treasury Notes	29,356	5,350	-	-	34,706
U.S. Agencies - Federal Farm Credit Bank	4,163	-	-	-	4,163
U.S. Agencies - Federal Home Loan Bank	13,051	-	-	-	13,051
U.S. Agencies - Federal Home Loan Mortgage Corporation	56,753	-	-	-	56,753
U.S. Agencies - Federal National Mortgage Association	52,328	-	-	-	52,328
Commerical Paper	59,944	-	-	-	59,944
Repurchase Agreements	11,014	-	-	-	11,014
	226,609	5,350	-	-	231,959
Investments with Fiscal Agents, Funds Commission, and Blended Component Units:					
U.S. Treasury Bills	27,948	-	-	-	27,948
U.S. Treasury Bonds and Notes	16,778	592	65	395	17,830
U.S. Agencies - Federal Farm Credit Bank	2,585	-	-	-	2,585
U.S. Agencies - Federal Home Loan Bank	21,734	1,455	-	-	23,189
U.S. Agencies - Federal Home Loan Mortgage Corporation	3,139	-	-	296	3,435
U.S. Agencies - Federal National Mortgage Association	27,422	84	-	-	27,506
Corporate Bonds and Notes	199	325	1,075	2,002	3,601
Guaranteed Investment Contracts	20,507	-	-	13,740	34,247
Mortgage Backed Securities - Commercial	105	-	-	-	105
Mortgage Backed Securities - Government	52	-	-	-	52
Repurchase Agreements	4,250	-	-	-	4,250
Common Stock	3,817	-	-	-	3,817
Mutual Funds - Equity	407,907	-	-	-	407,907
Mutual Funds - Fixed Income	12,263	-	330,006	-	342,269
Money Market Mutual Funds	76,680	-	-	-	76,680
	625,386	2,456	331,146	16,433	975,421
Total Investments	$ 1,782,059	$ 780,564	$ 444,915	$ 16,433	3,023,971
Total Deposit Overdraft					(960)
Total Cash on Hand					204
Total Investments, Deposits, and Cash on Hand (Includes SDCERS Pooled Cash and Investments with the City - $490)					$ 3,023,215

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, 2007, 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 Bills	Exempt	Exempt	$ 61,630	3.39%
U.S. Treasury Notes	Exempt	Exempt	399,363	21.98%
U.S. Agencies - Federal Farm Credit Bank	Aaa	N/A	34,889	1.92%
U.S. Agencies - Federal Home Loan Bank [1]	Aaa	N/A	289,328	15.93%
U.S. Agencies - Federal Home Loan Bank [1]	P-1	N/A	49,922	2.75%
U.S. Agencies - Federal Home Loan Mortgage Corporation [1]	Aaa	N/A	190,408	10.48%
U.S. Agencies - Federal Home Loan Mortgage Corporation [1]	Aa2	N/A	15,324	0.84%
U.S. Agencies - Federal Home Loan Mortgage Corporation [1]	Not Available	A-1+	72,864	4.01%
U.S. Agencies - Federal National Mortgage Association [1]	Aaa	N/A	200,118	11.02%
U.S. Agencies - Federal National Mortgage Association [1]	P-1	N/A	68,277	3.76%
U.S. Agencies - Federal National Mortgage Association [1]	Not Available	A-1+	86,649	4.77%
Commercial Paper	P-1	N/A	139,594	7.68%
Corporate Notes	Aaa	N/A	44,854	2.47%
Corporate Notes	Aa1	N/A	19,420	1.07%
Corporate Notes	Aa2	N/A	27,211	1.50%
Corporate Notes	Aa3	N/A	63,865	3.52%
Repurchase Agreements	Not Rated	Not Rated	29,986	1.65%
State Local Agency Investment Fund	Not Rated	Not Rated	22,889	1.26%
Subtotal - Pooled Investments			1,816,591	100.00%
Non-Pooled Investments with City Treasurer:				
U.S. Treasury Notes	Exempt	Exempt	34,706	14.96%
U.S. Agencies - Federal Farm Credit Bank	P-1	N/A	4,163	1.79%
U.S. Agencies - Federal Home Loan Bank [1]	Aaa	N/A	8,680	3.74%
U.S. Agencies - Federal Home Loan Bank [1]	P-1	N/A	4,371	1.88%
U.S. Agencies - Federal Home Loan Mortgage Corporation [1]	Aaa	N/A	12,035	5.19%
U.S. Agencies - Federal Home Loan Mortgage Corporation [1]	P-1	N/A	25,780	11.12%
U.S. Agencies - Federal Home Loan Mortgage Corporation [1]	Not Available	A-1+	18,938	8.16%
U.S. Agencies - Federal National Mortgage Association [1]	Aaa	N/A	10,937	4.72%
U.S. Agencies - Federal National Mortgage Association [1]	P-1	N/A	34,438	14.85%
U.S. Agencies - Federal National Mortgage Association [1]	Not Available	A-1+	6,953	3.00%
Commerical Paper	P-1	N/A	59,944	25.84%
Repurchase Agreements	Not Rated	Not Rated	11,014	4.75%
Subtotal - Non-Pooled Investments			231,959	100.00%

"Exempt" - Per GASB 40, US Treasury Obligations do not require disclosure of credit quality.

"N/A" - S&P rating not applicable, Moody's rating provided

"Not Available" - Bloomberg credit history did not have Moody's ratings, only S&P ratings

[1] More than 5% of total investments are with U.S. Agencies whose debt is not guaranteed by the U.S. Government.

(ratings continued on next page)

Investments with Fiscal Agents, Funds Commission, and Blended Component Units:	Moody's	S&P	Fair Value	Percentage
U.S. Treasury Bills	Exempt	Exempt	$ 27,948	2.87%
U.S. Treasury Bonds and Notes	Exempt	Exempt	17,830	1.83%
U.S. Agencies - Federal Farm Credit Bank	Aaa	N/A	2,585	0.27%
U.S. Agencies - Federal Home Loan Bank	Aaa	N/A	23,189	2.38%
U.S. Agencies - Federal Home Loan Mortgage Corporation	Aaa	N/A	296	0.03%
U.S. Agencies - Federal Home Loan Mortgage Corporation	Not Available	A-1+	3,139	0.32%
U.S. Agencies - Federal National Mortgage Association	Aaa	N/A	1,602	0.16%
U.S. Agencies - Federal National Mortgage Association	Not Available	A-1+	25,904	2.66%
Corporate Bonds and Notes	Aaa	N/A	99	0.01%
Corporate Bonds and Notes	Aa1	N/A	264	0.03%
Corporate Bonds and Notes	Aa2	N/A	650	0.07%
Corporate Bonds and Notes	Aa3	N/A	407	0.04%
Corporate Bonds and Notes	A1	N/A	729	0.07%
Corporate Bonds and Notes	A2	N/A	1,108	0.11%
Corporate Bonds and Notes	A3	N/A	344	0.04%
Guaranteed Investment Contracts	Not Rated	Not Rated	34,247	3.51%
Mortgage Backed Securities - Commercial	Aaa	N/A	105	0.01%
Mortgage Backed Securities - Government	Not Rated	Not Rated	52	0.01%
Repurchase Agreements	Not Rated	Not Rated	4,250	0.44%
Common Stock	Not Rated	Not Rated	3,817	0.39%
Mutual Funds - Equity	Not Rated	Not Rated	407,907	41.82%
Mutual Funds - Fixed Income	Not Rated	Not Rated	342,269	35.09%
Money Market Mutual Funds	Aaa	N/A	76,680	7.86%
Subtotal - Other Investments			975,421	100.00%
Total Investments			3,023,971	
Total Deposit Overdraft			(960)	
Total Cash on Hand			204	
Total Investments, Deposits, and Cash on Hand*			$ 3,023,215	

*(includes SDCERS Pooled Cash and Investments with the City - $490)

"Exempt" - Per GASB 40, US Treasury Obligations do not require disclosure of credit quality.

"N/A" - S&P rating not applicable, Moody's rating provided

"Not Available" - Bloomberg credit history did not have Moody's ratings, only S&P ratings

[1] More than 5% of total investments are with U.S. Agencies whose debt is not guaranteed by the U.S. Government.

Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the relative size of an investment in a single issuer. As of June 30, 2007, 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 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, 2007, the carrying amount of the City's cash deposits was an overdraft of approximately $(9,272), and the bank balance was approximately $12,666, the difference of which is substantially due to outstanding checks. For the balance of cash deposits in financial institutions, approximately $481 was covered by federal depository insurance and approximately $12,185 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, $11,345 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 $840, which is uninsured and uncollateralized. The amount subject to custodial credit risk includes approximately $753 in deposits relating to San Diego Data Processing Corporation and $87 in deposits relating to Southeastern Economic Development Corporation, Inc.

The City also has deposits held in escrow accounts with a carrying amount and bank balance of approximately $8,312. For the balance of deposits in escrow accounts, approximately $892 was covered by federal depository insurance. The remaining balance of $7,420 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, $7,420 of the City's deposits in escrow accounts are collateralized and pledged at 110%.

Investments

The City's investments at June 30, 2007 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, 2007, 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 Category 3:

Investment Type	Fair Value
U.S. Treasury Bonds and Notes	$ 1,258
U.S. Agencies	380
Corporate Bonds and Notes	3,601
Mortgage Backed Securities - Commercial	105
Mortgage Backed Securities - Government	52
Common Stock	3,817
Total	$ 9,213

h. Restricted Cash and Investments

Cash and investments at June 30, 2007 that are restricted by legal or contractual requirements are comprised of the following:

General Fund	
TRANS Repayment	$ 142,000
Total General Fund	142,000
Nonmajor Governmental Funds	
Reserved for Debt Service	127,205
Permanent Endowments	16,456
Total Nonmajor Governmental Funds	143,661
Environmental Services Enterprise Fund	
Funds set aside for landfill site closure and maintenance costs	34,389
Total Environmental Services Enterprise Fund	34,389
Water Utility Enterprise Fund	
Customer deposits	5,666
Interest and redemption funds	71,921
Total Water Utility Enterprise Fund	77,587
Sewer Utility Enterprise Fund	
Interest and redemption funds	101,168
Total Sewer Utility Enterprise Fund	101,168
Internal Service Fund	
San Diego Data Processing Corporation	140
Total Internal Service Fund	140
Miscellaneous Agency Funds	
Retention held in escrow	8,312
Total Miscellaneous Agency Funds	8,312
Total Restricted Cash and Investments	$ 507,257

Summary of Total Cash and Investments
(In Thousands)

Total Unrestricted Cash and Investments	$ 8,301,329
Total Restricted Cash and Investments	507,257
Total Cash and Investments	$ 8,808,586

Total Governmental Activities	$ 1,509,635
Total Business-Type Activities	718,528
Total Fiduciary Activities	6,580,423
Total Cash and Investments	$ 8,808,586

San Diego City Employees' Retirement System (SDCERS) – Disclosures for Policy and Specific Risks

Summary of Cash and Investments – San Diego City Employees' Retirement System

U.S. Fixed Income Portfolio (with tactical discretion)	$ 406,045
U.S. Fixed Income Portfolio	422,766
Non-U.S. Fixed Income Portfolio	180,530
Securities Lending Collateral	854,631
Cash and Investments exempt from GASB 40 disclosure	3,921,399
Total Cash and Investments for SDCERS (excluding Pooled Investments with the City)	$ 5,785,371

Narratives and tables presented in the following sections (i. through p.) are taken directly from the comprehensive annual financial report of the San Diego City Employees' Retirement System, as of June 30, 2007, issued March 31, 2008.

i. Investment Policy

Investments for the pension trust fund are authorized to be made by the Board of Administration of the SDCERS (Board) in accordance with Section 144 of the City Charter and the California State Constitution Article XVI, Section 17. The Board is authorized to invest in any securities that are allowed by general law for savings banks. The Board may also invest in additional investments as approved by resolution of the San Diego City Council. These investments include, but are not limited to, bonds, notes and other obligations, real estate investments, common stock, preferred stock, and pooled vehicles. Additionally, investment policies permit SDCERS' Board to invest in financial futures contracts provided the contracts do not leverage SDCERS' Trust Fund portfolio. Financial futures contracts are recorded at fair value each day and must be settled at expiration date. Changes in the fair value of the contracts will result in the recognition of a gain or loss under GASB Statement No. 25. Investment earnings from the pension trust fund are accounted for in accordance with GASB 25.

A copy of the SDCERS investment policy and additional details on the results of the system's investment activities are available at 401 West A Street, Suite 400, San Diego, CA 92101.

j. Interest Rate Risk

SDCERS' fixed income portfolios use duration to measure how changes in interest rates will affect the value of the portfolios. SDCERS' domestic convertible bond portfolio is not subject to interest rate risk because convertible bonds are usually positively correlated to interest rate movements compared to other fixed income securities.

The following tables display duration analysis for SDCERS' two-core plus domestic fixed income portfolios and single international fixed income portfolio, based on holdings as of June 30, 2007.

Domestic Fixed Income Portfolio
(with tactical discretion to invest in non-U.S. fixed income securities)
Portfolio Duration Analysis as of June 30, 2007

Type of Security	Fair Value (in thousands)	Percentage of Fair Value	Effective Duration (in years)	Effective Duration Contribution to Portfolio (in years)	Percent Duration of Portfolio
Credit Obligations:					
Corporate Bonds [2]	$ (3,241)	-0.8%	(13.29)	0.11	2.3%
High Yield	7,805	1.9%	1.73	0.03	0.6%
Municipal Bonds	1,877	0.5%	7.90	0.04	0.8%
U.S. Government & Agency Obligations:					
U.S. Treasuries	81,348	20.0%	2.95	0.59	12.3%
U.S. Agencies	6,432	1.6%	5.09	0.08	1.7%
International Government:					
Sovereign & Yankee Bonds	39,385	9.7%	(2.71)	(0.26)	-5.4%
Emerging Markets	35,573	8.8%	4.45	0.40	8.3%
Collateralized Mortgage Obligations:					
Mortgages [1]	149,339	36.8%	4.41	1.62	33.8%
Collateralized Mortgage Obligations [1]	18,841	4.6%	2.67	0.12	2.5%
Short-Term/Other:					
Miscellaneous	3,820	0.9%	1.58	0.01	0.2%
Cash/Cash Equivalents	64,866	16.0%	12.88	2.06	42.9%
Total Portfolio	$ 406,045	100.0%		4.80	100.0%

[1] Mortgages represent agency pass-through securities and Collateralized Mortgage Obligations represent structured products backed by mortgages with this manager holding specific traunches.

[2] The negative fair value and duration for corporate bonds results from the fair value of credit default swaps.

The domestic fixed income strategy is restricted to a duration of +/- 2 years from that of the effective duration of the Lehman Brothers Aggregate Index.
Source: SDCERS' CAFR as of June 30, 2007

Domestic Fixed Income Portfolio
Portfolio Duration Anaylsis
As of June 30, 2007

Type of Security	Fair Value (In Thousands)	Effective Duration	Benchmark Duration	Difference
Government	$ 148,664	5.75	4.48	1.27
Corporate	85,046	4.39	6.11	(1.72)
Mortgage Backed Securities	177,995	3.64	4.24	(0.60)
Asset-Backed Securities	11,061	3.75	2.85	0.90
Cash Equivalents [1]	15,996	0.04	0.00	0.04
Totals	$ 438,762	4.70	4.70	0.00

[1] Net cash expense is included on this schedule, as cash is a portfolio duration arrangement tool in fixed income investing.

The above strategy is restricted to an average duration of +/- 1 year from that of the effective duration of the the Lehman Brothers Aggregate Index.
Source: SDCERS' CAFR as of June 30, 2007

International Fixed Income Portfolio
Portfolio Duration Anaylsis
As of June 30, 2007

Type of Security	Fair Value (In Thousands)	Effective Duration	Benchmark Duration	Difference
Cash and Forward Foreign Exchange	$ 1,100	0.00	0.00	0.00
Asset Backed Securities	13,869	7.61	0.00	7.61
Credit Obligations	22,033	9.02	0.00	9.02
International Government and Agency	143,528	5.76	6.27	(0.51)
Totals	$ 180,530	6.27	6.27	0.00

The above strategy is restricted to an average duration of between 0.5 and 1.5 times that of the J.P. Morgan Non-U.S. Bond Index.
Source: SDCERS' CAFR as of June 30, 2007

Investments Highly Sensitive to Interest Rate Changes

SDCERS' fixed income investment managers construct portfolios that have attributes of differing price sensitivity (also known as convexity) and interest rate sensitivity. Convexity measures the movement in bond prices in response to interest rate changes. Interest rate sensitivity measures the impact of interest rate changes on the duration of a bond portfolio. SDCERS' managers select securities that when aggregated together create an overall investment strategy and total portfolio duration.

Domestic Fixed Income Manager (with tactical discretion to invest in non-U.S. securities)

SDCERS' domestic fixed income portfolio (with tactical discretion to invest in non-U.S. securities) uses two methods to measure interest rate sensitivity. The first measure is Bull Duration, the scenario where interest rates decline by 50 basis points. The second measure is Bear Duration, the scenario where interest rates rise by 50 basis points. The analysis of interest rate change on duration for this portfolio as of June 30, 2007 is shown below.

Total Effective Duration of the fixed income portfolio: 4.80 years

Bull Duration: 4.27 years – portfolio duration shortens by -0.53 during a 50 basis point decline
Bear Duration: 5.18 years – portfolio duration lengthens by +0.38 years during a 50 basis point increase

Domestic Fixed Income Manager

SDCERS' core-plus domestic fixed income manager applies multiple value-added strategies in the pursuit to outperform their benchmark, to achieve below average volatility, and to preserve capital. The manager makes shifts in the duration of the portfolio and looks at all sectors of the bond market. In some cases, the manager may select issues which are more highly sensitive to interest rate changes than the average holding but contribute to the overall strategy of the portfolio. As of June 30, 2007, the total values of securities that are more highly sensitive to interest rate changes in this portfolio are shown below.

Holdings (U.S. Treasury and Corporate securities) with greater than 10 years duration totaled $45,791, or 10.44% of the portfolio.

Holdings with interest only strips and inverse floating rate notes totaled $7,241, or 1.66% of the portfolio.

International Fixed Income Manager

The analysis of high interest rate sensitivity for the international fixed income portfolio is presented below.

Total Effective Duration: 4.70 years.
Duration with 50 basis point decrease in interest rates: -0.165 years.

k. Credit Risk

SDCERS' fixed income portfolios are sensitive to credit risk. Unless information is available to the contrary, obligations of the U.S. Government or obligations explicitly guaranteed by the U.S. Government are not considered to have credit risk and do not require disclosure of credit quality. "NR" represents those securities that are not rated and "NA" represents those securities that are not applicable to the rating disclosure requirements. The tables on the following pages identify the credit quality for SDCERS' two domestic fixed income portfolios, based on holdings as of June 30, 2007.

Domestic Fixed Income Portfolio
(with tactical discretion to invest in non-U.S. fixed income securities)
As of June 30, 2007

S&P Quality Rating	Moody's Quality Rating	Total Fair Value (in thousands)	Credit Obligations	U.S. Government & Agency Obligations	International Government Obligations	Collateralized Mortgage Obligations	Short-Term/ Other
AAA	Aaa	$ 169,038	$ -	$ 7,913	$ 178	$ 160,947	$ -
AAA	NR	7,233	-	-	-	7,233	-
AA+	Aaa	12,003	-	12,003	-	-	-
AA	Aaa	3,017	-	3,018	(1) [1]	-	-
AA	Aa1	8,023	886	9,020	(1,883) [1]	-	-
AA	Aa2	(962)	191	-	(1,153) [1]	-	-
AA-	Aa1	55,861	-	54,843	1,018	-	-
AA-	Aa2	497	497	-	-	-	-
AA-	Aa3	26,908	-	(5,881) [1]	(4,104) [1]	-	36,893
NR	Aa3	700	-	-	-	-	700
A+	A1	15,237	101	(13) [1]	5,041	-	10,108
A+	Aa3	32,385	309	28,101	-	-	3,975
A	A1	289	289	-	-	-	-
A	A2	5,991	605	-	191	-	5,195
A	Aa3	573	474	-	99	-	-
A-	Aaa	1,701	-	-	-	-	1,701
A-	Aa3	1,145	1,145	-	-	-	-
A-	Baa1	801	-	-	-	-	801
BBB+	Baa2	882	882	-	-	-	-
BBB	A2	191	191	-	-	-	-
BBB	A3	4,603	-	-	-	-	4,603
BBB	Baa1	3,189	-	-	81	-	3,108
BBB	Baa2	202	202	-	-	-	-
BBB	Baa3	1,483	1,483	-	-	-	-
BBB-	Ba1	726	726	-	-	-	-
BBB-	Baa3	1,602	-	-	-	-	1,602
BBB-	NR	488	-	-	488	-	-
BB+	Ba1	4,083	4,083	-	-	-	-
BB+	Ba2	5,461	-	-	5,461	-	-
BB	Ba1	416	416	-	-	-	-
BB-	Ba3	1,780	1,780	-	-	-	-
BB-	B1	1,905	-	-	1,905	-	-
B+	B1	11	11	-	-	-	-
B	B1	100	100	-	-	-	-
NR	NR	38,483	(7,930) [2]	(21,224) [3]	67,637	-	-
Totals		$ 406,045	$ 6,441	$ 87,780	$ 74,958	$ 168,180	$ 68,686

[1] Negative amounts are representative of pay fixed interest rate swaps.

[2] This value represents swaptions that are not rated.

[3] These amounts include short positions in exchange traded futures and options that are not rated.

Concentration guidelines for this portfolio are as follows:

Maximum Exposure (except U.S. Treasury/Agency Organization for Economic Co-operation and Development Government Issues)

Issue	3% of portfolio
Issuer	5% of portfolio
Foreign Investments	30% of portfolio
Emerging Market Exposure	10% of portfolio
Foreign Currency Exposure	25% of non-U.S. dollar investments

Source: SCDERS' CAFR as of June 30, 2007

Domestic Fixed Income Portfolio
Credit Risk Analysis By Rating Agency as of June 30, 2007

S&P Quality Rating	Total Fair Value (in thousands)	Governments	Corporates	Mortgaged-Backed Securities	Asset-Backed Securities
U.S. Treasury	$ 148,902	$ 148,664	$ -	$ 238	$ -
AAA	135,502	-	2,908	124,026	8,568
AA+	2,260	-	-	-	2,260
AA	1,896	-	1,896	-	-
AA-	3,056	-	3,056	-	-
A+	16,712	-	16,712	-	-
A	459	-	459	-	-
A-	11,670	-	11,670	-	-
BBB+	6,285	-	6,285	-	-
BBB	6,469	-	6,469	-	-
BBB-	13,334	-	13,334	-	-
BB+	6,061	-	6,061	-	-
BB	10,585	-	10,585	-	-
BB-	233	-	-	-	233
B	4,413	-	4,413	-	-
B-	1,198	-	1,198	-	-
NR	8,425	-	-	8,425	-
NR [1]	45,306	-	-	45,306	-
Totals	$ 422,766	$ 148,664	$ 85,046	$ 177,995	$ 11,061

Moody's Quality Rating	Total Fair Value (in thousands)	Governments	Corporates	Mortgaged-Backed Securities	Asset-Backed Securities
U.S. Treasury	$ 148,902	$ 148,664	$ -	$ 238	$ -
Aaa	71,281	-	3,728	58,985	8,568
Aa1	4,683	-	4,683	-	-
Aa3	8,237	-	8,237	-	-
A1	7,307	-	7,307	-	-
A2	3,219	-	3,219	-	-
A3	4,075	-	4,075	-	-
Baa1	5,646	-	5,646	-	-
Baa2	9,050	-	9,050	-	-
Baa3	8,981	-	8,981	-	-
Ba1	13,177	-	13,177	-	-
Ba2	233	-	-	-	233
Ba3	4,118	-	4,118	-	-
B1	4,413	-	4,413	-	-
B3	1,198	-	1,198	-	-
NR	82,940	-	7,214	73,466	2,260
NR [1]	45,306	-	-	45,306	-
Totals	$ 422,766	$ 148,664	$ 85,046	$ 177,995	$ 11,061

[1] Issued by governmental agencies.

Concentration guidelines for this portfolio are as follows:

Maximum Exposure (except U.S. Treasury/Agency)

Issue	5% of portfolio
Issuer	5% of portfolio
Non-Investment Grade	10% of portfolio
Mortgage back derivatives	5% of portfolio
USD Foreign Investments	15% of portfolio
Foreign Currency Exposure	0% of portfolio

Source: SDCERS' CAFR as of June 30, 2007

SDCERS' international fixed income portfolio has an average credit quality of A (market value weighted) by at least one of the major rating services. Credit ratings refer to the long-term foreign currency rating. The following table identifies the credit quality for SDCERS' international fixed income portfolio, based on holdings as of June 30, 2007.

International Fixed Income Portfolio
Credit Risk Analysis as of June 30, 2007

S&P Quality Rating	Total Fair Value (in thousands)	Cash & Forward Foreign Exchange	Asset Backed Securities	Credit Obligations	International Government & Agency Obligations
AAA	$ 123,782	$ 1,100	$ 13,869	$ 13,858	$ 94,955
AA+	7,973	-	-	-	7,973
AA	24,650	-	-	-	24,650
A	3,132	-	-	3,132	-
A-	4,348	-	-	2,481	1,867
BBB+	179	-	-	179	-
BBB	4,070	-	-	1,578	2,492
BBB-	805	-	-	805	-
BB	2,662	-	-	-	2,662
BB-	1,948	-	-	-	1,948
B+	6,981	-	-	-	6,981
Totals	$ 180,530	$ 1,100	$ 13,869	$ 22,033	$ 143,528

Source: SDCERS' CAFR as of June 30, 2007

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, 2007, no single issuer exceeded 5% of SDCERS' total investments. Investments issued explicitly guaranteed by the U.S. government and investments in mutual funds, external investment pools, and other pooled investments are excluded. While there are no general policies addressing concentration of credit risk, specific investment guidelines with each manager place limitations on the maximum holdings in any one issuer.

I. Custodial Credit Risk

Custodial credit risk is the risk that if a financial institution or counterparty fails, SDCERS would not be able to recover the value of its deposits, investments, or securities. SDCERS' exposure to custodial credit risk is further discussed in the following paragraphs.

Deposits

SDCERS' is exposed to custodial credit risk for uncollateralized cash and cash equivalents that are not covered by federal depository insurance. At June 30, 2007, the amount of cash and cash equivalents on deposit with SDCERS' custodial bank totaled $ 94,380.

Investments

As of June 30, 2007, 100% of SDCERS' investments were held in SDCERS' name. SDCERS is not exposed to custodial credit risk related to these investments.

Securities Lending Collateral

SDCERS is exposed to custodial credit risk for the securities lending collateral such that certain collateral is received in the form of letters of credit, tri-party collateral or securities collateral. The fair value of securities on loan collateralized by these non-cash vehicles totaled $29,535 as of June 30, 2007 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 $854,631 as of June 30, 2007, is also at risk as it is invested in a pooled vehicle managed by the custodian.

m. Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or a deposit. The following table represents SDCERS' securities (in thousands) held in a foreign currency as of June 30, 2007.

Foreign Currency Risk
As of June 30, 2007
(All values in U.S. Dollars)

Local Currency Name	Cash	Equity	Fixed income	Total
Australian Dollar	$ 210	$ 20,319	$ 9,347	$ 29,876
Brazilian Real	-	911	-	911
Canadian Dollar	67	13,587	2,561	16,215
Danish Krone	30	1,058	13,074	14,162
Euro Currency	616	324,332	71,100	396,048
Hong Kong Dollar	15	13,083	-	13,098
Indonesian Rupiah	7	4,384	-	4,391
Japanese Yen	1,502	149,724	48,860	200,086
Mexican Peso	-	1,822	-	1,822
New Zealand Dollar	-	1,331	-	1,331
Norwegian Krone	3	9,012	-	9,015
Singapore Dollar	51	9,585	-	9,636
South Korean Won	1	27,790	1,624	29,415
Swedish Krona	403	20,556	5,435	26,394
Swiss Franc	22	35,091	-	35,113
UK Pound	355	124,304	11,058	135,717
Totals	$ 3,282	$ 756,889	$ 163,059	$ 923,230

The foreign exchange exposure in SDCERS' international equity small cap value portfolio (an institutional mutual fund investment) is not included in this disclosure.

Foreign currency is comprised of international investment proceeds and income to be repatriated into U.S. dollars and funds available to purchase international securities. Foreign currency is not held by SDCERS as an investment. Foreign currency is held temporarily in foreign accounts until it is able to be repatriated or expended to settle trades. A significant component of the diversification benefit of non-domestic investments comes from foreign currency exposure. As such, SDCERS does not have a policy to hedge against fluctuations in foreign exchange rates. SDCERS' investment managers may hedge currencies at their discretion pursuant to specific guidelines included in their investment management agreements.

n. Derivative Instruments

SDCERS' investment managers, as permitted by specific investment guidelines, may enter into transactions involving derivative financial instruments, consistent with the objectives established by the Board's Investment Policy Statement. These instruments include futures, options and swaps. By Board policy these investment vehicles may not be used to leverage SDCERS' portfolio. These instruments are used primarily to enhance a portfolio's performance and to reduce its risk or volatility. To reduce credit risk exposure, SDCERS enters into derivative transactions with counterparty institutions with a credit rating of at least A-, and to date no losses due to counterparty non-performance on derivative financial instruments have been incurred. Credit risk is also mitigated through the use of exchange traded contracts on exchanges subject to regulatory oversight. SDCERS is exposed to market risk, which is the risk that future changes in market conditions may make an instrument less valuable. Exposure to market risk is managed in accordance with a manager's specific investment guidelines, through buying or selling instruments or entering into offsetting positions.

The notional (underlying) or contractual amounts of derivatives indicate the extent of SDCERS' involvement in the various types and uses of derivative financial instruments and do not measure the exposure to credit or market risks and do not necessarily represent amounts exchanged by the parties. The amounts exchanged are determined by reference to the notional amounts and the other terms of the derivatives.

The aggregate notional or contractual amounts for SDCERS' derivative financial instruments at June 30, 2007 were as follows:

Money Market Futures	$ 712,881
Government Bond Futures	(27,653)
Options	(177)
Swaps	(2,515)
Total Derivatives	$ 682,536

Source: SDCERS' CAFR as of June 30, 2007

Futures contracts are contracts in which the buyer agrees to purchase and the seller agrees to make delivery on a specific financial instrument on a predetermined date and price. Gains and losses on futures contracts are settled daily based on a notional principal value and do not involve an actual transfer of the specific instrument. Futures contracts are standardized and are traded on exchanges. The exchange assumes the risk that counterparty will not pay and generally requires margin payments to minimize such risk.

Option contracts provide the option purchaser with the right, but not the obligation, to buy or sell the underlying security at a set price during a period or at a specified date. The option writer is obligated to buy or sell the underlying security if the option purchaser chooses to exercise the option. SDCERS uses exchange-traded and over-the-counter options. Options are sold and proceeds are received to enhance fixed income portfolio performance. Option contracts sold were predominantly on money market and short-term instruments of less than one-year to maturity. In call option contracts, if interest rates remained steady or declined during the option contract periods, the contracts would expire unexercised. By contrast, on put option contracts, if interest rates rose sufficiently to result in the purchase of the securities on or before the end of the option periods, this would occur at prices attractive to the portfolio manager.

Swap agreements are used to modify investment returns or interest rates on investments. Swap transactions involve the exchange of investment returns or interest rate payments without the exchange of the underlying principal amounts. These swaps could expose investors entering into these types of arrangements to credit risk in the event of non-performance by counterparties.

o. Real Estate

SDCERS' target allocation to real estate is 11%. The real estate investment program is structured with a target allocation of approximately 30% in stable core real estate and approximately 70% to enhanced, high return and opportunistic real estate opportunities. The 70% target is divided between REIT securities (25%) and limited partnership investments in commingled real estate funds (45%). 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 SDCERS adds non-U.S. investments to its real estate portfolio, new capital commitments will be made to pool funds that target enhanced and high return strategies. As of June 30, 2007, real estate investments totaled $440,972.

Subprime Market Activity

The recent events surrounding subprime residential mortgage-backed securities and the housing real estate market have not to date materially affected investment performance of SDCERS. Future investment returns could be adversely impacted due to market liquidity issues or "credit crunch" experienced as a result of the fall out in the collateralized debt obligation markets or forecasts of an economic slow down or recession.

SDCERS invests in a diversified portfolio with allocations to equities, fixed income and real estate, both domestic and international to reduce risk. SDCERS' target allocation to real estate is 11% and is composed of a combination of stable core real estate, REIT securities, and limited partnership investments in commingled real estate funds. SDCERS' portfolio has a neutral market weight to equity securities classified as financial companies. SDCERS is minimally exposed to asset-backed securities that are collateralized by subprime mortgages. SDCERS' domestic fixed income managers invest in agency pass through mortgage securities that are guaranteed by the U.S. Government. Additionally, in any collateralized mortgage obligations or asset-backed securities, SDCERS' managers invest in the most highly-rated, self-liquidating (near to maturity), senior positions.

Management of SDCERS has recently contacted all of SDCERS' publicly-traded investment managers to understand the risks to their portfolios resulting from recent market activity. Management is comfortable that SDCERS' investment managers have positioned their respective portfolios to protect against various market factors. SDCERS' management will continue to monitor manager investment performance in accordance with SDCERS' Investment Policy Statement.

p. Securities Lending Collateral

SDCERS has entered into an agreement with its custodial bank, State Street Bank & Trust Company, to lend domestic and international equity and fixed income securities to broker-dealers and banks in exchange for pledged collateral. A simultaneous agreement is entered into by which State Street agrees to return the collateral plus a fee to the borrower in the future for return of the same securities originally lent. All securities loans can be terminated on demand by either the lender or the borrower.

State Street manages the securities lending program and receives cash (United States and foreign currency), securities issued or guaranteed by the United States government, sovereign debt rated "A" or better, Canadian provincial debt, convertible bonds, and irrevocable letters of credit as collateral. State Street does not have the ability to pledge or sell collateral securities delivered absent a borrower default. Borrowers are required to deliver collateral for each loan equal to: (i) in the case of loaned securities denominated in United States dollars or whose primary trading market was located in the United States or sovereign debt issued by foreign governments, 101.5% of the market value of the loaned securities; and (ii) in the case of loaned securities not denominated in United States dollars or whose primary trading market was not located in the United States, 104.5% of the market value of the loaned securities.

SDCERS had no credit risk exposure to borrowers because the amounts provided to State Street on behalf of SDCERS, in the form of collateral plus accrued interest, exceeded the amounts broker-dealers and banks owed to the State Street on behalf of SDCERS for securities borrowed. State Street has indemnified SDCERS by agreeing to purchase replacement securities or return cash collateral in the event a borrower fails to return or pay distributions on a loaned security. 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.

The SDCERS securities lending transactions, collateralized by cash as of June 30, 2007 had a fair value of $831,415 and a collateral value of $854,631, which were reported in the assets or liabilities in the statements of plan net assets for the City Employees' Retirement System in accordance with GASB Statement No. 28. As of June 30, 2007, the securities lending transactions collateralized by securities, irrevocable letters of credit, or tri-party collateral had a fair value of $29,535 and a collateral value of $34,075, which were not reported in the assets or liabilities in the accompanying statements of plan net assets for the City Employees' Retirement System per GASB Statement No. 28. The total collateral pledged to SDCERS at fiscal year end for its securities lending activities was $888,705.

The cash collateral received on lent securities was invested by State Street, together with the cash collateral of other qualified tax-exempt plan lenders, in a collective investment pool. Because the securities loans were terminable at will, their duration did not generally match the duration of the investments made with cash collateral. As of June 30, 2007, the investment pool had an average duration of 68.25 days and an average weighted maturity of 532.81 days for U.S. Dollar (USD) denominated collateral. Beginning in fiscal year 2007, the securities lending program was expanded to allow the acceptance of Euro (EUR) denominated collateral. The Euro collateral pool had an average duration of 49 days and an average weighted maturity of 871 days.

SDCERS may encounter various risks related to securities lending agreements. However, State Street is required to maintain its securities lending program in compliance with applicable laws of the United States and all countries in which lending activities take place, and all rules, regulations, and exemptions from time to time promulgated and issued under the authority of those laws.

Discretely Presented Component Units – Disclosures for Policy and Specific Risks

Narratives and tables presented in the following sections (q. through r.) are taken directly from the comprehensive annual financial reports of the San Diego Convention Center Corporation and the San Diego Housing Commission, as of June 30, 2007.

q. San Diego Convention Center Corporation

Deposits (In Thousands)

On June 30, 2007, the carrying amount of the San Diego Convention Center Corporation's (SDCCC) cash on hand and deposits was $639 and the bank balance was $682. Of the bank balance, $383 was covered by federal depository insurance. The remaining balance was either collateralized with the collateral held by an affiliate of the counterparty's financial institution or is uncollateralized, and therefore exposed to custodial credit risk. SDCCC does not have a formal deposit and investment policy that addresses custodial credit risk.

Investments (In Thousands)

At June 30, 2007, SDCCC had a total investment balance of $15,140. The total investment balance includes $13,858 in several money market funds and $1,282 maintained in two certificates of deposit, which bear an interest rate of 4.05% and have maturities of less than one year. Neither the money market mutual funds nor the certificates of deposit are rated by credit rating agencies. SDCCC does not have a formal deposit and investment policy that addresses credit quality risk.

Cash deposits and investments for SDCCC were categorized as follows at June 30, 2007:

Cash on hand	$ 24
Deposits	615
Money market mutual funds	13,858
Certificates of deposit	1,282
Total cash and investments	$ 15,779

r. San Diego Housing Commission

Cash, cash equivalents, and investments at June 30, 2007 consisted of the following:

Deposits	$ 744
Petty cash	9
Certificates of deposit	35,000
Local agency investment fund	38,746
Total cash and investments	74,499
Restricted cash and cash equivalents	1,723
Total	$ 76,222

Deposits (In Thousands)

The carrying amounts of the San Diego Housing Commission's (SDHC) cash deposits were $1,081 and the bank balance was $1,640 at June 30, 2007. 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, 2007, SDHC had a carrying amount and bank balance of $35,000 in non-negotiable certificates of deposit. The certificates of deposit were not covered by insurance and were collateralized 100% with securities held by pledging financial institutions.

Investments (In Thousands)

As of June 30, 2007, SDHC had $38,746 invested with the California Local Agency Investment Fund (LAIF). The investment in LAIF represents SDHC's equity in the pooled investments of that fund. LAIF had 3.466% of the pool investment funds in structured notes and asset-backed securities.

Policy

In accordance with state statutes and HUD regulations, SDHC has authorized the CFO, the Budget Officer, or their designee to invest in obligations of the U.S. Treasury and U.S. Government agencies. 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. At June 30, 2007, SDHC does not have any debt investments that are highly sensitive to changes in interest rates.

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 the California 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, 2007, SDHC did not have any investments exposed to custodial risk. All investments are held by the State of California or a pledging financial institution in the name of SDHC.

4. CAPITAL ASSETS (In Thousands)

Capital asset activity for the year ended June 30, 2007 was as follows:

	Primary Government				
	Beginning Balance	Increases	Decreases/ Adjustments	Transfers	Ending Balance
GOVERNMENTAL ACTIVITIES:					
Non-Depreciable Capital Assets:					
Land, Easements, Rights of Way	$ 1,711,064	$ 13,013	$ (7,340)	$ 14,266	$ 1,731,003
Construction in Progress	223,903	100,460	(9,733)	(104,546)	210,084
Total Non-Depreciable Capital Assets	1,934,967	113,473	(17,073)	(90,280)	1,941,087
Depreciable Capital Assets:					
Structures and Improvements	1,045,029	412	(14,502)	41,084	1,072,023
Equipment	374,240	20,229	(13,648)	1,820	382,641
Infrastructure	2,863,314	33,888	(39,531)	48,846	2,906,517
Total Depreciable Capital Assets	4,282,583	54,529	(67,681)	91,750	4,361,181
Less Accumulated Depreciation For:					
Structures and Improvements	(259,871)	(33,095)	2,715	27	(290,224)
Equipment	(263,269)	(24,323)	12,616	(1,533)	(276,509)
Infrastructure	(1,386,770)	(86,464)	1,869	-	(1,471,365)
Total Accumulated Depreciation	(1,909,910)	(143,882)	17,200	(1,506)	(2,038,098)
Total Depreciable Capital Assets - Net of Depreciation	2,372,673	(89,353)	(50,481)	90,244	2,323,083
Governmental Activities Capital Assets, Net	$ 4,307,640	$ 24,120	$ (67,554)	$ (36)	$ 4,264,170
BUSINESS-TYPE ACTIVITIES:					
Non-Depreciable Capital Assets:					
Land, Easements, Rights of Way	$ 89,769	$ 180	$ -	$ 62	$ 90,011
Construction in Progress	399,422	70,325	(13,139)	(166,447)	290,161
Total Non-Depreciable Capital Assets	489,191	70,505	(13,139)	(166,385)	380,172
Depreciable Capital Assets:					
Structures and Improvements	1,565,973	10,746	(26)	85,871	1,662,564
Equipment	316,115	2,230	(149)	8,404	326,600
Distribution & Collection Systems and Other Infrastructure	3,205,493	108,753	(4,565)	70,640	3,380,321
Total Depreciable Capital Assets	5,087,581	121,729	(4,740)	164,915	5,369,485
Less Accumulated Depreciation For:					
Structures and Improvements	(293,823)	(35,896)	25	(27)	(329,721)
Equipment	(200,250)	(24,224)	148	1,533	(222,793)
Distribution & Collection Systems and Other Infrastructure	(546,386)	(46,975)	1,502	-	(591,859)
Total Accumulated Depreciation	(1,040,459)	(107,095)	1,675	1,506	(1,144,373)
Total Depreciable Capital Assets - Net of Depreciation	4,047,122	14,634	(3,065)	166,421	4,225,112
Business-Type Activities Capital Assets, Net	$ 4,536,313	$ 85,139	$ (16,204)	$ 36	$ 4,605,284

Governmental Activities capital assets net of accumulated depreciation at June 30, 2007 are comprised of the following:

General Capital Assets, Net	$	4,196,903
Internal Service Funds Capital Assets, Net		67,267
Total	$	4,264,170

Business-Type Activities capital assets net of accumulated depreciation at June 30, 2007 are comprised of the following:

Enterprise Funds Capital Assets, Net	$	4,605,048
Internal Service Funds Capital Assets, Net		236
Total	$	4,605,284

Depreciation expense was charged to functions/programs of the primary government as follows:

Governmental Activities:

General Government and Support	$	1,077
Public Safety - Police		5,157
Public Safety - Fire and Life Safety		5,106
Parks, Recreation, Culture and Leisure		38,844
Transportation		75,015
Sanitation and Health		650
Neighborhood Services		1,431
Subtotal		127,280
Internal Service (Except Special Engineering)		16,602
Total Depreciation Expense	$	143,882

Business-Type Activities:

Airports	$	497
City Store		1
Development Services		247
Environmental Services		7,405
Golf Course		503
Recycling		1,059
Sewer Utility		69,696
Water Utility		27,644
Subtotal		107,052
Internal Service (Special Engineering)		43
Total Depreciation Expense	$	107,095

Discretely Presented Component Units

Capital asset activities for the City's Discretely Presented Component Units for the year ended June 30, 2007 are as follows:

	Discretely Presented Component Unit - San Diego Convention Center Corp.				
	Beginning Balance	Increases	Decreases/ Adjustments	Transfers	Ending Balance
Depreciable Capital Assets:					
Structures and Improvements	$ 22,236	$ 1,622	$ (117)	$ -	$ 23,741
Equipment	8,404	612	(879)	-	8,137
Total Depreciable Capital Assets	30,640	2,234	(996)	-	31,878
Less Accumulated Depreciation For:					
Structures and Improvements	(7,615)	(1,506)	604	-	(8,517)
Equipment	(6,213)	(936)	347	-	(6,802)
Total Accumulated Depreciation	(13,828)	(2,442)	951	-	(15,319)
Capital Assets, Net	$ 16,812	$ (208)	$ (45)	$ -	$ 16,559

	Discretely Presented Component Unit - San Diego Housing Commission				
	Beginning Balance	Increases	Decreases/ Adjustments	Transfers	Ending Balance
Non-Depreciable Capital Assets:					
Land, Easements, Rights of Way	$ 30,544	$ -	$ (1,108)	$ -	$ 29,436
Construction in Progress	9,943	665	-	-	10,608
Total Non-Depreciable Capital Assets	40,487	665	(1,108)	-	40,044
Depreciable Capital Assets:					
Structures and Improvements	83,145	23,175	(2,258)	-	104,062
Equipment	986	2,385	(89)	-	3,282
Total Depreciable Capital Assets	84,131	25,560	(2,347)	-	107,344
Less Accumulated Depreciation For:					
Structures and Improvements	(42,568)	(3,281)	697	-	(45,152)
Equipment	(870)	(348)	89	-	(1,129)
Total Accumulated Depreciation	(43,438)	(3,629)	786	-	(46,281)
Total Depreciable Capital Assets - Net of Depreciation	40,693	21,931	(1,561)	-	61,063
Capital Assets, Net	$ 81,180	$ 22,596	$ (2,669)	$ -	$ 101,107

5. GOVERNMENTAL ACTIVITIES LONG-TERM LIABILITIES (IN THOUSANDS)

a. Long-Term Liabilities

Governmental long-term liabilities as of June 30, 2007 are comprised of the following:

Type of Obligation	Interest Rates (%)	Fiscal Year Maturity Date	Original Amount	Balance Outstanding June 30, 2007
Compensated Absences				$ 73,050
Liability Claims				226,487
Capital Lease Obligations				39,130
Contracts Payable:				
Contract Payable to SDSU Foundation, dated December 1991	variable*	---	$ 1,598	1,598
Amendment to Contract Payable to SDSU Foundation, dated January 1995	variable*	---	117	117
Contract Payable to Western Pacific Housing, Inc., dated April 2004	5.0	---	900	900
Total Contracts Payable				2,615
Notes Payable:				
Note Payable to Wal-Mart, dated June 1998	10.0	2017	1,308	171
Note Payable to Price Charities, dated April 2001	5.0	2032	5,115	4,104
Note Payable to Price Charities, dated May 2005	8.0	2025	2,100	2,100
Amendment to Note Payable to Price Charities, dated February 2006	8.0	2025	180	180
Note Payable to Price Charities, dated March 2007	7.0	2013	2,000	2,000
Total Notes Payable				8,555
Loans Payable:				
International Gateway Associates, LLC, dated October 2001	10.0	2032	1,876	1,823
PCCP/SB Las America, LLC, dated August 2005	10.0	2036	1,247	1,239
Centerpoint, LLC, dated April 2006	7.0	2021	5,246	5,246
Bank of America, N.A. Line of Credit, dated October 2006	4.25 - 6.57	2009	8,530	8,530
California Energy Resources Conservation and Development Commission, dated March 2007	3.95	2019	2,154	1,937
Total Loans Payable				18,775
San Diego Association of Governments (SANDAG)				
Loans Payable	variable*	2008		2,287
Section 108 Loans Payable	1.21 - 7.958	2025		39,431
General Obligation Bonds:				
Public Safety Communications Project, Series 1991	5.0 - 8.0**	2012	25,500	9,905
Open Space Park Refunding Bonds, Series 1994	5.0 - 6.0**	2009	64,260	800
Total General Obligation Bonds				10,705

(continued on next page)

Type of Obligation	Interest Rates (%)	Fiscal Year Maturity Date	Original Amount	Balance Outstanding June 30, 2007
Revenue Bonds / Lease Revenue Bonds / COPs:				
MTDB Authority Lease Revenue Refunding Bonds, Series 1994	4.25 - 5.625**	2010	$ 66,570	$ 7,880
Public Facilities Financing Authority Stadium Lease Revenue Bonds, Series 1996 A	6.2 - 7.45**	2027	68,425	59,180
San Diego Facilities and Equipment Leasing Corp. Certificates of Participation, Series 1996 A	4.0 - 5.6**	2011	33,430	12,675
San Diego Facilities and Equipment Leasing Corp. Certificates of Participation Refunding, Series 1996 B	4.0 - 6.0**	2022	11,720	8,825
Convention Center Expansion Financing Authority Lease Revenue Bonds, Series 1998 A	3.8 - 5.25**	2028	205,000	178,430
Centre City Parking Revenue Bonds, Series 1999 A	4.5 - 6.49**	2026	12,105	10,510
Public Facilities Financing Authority Reassessment District Refunding Revenue Bonds, Series 1999 A	2.75 - 4.75**	2018	30,515	15,515
Public Facilities Financing Authority Reassessment District Refunding Revenue Bonds, Series 1999 B	3.5 - 5.10**	2018	7,630	3,840
Public Facilities Financing Authority Fire and Life Safety Lease Revenue Bonds, Series 2002 B	3.55 - 7.0**	2032	25,070	23,305
Centre City Parking Revenue Bonds, Series 2003 B	3.0 - 5.30**	2027	20,515	18,800
MTDB Authority Lease Revenue Refunding Bonds, Series 2003	2.0 - 4.375**	2023	15,255	13,420
San Diego Facilities Equipment Leasing Corp. Certificates of Participation Refunding, Series 2003	1.0 - 4.0**	2024	17,425	12,270
Public Facilities Financing Authority Ballpark Lease Revenue Refunding Bonds, Series 2007A	5.0 - 5.25**	2032	156,560	156,560
Total Revenue Bonds / Lease Revenue Bonds / COPs				521,210
Special Assessment / Special Tax Bonds:				
Otay Mesa Industrial Park Limited Obligation Improvement Bonds, Issued May 1992	5.5 - 7.95**	2013	2,235	350
Miramar Ranch North Special Tax Refunding Bonds, Series 1998	3.75 - 5.375**	2021	59,465	44,380
Santaluz Special Tax Bonds, Improvement Area No.1, Series 2000 A	4.75 - 6.375**	2031	56,020	53,820
Santaluz Special Tax Bonds, Improvement Area No.3, Series 2000 B	4.5 - 6.2**	2031	4,350	4,155
City of San Diego Reassessment District No. 2003-1 Limited Obligation Refunding Bonds	4.25 - 5.8**	2018	8,850	7,345
Piper Ranch Limited Obligation Improvement Bonds, Issued January 2004	2.5 - 6.2**	2034	5,430	5,110
Santaluz Special Tax Bonds, Improvement Area No.1, Series 2004 A	1.7 - 5.5**	2031	5,000	4,760
Santaluz Special Tax Bonds, Improvement Area No.4, Series 2004 A	1.65 - 5.5**	2034	9,965	9,705
Liberty Station Special Tax Bonds, Series 2006 A	5.0 - 5.75**	2037	16,000	16,000
Total Special Assessment / Special Tax Bonds				145,625

(continued on next page)

Type of Obligation	Interest Rates (%)	Fiscal Year Maturity Date	Original Amount	Balance Outstanding June 30, 2007
Tax Allocation Bonds:				
Gateway Center West Redevelopment Project Tax Allocation Bonds, Series 1995	7.8 - 9.75**	2014	$ 1,400	$ 745
Mount Hope Redevelopment Project Tax Allocation Bonds, Series 1995 A	4.4 - 6.0**	2020	1,200	840
Mount Hope Redevelopment Project Tax Allocation Bonds, Series 1995 B	6.9 - 8.2**	2021	3,955	3,085
Southcrest Redevelopment Project Tax Allocation Bonds, Series 1995	4.75 - 6.592**	2020	3,750	2,340
Horton Plaza Redevelopment Project Tax Allocation Refunding Bonds, Series 1996 A	3.8 - 6.0**	2016	12,970	7,750
Centre City Redevelopment Tax Allocation Bonds, Series 1999 A	3.0 - 5.125**	2019	25,680	25,285
Centre City Redevelopment Tax Allocation Bonds, Series 1999 B	6.25**	2014	11,360	11,360
Centre City Redevelopment Tax Allocation Bonds, Series 1999 C	3.1 - 4.75**	2025	13,610	12,180
City Heights Redevelopment Tax Allocation Bonds, Series 1999 A	4.5 - 5.8**	2029	5,690	5,330
City Heights Redevelopment Tax Allocation Bonds, Series 1999 B	5.75 - 6.4***	2029	10,141	9,604
Central Imperial Redevelopment Project Tax Allocation Bonds, Series 2000	4.45 - 6.69**	2031	3,395	3,100
Centre City Redevelopment Project Tax Allocation Bonds, Series 2000 A	4.0 - 5.6**	2025	6,100	5,175
Centre City Redevelopment Project Tax Allocation Bonds, Series 2000 B	3.95 - 5.35**	2025	21,390	19,195
Horton Plaza Redevelopment Project Tax Allocation Bonds, Series 2000	4.25 - 5.8**	2022	15,025	14,290
North Bay Redevelopment Project Tax Allocation Bonds, Series 2000	4.25 - 5.875**	2031	13,000	11,690
North Park Redevelopment Project Tax Allocation Bonds, Series 2000	4.1 - 5.9**	2031	7,000	6,300
Southcrest Redevelopment Project Tax Allocation Bonds, Series 2000	4.45 - 6.5**	2026	1,860	1,620
Centre City Redevelopment Tax Allocation Bonds, Series 2001 A	4.93 - 5.55****	2027	58,425	56,730
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	18,575
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	555

(continued on next page)

Type of Obligation	Interest Rates (%)	Fiscal Year Maturity Date	Original Amount	Balance Outstanding June 30, 2007
North Park Redevelopment Project Tax Allocation Bonds, Series 2003 A	1.5 - 6.125**	2028	$ 7,145	$ 6,425
North Park Redevelopment Project Tax Allocation Bonds, Series 2003 B	4.75 - 5.0**	2034	5,360	5,360
Horton Plaza Redevelopment Project Tax Allocation Bonds, Series 2003 A	4.65 - 5.1**	2022	6,325	6,325
Horton Plaza Redevelopment Project Tax Allocation Bonds, Series 2003 B	3.25 - 5.45**	2022	4,530	4,530
Horton Plaza Redevelopment Project Tax Allocation Bonds, Series 2003 C	3.49 - 7.74**	2022	8,000	7,175
Centre City Redevelopment Project Tax Allocation Bonds, Series 2004 A	3.5 - 5.25**	2030	101,180	97,655
Centre City Redevelopment Project Tax Allocation Bonds, Series 2004 B	2.26 - 4.58**	2011	9,855	6,565
Centre City Redevelopment Project Tax Allocation Bonds, Series 2004 C	2.26 - 6.18**	2030	27,785	26,520
Centre City Redevelopment Project Tax Allocation Bonds, Series 2004 D	2.26 - 6.28**	2030	8,905	8,505
Centre City Redevelopment Project Tax Allocation Bonds, Series 2006 A	4.25 - 5.25**	2033	76,225	76,225
Centre City Redevelopment Project Tax Allocation Bonds, Series 2006 B	5.66 - 6.2**	2032	33,760	33,760
Total Tax Allocation Bonds				502,804
Tobacco Settlement Asset-Backed Bonds:				
Tobacco Settlement Revenue Funding Corporation Asset-Backed Bonds, Series 2006	7.125**	2023	105,400	102,700
Total Bonds Payable				1,283,044
Net Pension Obligation				158,162
Total Governmental Activities Long-Term Liabilities				$ 1,851,536

* Additional information on the variable rate contracts payable with the SDSU Foundation and loans payable with SANDAG are discussed further on the following page.

** Interest rates are fixed, and reflect the range of rates for various maturities from the date of issuance to maturity.

*** The City Heights Redevelopment Tax Allocation Bonds, Series 1999 B, are capital appreciation bonds, which mature from fiscal year 2011 through 2029. The balance outstanding at June 30, 2007 does not include accreted interest of $6,156.

**** 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, 2007 does not include accreted interest of $4,859.

Liability claims are primarily liquidated by the Self Insurance Fund and Enterprise Funds. Compensated absences are paid out of the operating funds and certain internal service funds. Pension liabilities are paid out of the operating funds based on a percentage of payroll.

Public safety general obligation bonds are secured by a pledge of the full faith and credit of the City or by a pledge of the City to levy ad valorem property taxes without limitation. Open space general obligation bonds are backed by Environmental Growth Fund 2/3 franchise fees.

Revenue bonds are secured by a pledge of specific revenue generally derived from fees or service charges related to the operation of the project being financed. Certificates of Participation (COPs) and lease revenue bonds provide long-term financing through a lease agreement, installment sales agreement, or loan agreement that does not constitute indebtedness under the state constitutional debt limitation and is not subject to other statutory requirements applicable to bonds.

Special assessment/special tax bonds are issued by the City to provide funds for public improvements in/and or serving special assessment and Mello-Roos districts created by the City. The bonds are secured by assessments and special taxes levied on the properties located within the assessment districts and the community facilities districts, and are payable solely from the assessments and special taxes collected. The assessments and special taxes, and any bonds payable from them, are secured by a lien on the properties upon which the assessments and special taxes are levied. Neither the faith and credit nor the taxing power of the City is pledged to the payment of the bonds.

Section 108 loans are the loan guarantee provisions of the Community Development Block Grant (CDBG) program. Section 108 loans provide the community with a source of financing for economic development, housing rehabilitation, public facilities, and capital improvement and infrastructure projects.

SANDAG loans are comprised of two components: repayment of debt service on bonds, and repayment of proceeds from commercial paper. The City receives distributions of SANDAG bond proceeds, based on the City's agreement with SANDAG. The annual debt service payments related to these bond issuances are recovered by SANDAG through reductions in TransNet allocations that would otherwise be available for payment to the City. TransNet-Proposition A, was passed in 1987 to enact a ½ percent sales tax increase to fund regional transportation projects. All expenses must first be approved by SANDAG and be included on the Regional Transportation Plan (RTP). The City recognizes repayment of the principal and interest on bonds as an increase in TransNet revenues and an offsetting debt service expenditure. The interest rates on the outstanding bonds range from 4.75 percent to 5.50 percent. In addition to financing from bond issuances, financing for TransNet related projects is available through the issuance of commercial paper notes by SANDAG, at the request of the City. Repayment of proceeds related to the commercial paper is collected in future periods through reductions in TransNet allocations, similar to the repayment of the debt service on bonds. Interest rates on commercial paper notes during the current year have varied from 2.40 percent to 3.58 percent, with maturities from 1 day to 166 days. Interest rates on outstanding commercial paper note amounts at June 30, 2007 ranged from 3.50 percent to 3.58 percent. The maturity date of the current SANDAG loan is June 2008.

San Diego State University Foundation executed an Agreement for Processing a Redevelopment Plan and Land Use Entitlements with RDA, which allows for reimbursement of expenses incurred by the Foundation, in assisting in the preparation and processing of the Redevelopment Plan and Land Use Entitlements in the College Area. The agreement is a variable rate obligation of RDA. The unpaid principal bears interest at the prime rate and is fixed on a quarterly basis, using the prime rate established on the first banking day of each calendar quarter. Interest calculations are made on the quarterly weighted average of the principal balance and are made at the end of the quarter based upon the rate fixed for that quarter. The effective interest rate as of June 30, 2007 is 8.25 percent.

Loans Payable includes a line of credit executed by RDA with Bank of America, N.A. on October 31, 2006. The line of credit is to be used to refinance the North Park Theatre, to pay sums of settlement of eminent domain actions relating to the North Park Redevelopment Area and for other redevelopment activities in the North Park Redevelopment Area. As of June 30, 2007, the tax-exempt portion of the line of credit has an effective interest rate of 4.25 percent and the taxable portion has an effective interest rate of 6.57 percent . The effective interest rate will reset on October 31, annually.

Tobacco Settlement Asset-Backed Bonds are limited obligations of the Tobacco Settlement Revenue Funding Corporation, which is a separate legal California nonprofit public benefit corporation established by the City of San Diego. The Corporation purchased from the City the rights to receive future tobacco settlement revenues due to the City. The Tobacco Settlement Asset-Backed Bonds are payable from and secured solely by pledged tobacco settlement revenues.

b. Amortization Requirements

The annual requirements to amortize such long-term debt outstanding as of June 30, 2007, including interest payments to maturity, are as follows:

Year Ended June 30,	Capital Lease Obligations Principal	Capital Lease Obligations Interest	Contracts Payable Principal	Contracts Payable Interest	Notes Payable Principal	Notes Payable Interest
2008	$ 8,181	$ 1,498	$ -	$ -	$ -	$ 140
2009	7,580	1,195	-	-	-	140
2010	6,598	899	-	-	-	140
2011	5,247	644	-	-	-	140
2012	5,146	426	-	-	-	141
2013-2017	6,378	280	-	-	-	35
Unscheduled*	-	-	2,615	1,978	8,555	3,282
Total	$ 39,130	$ 4,942	$ 2,615	$ 1,978	$ 8,555	$ 4,018

** The contracts payable to SDSU Foundation in the amount of $1,715, the contract payable to Western Pacific Housing, Inc. in the amount of $900, and the notes payable to Wal-Mart of $171 and Price Charities of $8,384, do not have annual repayment schedules. Annual payments on the San Diego State University debt is based on the availability of tax increment net of the low-moderate and taxing agency set-asides as well as project area administration costs. Annual payments to the Wal-Mart, Western Pacific Housing, Inc., and Price Charities debt are based on available tax increment.*

Year Ended June 30,	Loans Payable Principal	Loans Payable Interest	SANDAG Loans Principal	SANDAG Loans Interest	Section 108 Loans Principal	Section 108 Loans Interest	General Obligation Bonds Principal	General Obligation Bonds Interest
2008	$ 61	$ 877	$ 2,287	$ 82	$ 3,535	$ 2,203	$ 2,125	$ 641
2009	8,699	575	-	-	2,364	2,046	2,265	502
2010	177	369	-	-	2,457	1,920	1,975	353
2011	185	360	-	-	2,595	1,783	2,100	219
2012	195	351	-	-	2,724	1,633	2,240	74
2013-2017	1,140	1,592	-	-	14,635	5,518	-	-
2018-2022	805	1,280	-	-	8,395	1,886	-	-
2023-2027	639	1,017	-	-	2,726	222	-	-
2028-2032	1,028	628	-	-	-	-	-	-
2033-2037	600	128	-	-	-	-	-	-
Unscheduled*	5,246	-	-	-	-	-	-	-
Total	$ 18,775	$ 7,177	$ 2,287	$ 82	$ 39,431	$ 17,211	$ 10,705	$ 1,789

** The loan payable to Centerpoint, LLC in the amount of $5,246 does not have an annual repayment schedule. Annual payments are based upon future receipts of unallocated tax increment or other available sources.*

Year Ended June 30,	Revenue Bonds / COPs Principal	Revenue Bonds / COPs Interest	Special Assessment / Special Tax Bonds Principal	Special Assessment / Special Tax Bonds Interest	Tax Allocation Bonds Principal	Tax Allocation Bonds Unaccreted Appreciation*	Tax Allocation Bonds Interest	Tobacco Asset-Backed Bonds** Principal	Tobacco Asset-Backed Bonds** Interest
2008	$ 22,220	$ 26,354	$ 4,150	$ 7,998	$ 13,371	$ 1,996	$ 24,746	$ 3,300	$ 7,317
2009	22,315	25,906	4,550	7,798	14,476	2,081	24,208	3,600	7,082
2010	21,975	24,866	4,875	7,575	15,089	2,163	23,555	3,800	6,826
2011	20,040	23,856	5,215	7,327	15,853	2,243	22,808	4,000	6,555
2012	17,465	22,920	5,575	7,055	16,649	2,317	21,996	4,400	6,270
2013-2017	96,845	100,253	32,470	30,395	108,113	12,155	94,452	26,900	26,227
2018-2022	115,405	73,168	33,645	21,044	126,018	10,653	64,779	38,000	15,162
2023-2027	136,025	39,964	22,835	13,442	119,558	4,900	34,443	18,700	1,332
2028-2032	68,920	9,660	25,500	5,440	63,107	154	10,176	-	-
2033-2037	-	-	6,810	837	10,570	-	356	-	-
Subtotal	521,210	346,947	145,625	108,911	502,804	38,662	321,519	102,700	76,771
Add:									
Accreted Appreciation through June 30, 2007	-	-	-	-	11,015	-	-	-	-
Total	$ 521,210	$ 346,947	$ 145,625	$ 108,911	$ 513,819	$ 38,662	$ 321,519	$ 102,700	$ 76,771

** The unaccreted appreciation reflects future accretion and is not based on when debt service is due on the accretion.*

*** 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, 2007. The effect of bond accretion, bond premiums, discounts, and deferred amounts on bond refunds are amortized as adjustments to long-term liabilities.

	Governmental Activities				
	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Compensated Absences	$ 71,820	$ 50,530	$ (49,300)	$ 73,050	$ 29,908
Liability Claims	202,482	76,881	(52,876)	226,487	36,113
Capital Lease Obligations	40,541	7,655	(9,066)	39,130	8,181
Contracts Payable	2,615	-	-	2,615	-
Notes Payable	7,294	2,180	(919)	8,555	-
Loans Payable	14,345	10,823	(6,393)	18,775	61
SANDAG Loans Payable	7,355	-	(5,068)	2,287	2,287
Section 108 Loans Payable	42,499	-	(3,068)	39,431	3,535
General Obligation Bonds	12,690	-	(1,985)	10,705	2,125
Revenue Bonds / COPs	549,850	156,560	(185,200)	521,210	22,220
Unamortized Bond Premiums, Discounts					
and Deferred Amounts on Refunding	(899)	(3,746)	207	(4,438)	(201)
Net Revenue Bonds/COP's	548,951	152,814	(184,993)	516,772	22,019
Special Assessment / Special					
Tax Bonds	133,605	16,000	(3,980)	145,625	4,150
Unamortized Bond Premiums, Discounts					
and Deferred Amounts on Refunding	(608)	-	52	(556)	(48)
Net Special Assestment Bonds	132,997	16,000	(3,928)	145,069	4,102
Tax Allocation Bonds	514,845		(12,041)	502,804	13,371
Interest Accretion	9,219	1,910	(114)	11,015	
Balance with Accretion	524,064	1,910	(12,155)	513,819	13,371
Unamortized Bond Premiums, Discounts					
and Deferred Amounts on Refunding	5,623	-	5	5,628	-
Net Tax Allocation Bonds	529,687	1,910	(12,150)	519,447	13,371
Tobacco Settlement Asset-Backed Bonds	105,400		(2,700)	102,700	3,300
Net Pension Obligation	158,087	75	-	158,162	-
Total	$ 1,876,763	$ 318,868	$ (332,446)	$ 1,863,185	$ 125,002

d. Redemption of Debt

Lease Revenue Refunding Bonds, Series 2007A (Ballpark Refunding) for PFFA were issued in the amount of $156,560. The bond proceeds were used to refund the remaining outstanding PFFA Lease Revenue Bonds, Series 2002 (Ballpark Project). The refunded bonds are fully redeemed and the corresponding liability has been removed from the Statement of Net Assets. The refunding transaction resulted in a total economic gain of approximately $51,572 and a cash flow savings of approximately $93,017. The refunded bonds were redeemed at a call date prior to the end of the fiscal year, and accordingly, there was no balance outstanding as of June 30, 2007.

6. BUSINESS-TYPE ACTIVITIES LONG-TERM LIABILITIES (In Thousands)

a. Long-Term Liabilities

Business-type activities long-term liabilities as of June 30, 2007 are comprised of the following:

Type of Obligation	Interest Rates (%)	Fiscal Year Maturity Date	Original Amount	Balance Outstanding June 30, 2007
Arbitrage Liability				$ 224
Compensated Absences				15,154
Liability Claims				53,555
Capital Lease Obligations				1,006
Revenue Notes Payable:				
Subordinated Sewer Revenue Notes, Series 2007	5.0	2009	$ 223,830	223,830
Subordinated Water Revenue Notes, Series 2007A	4.06*	2009	57,000	57,000
Total Revenue Notes Payable				280,830
Loans Payable:				
Loans Payable to San Diego County Water Authority	-	-	100	100
Loans Payable to State Water Resources Control Board, issued February 9, 2000	1.80**	2020	10,606	7,320
Loans Payable to State Water Resources Control Board, issued February 9, 2000	1.80**	2022	6,684	5,232
Loans Payable to State Water Resources Control Board, issued March 30, 2001	1.80**	2022	33,720	26,390
Loans Payable to State Water Resources Control Board, issued May 17, 2001	1.80**	2022	7,742	6,057
Loans Payable to State Water Resources Control Board, issued May 17, 2001	1.80**	2021	860	634
Loans Payable to State Water Resources Control Board, issued June 11, 2001	1.80**	2021	2,525	1,861
Loans Payable to State Water Resources Control Board, issued October 3, 2002	1.99**	2020	3,767	2,851
Loans Payable to State Water Resources Control Board, issued October 3, 2002	1.80**	2023	8,068	6,676
Loans Payable to State Water Resources Control Board, issued December 14, 2005	1.89**	2024	10,093	9,192
Loans Payable to Department of Health Services, issued July 6, 2005	2.51**	2026	21,525	20,257
Loans Payable to State Water Resources Control Board, issued October 15, 2006	1.99**	2024	3,858	3,678
Loans Payable to State Water Resources Control Board, issued February 28, 2007	1.89**	2025	11,068	11,068
Total Loans Payable				101,316
Bonds Payable:				
Sewer Revenue Bonds, Series 1993	2.8 - 5.25*	2023	250,000	175,330
Sewer Revenue Bonds, Series 1995	3.9 - 6.0*	2025	350,000	275,300
Sewer Revenue Bonds, Series 1997 A	3.7 - 5.375*	2027	183,000	148,445
Sewer Revenue Bonds, Series 1997 B	3.7 - 5.375*	2027	67,000	54,345

(continued on next page)

Type of Obligation	Interest Rates (%)	Fiscal Year Maturity Date	Original Amount	Balance Outstanding June 30, 2007
Water Certificate of Undivided Interest, Series 1998	4.0 - 5.375*	2029	$ 385,000	$ 262,750
Sewer Revenue Bonds, Series 1999 A	3.5 - 5.125*	2029	203,350	174,275
Sewer Revenue Bonds, Series 1999 B	3.5 - 5.125*	2029	112,060	96,250
Subordinated Water Revenue Bonds, Series 2002	2.0 - 5.0*	2033	286,945	282,365
Total Bonds Payable				1,469,060
Estimated Landfill Closure and Postclosure Care				16,935
Net Pension Obligation				36,418
Total Business-Type Activities Long-Term Liabilities				$ 1,974,498

** 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, 2007, including interest payments to maturity, are as follows:

Year Ended June 30	Capital Lease Obligations Principal	Capital Lease Obligations Interest	Revenue Notes Payable Principal	Revenue Notes Payable Interest	Loans Payable Principal	Loans Payable Interest	Revenue Bonds Payable Principal	Revenue Bonds Payable Interest
2008	$ 840	$ 31	$ -	$ 13,761	$ 5,441	$ 1,995	$ 43,615	$ 72,825
2009	166	4	280,830	13,499	5,547	1,889	45,595	70,851
2010	-	-	-	-	5,655	1,780	47,585	68,850
2011	-	-	-	-	5,765	1,670	49,810	66,621
2012	-	-	-	-	5,878	1,557	52,315	64,120
2013-2017	-	-	-	-	31,154	6,022	304,530	277,876
2018-2022	-	-	-	-	32,309	2,887	388,555	192,212
2023-2027	-	-	-	-	9,467	418	379,290	89,043
2028-2032	-	-	-	-	-	-	144,365	16,076
2033-2037	-	-	-	-	-	-	13,400	335
Unscheduled *	-	-	-	-	100	-	-	-
Total	$ 1,006	$ 35	$ 280,830	$ 27,260	$ 101,316	$ 18,218	$ 1,469,060	$ 918,809

** The loan payable to the San Diego County Water Authority in the amount of $100 does not have an annual repayment schedule. The payment is due if funding for the projects for which the loan was received becomes available from other sources.*

c. Change in Long-Term Liabilities

The following is a summary of changes in long-term liabilities for the year ended June 30, 2007. 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	$ 193	$ 31	$ -	$ 224	$ -
Compensated Absences	16,390	12,868	(14,104)	15,154	7,305
Liability Claims	50,379	5,539	(2,363)	53,555	4,298
Capital Lease Obligations	2,051	-	(1,045)	1,006	840
Revenue Notes Payable	-	280,830	-	280,830	-
Unamortized Bond Premiums, Discounts and Deferred Amounts on Refunding	-	1,035	(518)	517	517
Net Revenue Notes Payable	-	281,865	(518)	281,347	517
Loans Payable	91,247	14,926	(4,857)	101,316	5,441
Revenue Bonds Payable	1,662,705	-	(193,645)	1,469,060	43,615
Unamortized Bond Premiums, Discounts and Deferred Amounts on Refunding	(7,759)	-	570	(7,189)	(570)
Net Revenue Bonds Payable	1,654,946	-	(193,075)	1,461,871	43,045
Estimated Landfill Closure and Postclosure Care	14,811	2,124	-	16,935	-
Net Pension Obligation	36,394	24	-	36,418	-
Total	$ 1,866,411	$ 317,377	$ (215,962)	$ 1,967,826	$ 61,446

d. Redemption of Debt

Subordinate Sewer Revenue Notes, Series 2007 for PFFA were issued on a private placement basis in the amount of $223,830. $144,400 of the bond proceeds were used to current refund the remaining outstanding Subordinate Sewer Revenue Bonds, Series 2004 and $79,430 of the proceeds were used either to finance or reimburse for previous costs incurred for upgrades to the City's sewer system. The final maturity date for the Series 2007 Notes is May 15, 2009. The refunded Sewer Revenue Bonds, Series 2004 were issued on a private placement basis and had a final maturity of December 15, 2011. The Sewer Revenue Bonds, Series 2004 were fully redeemed on May 7, 2007 and the corresponding liability has been removed from the Statement of Net Assets. The refunding transaction resulted in a total economic gain of approximately $381 and a cash flow savings of approximately $2,507. The refunded bonds were redeemed prior to the end of the fiscal year, and accordingly, there was no balance outstanding as of June 30, 2007.

e. Defeasance of Debt

As of June 30, 2007, principal amounts payable from escrow funds established for defeased bonds are as follows:

Defeased Bonds	Balance
Water Revenue Bonds, Series 1998	$ 77,155
Total Defeased Bonds Outstanding	$ 77,155

7. DISCRETELY PRESENTED COMPONENT UNITS LONG-TERM LIABILITIES (In Thousands)

Discretely presented component units long-term liabilities as of June 30, 2007 are comprised as follows:

San Diego Convention Center Corporation

Type of Obligation	Interest Rate	Fiscal Year Maturity Date	Original Amount	Balance Outstanding June 30, 2007	Due Within One Year
Compensated Absences				$ 1,094	$ 1,094
Capital Leases			$ 3,942	2,956	755
Note Payable to San Diego Unified Port District, dated 1999	0.00%	2011	10,000	3,500	1,000
Total Long-Term Liabilities				$ 7,550	$ 2,849

Annual requirements to amortize long-term debt as of June 30, 2007, are as follows:

Capital Leases		Note Payable	
Fiscal Year	Amount	Fiscal Year	Amount
2008	$ 755	2008	$ 1,000
2009	807	2009	1,000
2010	863	2010	1,000
2011	531	2011	500
Total	$ 2,956	Total	$ 3,500

San Diego Housing Commission

Type of Obligation	Interest Rate (%)	Fiscal Year Maturity Date	Original Amount	Balance Outstanding June 30, 2007	Due Within One Year
Compensated Absences				$ 1,320	$ 1,320
Note Payable to Bank of America, dated February 1985	5.0 – 10.2	2025	$ 3,789	2,975	107
Note Payable to Washington Mutual, dated June 1995	Variable*	2012	4,725	3,558	128
Note Payable to State of California (RHCP)	0.0	2013	1,405	1,405	-
Note Payable to State of California (RHCP)	0.0	2015	3,149	3,149	-
Note Payable to State of California (CalHELP)	3.0	2013	704	1,892	-
Note Payable to US Bank, dated November 2006	Variable*	2012	20,550	19,515	207
Note Payable to Wells Fargo Bank	6.38	2008	87	25	25
Total Notes Payable				32,519	467
Total Long-Term Liabilities				$ 33,839	$ 1,787

* The effective interest rate as of June 30, 2007 was 4.31% for the Washington Mutual Note Payable and 7.57% for the US Bank Note Payable.

Annual requirements to amortize such long-term debt as of June 30, 2007 to maturity are as follows:

Year Ending June 30	Principal	Interest
2008	$ 467	$ 1,793
2009	439	1,822
2010	451	1,810
2011	463	1,797
2012	21,678	1,784
2013-2017	7,211	1,772
2018-2022	261	312
2023-2025	1,549	58
Total	$ 32,519	$ 11,148

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, 2007, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance
Tax and Revenue Anticipation Notes	$ -	$ 142,000	$ -	$ 142,000

The $142,000 FY07 TRANs issue, which was a 13 month note obligation, had an interest rate of 4.18% and was repaid on August 3, 2007.

9. JOINT VENTURE and JOINTLY GOVERNED ORGANIZATIONS (In Thousands)

San Diego Medical Services Enterprise, LLC

A joint venture is a legal entity or other organization that results from a contractual arrangement and that is owned, operated, or governed by two or more participants as a separate and specific activity subject to joint control. San Diego Medical Services Enterprise, LLC (SDMSE) is a joint venture that is reported within the General Fund.

SDMSE was organized on May 2, 1997 to provide emergency medical services and medical transportation services to the citizens of San Diego. Operations began July 1, 1997 under an initial 5 year agreement that was extended on July 1, 2002 and again on July 1, 2005 for an additional three year period. On July 1, 2008 operations were extended until December 31, 2008 under a separate extension agreement while a competitive bidding process is being conducted. The operating agreement will expire on December 31, 2008 unless SDMSE is awarded a new contract after the competitive bidding process.

The SDMSE partners are the City of San Diego and Rural Metro of San Diego, Inc., a wholly owned subsidiary of Rural Metro Corporation (a publicly traded corporation). The SDMSE governing board is comprised of five members, three of whom are appointed by the City. In accordance with GASB 14, the financial impacts of the joint venture are reported in the General Fund.

The maximum funds which the City is required to contribute to the costs of SDMSE operations are limited to an aggregate of $8,450 during the term of the third amended agreement. This aggregate includes a $650 annual subsidy and any other amounts to be paid to the City since 1997 under the original contract, and any losses the City is required to cover under the extended contract, excluding any amount the City contributes for Medicare fee reimbursements. Cumulatively, the City has paid annual subsidies totaling $5,700 as of June 30, 2007. Effective in fiscal year 2006, the City is no longer required to pay the $650 annual subsidy and the Medicare fee reimbursements shall not exceed $250 per fiscal year. Net assets of SDMSE are pro-rated to each partner based on a 50/50 split. In accordance with the operating agreement, profit and loss for each fiscal year is allocated equally to the members, subject to an aggregate limitation on loss to the City of $8,450 (equal to the amount of subsidies discussed above). For the fiscal year ended June 30, 2007, SDMSE reported a net income of $2,768, a member distribution of $2,700, and ending net assets of $4,195.

Under the terms of an operating agreement between Rural/Metro of San Diego, Inc. and SDMSE, Rural/Metro of San Diego, Inc. has made available a line-of-credit in the initial amount of $3,500 bearing an interest rate of 9.5%. SDMSE did not have an outstanding balance, nor did it borrow on the line-of-credit at June 30, 2007.

Complete financial statements can be requested from San Diego Medical Services Enterprise, LLC, 8401 East Indian School Rd., Scottsdale, Arizona 85251.

San Diego Workforce Partnership

The City of San Diego and the County of San Diego jointly govern the San Diego Workforce Partnership (Consortium). The Consortium's Board of Directors consists of two members of the City Council, two members from the County Board of Supervisors, and one member of a charitable organization. The purpose of the Consortium is to provide regional employment and training services in order to develop and create job opportunities throughout San Diego County. The Consortium is empowered to make applications for and receive grants from governmental or private sources. The City does not appoint a majority of the Board, is not able to impose its will on the Consortium, and the Consortium is not fiscally dependent on the City. Therefore, it is the City's conclusion that the Consortium is a governmental organization with a jointly appointed board and not a component unit of the City. However, the City and County do share a joint responsibility for any liabilities arising from mismanagement of federal funds. The United States Department of Labor (DOL) issued an audit report in February 2007, finding that the Consortium did not consistently follow Federal cost principles and regulations when managing federal grant funds. A settlement was reached between the Consortium and the DOL in June 2008 which resulted in a liability of approximately $1,100 payable to the DOL for the disallowed project costs. This liability will be split between the City and County and paid over a four year period. City Council approved the first payment of $67 (city's share) to the DOL on October 14, 2008 per resolution 304261.

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, marketing and licensing compiled digital geographic data and software, providing technical services and publishing geographical and land-related information.

Complete financial statements can be requested from SanGIS, 5469 Kearney Villa Road, Suite 102, San Diego, CA 92123.

10. LEASE COMMITMENTS (In Thousands)

The City leases various properties and equipment. Leased property having elements of ownership are recorded as capital leases and reported as capital assets in the government-wide financial statements, along with a corresponding capital lease obligation. Leased property that does not have elements of ownership is reported as an operating lease and is expensed when paid.

Operating Leases

The City's operating leases consist primarily of rental property occupied by City departments. The following is a schedule of future minimum rental payments required under operating leases entered into by the City for property that has initial or remaining non-cancelable lease terms in excess of one year as of June 30, 2007:

Year Ended June 30	Amount
2008	$ 11,815
2009	11,914
2010	11,466
2011	10,924
2012	11,082
2013-2017	18,021
2018-2022	245
2023-2027	98
Total	$ 75,565

Rent expense as related to operating leases was $12,132 for the year ended June 30, 2007.

Capital Leases

The City has entered into various capital leases for equipment, vehicles and property. These capital leases have maturity dates ranging from July 1, 2006 through November 30, 2014, and interest rates ranging from 2.59% to 7.94%. A schedule of future minimum lease payments under capital leases as of June 30, 2007 is provided in Notes 5 and 6. The value of all capital leased assets as of June 30, 2007 for governmental assets is $26,021, net of accumulated depreciation of $85,803, and business-type assets of $5,950, net of accumulated depreciation of $13,556.

Lease Revenues

The City has operating leases for certain land, buildings, and facilities with tenants and concessionaires. Leased capital asset carrying values of approximately $65,363, 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
2008	$ 30,764
2009	29,993
2010	29,080
2011	28,630
2012	28,049
2013-2017	131,715
2018-2022	115,031
2023-2027	110,267
2028-2032	103,658
2033-2037	93,155
2038-2042	85,990
2043-2047	71,463
2048-2052	26,203
2053-2057	7,480
2058-2062	2,200
Total	$ 893,678

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 $78,548 for the year ended June 30, 2007, which includes contingent rentals of $48,447.

11. DEFERRED COMPENSATION PLAN (In Thousands)

The City, San Diego Convention Center Corporation (SDCCC), San Diego Data Processing Corporation (SDDPC), and San Diego Housing Commission (SDHC) each offer their employees a deferred compensation plan, created in accordance with Internal Revenue Service Code Section 457, State and Local Government Deferred Compensation Plans. These plans, available to eligible employees, permit them to defer, pre-tax, a portion of their salary until future years. Deferred compensation is not available to employees until termination, retirement, death, disability, or an unforeseeable emergency. All assets and income of the deferred compensation plan are held in trust for the exclusive benefit of plan participants and their beneficiaries. The deferred compensation plans are not considered part of the City of San Diego's financial reporting entity.

12. PENSION PLANS (In Thousands)

The City has a defined benefit pension plan and various defined contribution pension plans covering substantially all of its employees.

DEFINED BENEFIT PLAN

a. **Plan Description**

San Diego City Employees' Retirement System ("SDCERS"), as authorized by Article IX of the City Charter, is a public employee retirement system established in fiscal year 1927 by the City. SDCERS is an agent multiple-employer defined benefit public pension plan (the Plan) and acts as a common investment and administrative agent for the City, the Port of San Diego (the "Port"), and the San Diego County Regional Airport Authority (the "Airport"). It is administered by the SDCERS Board (the "Board") to provide retirement, disability, death and survivor benefits for its members. Amendments to the City's benefit provisions require City Council approval as well as a majority vote by members. As of January 1, 2007, benefit increases also require a majority vote of the public. All approved benefit changes are codified in the City's Municipal Code.

The Plan covers all eligible employees of the City, the Port, and the Airport. All City employees working half-time or greater and full-time employees of the Port and the Airport, are eligible for membership and are required to join SDCERS. The Port and Airport are not component units of the City CAFR, however, and the information herein relates solely to the City's participation in SDCERS. City employment classes participating in the Plan are elected officers, general and safety (including police, fire and lifeguard members). These classes are represented by various unions depending on the type and nature of work performed, except for elected officials, unclassified and unrepresented employees.

Plan Membership as of June 30, 2007 (actual member count)

	General	Safety	Total by Classification
Active Members	6,072	2,422	8,494
Terminated Members	2,157	449	2,606
Retirees, Disabled and Beneficiaries	4,004	2,675	6,679
Total Members, as of June 30, 2007	12,233	5,546	17,779

Source: SDCERS-City of San Diego Actuarial Valuation as of June 30, 2007

As a defined benefit plan, retirement benefits are determined primarily by a member's class, age at retirement, number of years of creditable service, and the member's final compensation based on the highest salary earned over a consecutive one-year period. The Plan provides cost of living adjustments of 2% to retirees, which is factored into the actuarial assumptions. Increases in retirement benefits due to cost of living adjustments do not require voter approval. The Plan requires ten years of service at age 62, or 20 years of service at age 55 for general members (50 for safety members), which could include certain service purchased or service earned at a reciprocating government entity, to vest for a benefit. Typically, retirement benefits are awarded at a rate of 2.5% of the employee's one-year high annual salary per year of service at age 55 for general members, and 3% for Safety members starting at the age of 50. The actual percentage of final average salary per year served component of the calculation rises as the employee's retirement age increases and depends on the retirement option selected by the employee. General plan percentage of final average salary per year served is a maximum of 2.8% for general members and 3% for safety members.

On July 28, 2008, the City Council approved R-303977 which presents modified defined contribution and defined benefit plans for all non-safety City employees hired on or after July 1, 2009. The new defined benefit plan includes modified percentages used to determine annual retirement allowance (depending on employees' age at retirement), a pensionable salary calculation used to determine retirement allowances based on a 3-year average, and a maximum annual retiree benefit of 80% of employees' pensionable salary. Additionally, the new defined contribution plan includes mandatory employee contributions to the Supplemental Pension Savings Plan (SPSP), of 1%, as well as City match, and the introduction of mandatory employee contribution to a retiree medical trust plan (as well as City match) of 0.25%. The modified plans were drafted and agreed upon by the Mayor's Office and related labor unions representing non-safety City employees.

Deferred Retirement Option Program (DROP)

The City also has a Deferred Retirement Option Program (DROP) where participants continue to work for the City and receive a regular paycheck. SDCERS' members electing to participate in DROP must agree to participate in the program for a specific period, up to a maximum of five years. A DROP participant must agree to end employment with the City on or before the end of the selected DROP participation period. A SDCERS member's decision to enter DROP is irrevocable.

Upon entering the program, the DROP participant stops making contributions to SDCERS and stops earning creditable service. Instead, amounts equivalent to the participant's retirement benefit plus 8% earnings and additional contributions are credited to an interest bearing individual account held in the participant's name. The DROP benefit is the value of a DROP participant's account at the end of the DROP participation period. Participants select the form of the distribution of the DROP account when they leave employment and begin retirement. The distribution is made as a single lump sum or in 240 equal monthly payments, or as otherwise allowed by applicable provisions of the Internal Revenue Code. Outstanding liabilities for DROP are shown on the Statement of Fiduciary Net Assets in the basic financial statements. During the period of participation, the participant continues to receive most of the employer offered benefits available to regular employees with exception to earning creditable service, as previously discussed.

SDCERS' members who were hired on or after July 1, 2005 are ineligible to participate in the DROP program due to the benefit changes negotiated with the July 1, 2005 Memoranda of Understanding (MOU). However, SDCERS has asserted that due to delays in codification of benefit changes into the Municipal Code, the effective cut off date would instead be February 16, 2007, which is when the Ordinance O-19567 was officially codified in the Municipal Code. As of the issuance of this report, the City Attorney and SDCERS legal counsel do not agree on the effective date [refer to Note 18 for additional information]. Notwithstanding amendments to the municipal code, SDCERS' members who were hired prior to July 1, 2005 are eligible to participate in DROP when they are eligible for a service retirement.

Purchase of Service Credits

Article 4 Division 13 of the City's Municipal Code allows plan members to purchase years of Creditable Service for use in determining retirement allowances. To purchase Creditable Service, a Member must elect to pay and thereafter pay, in accordance with such election before retirement, into the Retirement Fund an amount, including interest, determined by the Board. No Member will receive Creditable Service under this Division for any service for which payment has not been completed pursuant to this Division before the effective date of the Member's retirement. The City Attorney has opined that in the past, the Purchase of Service Credits were under priced by the Board of Administration. After review of the purchase of service program, SDCERS' actuary concluded that the service credit pricing structure that was in place prior to November 2003 did not reflect the full cost in the price then charged to SDCERS members. The pricing shortfall of approximately $146,000, which is included in the Unfunded Actuarial Accrued Liability (UAAL), is reported in the RSI of these financial statements. The service credit pricing structure used after November 2003, however, does cover the full projected cost to the System when members purchased the service credits (this is discussed in Note 18: Contingencies).

SDCERS' members who were hired on or after July 1, 2005 are ineligible to participate in the Purchase of Service Credit program due to the benefit changes negotiated with the July 1, 2005 Memoranda of Understanding (MOU). However, SDCERS has asserted that due to delays in codification of benefit changes into the municipal code, the effective cut off date would instead be February 16, 2007, which is when the Ordinance O-19567 was officially codified in the Municipal Code. As of the issuance of this report, the City Attorney and SDCERS legal counsel do not agree on the effective date [refer to Note 18 for additional information]. Notwithstanding amendments to the municipal code, SDCERS' members who were hired prior to July 1, 2005 are eligible to participate the Purchase of Service Credit Program.

Corbett Settlement Benefits and Retirement Factors

In 1998, a lawsuit was filed by retired employees who alleged that the City's definition of compensation subject to the computation of retirement benefits improperly excluded the value of certain earnings. The City and SDCERS settled in May of 2000, which is known as the Corbett Settlement. This settlement provided for a flat increase of 7% in benefits payable to eligible members who retired prior to July 1, 2000, payable annually. The settlement also provided a 10% benefit increase and allows for two options in calculating the service retirement allowance for employees active at the time of the settlement and who joined the Retirement System before July 1, 2000 and who retired after July 1, 2000.

The options for calculating the service retirement allowance are outlined in the San Diego Municipal Code sections 24.0402 and 24.0403 which can be obtained at City of San Diego City Clerks Office, 202 C Street, San Diego, CA 92101 or online at www.sandiego.gov.

On July 1, 2002, the City Council increased the retirement factors used for calculating retirement allowances; this action was related to MP-2 (as discussed later in this note). As a result of the Corbett Settlement and other benefit actions taken by the City Council, the service retirement factors for general members (non-safety and non-legislative) range from 2.0% at age 55 to 2.8% at age 65. The service retirement factors for Safety Members (Fire, Police and Lifeguard) range from 2.2% at age 50 to 3.0% at age 50 depending on the Corbett Settlement option selected. Finally, the City also maintains an Elected Officer's Retirement Plan where members are eligible to receive 3.5% of their final average salary per year of creditable service. Depending on the number of years serviced, participants of the Elected Officer's Retirement plan can retire earlier than the age of 55, however, their retirement allowance is reduced by 2.0% for each year under the age of 55.

Preservation of Benefit Plan

On March 19, 2001, the City Council adopted Ordinance O-18930, adding SDMC sections 24.1601 through 24.1608, establishing 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), 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 SDMC 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. As of issuance of this report, actuarial liabilities related to retired member benefits that exceeded §415 limits are included in the RSI for the City's core pension plan for valuation years up to and including fiscal year 2005. In the fiscal year 2006 actuarial valuation, the estimated actuarial accrued liability related to excess benefits for eligible active members of the system, amounting to approximately $22,800, was removed from the plan's Actuarial Liabilities (this liability is estimated to be approximately $30,400 in the fiscal year 2007 actuarial valuation). Additionally, the liability for retired members of the POB Plan, amounting to approximately $6,400, has been excluded from the fiscal year 2007 actuarial valuation. Estimates related to the actuarial liability for benefits that exceed IRS §415 limits were calculated using actuarial assumptions consistent with those used to perform actuarial valuations for the City's core pension plan and also pursuant to the Compliance Statement, dated December 20, 2007, and Tax Determination Letter provided by the IRS during Voluntary Correction Program discussions.

The most current estimates related to the Preservation of Benefit plan are that approximately 58 beneficiaries have received benefits of approximately $2,900 in excess of IRC §415 limits through June 30, 2006; an additional approximate $900 in benefits were paid in the fiscal year ended June 30, 2007 for an estimated cumulative payment in excess of the IRC §415 limit of $3,800. No additional plan payments or repayments are required as a result of the Compliance Statement. The number of plan participants, in any given year, for the Preservation of Benefit Plan is determined by the number of plan participants who exceed the current year's IRS §415(b) limitations as calculated by SDCERS' actuary. The maximum annual payment for the calendar year 2007 was $180 (calendar year 2008 maximum annual payment is $185) and is adjusted downward depending on the age of the participant when benefits began.

Charter Amendment

On November 7, 2006, the citizens approved an amendment to Article 9, Section 143 of the City's Charter, requiring voter approval of certain increases in retirement system benefits for public employees. Specifically, this amendment requires a majority approval of the public of any ordinance that amends the City's retirement system by increasing the benefits of any employee.

Additional details of retirement benefits can be obtained from SDCERS. SDCERS is considered part of the City of San Diego's financial reporting entity and is reported as a pension and employee savings trust fund. SDCERS issues stand-alone financial statements which are available at its office located at 401 West A Street, Suite 400, San Diego, California 92101 or at www.sdcers.org.

b. **Summary of Significant Accounting Policies – Pension**

Basis of Accounting - The pension trust fund uses the economic resources measurement focus and the accrual basis of accounting. Contributions are recognized as additions in the period in which the contributions are due and a formal commitment to provide the contributions has been made. Benefits and refunds are recognized when due and payable in accordance with the Plan.

Method Used to Value Investments - SDCERS investments are stated at fair value. The SDCERS custodial agent provides market values of invested assets with the exception of the fair value of directly owned real estate assets which are provided by the responsible investment manager and independent third party appraisal firms. Investment income is recognized in accordance with GASB 25 and is stated net of investment management fees and related expenses.

c. **Contributions and Reserves - Disclosure Related to Long - Term Contracts and Other Agreements**

Funding Contracts: MP-1 and MP-2

The City employer contributions for fiscal years 1996 - 2003 were not based on the full actuarial rates. Instead, employer contributions were less than the full actuarial rates in accordance with an agreement between the City and SDCERS, commonly referred to as Manager's Proposal 1 (MP-1). MP-1 provided that the City would make annual payments according to a contractually fixed formula of increasing percentages of total payroll instead of annual payments based on the annually required contribution (ARC) rates determined by the actuary. This agreement was subject to an actuarially determined funding ratio ("the trigger") of 82.3%. In the event the trigger was reached, the City would be required to make a lump sum payment to return the system to the funding ratio of 82.3%. The funding provision established by MP-1 was to be effective until fiscal year 2007, at which time, the City's contribution would return to the full ARC rate determined by the actuary. In the opinion of Kroll (a professional consulting firm engaged by the City to act in the capacity of an Audit Committee) and the City Attorney, the funding mechanism of MP-1 was illegal in violation of the City Charter and the State Constitution.

In 2002, a second agreement between the City and SDCERS was ratified; this agreement subsequently became known as Manager's Proposal 2 (MP-2). MP-2 modified MP-1 principally by allowing the City to avoid a balloon payment if the trigger was reached. Instead, MP-2 allowed the City to increase its funding until the full ARC was reached. This provision of MP-2 required that funding be increased over a five year period. In the opinion of Kroll and the City Attorney, the funding mechanism of MP-2 was illegal in violation of the City Charter and the State Constitution.

The actuarial valuation as of June 30, 2002, received in January 2003, which applies to contributions made in fiscal year 2004, reported the funded ratio to be 77.3%, thus the trigger had been breached. As a result, the City paid the increased contribution rates (which were less than the full actuarial rates) as required by MP-2 in the next fiscal year (fiscal year ended June 30, 2004). MP-1 and MP -2 are no longer in effect due to the Gleason settlement (see the section titled "Funding Commitments Related to Legal Settlements" in this Note).

A discussion of funding levels can be found in the Funding Policy and Annual Pension Cost section of this note.

Funding Contracts: Union Agreements

The City has historically picked up a portion of the employee's retirement contributions. The fiscal year 2006 MOUs and the changes to current and future employee benefits therein were introduced to Council in June 2005, and the changes in benefit eligibility were approved by Council Resolution 300600.

The agreement in the MOUs (agreements with the police union were not reached) was to reduce the amount of individual employees' pension contributions which are paid for by the City, effective fiscal year 2006. The agreements with labor unions resulted in the reduction of City offset of the employee pension contribution by 3% for the Municipal Employees' Association (MEA), the International Association of Fire Fighters Local 145, and the Deputy City Attorney Association (DCAA) and a unilaterally imposed reduction of 3.2% for the San Diego Police Officers Association (POA). In addition, the American Federation of State and County Municipal Employees (AFSCME) Local 127 negotiated a 1.9% salary reduction in lieu of a City "pick up" contribution reduction and a benefit freeze.

The agreements with the bargaining units explicitly indicate that savings to the City must be used to help address its UAAL within the timeframe of the respective contracts. The labor contract with Local 127 states that "By June 30, 2008, if the City has not dedicated a total of $600,000 or more to the UAAL reduction, including the amount received by leveraging employee salary reduction and pension contribution monies, the AFSCME salary reduction monies with interest will revert to SDCERS Employee Contribution Rate Reserve for benefit of Local 127 unit members to defray employee pension contributions."

In June 2006, the City leveraged a portion of the employee pick up savings by contributing $90,800 from securitization of future tobacco settlement revenues, $9,200 of current tobacco settlement revenues, and $8,300 from the remaining balance in the employee "pick-up" amount as part of meeting its negotiated commitment. The $100,000 payment in excess of the ARC from tobacco settlement revenues is 100% backed by general fund revenues, and therefore, was directly allocated to reduce the Net Pension Obligation (NPO) of the general fund only. The additional contribution of $8,300 in excess of the ARC, however, was allocated Citywide as a reduction to the NPO. In June 2007, the City contributed approximately $7,000 in addition to the ARC from the savings of the employee "pick-up" reduction and in July 2007 the City contributed approximately $27,300 in addition to the ARC. (These agreements are also discussed in the Subsequent Events Note 22). Upon the conclusion of the fiscal year ended June 30, 2008, the City was not able to meet the outstanding commitment in its entirety. As such, the City is currently in discussions with Local 127 and MEA regarding the plan to return the salary reduction and employee contribution offset monies, with interest, to the bargaining unit memberships. Also after June 30, 2008 MEA filed a grievance against the City, which as of the issuance of this report is under negotiation.

Funding Commitments Related to Legal Settlements

Subsequent to the adoption of MP-2, the City settled a class action lawsuit regarding alleged breaches of fiduciary duty and law regarding the City's underfunding of the pension system resulting from the adoption of MP-1 and MP-2. The Gleason Settlement Agreement addressed the issues raised regarding the City's underfunding of the pension system by imposing the following requirements on the City for fiscal years 2005 through 2008:

1. Contribute $130,000 in fiscal year 2005. *
2. Pay its full ARC beginning fiscal year 2006.
3. Repeal Municipal Code Sections that legitimized the City's contribution obligations related to MP-2.
4. Provide a total of $375,000 of real property as collateral for payments required via the Gleason Settlement Agreement.

* The City's Gleason Settlement required contribution of $130,000 in fiscal year 2005 was paid prior to the execution of the agreement on July 7, 2005, and therefore, was omitted from the final agreement.

The Gleason Settlement also stipulated that certain actuarial assumptions be fixed, notably, that the amortization period was reset to a 29-year closed period commencing with the June 30, 2004 Annual Actuarial Valuation. These assumptions were to remain in place for the duration of the settlement. On July 1, 2004, the City made the Gleason Settlement required contribution of $130,000 for fiscal year 2005 in addition to providing real property totaling $375,000 as collateral to be returned in annual installments of $125,000. On July 1, 2005, the City made the annually required contribution of $163,000 for fiscal year 2006. Additionally, the City made a contribution in excess of the ARC in the amount of $108,300 on June 30, 2006. On July 3, 2006 the City made its full annually required contribution of $162,000 as well as an additional $7,000 contribution in excess of the ARC for fiscal year 2007 and on July 2, 2007, the City made its full annually required contribution of $137,700 as well as an additional $27,300 contribution in excess of the ARC for fiscal year 2008. The final installment of $125,000 of real property collateral was returned to the City on November 9, 2007.

The annual required contributions for fiscal years 2005, 2006, and 2007 did not include the effects of the Corbett settlement because the SDCERS' Board viewed those benefits as contingent (see section a. for a description of the Corbett Settlement). Subsequent to those payments, the City determined that the Corbett Settlement liabilities are not contingent. As a result, the ARC for financial reporting was restated from the original ARC calculated by SDCERS' actuary to include Corbett Settlement liabilities. As a result, the City's NPO includes the effects of the Corbett Settlement.

In September 2006, the City entered into a settlement of McGuigan v. City of San Diego (the "McGuigan Settlement") related to the underfunding by the City of the pension system. This agreement stipulated that the City pay $173,000 plus interest on amounts outstanding to SDCERS over a period of 5 years. An additional requirement of the McGuigan Settlement is that the City provides SDCERS real property collateral totaling $100,000 (Non-Depreciable Capital Assets – Land). These amounts are in addition to those required by the Gleason Settlement and are to be returned upon the full payment of the settlement.

As of the issuance of this report, the City has provided the real property collateral in addition to approximately $142,600 of additional payments to SDCERS, in an attempt to meet the terms of the McGuigan Settlement. This leaves an outstanding obligation resulting from the McGuigan Settlement of approximately $35,000, including interest. The McGuigan Settlement was partially funded through the securitization of future tobacco revenue, transfers of actual tobacco revenue receipts, additional employee "pick up" savings, and City contributions made in addition to the ARC. This contribution is further discussed in the Funding Contracts: Union Agreements section above.

In January, 2006, the City reached a settlement on a separate civil action captioned: Newsome v. City of San Diego Retirement System, City of San Diego (the "Newsome Settlement"). As part of this settlement, the plaintiff has agreed to dismiss the lawsuit if the City provides an additional $100,000 in funding over five years to SDCERS or, the funding ratio of the City's retirement plan returns to 82.3%. The amounts stipulated in the Newsome settlement are in addition to the amount stipulated in the settlement of the McGuigan Settlement. Under the Newsome Settlement, if the City does not provide the additional funding, the plaintiff then has the right to re-file the lawsuit after giving the City 60 days notice.

d. **Funding Policy and Contribution Rates**

City Charter Article IX Section 143 requires employees and employers to contribute to the retirement plan. The Charter section, which was amended in fiscal year 2005, stipulates that funding obligations of the City shall be determined by the Board of SDCERS and are not subject to modification by the City. The section also stipulates that under no circumstances, may the City and Board enter into any multi-year funding agreements that delay full funding of the retirement plan. The Charter requires that employer contributions be substantially equal to employee contributions (SDCERS' legal counsel has opined that this requirement applies to the normal cost contribution only). Pursuant to the Charter, City employer contribution rates, adjusted for payment at the beginning of the year, are actuarially determined rates and are expressed as a fixed annual required contribution as well as percentages of annual covered payroll. The entire expense of SDCERS' administration is charged against the earnings and plan assets of SDCERS.

The following table shows the City's contribution rates for fiscal year 2007, based on the valuation ended June 30, 2005, expressed as percentages of active payroll:

	Employer Contribution Rates	
	General Members	Safety Members
Normal Cost*	11.28%	19.74%
Amortization Payment*	9.91%	20.88%
Normal Cost Adjusted for Amortization Payment*	21.19%	40.62%
City Contribution Rates Adjusted for Payment at the Beginning of the Year	20.39%	39.08%

** 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 = That 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 2007, the City employee contribution rates as a percentage of annual covered payroll, averaged 9.86% for general members and 12.07% for safety members. A portion of the employee's share, depending on the employee's member class, is paid by the City. In fiscal year 2007, the amount paid by the City ranges from 2.4% to 5.89% of covered payroll for general members and the rate for safety plan members ranges from 4.1% to 4.3%. Employee contributions paid by the City, amounting to approximately $18,270 in fiscal year 2007, 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 and reduced the amount of the employee contribution paid for by the City. In accordance with agreements with the labor unions, any and all savings realized by these agreements must be set aside and ultimately leveraged to reduce the pension system's UAAL.

On August 29, 2008, Council approved O-19781 which amended Chapter 2, Article 4, Division 15 of the San Diego Municipal Code. The intent of the amendment was to eliminate the concept of "Surplus Earnings" (earnings in excess of those earned using the assumed actuarial rate of return) which was the historical term for the funds used to pay for supplemental and contingent benefits. In accordance with these revised SDMC sections, annual distributions of these benefits are paid from Plan assets and take place in priority order. The Plan assets are distributed to various SDCERS system reserves, SDCERS budget, and contingent benefits. The order of distribution and a more detailed discussion of each distribution follows: First, Plan assets are used to credit interest, at a rate determined by the SDCERS Board, which is currently 8%, to the Employer and Employee Contribution Reserves and DROP member accounts. Second, Plan assets are used to fund the SDCERS Annual Budget. Third, Plan assets are distributed for supplemental or contingent payments or transfers to reserves. These items include in a priority order: 1) Annual Supplement Benefit Payment ("13th Check") paid to retirees generally equal to approximately $30 (whole dollars) times the number of years of employment. 2) Corbett Settlement Payment paid to retirees who terminated employment prior to July 1, 2000 (Corbett Settlement payments not paid in any one year accrue to the next year and remain an obligation of SDCERS until paid). 3) Crediting interest to the Reserve for Supplemental Cost of Living Adjustment ("COLA").

Beginning in fiscal year 2005 when the reserve fund for healthcare benefits was depleted, the City funded the remaining retiree health benefits expense for fiscal year 2005 and the expenses for fiscal years 2006 and 2007 by transferring from the general and non-general funds into the retiree healthcare trust fund (discussed further in Note 13).

In November 2004, voters changed the City Charter and the mix of Board members requiring that a majority of the Board be independent of the City. Also, the Charter now requires that a 15-year amortization period be used for the UAAL beginning in fiscal year 2009; however, the SDCERS Board, in conjunction with the actuary, is using a

20-year amortization period with no negative amortization and has taken the position that the Board is legally responsible for establishing the valuation parameters, including the amortization period. City management agrees that the use of a 15-year amortization assumption with negative amortization instead of a 20-year amortization assumption with no negative amortization would increase the ARC if calculated as part of the fiscal year 2007 valuation.

e. **Annual Pension Cost and Net Pension Obligation**

Annual Pension Costs

The normal cost (i.e. the actuarial present value of pension plan benefits allocated to the current year) and the UAAL amortization cost (i.e. the portion of the pension plan payment designed to amortize the UAAL) were determined using the Projected Unit Credit (PUC) actuarial funding method. The following are the principal actuarial assumptions used for the 2005 valuation (additional assumptions were used regarding a variety of other factors):

(a) An 8.0% investment rate of return, net of administrative expenses.**
(b) Projected salary increases of at least 4.25% per year.**
(c) An assumed annual cost-of-living adjustment that is generally 2% per annum and compounded. In addition, there is a closed group of special safety officers whose annual adjustment is equal to inflation (4.25% per year).

**Both (a) and (b) included an inflation rate of 4.25%.

The actuarial value of assets was determined using techniques that smooth the effects of short-term volatility in the market value of investments over a five-year period. In fiscal year 2007, the SDCERS Board approved a different asset smoothing method by marking the actuarial value of assets to market value in the fiscal year 2006 actuarial valuation. The method used by the actuary in fiscal year 2005 was not a commonly used method. The expected asset value asset smoothing method commenced with the fiscal year 2007 valuation. The UAAL for funding purposes, pursuant to the Gleason Settlement, is being amortized over a fixed 30-year period for the fiscal years 2006, 2007, and 2008. As of June 30, 2005, the valuation year used to compute the fiscal year 2007 annually required contribution, there were 28 years remaining in the amortization period. For valuations effective June 30, 2007, SDCERS' Board of Administration decided to use a 20-year amortization schedule. Beginning with the valuation dated June 30, 2007, the normal cost and UAAL amortization cost will be determined using the Entry Age Normal actuarial method, the result of which will cause the UAAL used in the determination of the fiscal year 2009 ARC to increase by approximately $252,200.

The following table shows the City's annual pension cost ("APC") and the percentage of APC contributed for the fiscal year ended June 30, 2007 and two preceding years (in thousands):

Fiscal Year Ended June 30	APC	Percentage Contributed	Net Pension Obligation
2005	$ 179,743	67.92%	$ 290,190
2006	175,879	154.28%	194,720
2007	169,762	99.63%	195,356

Net Pension Obligation

Net Pension Obligation (NPO) is the cumulative difference, since the effective date of GASB 27 (fiscal year 1998), 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, 2007, the City's NPO is approximately $195,356 and is reported in accordance with GASB 27. See table above.

The change to NPO is derived by first calculating the City's Annual Required Contribution ("ARC"). The ARC is calculated by actuarially determining the cost of pension benefits accrued during the year (normal cost) and adding to that 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 2007]	$	165,222
Contributions [Fiscal Year 2007]		(169,126)
Interest on NPO		15,556
ARC Adjustment		(11,016)
Change in NPO		636
NPO Beginning of Year [July 1, 2006]		194,720
NPO End of Year [June 30, 2007]	$	195,356

NPO Components related to Retiree Health

The City's annual contribution to SDCERS pension trust fund, for the fiscal years ended June 30, 2005, 2004, and 2003, included amounts that were contributed to the 401(h) Fund for healthcare benefits and are reported net of this contribution. Annual realized earnings, as determined by the SDMC Sections 24.1501 and 24.1502, in the pension trust fund were withdrawn and used to offset the portion of the City's contribution that went to healthcare benefits instead of being retained in the pension trust fund. This funding mechanism is a violation of the Internal Revenue Code (IRC) Section 401(a). SDCERS hired counsel to make a filing to the IRS to correct this operational failure and IRC violation. (See Contingencies Note 18 for additional disclosures). The amounts paid from the pension trust fund for healthcare benefits were approximately $7,900 in fiscal year 2005, $12,800 in fiscal year 2004, and $11,500 in fiscal year 2003. These payments have been removed from the City contribution amounts and resulted in an increase to the City's NPO. The cumulative impact to the City's NPO related to the diversion of assets to fund retiree health is approximately $79,000. The City's contribution related to retiree health for the fiscal year 2007 was placed in a Retiree Health Trust Fund which is paid from the City's operating funds. (See Other Post Employment Benefits Note 13 for further details.)

NPO Components related to Employee Offset Liabilities

In fiscal year 1998, the City set aside $37,800 in funds from the pension trust fund's undistributed earnings to fund the Employee Contribution Rate Reserve, and in accordance with SDMC §24.1502, annually added 8% interest earnings to this reserve. This employee contribution reserve was to pay for the City's share (offset) of the employee's retirement contribution. The amount of NPO related to the employee offset as of June 30, 2007 is $34,500. This reserve was depleted in fiscal year 2006. As noted in the Funding Contracts: Union Agreements section above, the agreements with labor unions resulted in the reduction of City "pick-up" of the employee pension contribution, followed by employees paying for the contribution upon depletion of the reserve.

NPO Components related to Corbett Settlement and Subsequent Benefit Increases

The City is amortizing the unfunded liability incurred as a result of the benefit increases pursuant to the Corbett Settlement. The City interprets GASB 27 to require that the amortization methods used in calculating funding for the Plan to be consistent with the method used to calculate Plan expense. Thus, the previous amortization method of 40 years open for expensing plan costs was found to be incorrect. The impact on the NPO related to Corbett as of June 30, 2007 is approximately $32,000.

NPO Components related to the Under Funding of Plan Contributions

As a result of the MP-1 and MP-2 funding contracts, the City's contributions for fiscal years 1996-2003 were less than the annual required contribution as determined by the actuary. The impact on the NPO related to the under funding of plan contributions as of June 30, 2007 is approximately $49,900.

f. **Actions taken on behalf of the City to address Pension Liability and Net Pension Obligation**

As part of the agreements with the labor unions, several benefits were altered or eliminated for all employees hired on or after July 1, 2005, including the Deferred Retirement Option Plan (DROP), the 13th Check, the option to purchase years of service credits ("air-time"), and retiree healthcare benefits; however, the retirement formula generally remains 2.5% at 55 for general members and 3.0% at 50 for safety members. Also for employees hired on or after July 1, 2005, it was agreed to establish a trust vehicle for a defined contribution plan to fund and determine retiree medical benefits. As of the issuance of this report, the employer/employee contributions for such a plan have not been determined. The City has consolidated health care options to help manage the cost of health care for both current and retired employees, and as part of the agreements with the labor unions, the new definition of "health-eligible retiree" states that employees must have 10 years of service with the City to receive 100% of the retiree health benefit and five years of service to receive 50% of the retiree health benefit.

In fiscal years 2006 and 2007, the City contributed $115,300 in addition to the ARC through the securitization of future tobacco revenue, transfers of actual tobacco revenue receipts, and additional employee "pick up" savings. In fiscal year 2008, the City contributed approximately $27,300 in addition to the ARC which resulted in a total cumulative payment in addition to the ARC of approximately $142,600 for the fiscal years 2006 through 2008. These contributions are the same as those discussed in the Funding Contracts: Union Agreements section discussed previously.

DEFINED CONTRIBUTION PLANS

a. **Supplemental Pension Savings Plan - City**

Pursuant to the City's withdrawal from the Federal Social Security System effective January 8, 1982, the City established the Supplemental Pension Savings Plan ("SPSP"). Pursuant to the Federal Government's mandate of a Social Security Medicare tax for all employees not covered by Social Security hired on or after April 1, 1986, the City established the Supplemental Pension Savings Plan-Medicare ("SPSP-M"). The SPSP and SPSP-M Plans were merged into a single plan ("SPSP") on November 12, 2004 for administrative simplification, without a change in benefits. Pursuant to the requirements of the Omnibus Budget Reconciliation Act of 1990 ("OBRA-90") requiring employee coverage under a retirement system in lieu of coverage under the Federal Insurance Contributions Act ("FICA") effective July 1, 1991, the City established the Supplemental Pension Savings Plan-Hourly ("SPSP-H"). These supplemental plans are defined contribution plans administered by Wachovia Corporation to provide pension benefits for eligible employees. There are no plan members who belong to an entity other than the City. In a defined contribution plan, benefits depend solely on amounts contributed to the plan plus investment earnings, less investment losses. The City's general retirement members and lifeguard members of the City's safety retirement members participate in the plan. Eligible employees may participate from the date of employment.

The following table details plan participation as of June 30, 2007:

Plan	Participants
SPSP	8,461
SPSP – H	4,181

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 2007, the City and the covered employees contributed approximately $23,372 and $23,360, respectively. As of June 30, 2007, the fair value of plan assets totaled approximately $542,777. SPSP is considered part of the City of San Diego's financial reporting entity and is reported as a pension and employee savings trust fund.

b. **401(k) Plan - City**

The City established a 401(k) Plan effective July 1, 1985. The 401(k) Plan is a defined contribution plan administered by Wachovia Corporation to provide pension benefits for eligible employees. Employees are eligible to participate from date of employment. Employees make contributions to their 401(k) Plan accounts through payroll deductions, and may also elect to contribute to their 401(k) account through the City's Employees' Flexible Benefits Program.

The employees' 401(k) contributions are based on IRS calendar year limits. Employees contributed approximately $27,025 during the fiscal year ended June 30, 2007. There is no City contribution towards the 401(k) Plan.

As of June 30, 2007, the fair value of plan assets totaled approximately $234,883. The 401(k) Plan is considered part of the City's financial reporting entity and is reported as a pension and employee savings trust fund.

c. **Pension Plan - Centre City Development Corporation (CCDC)**

CCDC has a Money Purchase Pension Plan covering all full-time permanent employees (the "CCDC Plan"). The CCDC Plan is a defined contribution plan under which benefits depend solely on amounts contributed to the plan plus investment earnings. Employees are eligible to participate on the first day of the month following 90 days after their date of employment. During each year, CCDC contributes semi-monthly an amount equal to 8% of the total quarterly compensation for all employees. CCDC's contributions for each employee are fully vested after six years of continuous service. CCDC's total payroll in fiscal year 2007 was approximately $3,900. CCDC contributions were calculated using the base salary amount of approximately $3,544. CCDC made the required 8% contribution amounting to approximately $284 (net of forfeitures) for fiscal year 2007.

In addition, CCDC has a Tax Deferred Annuity Plan covering all full-time permanent employees. The CCDC Plan is a defined contribution plan under which benefits depend solely on amounts contributed to the plan by the employer and the employees, plus investment earnings. Employees are eligible to participate on the first day of the month following 90 days after their date of employment. During each plan year, CCDC contributes semi-monthly an amount equal to 16% of the total semi-monthly compensation for eligible employees. CCDC's contributions for each employee are fully vested at time of contribution. The Tax Deferred Annuity Plan includes amounts deposited by employees prior to CCDC becoming a contributor to the CCDC Plan. CCDC made the required 16% contribution amounting to approximately $567 for fiscal year 2007.

The fiduciary responsibilities of CCDC consist of making contributions and remitting deposits collected. The City does not hold these assets in a trustee or agency capacity for CCDC; therefore, these assets are not reported within the City's basic financial statements.

d. **Pension Plan - San Diego Convention Center Corporation (SDCCC)**

SDCCC's Money Purchase Pension Plan (the "SDCCC Plan") became effective January 1, 1986. The SDCCC Plan is a qualified defined contribution plan and as such, benefits depend on amounts contributed to the SDCCC Plan plus investment earnings less allowable plan expenses. The SDCCC Plan covers employees not otherwise entitled to a retirement/pension plan provided through a collective bargaining unit agreement. Employees are eligible at the earlier of the date on which they complete six months of continuous full-time service, or the twelve-month period beginning on the hire date (or any subsequent Plan year) during which they complete 1,000 hours of service.

A plan year is defined as a calendar year. SDCCC's balance for each eligible employee is vested gradually over five years of continuing service with an eligible employee becoming fully vested after five years. Forfeitures and

SDCCC Plan expenses are allocated in accordance with Plan provisions. A trustee bank holds the SDCCC Plan assets. The City does not act in a trustee or agency capacity for the SDCCC plan; therefore, these assets are not reported within the City's basic financial statements.

For the year ended June 30, 2007, pension expenditures for the SDCCC Plan amounted to $1,269. SDCCC records pension expenditures during the fiscal year based upon estimated covered compensation.

e. **Pension Plan - San Diego Data Processing Corporation (SDDPC)**

SDDPC has accrued and set aside funds in a money market account to provide employees who transferred from the City to SDDPC with retirement benefits approximately equal to those under the City's retirement plan. As of June 30, 2007, the balance in the account was $140.

The balance at June 30, 2007 consisted of the total estimated liability plus interest earned on the account since its establishment in fiscal year 1991.

In addition, SDDPC has in effect a Money Purchase Pension Plan (the "SDDPC Plan") covering substantially all employees. The SDDPC Plan is a defined contribution plan, wherein benefits depend solely on amounts contributed to the plan plus investment earnings. Employees are eligible to participate from the date of employment. During each plan year, SDDPC contributes monthly an amount equal to 20% of the total monthly compensation for all employees. SDDPC contributions for each employee are fully vested after four years of continuing service. The City does not act in a trustee or agency capacity for the SDDPC Plan; therefore, these assets are not reported within the City's basic financial statements. In fiscal year 2007, SDDPC made the required 20% contribution, amounting to approximately $3,483.

SDDPC also administers a Tax Sheltered Annuity Plan, a voluntary defined contribution plan covering all employees of SDDPC who are eligible for membership as defined by the plan document. There are no employer contributions to this plan.

f. **Pension Plan - San Diego Housing Commission (SDHC)**

SDHC provides pension benefits for all its full-time employees through a defined contribution plan (the "SDHC Plan"). In a defined contribution plan, benefits depend solely on amounts contributed to the plan plus investment earnings. Employees are eligible to participate on the first day of their employment. SDHC's contributions for each employee (and interest allocated to the employee's account) are fully vested after four years of continuous service. SDHC's contributions for, and interest forfeited by, employees who leave employment before four years of service are used to reduce the SDHC's current-period contribution requirement. SDHC's covered payroll in fiscal year 2007 was approximately $11,514. SDHC made the required 14% contribution, amounting to approximately $1,614 for fiscal year 2007. The City does not act in a trustee or agency capacity for the SDHC Plan; therefore, these assets are not reported within the City's basic financial statements.

g. **Pension Plan - Southeastern Economic Development Corporation (SEDC)**

SEDC has an optional Simplified Employee Pension Plan covering all full-time permanent employees (the "SEDC Plan"). The SEDC Plan is a defined contribution plan administered by James Kerr & Associates, Inc and Morgan Stanley Dean Witter is the investment advisor. Under section 212 of the SEDC Employee Handbook, employees are eligible to participate six months after their date of employment, and SEDC contributes a monthly amount equal to 12% of the employees' base salary, or 15% of management employees' base salary. Such contributions are fully vested upon contribution. SEDC's total payroll in fiscal year 2007 was approximately $1,009. SEDC contributions were calculated using the base salary amount of approximately $889. SEDC made the required contribution, amounting to approximately $118 for fiscal year 2007. SEDC Plan members contributed an additional $3.6.

13. OTHER POSTEMPLOYMENT BENEFITS (In Thousands)

a. Plan Description

The City provides certain healthcare benefits to a variety of retired employees through SDCERS, as provided for in San Diego Municipal Code (SDMC) Sections 24.1201 through 24.1204. Currently, the benefits are primarily for health eligible retirees who were actively employed on or after October 5, 1980 and were otherwise entitled to retirement allowances. Health eligible retirees can obtain health insurance coverage with the plan of their choice, including any City sponsored, union sponsored, or privately secured health plan. In fiscal year 2007, health eligible retirees who are also eligible for Medicare are entitled to receive reimbursement/payment of healthcare premiums, limited to approximately $7.8 per year, in addition to reimbursement/payment for Medicare Part B premiums, limited to approximately $1.1 per year. Health eligible retirees who are not eligible for Medicare are entitled to receive reimbursement/payment of healthcare premiums, limited to approximately $7.3 per year. Non-health eligible employees who retired or terminated prior to October 6, 1980 and who are otherwise eligible for retirement allowances are also eligible for reimbursement/payment of healthcare benefits limited to a total of $1.2 per year.

b. Contributions

Expenses for postemployment healthcare benefits were paid for on a pay-as-you-go basis through fiscal year 2007. In fiscal year 2007, approximately 4,400 retirees received either City paid insurance or were reimbursed for other health insurance costs incurred amounting to approximately $27,100. Approximately $20,400 was paid by the City and approximately $6,700 was paid by retirees for beneficiary health benefits. These contributions were placed into a trust fund called the Retiree Health Trust Fund, and all retiree healthcare expenses are paid directly from this fund by SDCERS.

In July 2004, GASB issued GASB 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions* (OPEB), which establishes standards for the measurement, recognition, and display of OPEB expense/expenditures and related liabilities, note disclosures, and, if applicable, required supplementary information in the financial statements. The City will implement GASB 45 in the financial statements for the fiscal year ending June 30, 2008. In preparation to meet the requirements of GASB 45, the City entered into an agreement on January 18, 2008 to pre-fund expenses related to postemployment healthcare benefits. The investment trust, administered by CalPERS, requires the City to pre-fund the trust in an amount not less than $5 annually. The City has already submitted partial ARC contributions to CalPERS for fiscal years 2008 and 2009, amounting to approximately $30,129 and $23,911, respectively. Beginning in fiscal year 2008, the postemployment healthcare actuarial accrued liability of approximately $882,646, all of which is unfunded, will be reported in the notes to the financial statements as well as in the required supplemental information in a manner similar to pension obligations.

14. INTERFUND RECEIVABLES, PAYABLES, AND TRANSFERS (In Thousands)

Interfund Working Capital Advance (WCA) balances are the result of loans between funds that are expected to be repaid in excess of one year. The majority of the advances, approximately $7,700, are advances from the Housing and Urban Development (HUD) Section 108 and Naval Training Center Section 108 grant funds to RDA. Interfund WCA balances at June 30, 2007 are as follows:

Contributing Fund (Receivable)	Benefiting Fund (Payable) Nonmajor Governmental
General Fund	$ 300
Nonmajor Governmental	8,252
Total	$ 8,552

Interfund receivable and payable balances are the result of loans between funds that are expected to be repaid during the next fiscal year. The majority of these short-term loans, approximately $6,000, represents Transient Occupancy Tax (TOT) Fund loans to expenditure-driven grant funds that have temporary cash shortfalls pending reimbursement from the Federal Government and the State. Interfund receivable/payable balances at June 30, 2007 are as follows:

	Benefiting Fund (Payable)		
Contributing Fund (Receivable)	Nonmajor Governmental	Internal Service	Total
General Fund	$ 75	$ 1,400	$ 1,475
Nonmajor Governmental	6,563	-	6,563
Nonmajor Enterprise	3,326	-	3,326
Total	$ 9,964	$ 1,400	$ 11,364

The Sewer Utility Fund has an interfund loan receivable of $3,487, and the Black Mountain Ranch FBA Fund, a capital projects fund, has a corresponding interfund payable of $3,487 for advanced FBA project funding. The Sewer Fund agreed to finance the Carmel Valley Trunk Sewer project to facilitate earlier construction, of which a portion was deemed the responsibility of the Carmel Valley area developers and is intended to be reimbursed in fiscal year 2010 from FBA Fund assessment revenue.

Interfund transfers result from the transfer of assets without the expectation of repayment. Transfers are most commonly used to (1) move revenues from the fund in which it is legally required to collect them into the fund which is legally required to expend them, including TOT, Storm Drain, and TransNet funds collected in said funds but legally spent within the General Fund, (2) utilize unrestricted revenues collected in the General Fund to finance various programs accounted for in other funds, in accordance with budgetary authorizations, and (3) move tax revenues collected in the special revenue funds to capital projects and debt service funds to pay for the capital projects and debt service needs during the fiscal year. Interfund transfer balances for the year ended June 30, 2007 are as follows:

	Benefiting Fund							
Contributing Fund	General Fund	Nonmajor Governmental	Sewer Utility	Water Utility	Nonmajor Enterprise	Internal Service	Capital Asset Transfers (Governmental)	Total
General Fund	$ -	$ 46,018	$ -	$ -	$ 3	$ 1,370	$ -	$ 47,391
Nonmajor Governmental	86,980	158,536	80	84	1,235	774	-	247,689
Sewer Utility	-	2,161	-	-	-	220	1	2,382
Water Utility	-	1,365	-	-	-	234	348	1,947
NonMajor Enterprise	1,608	801	-	-	-	-	11	2,420
Internal Service	2,573	1,001	7,738	352	666	9	-	12,339
Capital Asset Transfers (Gov)	-	-	-	-	396	-	-	396
Total	$ 91,161	$ 209,882	$ 7,818	$ 436	$ 2,300	$ 2,607	$ 360	$ 314,564

15. RISK MANAGEMENT (In Thousands)

The City is exposed to various risks of loss related to torts; 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 $5,000.

The City offers a cafeteria-style flexible benefits plan. This plan requires employees to choose a health and life insurance plan and also gives employees the option of obtaining dental insurance, vision insurance, or catastrophic care insurance. Employees can place remaining flexible benefit dollars into IRS qualified dental/medical/vision and childcare reimbursement accounts, into their 401(k), and/or take as cash.

The City is self-insured for workers' compensation and long-term disability (LTD). All operating funds of the City participate in both these programs and make payments to the Self Insurance Fund. Each fund contributes an amount equal to a specified rate multiplied by the gross salaries of the fund. These payments are treated as operating expenditures in the contributing funds and operating revenues in the Self Insurance Fund.

Public liability, workers' compensation, and long-term disability estimated liabilities as of June 30, 2007 are determined based on results of independent actuarial evaluations and include amounts for claims incurred but not reported and adjustment expenses. Claims liabilities are calculated considering the effects of inflation, recent claim settlement trends including frequency and amount of payouts, and other economic and social factors. Estimated liabilities for all public liability claims have been recorded in the Government-wide Statement of Net Assets as well as 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, 2005	$ 102,349	$ 163,406	$ 265,755
Claims and Changes in Estimates	11,623	28,832	40,455
Claim Payments	(28,563)	(24,786)	(53,349)
Balance, June 30, 2006	85,409	167,452	252,861
Claims and Changes in Estimates	50,667	31,753	82,420
Claim Payments	(31,832)	(23,407)	(55,239)
Balance, June 30, 2007	$ 104,244	$ 175,798	$ 280,042

The City, in collaboration with CSAC-EIA, maintains an "All Risk" policy which includes flood and earthquake coverage for scheduled locations for amounts up to $25,000 per occurrence under the primary policy, with a $25 deductible. Limits include coverage for business interruption losses for designated lease-financed locations. There is no sharing of limits among the City and member counties of the CSAC-EIA pool, unless the City and member are mutually subject to the same loss. Limits and coverage may be adjusted periodically in response to the requirements of bond financed projects, acquisitions, and in response to changes in the insurance marketplace.

Earthquake coverage is provided for designated buildings/structures and certain designated City lease-financed locations in the amount of $60,000, including coverage for business interruption caused by earthquake at certain designated locations. Earthquake coverage is subject to a deductible of 5% of total values per unit per occurrence, subject to a $100 minimum. The City's earthquake coverage is purchased jointly and shared with the member counties in the CSAC-EIA pool. Due to the potential for geographically concentrated earthquake losses, the CSAC-EIA pool is geographically diverse to minimize any potential sharing of coverage in the case of an individual earthquake occurrence. Depending upon the availability and affordability of such earthquake insurance, the City may elect not to purchase such coverage in the future, or the City may elect to increase the deductible or reduce the coverage from present levels.

The City is a public agency subject to liability for the dishonest and negligent acts or omissions of its officers and employees acting within the scope of their duty ("employee dishonesty" and "faithful performance"). The City participates in the joint purchase of insurance covering employee dishonesty and faithful performance through the CSAC-EIA pool. Coverage is provided in the amount of $10,000 per occurrence, subject to a $25 deductible.

During fiscal year 2007, there were no significant reductions in insurance coverage from the prior year. For each of the past three fiscal years, the settlements have not exceeded insurance coverage.

See Contingencies, Note 18, for additional information.

16. FUND BALANCE / NET ASSETS (DEFICIT) (In Thousands)

The Grants Fund (Special Revenue) and the Capital Outlay Fund (Capital Projects) have net deficits of approximately ($8,971) and ($6,533), respectively, due to the large number of reimbursement grants accounted for within these funds. With reimbursement grants, the resources remain the property of the grantor until allowable costs are incurred. The grants revenues are recognized as soon as all eligibility criteria have been met and the amounts become available. This results in a deficit fund balance in these funds.

The Self Insurance Fund (Internal Service) has a net deficit of approximately ($178,686), which represents unfunded estimated claims and claim settlements related to Public Liability, Workers' Compensation, and Long-Term Disability. It is anticipated that individual claim settlements will be funded through future user charges subsequent to the filing of a claim and prior to its settlement. In addition to user charges, in January 2008, the Mayor's office presented a five-year financial outlook to the City Council that outlines a proposal to fund the Self Insurance Fund by contributing an additional $5,000 to the Public Liability Reserves in fiscal year 2008, $10,000 in fiscal year 2009, and an additional $5,000 to workers compensation in fiscal year 2009. On November 13, 2007 the City Council also approved the formal City Reserve Policy. This policy contains a "Risk Management Reserve Policy" for the self insurance funds which addresses funding reserves for both the Public Liability and Worker's Compensation funds in the future.

Publishing Services (Internal Service) has a net deficit of ($944), due to a decline in work production, and outdated pricing for services which are not fully cost recoverable. Publishing services is restructuring their rates to ensure full cost recovery.

Special Engineering (Internal Service) has a net deficit of ($1,005) which is primarily the result of the net pension costs incurred in the fund. Rates will be restructured to ensure this fund is fully cost recoverable.

17. COMMITMENTS (In Thousands)

As of June 30, 2007, the City's business-type activities contractual commitments are as follows:

Airports	$	1,864
Environmental Services		15,403
Sewer Utility		59,515
Water Utility		53,373
Other		5,706
Total Contractual Commitments	$	135,861

The contractual commitments are to be financed with existing reserves and future service charges. In addition, the Sewer and Water Utility Funds intend to finance the contractual commitments with existing reserves, future service charges, and financing proceeds secured by system revenues.

Consent Decree

On April 2, 2001, two environmental groups filed suit against the City alleging that the Municipal System's collection system was deficient as a result of sewer spills from December 1996 to the time of the filing. The complaint sought injunctive relief to prevent illegal discharges, a compliance schedule to upgrade the Municipal System's collection system, and civil penalties of $27.5 per day for each day of a violation. The City contested the plaintiffs' claims.

The U.S. Environmental Protection Agency (EPA) and the State also filed suits against the City alleging the same collection system violations, seeking unspecified penalties and injunctive relief for collection system improvements. All three cases were consolidated. On March 16, 2005, the City settled the State lawsuit for $1,200. Of this total, $1,000 funded three supplemental environmental projects to benefit the local environment, and $200 was deposited in the State's Cleanup and Abatement Account.

The EPA, the City and the environmental groups reached an agreement on additional requirements to reduce sewer spills, which are set forth in a Consent Decree (the "Consent Decree"). The Consent Decree requires increased sewer spill response and tracking, increased root control, replacement or rehabilitation of 250 miles of pipeline, a canyon economic and environmental analysis, pump station and force main upgrades, and entails court supervision of these upgrades at least through June 2013. The estimated average annual cost of this commitment is $108,000 per year in capital projects and $47,000 per year in operational maintenance to the sewer system through the term of the settlement; however, the costs for bidding, constructing and completing the required work will fluctuate depending on variables such as changes in the cost of materials and labor. No civil penalty payment was required, though stipulated penalties ranging from $375 (in whole dollars) to $20,000 (in whole dollars) per occurrence are included for subsequent violations of the Consent Decree. The Consent Decree was approved by the Court on October 9, 2007, settling all remaining issues in the case.

Four sewer rate increases were approved for FY 2007 through FY 2010 to partially fund the obligations of the Consent Decree. However, additional rate increases will be necessary (likely beginning in year 2011) to completely fund the Consent Decree. The City funds the Capital Projects in the Consent Decree through the issuance of notes and bonds which are repaid by the sewer system's revenues.

California Department of Public Health Compliance Order

In 1994, the City of San Diego entered into a compliance agreement with the State of California Department of Public Health ("DPH") with the approval of City Council, after the DPH Drinking Water Field Operations Branch conducted a sanitary survey of the City's water system. This agreement required the City to correct operational deficiencies and begin necessary capital improvements. The City was notified in January of 1997 that it was not in compliance with this agreement. At that time, the DPH issued a compliance order. The January 1997 Compliance Order was last amended in May of 2007 ("Amendment 11"), and included additional items that were not in the original Compliance Order. The DPH Compliance Order will remain in effect until the required projects are completed.

Presently, the Water Department is meeting all of the requirements of the DPH Compliance Order, including the ongoing obligation to provide DPH with quarterly progress reports. On February 26, 2007, the City authorized an increase in water rates and charges to continue funding projects mandated in the DPH Compliance Order as well as other Capital Improvement Program projects. In addition, on October 8, 2007, the City authorized a "pass-through" rate increase to account for the higher cost of water purchased from the San Diego County Water Authority. The pass-through rate increase took effect on January 1, 2008 and will help preserve the funds previously committed to DPH Compliance Order projects.

DPH has the authority to impose civil penalties if the City fails to meet DPH Compliance Order deadlines, although DPH has not imposed such penalties to date. Violation of the DPH Compliance Order may be subject to judicial action, including civil penalties specified in California Health and Safety Code, Section 116725. Section 116725 penalties for violating a schedule of compliance for a primary drinking water standard can go as high as $25,000 (in whole dollars) per day for each violation; for violating other standards, such as turbidity, the penalties can reach $5,000 (in whole dollars) per day. There are a number of additional enforcement tools prescribed by law, including mandatory water conservation, litigation and service connection moratoriums.

The costs for bidding, constructing and completing the required work will fluctuate depending on variables such as changes in the cost of materials and labor. As of 2007, the Water Department's DPH Compliance Order project and DPH related project costs approximate:

Total Projects	FY07	FY08 - FY11	FY12 - FY19	TOTAL
DPH & EPA Requirements	$ 28,292	$ 345,747	$ 214,877	$ 588,916
DPH Related Projects	4,614	137,191	315,245	457,050

These commitments are to be financed with existing net assets, present and future revenues, and financing proceeds secured by system revenues.

Convention Center Dewatering

The City is responsible for the disposition and monitoring of the quality of groundwater from the parking structure at the San Diego Convention Center located adjacent to San Diego Bay. The Convention Center includes a subterranean parking garage, which is subject to infiltration of groundwater, much of which originates from the bay. This groundwater must be continually pumped from the parking structure to prevent it from being inundated. Approximately 500,000 gallons of groundwater is pumped daily from the parking structure. Until March 26, 2008 this water was discharged into San Diego Bay. The City held a National Pollutant Discharge Elimination System ("NPDES") permit for the discharge, issued by the Regional Water Quality Control Board ("RWQCB"). The discharge had been failing to consistently meet water quality standards set forth in the permit, potentially exposing the City to fines and penalties of up to $25,000 (in whole dollars) per day.

Monthly groundwater discharge sample results have not met the standards dictated by the NPDES permit since the end of calendar year 2005. This triggered the implementation of work to cease effluent violations within twenty seven months (from the end of March 2008), pursuant to an order of the RWQCB.

To achieve compliance with groundwater discharge requirements, the City retained an engineering consultant in 2006 to review all previous work and develop the most cost-effective engineering solution to achieve compliance. The consultant's final report was received in August 2007. This report determined that the most cost effective method to comply with the RWQCB Order in the near term was to divert the discharge from the bay to the sewer system. The cost for implementing this solution is estimated to be $709,488 (in whole dollars) for FY 2009, with subsequent annual increases based on approved sewer rates, for operational and sewer service charges. There is also a one-time sewer capacity charge of $5,904,930 (in whole dollars) that is due after the first year of diversion to the sewer. The City's General Fund is responsible for the funding, although the San Diego Port District, which owns the Convention Center property, may also be partially responsible.

The City of San Diego established the diversion to the sewer effective March 26, 2008 in compliance with the RWQCB Order. On May 19, 2008, the City requested permission from the EPA to make diversion of the groundwater into the sewer system permanent. As of the issuance of this report, the EPA is considering this request.

18. CONTINGENCIES (In Thousands)

FEDERAL AND STATE GRANTS

Grant monies received as reimbursement for costs incurred in Federal and State programs administered by the City are recognized as revenue. 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 Audits for fiscal years ended June 30, 2004, 2005 and 2006 were completed by Macias Gini & O'Connell LLP and have been received and filed by the City Council.

Additionally, the local unit of the U.S. Department of Housing and Urban Development (HUD) has recently conducted an audit survey of the City's Community Development Block Grant (CDBG) program. The overall objective of the audit survey was to determine whether management complied with applicable laws, regulations, and requirements of HUD's CDBG program. After reviewing the program, HUD indicated that the City may not be in compliance with CFR 85.25. Specifically, HUD is concerned with CDBG loans to RDA, "Re-Loans", and other program eligibility issues.

The Office of the Inspector General (OIG) subsequently began an audit which focused on CDBG loans with RDA. As part of the audit process HUD has recommended that the City and RDA ensure timely payments of both principal and interest on CDBG loans made from the City to RDA. The total amount of the loans identified by HUD was $139,202. These loans are reported as a component of loans payable and accrued interest payable to the City in the long-term liabilities footnote of the Redevelopment Agency Financial Statements with an "unscheduled" maturity date. OIG has indicated a need to establish a repayment schedule; however, did not stipulate a proposed time period for repayment. Depending on the outcome of negotiations with HUD, repayment of the loans by RDA could impact RDA's liquidity. These loans do not appear in the City's CAFR as they represent interfund loans between two governmental funds in which repayment is not expected in a reasonable amount of time. Therefore, these loans are reported as interfund transfers in the fund level statements, and then eliminated as interfund activity in the government wide statements per GASB 34.

It is currently uncertain what, if any, other action HUD will take concerning potential non-compliance regulations over the use of federal funds. HUD also plans to proceed with another audit focusing on other CDBG activities, and this is scheduled to begin in October 2008.

CONTINUING DISCLOSURE OBLIGATIONS

The City, in connection with all bond offerings since the effective date (July 1995) of the continuing disclosure requirements of SEC Rule 15c2-12, has contractually obligated itself to provide annual financial information, including audited financial statements, within certain specified time periods (generally nine months) after the end of each fiscal year. The City has not been able to satisfy its contractual obligations to provide to the national repositories audited financial statements, or financial information and operating data derived from the financial statements, for fiscal years 2003 through 2007 on a timely basis. At the time of each deadline, the City, as required by its continuing disclosure contractual obligations, provided to the national repositories a notice of the failure to file the audited annual financial statements information.

REGULATORY AND OTHER INDEPENDENT INVESTIGATIONS

In November 2006, the Securities and Exchange Commission (SEC) entered an Order sanctioning the City of San Diego for committing securities fraud by failing to disclose, in 2002 and 2003, material information about its pension and retiree health care obligations in connection with disclosures relating to the sale of its municipal bonds. To settle the action, the City agreed to cease and desist from future securities fraud violations and to retain an independent consultant for three years to foster compliance with its disclosure obligations under the federal securities laws.

The SEC made the following determinations in the Order (figures are as of the date of the Order unless otherwise noted):

- The City failed to disclose that the City's unfunded liability to its pension plan was projected to increase to an estimated $2 billion at the beginning of fiscal year 2009, and that the City knew and failed to disclose that its health care liability would be in excess of $1.1 billion. (The information presented in the SDCERS actuarial valuation for the fiscal year ended June 30, 2007, which will be incorporated in the City's fiscal year 2009 financial statements, reported the unfunded actuarial liability to be $1.183 billion.)

- The City failed to disclose that it had been intentionally under-funding its pension obligations so that it could increase pension benefits but defer the costs, and that it would face severe difficulty funding its future pension and retiree healthcare obligations unless new revenues were obtained, pension and healthcare benefits were reduced, or City services were reduced.

- The City knew or was reckless in not knowing that its disclosures were materially misleading.

- The City made these misleading statements through three different means:

    1. In the offering documents for five municipal offerings in 2002 and 2003 that raised over $260 million from investors. The offering documents containing the misleading statements included the "official statements," which were intended to disclose material information to investors, and the "preliminary official statements," which were used to gauge investors' interest in a bond issuance.

    2. The City made misleading statements to the agencies that gave the City its credit rating for its municipal bonds.

    3. The City made misleading statements in its "continuing disclosure statements," which described the City's financial condition and were provided by the City to the municipal securities market with respect to prior City bond offerings.

The City consented to the issuance of the Order without admitting or denying the findings in the Order. The SEC's investigation with respect to the City's misleading disclosures is ongoing as to individuals and other entities that may have violated the federal securities laws.

The SEC Order sanctioning the City of San Diego for committing securities fraud is available at: www.sec.gov

Prior to settlement with the SEC, the City engaged a number of firms to review the City's disclosure practices and to investigate potential illegal acts. In February 2004, the law firm of Vinson & Elkins LLP (V&E) was engaged to conduct a review of the adequacy of the City's financial disclosure relating to the pension fund in bond offerings from 1996 to 2002 and to prepare a report on its findings. In September 2004, V&E released a report that identified a number of disclosure deficiencies and made recommendations on how to remediate their causes. The report did not offer conclusions on the culpability of individual members of the City's government.

Many of the recommendations contained in the V&E report were adopted by the City in October 2004. However, the City's accounting firm, KPMG, advised that the report did not provide a sufficient basis to conclude that all questions necessary to the completion of the audit were sufficiently investigated and resolved in a manner that would permit the issuance of an audit report. In response, the City engaged a professional consulting firm, Kroll Inc. (Kroll) and the law firm Willkie, Farr and Gallagher LLP, to act in the capacity of an audit committee. Kroll took over the investigation. The independent investigations concluded when Kroll presented its final report to the City on August 8, 2006. The Kroll report concluded that there were numerous failures on the part of City government to conform to law, to adhere to principles of sound governance and financial reporting, and to protect the financial integrity of the City's pension system. The Kroll report was more fully summarized in the City's fiscal year 2003 financial report. The City's fiscal year 2003 financial report, and the entire Kroll report including interview summaries and footnotes, as well as the V&E report, are available at: www.sandiego.gov.

REMEDIATION OF CITY DISCLOSURE DEFICIENCIES

The City has taken a variety of remedial actions in the wake of the disclosure deficiencies identified by V&E, Kroll and the SEC. In response to the V&E Report, the City amended the municipal code to address certain control environment issues. The Disclosure Ordinance created the Disclosure Practices Working Group composed of City officials and outside disclosure counsel to review the form and content of all financial disclosures by the City and its related entities and a finance and disclosure unit within the City Attorney's Office. Pursuant to the Ordinance, the Auditor and Comptroller is required to annually review and report on internal controls within the City. In addition, mandatory training is required for City staff and officials, including the City Council and Mayor, regarding their obligations under federal and state securities laws.

Further reforms were proposed by the Mayor to address deficiencies identified in the Kroll Report. A monitor, who also serves as the Independent Consultant pursuant to the Order, was appointed on January 26, 2007, to oversee the implementation of the Mayor's remediation plan. Structural changes were made to the City's Finance Department to enhance accountability to the City's Chief Financial Officer, who also serves as the Auditor and Comptroller. The City Council amended the Municipal Code to create an Audit Committee comprised of three Councilmembers, which provides legislative oversight of the City's accounting and financial reporting processes and internal audit function.

In Fall 2007, an Internal Auditor was appointed by the Mayor, in consultation with the Audit Committee. The Internal Auditor reports to both the Chief Operating Officer and the Audit Committee. The City has also retained an independent actuary to provide periodic analysis of SDCERS' actuarial reporting and of the fiscal impact of pension and benefit related decisions. An Enterprise Resource Planning ("ERP") system has been purchased to enhance the timeliness and accuracy of the City's operational reporting; the first ERP modules are scheduled for activation in October 2008.

Certain recommendations included in the Kroll Report and the Mayor's remediation plan require further action by the City or the voters. An ordinance imposing criminal penalties for City employees who improperly influence the City's outside consultants has not been presented to the City Council for consideration. Changes to the City Charter to enhance the independence of both the Internal Auditor and the Audit Committee were approved with the passage of Proposition C (Prop C) in the June 3, 2008 election and are discussed in more detail below and in Note 22.

INDEPENDENT CONSULTANT'S ANNUAL REVIEW

The Independent Consultant required by the SEC Order has several specific mandates. Among these are annual reviews, for a three year period, of the City's policies, procedures and internal controls regarding financial disclosures. The Independent Consultant is also required to make recommendations concerning the City's policies, procedures and internal controls and to assess the City's adoption and implementation of these recommendations.

On June 7, 2007, the Independent Consultant issued an interim report to the City and the SEC to provide a preliminary review and assessment of the City's policies, procedures and internal controls over financial reporting. This report was not an annual review, but intended to provide an initial update of the City's progress. The SEC issued a letter acknowledging this initial report on July 23, 2007, recognizing the recommendations outlined and indicating that subsequent reports would provide more complete, specific and concrete recommendations with specific deadlines. The City responded to the SEC letter on September 25, 2007, citing actions already taken by the City to strengthen internal controls over financial reporting and confirming the City's intent to continue working with the Independent Consultant in the near future.

On March 25, 2008 the Independent Consultant issued his first annual report to the City of San Diego which was received by the City Council on April 1, 2008. This report focused solely on the City's ongoing disclosure efforts and future compliance with disclosure obligations under federal securities laws. His recommendations are summarized below:

- Reconstitute the Audit Committee to be independent from financial management, which has the requisite expertise to perform its oversight functions, and has a sufficient relationship with the City Council to engender its confidence in view of the Council's role in the City's financial reporting. This recommendation was consistent with the June 3, 2008 Prop C charter revision which approved an Audit Committee consisting of two Councilmembers, one of whom would be chair, and three public members who must have at least 10 years of professional finance experience.

- Creation of an internal audit department separate from the Auditor and Comptroller's Office which directly reports to the Audit Committee. This recommendation was implemented with the approval of Prop C.

- Significantly increase staffing of the internal audit department.

- Involve the Audit Committee with hotline activity involving improper financial conduct and fraud.

- Establish a clear Chief Financial Officer position in the City Charter. This recommendation was implemented with the approval of Prop C.

- Better integrate and coordinate ERP and Internal Controls over Financial Reporting (ICFR) process to align objective and maximize resources. Devote additional resources to the ICFR process, and develop period end financial reporting routines. Also, report quarterly to the Audit Committee on the progress of these efforts.

- There were also several recommendations regarding the Audit Committee's procedures over CAFR review; consideration of a shelf-like disclosure system with the DPWG; review of the DPWG practices and functions; and others.

The complete report is available at: www.sandiego.gov.

GENERAL INVESTIGATIONS

The City Attorney is currently being investigated by the California State Bar. Bar investigations are confidential and the scope, nature, and likely outcome of the investigation are not known.

LITIGATION AND REGULATORY ACTIONS

The City is a defendant in lawsuits pertaining to material matters, including claims asserted which are incidental to performing routine governmental and other functions. This litigation includes but is not limited to: actions commenced and claims asserted against the City arising out of alleged torts; alleged breaches of contracts; alleged violations of law; and condemnation proceedings. The City has received approximately 2,300 notices of claims in fiscal year 2007.

The estimate of the liability for unsettled claims has been reported in the Government-Wide Statement of Net Assets and the Proprietary Funds financial statements. The liability was estimated by categorizing the various claims and supplemented by information provided by the City Attorney with respect to certain large individual claims and proceedings. The recorded liability is the City's best estimate based on available information.

Significant individual lawsuits are described below.

SDCERS v. City of San Diego

In 1996 and 2002, SDCERS, the City and various labor unions entered into agreements wherein the City of San Diego contributed less to the pension system than what was actuarially required. SDCERS has filed a complaint claiming the benefits are legal and should continue to be paid by the City. The City Attorney filed a cross-complaint alleging the benefits were not legal; however, that case was dismissed in December 2006. The City Attorney is currently appealing the case before the Court of Appeals.

San Diego Police Officer's/ABBE v. City of San Diego

On October 25, 2005, the SDPOA (SDPOA #2) filed a lawsuit against the City alleging failure to pay for overtime work under the Fair Labor Standards Act. The likelihood of an unfavorable outcome is reasonably possible and the liability is estimated to be in the range of $0 - $15,000.

Wayne Akeson, et al. v. City of San Diego

On August 6, 2006, a lawsuit arose following a water main break which caused flooding along a private street in the Colony Hills Homeowners Association (HOA) in La Jolla. Claimants allege the water main failure caused soil subsidence, hillside failure, road failure and diminished property values of 40 HOA homes. In the event of an adverse ruling, the liability facing the City is estimated to be in the range of $0 - $45,000.

Ace Properties v. City of San Diego

On October 2, 2006, Ace Properties entered into an inverse condemnation case against the City of San Diego. In the event of an adverse ruling, the liability facing the City is estimated to be in the range of $0 - $3,000.

Sunroad v. City of San Diego

City filed a nuisance abatement action against Sunroad for construction of 180 foot building into federally controlled airspace. Sunroad filed a cross-complaint claiming inverse condemnation. In the event of an adverse ruling, the liability facing the City is estimated to be in the range of $0 - $45,000.

Frazier, Patricia, et al v. City of San Diego

This is an action by former City employees who are now defendants to a civil action by the SEC. Plaintiffs seek a declaratory judgment in the form of an order from the courts for the City to defend and indemnify Plaintiffs. In the event of an adverse ruling, the liability facing the City is estimated to be in the range of $0 - $4,500.

San Diego State University Foundation v. City of San Diego

This case alleges that the Redevelopment Agency of the City of San Diego breached an agreement requiring the Agency to sell certain property to the Plaintiff. In the event of an adverse ruling, the liability facing the City is estimated to be in the range of $0 - $5,000.

Significant regulatory actions are described below (Other regulatory actions are described in Notes 17 and 22).

California Regional Water Quality Board Administrative Proceeding

The City is in an on-going administrative proceeding before the California Regional Water Quality Control Board (RWQCB) where it has been alleged that the City, along with eight other entities, have contributed to polluting San Diego Bay, a condition which requires abatement. The allegations relate to current and historic discharges of urban runoff into Chollas Creek, which drains into the San Diego Bay. The City has retained consultants to assess the available data and therefore it is difficult to determine likelihood of an unfavorable outcome. However, the RWQCB has estimated that remediation costs could range between $900 and $122,000 depending on the remedy selected, and the City would have a yet-to-be determined share of those remediation costs if an unfavorable outcome were to happen.

IRS Voluntary Correction Program Settlement

SDCERS is operated as a qualified governmental defined benefit plan under Internal Revenue Code (IRC) §§ 401(a) and 414(d). In light of various concerns raised in investigative reports regarding practices of SDCERS that could have jeopardized its status as a qualified governmental defined benefit plan, SDCERS requested its outside tax counsel, Ice Miller LLP, to perform a comprehensive document compliance review, prepare submissions in accordance with the IRS Voluntary Correction Program (VCP), and work with the IRS to finalize a compliance statement to resolve SDCERS' compliance issues. A comprehensive settlement was reached between the IRS and SDCERS on December 20, 2007 (Settlement). The Settlement required the City and SCDERS to take certain corrective actions, some of which required Council approval, regarding certain provisions of its retirement plan within 150 days of December 20, 2007. The Settlement did not require the City to pay any penalty payments or to make any additional contributions to the retirement system. On April 15, 2008, Council approved Ordinance O-2008-133 to comply with the IRS requirements outlined in the Settlement.

The VCP filings identified violations and proposed corrections regarding the City's Presidential Leave Program for presidents of certain labor organizations that represent City employees; compensation limits under IRC § 401(a)(17); minimum distribution requirements under IRC § 401(a)(9); eligible rollover distribution compliance under IRC § 401(a)(31); minimum distribution requirements from the Deferred Retirement Option Plan (DROP) program; overpayment of disability benefits; conversion of annual leave to purchased service credits; retiree healthcare benefits and health administrative expenses under IRC § 401(h); benefit and compensation limits under IRC §§§ 415(b), 415(c) and 415(n); and remedial plan amendments.

The practice of using pension plan assets, and later a bifurcation of City contributions to the pension plan to fund retirement healthcare benefits, resulted in the most significant plan violation in monetary terms. The compliance statement identified that from 1983 through 1991, retiree health benefits were paid by SDCERS when the plan document did not provide for such benefits. Additionally, the compliance statement states that the plan was not appropriately reimbursed for administrative expenses related to the provision of retiree health benefits from 1993 to 2006. Both of these failures were related to non-compliance with IRC § 401(a)(2). The cumulative value of improper payments associated with this failure was approximately $34 million. In a separate failure, the compliance statement also identified that from 1998 through 2005, the terms of the Plan did not comply with all of the provisions of IRC §§

401(a)2 and 401(h) as it relates to the plan's administration of retirement health benefits and the use of plan earnings to fund the benefits. The compliance statement indicated that the manner in which the benefits were funded "made it extremely difficult, if not impossible to resolve that there was no inappropriate use of the Plan Assets." In this regard, and for the purposes of presenting fairly the effect on net assets, the City has estimated that from 1988 through 2006, the cumulative effect of the improper funding and administration of Retiree Health Benefits was approximately $77.1 million. These amounts will be treated as a reduction to City contributions against its Annually Required Contribution during the year in which the expenditures occurred and instead recorded as part of the City's Net Pension Obligation.

With regard to benefit and compensation limits, in March 2001, the City Council authorized the establishment of a Preservation of Benefit Plan. A preservation of benefit plan (POB) is a qualified governmental excess benefit arrangement (QEBA) under IRC § 415(m), which is a vehicle created by Congress to allow the payment of promised pension benefits that exceed the IRC § 415(b) limits. While the City Council approved the establishment of a POB satisfying the requirements of § 415(m), the City has not received a determination letter from the IRS approving the formation of its POB QEBA. Under the Internal Revenue Code, the City may not pre-fund the POB to cover future liabilities beyond the current year, as with the 401(a) plan. Despite the creation of the POB by the City Council in March 2001, SDCERS continued to treat the excess amounts as payable from the 401(a) plan assets in violation of law. SDCERS did not establish a POB and Trust until February 2007. In future years, SDCERS will determine the amount necessary to fund any pension benefits payable during the calendar year in excess of the amount permitted by IRC § 415(b). This amount will include the projected amount of all excess pension benefits payable for the calendar year as well as the projected cost of administering the POB for the calendar year. SDCERS will provide this information to the City and the City will pay these costs on an annual basis. The City transferred money into a new POB account in December 2007 to fund POB payments. With the issuance of the Compliance Statement, SDCERS has stopped paying benefits in excess of IRC § 415(b) limits from the SDCERS Trust Fund. Benefits in excess of IRC § 415(b) limits will be paid only from the POB.

The estimated actuarially accrued liability related to excess benefits for eligible active members of the system, amounting to approximately $22.8 million, has been excluded from the actuarial valuation of the 401(a) retirement plan beginning in fiscal year 2006 (this liability is estimated to be approximately $30.4 million in the fiscal year 2007 actuarial valuation). Additionally, the liability for retired members of the Preservation of Benefit Plan, amounting to approximately $6.4 million, has been excluded from the fiscal year 2007 actuarial valuation of the 401(a) retirement plan. Accordingly, the liability related to excess benefits for retired members is reflected in the actuarial liabilities of the 401(a) plan in the actuarial valuation dated June 30, 2006 as well as in the ARC payable in fiscal year 2008.

In fiscal year 2005, costs related to the Preservation of Benefit Plan for both retired and active members are included in the actuarial liabilities presented in the Required Supplementary Information (RSI) for the City's core pension plan and are valued using the same set of assumptions. In a review of the financial statements of other local governments, the City has noted significant diversity of practice in how governments are accounting for QEBAs. As such, the City is in the process of implementing a plan to account for the QEBA with SDCERS.

City Attorney Concerns with Pension System

The City Attorney has concluded that, in his opinion, the retirement benefits paid in excess of IRC § 415(b) limits referenced above, require voter approval as such benefits constitute a distinct pension plan not authorized under the City Charter. Therefore, it is also his opinion that the retirement benefits paid in excess of IRC § 415(b) limits are illegal and that the City should immediately discontinue payment. Other members of management believe that this issue has yet to be resolved in court related to lawsuits previously filed by the City Attorney. As such, the City intends to continue to treat these benefits as legal obligations until instructed to do otherwise by a court of law. In the opinion of management, a decision to terminate such benefits would expose the City's residents to unnecessary and costly legal fees.

In addition, the City Attorney has written to the Internal Revenue Service, in letters dated September 13, 2007, October 3, 2007 and November 6, 2007, expressing his concerns that the pension plan in its current form violates various provisions of the City Charter and the Municipal Code, and that such violations could jeopardize the status of SDCERS as a qualified governmental defined benefit plan. In addition to matters identified elsewhere in these notes and the IRS Compliance Statement, set forth below are additional concerns raised in such letters or in other public pronouncements of the City Attorney:

1. DROP: The City Attorney has alleged that the DROP program, as discussed in Note 12, is not currently operated on a cost neutral basis. Municipal Code section 24.1401(b) provides that "DROP is intended to be cost neutral." In DROP, the employee's retirement benefit calculation is fixed as of the date of participation and they continue to work for the City up to five years, while their monthly pension benefit is deposited into an individual account held by SDCERS.[1]

2. Purchase of Service Credit Program: Employees hired before July 1, 2005 were permitted to buy creditable years of service below cost; however, such program was also intended to be cost neutral as reflected in a City Manager Memorandum to the Council at the time Council approved such program.[1]

3. Term Limit: Elected officials are permitted to buy creditable years of service in excess of the time they are permitted to serve under section 12(f) of the City Charter (two consecutive four-year terms).[2]

4. Pension Plan Vesting Requirement: Employees were allowed credit for pension years purchased below cost to satisfy the retirement plan's 10 year vesting requirement. In relation to non-public safety employees, the Charter provides that "No employee shall be retired before reaching the age of 62 years and before completing 10 years of service for which payment has been made, except such employees may be given the option to retire at the age of 55 years after 20 years of service for which payment has been made with a proportionally reduced allowance".[1]

5. Retirement Age: Non-public safety employees were permitted to use pension years purchased below cost to retire at 55 rather than 62, without regard to whether they have 20 years of service.[1]

Other members of management believe that the legal status of these matters has not been definitively determined and do not raise IRS qualification issues. Furthermore, other members of management note that while the IRS was made aware of these issues prior to issuing the compliance statement and Determination Letter discussed earlier in the note, to date the IRS has not determined to take any action regarding the issues alleged by the City Attorney.

[1] As of issuance of this report, these matters are currently on appeal to the California Court of Appeals, Fourth District, and the parties are presently waiting to be apprised of the briefing schedule by the court.

[2] As of issuance of this report, this concern has not been involved in any type of litigation.

19. THIRD PARTY DEBT (In Thousands)

The City has authorized the issuance of certain conduit revenue private activity bonds, in its name, to provide tax exempt status because it believes a substantial public benefit will be achieved through the use of the proceeds. Aside from the fact that these bonds have been issued in the City's name, the City has no legal obligation to make payment on these bonds and has not pledged any City assets as a guarantee to the bondholders. The following describes the various types of such third party debt:

Mortgage and Revenue Bonds

Single family mortgage revenue bonds have been issued to provide funds to purchase mortgage loans secured by first trust deeds on newly constructed and existing single-family residences. The purpose of this program is to provide low interest rate home mortgage loans to persons of low or moderate income who are unable to qualify for conventional mortgages at market rates. Multi-family housing revenue bonds are issued to provide construction and permanent financing to developers of multi-family residential rental projects located in the City to be partially occupied by persons of low income.

Industrial Development Revenue Bonds

Industrial Development Revenue bonds have been issued to provide financial assistance for the acquisition, construction, and installation of privately-owned facilities for industrial, commercial or business purposes to mutually benefit the citizens of the City of San Diego. The final payments on all outstanding Industrial Development Revenue bonds occurred on November 6, 2006, accordingly, there was no balance outstanding as of June 30, 2007.

As of June 30, 2007, the status of all third party bonds issued is as follows (in thousands):

	Original Amount	Balance June 30, 2007
Mortgage Revenue	$ 132,390	$ 32,530
Industrial Development Revenue	345,805	-
Total	$ 478,195	$ 32,530

These bonds do not constitute an indebtedness of the City. The bonds are payable solely from payments made on and secured by a pledge of the acquired mortgage loans, certain funds and other monies held for the benefit of the bondholders pursuant to the bond indentures, property liens and other loans. In reliance upon the opinion of bond counsel, City officials have determined that these bonds are not payable from any revenues or assets of the City, and neither the full faith nor credit for the taxing authority of the City, the state, or any political subdivision thereof is obligated to the payment of principal or interest on the bonds. In essence, the City is acting as a conduit for the private property owners/bondholders in collecting and forwarding the funds. Accordingly, no liability has been recorded in the City's government-wide statement of net assets.

20. CLOSURE AND POST CLOSURE CARE COST (In Thousands)

State and federal laws and regulations require that the City of San Diego place a final cover on its Miramar Landfill site when it stops accepting waste and to perform certain maintenance and monitoring functions at the site for thirty years after closure. Although closure and post closure care costs will be paid only near or after the date that the landfill stops accepting waste, the City reports a portion of these closure and post closure care costs as an operating expense in each period based on landfill capacity used as of each financial statement date.

The $16,935 reported as landfill closure and post closure care liability at June 30, 2007 represents the cumulative amount reported to date based on the use of 84% of the estimated capacity of the landfill.

The City will recognize the remaining estimated cost of closure and post closure care of $3,216 as the remaining estimated capacity is filled. These amounts are based on what it would cost to perform all closure and post-closure care at June 30, 2007. The City expects to close the landfill in fiscal year 2012. Actual costs may be higher due to inflation, changes in technology, or changes in regulations.

The City is required by state and federal laws and regulations to make annual contributions to finance closure and post-closure care. The City is in compliance with these requirements and at June 30, 2007, cash or equity in pooled cash and investments of $34,389 was held for this purpose. This is reported as restricted assets on the statement of net assets in the Environmental Services Fund. The City expects that future inflation costs will be paid from interest earnings on these annual contributions. However, if interest earnings are inadequate or additional post-closure care requirements are determined (due to changes in technology or applicable laws or regulations, for example), these costs may need to be paid by charges to future landfill users or from other sources.

21. OPERATING AGREEMENTS (In Thousands)

San Diego Data Processing Corporation and Automated Regional Justice Information System

SDDPC has a yearly information technology services contract agreement with a joint powers agency known as the Automated Regional Justice Information System ("ARJIS") whose main purpose is to pursue development of computerized law enforcement systems in the region.

Under the agreement, SDDPC provides information technology services to ARJIS at rates which, on an annual basis, are equivalent to those charged to other governmental agency clients. Included in SDDPC's services revenue is approximately $2,833 related to ARJIS for the year ended June 30, 2007.

City of San Diego and San Diego Medical Services Enterprise, LLC

On July 1, 1997, the City entered into an operating agreement with Rural/Metro Corporation, a provider of emergency medical transport services, to form San Diego Medical Services Enterprise, LLC (SDMSE) for the purpose of providing the City with emergency medical services and to provide for "911" emergency calls. The operating agreement and related contracts to provide such services were renewed on July 1, 2002 and again on July 1, 2005. On July 1, 2008 operations were extended until December 31, 2008 under a separate extension agreement while a competitive bidding process is being conducted. The operating agreement will expire on December 31, 2008 unless SDMSE is awarded a new contract after the competitive bidding process.

City of San Diego and Padres L.P.

On February 1, 2000, the City entered into a Joint Use and Management Agreement (Agreement) with the San Diego Padres baseball team (Padres) governing the rights and duties of the City and Padres with respect to the use and operation of the new Petco Park Ballpark Facility (Facility). The Facility was completed and operational in April 2004. The City and Padres jointly own the facility; the Padres having a 30% divided interest based upon the original Facility cost estimate of $267,500 (or $80,250) with the City owning 70% which is capitalized on the City's books. The City and the Padres have agreed upon the schedule of items and components that constitute the Padres' divided ownership, and the value of that divided ownership may vary from (but does not exceed) 30% due to the calculation of cost overruns for the Ballpark. Following termination of any occupancy agreement for the Ballpark, 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.

22. SUBSEQUENT EVENTS (In Thousands)

On July 2, 2007, the City privately placed a fiscal year 2007-2008 Tax Revenue Anticipation Note in the amount of $116,000 to meet general fund cash flow needs of the City on a thirteen month term. The fiscal year 2007-2008 Tax Revenue Anticipation Note was repaid on August 1, 2008.

On July 12, 2007, PFFA issued $17,230 of Series 2007A taxable pooled financing bonds for Southcrest, Central Imperial and Mount Hope Redevelopment Projects and $17,755 of Series 2007B tax-exempt pooled financing Bonds for Southcrest and Central Imperial Redevelopment Projects. The Series 2007A and Series 2007B bonds were issued to make loans to RDA for financing and refinancing redevelopment activities in the Southcrest, Central Imperial and Mount Hope Redevelopment Project areas. The issuance was through a public offering. The Series 2007A and 2007B bonds are secured by a Loan Agreement, a Second Supplemental Trust Agreement (Central Imperial Redevelopment Project Area), a Third Supplemental Trust Agreement (Southcrest Redevelopment Project Area), and a Fourth Supplemental Trust Agreement (Mount Hope Redevelopment Area), and are payable solely from the tax increment revenues derived from each project area. The fixed rate on the term bonds range from 4.0% to 6.65%, and the final maturity date is October 1, 2037.

On July 17, 2007, a breach of contract lawsuit was filed against the City of San Diego. In the event of an adverse ruling, the liability facing the City is estimated to be in the range of $0 - $2,000.

On July 26, 2007, RDA executed six separate non-revolving secured three-year term taxable and tax-exempt lines of credit with San Diego National Bank. Four taxable lines of credit are for affordable housing in North Park, City Heights, North Bay and Naval Training Center (NTC) Redevelopment Project Areas for an aggregate of $34,000. The two remaining lines of credit are for non-housing or general purposes, one of which is a taxable line of credit in the amount of $20,000 for City Heights, and the other is for the NTC Redevelopment Project, which is taxable for $6,000 and tax-exempt for $10,000. RDA may elect to have the taxable advance bear interest at a fixed rate equal to the United States Three-Year Treasury Constant Maturities Index plus 1.90%, which will remain fixed for the entire period of such advance, or elect to have the interest set at a fixed rate equal to the One-Month LIBOR Rate plus 1.10%. Tax-exempt advances will bear interest at a fixed rate determined by adding .70% to the product of the One-Month LIBOR Rate multiplied by 90%. Interest will be payable quarterly in arrears along with a .45% per annum loan fee on the unused commitment. Principal is due at maturity with no prepayment penalty.

On September 28, 2007, several current firefighters for the City of San Diego filed suit against the City of San Diego Fire Department alleging sexual harassment, failure to prevent harassment, retaliation, emotional distress, and violation of freedom of speech experienced during the 2007 Gay Pride Parade in San Diego. In the event of an adverse ruling, the liability facing the City is estimated to be in the range of $0 - $3,000.

On October 21, 2007, multiple wild fires began burning throughout the county of San Diego. Fueled by dry Santa Ana winds, these fires prompted the evacuation of an estimated 500,000 residents. As of the issuance of this report, the City estimates that the fire related costs are approximately $24,000. The City has received cash advances of $5,800 to reimburse a portion of these costs and expects to receive additional reimbursements from federal and state agencies and other sources ranging from $0 - $16,000.

In December, 2007 the City of San Diego submitted an application to the EPA to request a renewal of a modified permit for the Point Loma Wastewater Treatment Plant. Point Loma successfully received a modified permit (also known as a waiver) in 1995, which was renewed in 2002. This will be the City's second renewal request. The application is currently under review and a tentative decision is expected in late November or December 2008. In the event the waiver is not approved for renewal the current cost estimate is $1,500,000 to the City, assuming the City cannot access land from the Navy or the United States Park Service. This estimate includes all financing and interest costs. There would also be an estimated increase in operating and maintenance costs of approximately $40,000 per year.

On January 18, 2008, the City Council approved, by majority vote, to enter into a trust arrangement to pre-fund expenses related to Other Post Employment Benefits. The trust, administered by CalPERS, requires the City to pre-fund the post employment benefits in an amount not less than $5 annually.

On February 28, 2008, PFFA sold, on a private placement basis, $150,000 of Subordinated Water Revenue Notes to finance the acquisition and construction of the City's water system and to reimburse for previous costs incurred. The Series 2008A Notes are secured by and payable solely from net system revenues of the Water Utility Fund. The 2008A Notes bear an interest rate of 3.28%, and the maturity date is August 28, 2009.

On April 1, 2008, the City Council approved, by majority vote, the tri-party Compliance Statement between the City of San Diego, SDCERS, and the Internal Revenue Service, which resolves SDCERS' Voluntary Correction Plan submissions. The Compliance Statement requires City Council to adopt certain Technical Tax ordinance amendments in order for SDCERS to maintain their qualified tax exempt status. On April 15, 2008, O-19740 was approved unanimously by City Council to amend the Tax Ordinance Retirement Plan consistent with the Compliance Statement.

On April 10, 2008, the City issued $3,950 of Community Facilities District No. 3 (Liberty Station) Special Tax Bonds, Series 2008A. Proceeds of the bonds were used to finance various public improvements needed to develop property located within the District. The 2008 bonds were issued pursuant to the Mello-Roos Community Facilities Act of 1982 and are special, limited obligations of the district. The bonds are structured as serial and term bonds and were issued on a fixed rate basis. The interest rate on the bonds range from 3.5% to 6.1%, and the final maturity date is September 1, 2036.

On June 3, 2008, the voters of San Diego approved Proposition C (Prop C). Prop C amends the City Charter to separate the City's internal auditing function from supervision of the Manager (Mayor) by creating the new office of the City Auditor, which will be supervised by a restructured Audit Committee. The Audit Committee will consist of two Council members, one being chair, and three public members. The public members must have at least 10 years of professional finance experience, and will be appointed from candidates recommended from a screening committee comprised of the CFO, the IBA, one Council member, and two outside experts. Prop C also provides that the Manager (Mayor) will appoint, with Council confirmation, the CFO, who will assume the City's accounting responsibilities and oversee the City Treasurer. The measure also makes the Office of the IBA permanent, which would otherwise expire if the strong-mayor form of government does not get approved permanently in the year 2010.

On June 5, 2008, RDA issued $69,000 of Housing Tax Allocation Bonds for the purpose of financing certain improvements relating to, or increasing the supply of, low and moderate income housing in the Centre City Redevelopment Project and such other areas as authorized by the Redevelopment Law. The Series 2008A bonds are payable from, secured equally and are on parity with, outstanding Centre City Redevelopment Project Tax Allocation Housing Bonds, Series 2004C, Series 2004D and 2006B bonds, by a charge and lien on the pledged housing tax revenues derived by RDA from the Redevelopment Project. The bond issuance is structured as serial and term bonds and has an interest rate that ranges from 3.74% to 6.30%, with a final maturity date of September 1, 2020.

On July 1, 2008, the City privately placed a fiscal year 2008-2009 Tax Revenue Anticipation Note in the amount of $135,000 to meet the general fund cash flow needs of the City on a fifteen month term.

Effective July 1, 2008, the San Diego Transportation Improvement Program Ordinance and Expenditure Plan (TransNet Extension Ordinance) took effect based on the November 4, 2004 ballot approved by voters of San Diego County. The TransNet Extension Ordinance provides that SANDAG, acting as the Regional Transportation Commission, shall approve a multi-year program of projects submitted by local jurisdictions, identifying those transportation projects eligible to use transportation sales tax (TransNet) funds. The five-year period covered by the 2008 Regional Transportation Improvement Program (RTIP) includes fiscal years 2009 through 2013 and requires that annually, the amount of local discretionary funding for streets and roads be budgeted per the most recently established minimum maintenance of effort requirement adopted by SANDAG. The TransNet Extension Ordinance also requires an extraction of two thousand dollars from the private sector for each newly constructed residential housing unit in each jurisdiction to comply with the provisions of the Regional Transportation Congestion Improvement Program (RTCIP). On June 17, 2008, the City Council authorized the Mayor, or his designee, to make a submission for the 2008 RTIP for the City of San Diego.

On July 23, 2008, the President of SEDC was terminated by the Board of SEDC under allegations of misconduct. There currently is litigation over the appropriateness of the severance package awarded and also seeking to recover misappropriated assets. In September, an audit report was released publicly that documented suspected incidences of fraudulent activity related to, among other things, executive compensation. On September 10, 2008, the Mayor requested that the District Attorney investigate this audit finding to determine if there was any criminal conduct involved.

On July 24, 2008, the President of CCDC resigned. During the months preceding and also subsequent to the resignation, allegations of misconduct stemming from potential violations of City and State of California conflict of interest laws became public. CCDC has since suspended activity on the projects associated with the alleged conflict of interest violations. Depending on the extent to which the counterparty was aware of conflicts of interest, CCDC could potentially be subject to litigation arising from construction delays or project cancellations. The full nature and extent of the misconduct along with the extent of any possible liability to the City or CCDC is currently unknown.

On August 21, 2008, the City issued $12,365 of Community Facilities District No. 4 (Black Mountain Ranch Villages) Special Tax Bonds to finance public improvements required in connection with the district. The Series 2008A bonds were issued pursuant to the Mello-Roos Community Facilities Act of 1982 and are limited obligations of the district. The bonds were structured as serial and term bonds, and were issued on a fixed rate basis. The fixed rate on the bonds range from 3.125% to 6.0%, and the final maturity date is September 1, 2037.

On September 22, 2008, the State passed its fiscal year 2008-2009 budget. This budget included a one-year, one-time ERAF shift of $350,000 from all California redevelopment agencies. ERAF is the Educational Revenue Anticipation Fund which is used by the County to accumulate property tax amounts shifted from local governments back to the State. These funds will not be repaid. The negative impact to RDA is projected to be $11,675 across all project areas.

The recent turmoil in the financial markets has been unprecedented. SDCERS has advised the City that as of June 30, 2008 the fair value of the Retirement System's total portfolio was approximately $4,687,989 (unaudited), excluding securities lending and transactions in transit. As of September 30, 2008, SDCERS has estimated the fair value to be $4,320,007 (unaudited), which represents a decrease of $367,982, or 7.8%, during the first quarter in fiscal year 2009 (all values are based on available unaudited information). Changes in the value of the Retirement System assets are the result of gains and losses in investments and the variability of cash flows. The market continues to be volatile after September 30, 2008.

As of November 30, 2008, SDCERS has advised the City that the fair value of their total portfolio is approximately $3,585,593 (unaudited), of which the City's share is estimated to be $3,370,000 (unaudited). This represents an additional decrease in the fair value of system assets of approximately $734,414, or 17% since September 30, 2008. The total estimated decrease in the fair value of system assets from June 30, 2008 is approximately $1,102,396, or 24%. All values discussed in this and the preceding paragraph are based on available unaudited information. All other factors being constant, a decline in market value as of the actuarial date of June 30, 2009would increase the City's unfunded actuarial liability and the annual required contribution for fiscal year 2011.

As is the case with most retirement systems, SDCERS is exposed to general market risk. This general market risk is reflected in asset valuations fluctuating with market volatility. Any impact from market volatility on the Retirement System depends in large measure on how deep the market downturn is, how long it lasts, and how it fits within fiscal year reporting periods. The resulting market risk and associated realized and unrealized gains and losses could impact the financial condition of the Retirement System and the City's required contribution to the Retirement System. The reader of these financial statements is advised that financial markets continue to be volatile and are experiencing significant changes on almost a daily basis.

The City Treasurer's Investment Policy limits the composition of the holdings within the City's Equity in Pooled Cash and Investments held in City Treasury. The City Treasurer's Investment staff continues to focus investment decisions in accordance with Investment Policy primary objectives, which are preservation of principal and liquidity and therefore any potential loss of principal on any of the City's pooled investments is limited.

On November 13, 2008, Judge William R. Nevitt, Jr. issued a Minute Order in the case entitled City of San Diego (City) v. San Diego City Employees' Retirement System (SDCERS). The tentative ruling ordered the SDCERS Board to set aside its November 16, 2007 decision, which was to continue to amortize the underpaid purchase of service credits through the City's existing unfunded actuarial liability. The ruling states that this Board action was unlawful and contrary to the Municipal Code and the City Charter and prevents SDCERS from charging the City for certain "underpaid" purchase of service credits. A proposed final judgment, the terms of which were agreed upon by SDCERS, was submitted to the court on November 24, 2008. Once the final judgment is issued by the Court, SDCERS will have 60 days to appeal.

On December 19, 2008, the SDCERS Board received Cheiron's actuarial valuation report as of June 30, 2008. This report is scheduled to be approved by the SDCERS Board in January 2009. The City's actuarial value of assets, total actuarial liability, and the unfunded actuarial liability as of June 30, 2008, are $4,662,836, $5,963,550, and $1,300,713 respectively. This calculates to a 78.2% funding ratio. The June 30, 2008 valuation was prepared using revised assumptions approved by the Board in September 2008 following the receipt of Cheiron's Experience Study in July 2008. The Cheiron experience study and the valuation are both available on-line at www.sdcers.org.

Required Supplementary Information
(Unaudited)
Pension Trust Funds Analysis of Funding Progress

The following table shows the funding progress of the full City's portion of SDCERS (excluding the Port and the Airport) 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)
6/30/2005 *	$ 2,983,080	$ 4,436,017	$ 1,452,937	67.25%	$ 557,631	260.56%
6/30/2006	3,981,932	4,982,700	1,000,768	79.92%	534,103	187.37%
6/30/2007 **	4,413,411	5,597,653	1,184,242	78.84%	512,440	231.10%

Source: Cheiron, Inc.

* For fiscal year 2005, the actuarial accrued liability, UAAL, and funded ratio has been adjusted to reflect the impact of the Corbett contingent benefit. The actuarial valuation provided by the actuary for this year does not include this contingent benefit in the funded ratio. However, the valuations prepared by the actuary for fiscal years 2006 and 2007 do include the impact of the Corbett contingent benefit.

** The actuarial accrued liability was calculated using the Entry Age Normal (EAN) method beginning in fiscal year 2007. Prior to fiscal year 2007, the Projected Unit Credit (PUC) method was used.

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Required Supplementary Information - General Fund

GENERAL FUND

The general fund is the chief operating fund of the City. It is used to account for all financial resources except those required to be accounted for in another fund.

General fund revenues are derived from such sources as: Taxes; Licenses and Permits; Fines, Forfeitures, and Penalties; Use of Money and Property; Aid from Other Governmental Agencies; Charges for Current Services; and Other Revenue.

Current expenditures and encumbrances are classified by the functions of: General Government and Support; Public Safety–Police; Public Safety–Fire and Life Safety and Homeland Security; Parks, Recreation, Culture and Leisure; Transportation; Sanitation and Health; Neighborhood Services; and Debt Service Principal and Interest. Appropriations are made from the fund annually.

GENERAL FUND
SCHEDULE OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE
BUDGET AND ACTUAL (BUDGETARY BASIS)
YEAR ENDED JUNE 30, 2007
(In Thousands)

	Original Budget	Final Budget	Actual Amounts	Variance with Final Budget Positive (Negative)
REVENUES				
Property Tax	$ 344,824	$ 355,348	$ 361,062	$ 5,714
Sales Tax	243,070	243,070	233,385	(9,685)
Transient Occupancy Tax	72,863	72,863	80,703	7,840
Other Local Taxes	79,655	79,656	74,069	(5,587)
Licenses and Permits	30,808	31,119	31,475	356
Fines, Forfeitures and Penalties	34,548	37,950	40,346	2,396
Revenue from Use of Money and Property	35,435	41,143	42,157	1,014
Revenue from Federal Agencies	3,433	3,433	5,066	1,633
Revenue from Other Agencies	25,506	25,506	16,644	(8,862)
Charges for Current Services	94,209	94,574	85,026	(9,548)
Other Revenue	3,456	3,349	2,730	(619)
TOTAL REVENUES	967,807	988,011	972,663	(15,348)
EXPENDITURES				
Current:				
General Government and Support	226,412	231,157	202,910	28,247
Public Safety - Police	355,277	360,403	349,364	11,039
Public Safety - Fire and Life Safety and Homeland Security	171,147	174,015	173,005	1,010
Parks, Recreation, Culture and Leisure	121,907	122,534	116,352	6,182
Transportation	76,524	70,003	68,090	1,913
Sanitation and Health	40,670	42,708	40,393	2,315
Neighborhood Services	20,477	21,577	20,276	1,301
Debt Service:				
Principal Retirement	-	2,604	2,604	-
Interest	2,000	6,529	6,519	10
TOTAL EXPENDITURES	1,014,414	1,031,530	979,513	52,017
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	(46,607)	(43,519)	(6,850)	36,669
OTHER FINANCING SOURCES (USES)				
Transfers from Proprietary Funds	2,215	2,215	4,181	1,966
Transfers from Other Funds	53,310	53,356	86,980	33,624
Transfers to Proprietary Funds	(199)	(1,373)	(1,373)	-
Transfers to Other Funds	(27,842)	(46,018)	(46,018)	-
Net Income from Joint Venture	-	-	35	35
TOTAL OTHER FINANCING SOURCES (USES)	27,484	8,180	43,805	35,625
NET CHANGE IN FUND BALANCE	(19,123)	(35,339)	36,955	72,294
Fund Balance Undesignated at July 1, 2006	39,884	39,884	39,884	-
Reserved for Encumbrances at July 1, 2006	18,916	18,916	18,916	-
Reserved for Minority Interest in Joint Venture at July 1, 2006	-	-	2,063	2,063
Reserved for Minority Interest in Joint Venture at June 30, 2007	-	-	(2,097)	(2,097)
Designated for Subsequent Years' Expenditures at July 1, 2006	469	469	469	-
Designated for Subsequent Years' Expenditures at June 30, 2007	-	-	(1,159)	(1,159)
FUND BALANCE UNDESIGNATED AT JUNE 30, 2007	$ 40,146	$ 23,930	$ 95,031	$ 71,101

The accompanying note is an integral part of the financial statements.

Note to Required Supplementary Information
Year Ended June 30, 2007

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a. Budgetary Data

On or before the first meeting in May of each year, the City Manager submits to the City Council a proposed operating and capital improvements budget for the fiscal year commencing July 1. This budget includes annual budgets for the following funds:

- **General Fund**
- **Special Revenue Funds:**
  - -City of San Diego:
    - -Acquisition, Improvement and Operations
    - -Environmental Growth Funds:
      - -Two-Thirds Requirement
      - -One-Third Requirement
    - -Police Decentralization
    - -Public Transportation
    - -Qualcomm Stadium Operations
    - -Special Gas Tax Street Improvement
    - -Street Division Operations
    - -Transient Occupancy Tax
    - -Underground Surcharge
    - -Zoological Exhibits
    - -Other Special Revenue
  - -Centre City Development Corporation
  - -Southeastern Economic Development Corporation
- **Debt Service Funds:**
  - -City of San Diego:
    - -Public Safety Communications Project
  - -San Diego Open Space Park Facilities District #1

Public hearings are then conducted to obtain citizen comments on the proposed budget. During the month of July the budget is legally adopted through passage of an appropriation ordinance by the City Council. Budgets are prepared on the modified accrual basis of accounting except that (1) encumbrances outstanding at year-end are considered expenditures and (2) the increase/decrease in reserve for advances and deposits to other funds and agencies are considered as additions/deductions of expenditures. The City budget is prepared excluding unrealized gains or losses resulting from the change in fair value of investments, proceeds from capital leases, and net income from joint venture.

The legal level of budgetary control for the City's general fund is exercised at the salaries and wages and non-personnel expenditures level. Budgetary control for the other budgeted funds, including those of certain component units, is maintained at the total fund appropriation level. All amendments to the adopted budget require City Council approval except as delegated in the Annual Appropriation Ordinance.

Reported budget figures are as originally adopted or subsequently amended plus prior year continuing appropriations.

Such budget amendments during the year, including those related to supplemental appropriations, did not cause these reported budget amounts to be significantly different than the originally adopted budget amounts. Appropriations lapse at year-end to the extent that they have not been expended or encumbered, except for those of a capital nature, which continue to subsequent years.

The following is a reconciliation of the net change in fund balance prepared on a GAAP basis to that prepared on the budgetary basis for the year ended June 30, 2007 (in thousands):

	General Fund
Net Change in Fund Balances - GAAP Basis	$ 70,407
Add (Deduct):	
Encumbrances Outstanding, June 30, 2007	(33,452)
Reserved for Advances, June 30, 2007	(309)
Reserved for Advances, June 30, 2006	309
Net Change in Fund Balances - Budgetary Basis	$ 36,955

b. Encumbrances

Encumbrance accounting, under which purchase orders, contracts and other commitments for the expenditure of funds are recorded in order to reserve that portion of the applicable appropriation, is employed as an extension of formal budgetary control in the budgeted governmental funds.

Encumbrances outstanding at year-end are reported as reservations of fund balances, since the commitments will be honored through subsequent years' continuing appropriations. Encumbrances do not constitute expenditures or liabilities for GAAP reporting purposes.

Statistical Section [Not Audited]

City of San Diego
Pledged-Revenue Coverage - Water Bonds (Unaudited)
Last Ten Fiscal Years (In Thousands)

Fiscal Year Ended June 30	Total Income	Total Expenses	Net System Revenue	Less: Interest Earnings on Reserve Fund - Parity Obligations	Adjusted Net System Revenue
1998 [1]					
1999	$ 210,490	$ 195,407	$ 15,083	$ (884)	$ 14,199
2000	255,736	213,358	42,378	-	42,378
2001	255,974	214,056	41,918	(54)	41,864
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

Footnote:
[1] The Water Utility had no bonded debt for fiscal year 1998.

Source: Comprehensive Annual Financial Reports

Table 13-1

Debt Service					
Principal	Interest	Total	Less: Parity Interest Earnings	Adjusted Debt Service	Adjusted Debt Service Coverage
$ -	$ 9,365	$ 9,365	$ (884)	$ 8,481	1.67
-	18,730	18,730	-	18,730	2.26
-	18,730	18,730	(54)	18,676	2.24
6,780	18,594	25,374	(3,444)	21,930	1.63
7,055	16,308	23,363	(1,305)	22,058	1.34
7,345	14,010	21,355	(1,296)	20,059	1.70
7,645	13,710	21,355	(1,262)	20,093	2.95
7,965	13,390	21,355	(1,228)	20,127	2.98
8,305	13,046	21,351	(1,346)	20,005	3.99

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APPENDIX E

SUMMARY OF PRINCIPAL LEGAL DOCUMENTS

The following is a summary of certain definitions and provisions set forth in the Indenture, the Amended and Restated Master Installment Purchase Agreement, the 2009A Supplement to the Master Installment Purchase Agreement and the Assignment Agreement relating to the Series 2009A Bonds. The Series 2009A Bonds are described in this Summary as the "2009A Bonds." These summaries do not purport to be comprehensive, and reference should be made to such documents for a full and complete statement of such definitions and provisions. Copies of these documents are available from the Trustee.

INDENTURE

The Indenture sets forth certain terms of the Bonds, the nature and extent of the security for the Bonds, the rights of the Owners of the Bonds, rights, duties and immunities of the Trustee and the rights and obligations of the Authority. Certain provisions of the Indenture are summarized below. Other provisions are summarized in the body of this Official Statement under the captions, "DESCRIPTION OF THE SERIES 2009A BONDS" and "SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2009A BONDS." Capitalized terms used in connection with the Indenture but not defined below have the meanings ascribed thereto in the body of this Official Statement; certain capitalized terms are defined herein following the description of the Indenture, in connection with the description of the Installment Purchase Agreement. The term "Bonds" initially refers to the Series 2009A Bonds.

Selected Definitions

Additional Bonds

The term "Additional Bonds" means those Bonds authorized and issued hereunder on a parity with the 2009A Bonds, in accordance with Indenture.

Authorized Denominations

The term "Authorized Denominations" means, with respect to the Bonds, $5,000 and any integral multiple thereof and with respect to any Additional Bonds, the authorized denominations specified in a Supplemental Indenture related to such Additional Bonds.

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 Commissioners of the Authority.

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.

Bond Law

The term "Bond Law" means the Marks-Roos Local Bond Pooling Act of 1985, as amended, being Section 6584 *et seq.* of the Government Code of the State.

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 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 Authority

The term "Certificate of the Authority" means an instrument in writing signed by the Chair, the Vice Chair or the Secretary of the Authority, or by any other officer of the Authority duly authorized by the Authority for that purpose. If and to the extent required by the provisions of the Indenture, each Certificate of Authority shall include the statements provided for in the Indenture.

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; the term "2009A Closing Date" means January 29, 2009.

Code

The term "Code" means the Internal Revenue Code of 1986, as amended, and the regulations thereunder, and any successor laws or regulations.

Components; Refunded Components.

The term "Components" means components of the Project for which the City makes Installment Payments or Subordinated Installment Payments pursuant to any Supplement. The term "Refunded

Components" means the Components originally financed with the proceeds of the Refunded Certificates and the Series 2007A Subordinated Notes, which are being refunded with the proceeds of sale of the 2009A Bonds.

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 hereunder, including but not limited to, costs of preparation and reproduction of documents; fees and expenses of the Feasibility Consultant; fees and expenses of the Authority (including its counsel); expenses of City, 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 account by that name established within the Acquisition Fund under the Indenture, for the payment of Costs of Issuance.

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 the meaning set forth in the Indenture, as described below.

Feasibility Consultant

The term "Feasibility Consultant" means the consultant who, or whose firm, provides services to the City respecting the future ability of Project components being acquired, installed or constructed with proceeds of sale of the Bonds to generate sufficient Net System Revenues to permit the City to incur Additional Obligations, as set forth in the Agreement.

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.

Fiscal Year

The term "Fiscal Year" means the fiscal year of the Authority which, as of the date hereof, 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.

Information Services

Information Services being Financial Information, Inc.'s "Daily Called Bond Service," 30 Montgomery Street, 10th Floor, Jersey City, New Jersey 07302, Attention: Editor; Moody's "Municipal and Government," 99 Church Street, 8th Floor, New York, New York 10007, Attention: Municipal News Reports; and Xcitek's "Called Bond Service," 5 Hanover Square, New York, New York 10004, Attention: Bond Redemption Group; provided, however, in accordance with then current guidelines of the Securities and Exchange Commission, Information Services 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 August 1, 2009, and each February 1 and August 1 thereafter until the Bonds are paid or redeemed in full.

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 and existing 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.

Outstanding

The term "Outstanding," when used as of any particular time with reference to Bonds, means (subject to the provisions of the Indenture) all Bonds theretofore or thereupon executed by the Authority and authenticated and delivered by the Trustee pursuant to the terms hereof, 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.

Outstanding Parity Obligations

The term "Outstanding Parity Obligations" means the outstanding principal amount of the San Diego Facilities and Equipment Leasing Corporation Certificates of Undivided Interest (In Installment Payments Payable from the Net System Revenues of the Water Utility Fund of the City of San Diego) Series 1998, following the refunding described in this Official Statement.

Outstanding Subordinated Bonds

The term "Outstanding Subordinated Bonds" means the outstanding principal amount of 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 Net System Revenues of the Water Utility Fund).

Outstanding Subordinated Notes

The term "Outstanding Subordinated Notes" means the Public Facilities Financing Authority of the City of San Diego Subordinated Water Revenue Notes, Series 2008A (Payable Solely From Subordinated Installment Payments Secured By Net System Revenues of the Water Utility Fund).

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 Obligations

The term "Parity Obligations" means any Obligations payable from Net System Revenues that are secured by a first priority lien on Net System Revenues and are senior in priority to payment of Subordinated Installment Payments.

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 "A1/P1/F1" by two Rating Agencies;

(5) Deposit accounts or certificates of deposit, whether negotiable or non-negotiable, issued by a state or national bank (including the Trustee) or a state or federal savings and loan association or a state-licensed branch of a foreign bank; provided, however, that such certificates of deposit or deposit accounts 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 contract, including forward delivery agreements ("FDAs") and forward purchase agreements ("FPAs"), with a financial institution or insurance company which has at the date of execution thereof an outstanding issue of unsecured, uninsured and unguaranteed debt obligations or a claims-paying ability rated within the two highest rating categories of two or more Rating Agencies. Only Permitted Investments described in clause (1) above and having maturities equal to or less than 30 years from their date of delivery will be considered eligible for any collateralization/delivery purposes for guaranteed investment contracts, FDAs or FPAs;

(10) Certificates, notes, warrants, bonds or other evidence of indebtedness of the State or of any political subdivision or public agency thereof which are rated in the highest short-term rating category or within one of the three highest long-term rating categories of two Rating Agencies (excluding securities that do not have a fixed par value and/or whose terms do not promise a fixed dollar amount at maturity or call date);

(11) For amounts less than $10,000, interest-bearing demand or time deposits (including certificates of deposit) in a nationally or state-chartered bank, or a state or federal savings and loan association in the State, fully insured by the Federal Deposit Insurance Corporation, including the Trustee or any affiliate thereof;

(12) Investments in taxable money market funds or portfolios restricted to obligations with an average maturity of one year or less and which funds or portfolios are rated in either of the two highest rating categories by two Rating Agencies or have or are portfolios guaranteed as to payment of principal and interest by the full faith and credit of the United States of America;

(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" means 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 each August 1, commencing August 1, 2009 through and including August 1, 2038.

Project

The term "Project" means the acquisition, construction, installation and improvements to the Water System described in Exhibit A to the Agreement and as modified with respect to Components in conformance with the Agreement.

Purchase Price

The term "Purchase Price" means the principal amount plus interest thereon owed by the City under the terms of the Agreement as provided in the Indenture thereof and as specified in a Supplement.

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 Certificates

The term "Refunded Certificates" means those maturities of the San Diego Facilities and Equipment Leasing Corporation Certificates of Undivided Interest (In Installment Payments Payable from the Net System Revenues of the Water Utility Fund of the City of San Diego) Series 1998 to be refunded with a portion of the proceeds of the 2009A Bonds.

Refunded Obligations

The term "Refunded Obligations" means the Refunded Certificates and the Series 2007A Subordinated Notes paid or called and refunded with portions of the proceeds of the Bonds.

Representative

The term "Representative" means Morgan Stanley & Co. Incorporated, as representative of the several Underwriters of the 2009A 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; 2009A Reserve Requirement

The term "Reserve Requirement" means, as of any date of calculation, the least of (i) ten percent (10%) of the proceeds (within the meaning of section 148 of the Code) of the Bonds; (ii) 125% of average annual debt service on the then-Outstanding Bonds; or (iii) the Maximum Annual Debt Service for that and any subsequent year. The term "2009A Reserve Requirement" shall mean, initially, the sum of $11,125,361.19. 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 Series 2009A Installment Payments received by or due to be paid to the Corporation pursuant to the 2009A Supplement, and the interest or profits from the investment of money in any account or fund (other than 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.

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.

Series 2007A Subordinated Notes

The term "Series 2007A Subordinated Notes" means the Public Facilities Financing Authority of the City of San Diego Non–Transferable Subordinated Water Revenue Notes, Series 2007A (Payable Solely From Subordinated Installment Payments Secured By Net System Revenues of the Water Utility Fund), in the original principal amount of $57,000,000.

Series 2008A Subordinated Installment Payments

The term "Series 2008A Subordinated Installment Payments" means the Series 2008A Subordinated Installment Payments specified in Section 4.01 of the 2008A Supplement.

Series 2008A Subordinated Notes

The term "Series 2008A Subordinated Notes" means the Public Facilities Financing Authority of the City of San Diego Subordinated Water Revenue Notes, Series 2008A (Payable Solely From Subordinated Installment Payments Secured By Net System Revenues of the Water Utility Fund), in the original principal amount of $150,000,000.

State

The term "State" means the State of California.

Subordinated Installment Payments

The term "Subordinated Installment Payments" means Installment Payments that are Subordinated Obligations (as defined in the Agreement), scheduled to be paid by the City under and pursuant to any Supplement that has been assigned to the Trustee (as assignee of the Authority) to secure any Subordinated Bonds or Notes.

Supplement

The term "Supplement" means a supplement 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.

2007 Supplement

The term "2007 Supplement" means the 2007A Supplement to the Agreement, by and between the City and the Corporation, dated as of January 1, 2007.

2009A Installment Payments

The term "2009A Installment Payments" means those Installment Payments scheduled to be paid by the City under the 2009A Supplement.

2009A Supplement

The term "2009A Supplement" means the 2009A Supplement to the Agreement, by and between the City and the Corporation, dated as of January 1, 2009.

Supplemental Indenture

The term "Supplemental Indenture" means any indenture supplemental hereto or amendatory hereof duly executed and delivered by the Authority and the Trustee as authorized hereunder.

Surety Bond

The term "Surety Bond" means a reserve surety bond, insurance policy, letter of credit or other similar instrument providing, by its terms, a stated amount as a credit towards or in satisfaction of all or part of the Reserve Requirement, which shall be held by the Trustee in trust, pursuant to the Indenture.

Tax Certificate

The term "Tax Certificate" means the Tax Exemption Certificate delivered with respect to Tax-Exempt Bonds on their Closing Date.

Tax Code

The term "Tax Code" means the Internal Revenue Code of 1986, as amended, and the Regulations promulgated by the Internal Revenue Service pursuant thereto.

Tax-Exempt Bonds

The term "Tax-Exempt Bonds" means those Bonds which, by their terms, bear interest that is excluded from gross income for federal income tax purposes, pursuant to the Tax Code.

Treasurer

The term "Treasurer" means the Office of the City Treasurer of the City of San Diego.

1998 Trust Agreement

The term "1998 Trust Agreement" means that certain Trust Agreement, dated as of August 1, 1998, by and among the City, the Corporation and the 1998 Trustee, pursuant to which the Refunded Certificates were executed and delivered.

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 which may at any time be substituted in its place as provided in the Indenture.

1998 Trustee

The term "1998 Trustee" means Wells Fargo Bank, National Association, as successor trustee under the 1998 Trust Agreement.

Underwriters

The term "Underwriters" means, collectively, Morgan Stanley & Co. Incorporated, J.P. Morgan Securities Inc., Estrada Hinojosa & Co., Inc., Ramirez & Co., Inc. and Siebert Brandford Shank & Co., LLC.

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 an instrument in writing signed by the Chair, the Vice Chair, or the Secretary of the Authority, or by any other officer or Commissioner of the Board duly authorized by the Authority for that purpose.

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.

Establishment of Funds; Deposit and Application

Establishment of Funds and Accounts.

(a) The Authority shall cause the City to establish and maintain a special trust fund to be held by the Treasurer designated the "City of San Diego Water System Improvement Project

Acquisition Fund – 2009A Bonds" (the "Acquisition Fund"), within which the Treasurer shall establish the Costs of Issuance Account.

(b) The Trustee shall establish and maintain the Payment Fund, including the Interest Account, the Principal Account, and the Redemption Account.

(c) The Trustee shall also establish and maintain the Reserve Fund, and within the Reserve Fund, the 2009A Reserve Account.

Use of Moneys in Acquisition Fund. The Acquisition Fund shall initially be unfunded, except for a deposit to pay Costs of Issuance The Treasurer shall hold moneys in the Costs of Issuance Account within the Acquisition Fund and the Comptroller shall disburse moneys therefrom to pay Costs of Issuance with respect to the 2009A 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 hereto as Exhibit B.

Reserve Fund. (a) The Reserve Fund is to be a separate fund held in trust by the Trustee. The Trustee shall receive for deposit into the Reserve Fund $11,125,361.19 in satisfaction of the 2009A Reserve Requirement. 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 Bonds, including the redemption price of the Bonds coming due and payable by operation of mandatory sinking fund redemption pursuant to the Indenture, in the event that the moneys in the Payment Fund are insufficient therefor. If and during such time as a Surety Bond is in effect, not less than two Business Days prior to each Interest Payment Date, the Trustee 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 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.

(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 hereunder, 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.

In no event shall the City or the Authority be required to replace any Surety Bond initially delivered hereunder with a similar instrument or with cash.

(e) In the event that the amount on deposit in the Reserve Fund at any time falls below the Reserve Requirement or in the event of a draw on the Surety Bond deposited therein, the Trustee 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, 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. 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 Revenues.

(a) All Revenues and amounts on deposit in the funds and accounts established under the Indenture (other than amounts on deposit in the Rebate Fund) are irrevocably pledged to the payment of the interest on and principal of the Bonds, but only as provided in the Indenture, and the Revenues shall not be used for any other purpose while any of the Bonds remain Outstanding; provided, that out of the Revenues there may be allocated such sums for such purposes as are expressly permitted by the Indenture.

(b) To secure the pledge of the Revenues contained in the Indenture, the Authority transfers, conveys and assigns to the Trustee, for the benefit of the Owners, all of the Authority's rights under the 2009A Supplement, 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 hereby 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 2009A Installment Payments, and any 2009A 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 herein, the Authority agrees and covenants that all Revenues when and as received shall be received in trust hereunder 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 herein provided. All Revenues, whether received by the Authority in trust or deposited with the Trustee as herein provided, shall nevertheless be allocated, applied and disbursed solely to the purposes and uses hereinafter 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 Bonds on such Interest Payment Date. No deposit need be made in the Interest Account if the amount contained in the Interest Account equals at least the aggregate amount of interest becoming due and payable on all Outstanding Bonds on such Interest Payment Date. All money in the Interest Account shall be used and withdrawn by the Trustee solely for the purpose of paying the interest on the Bonds as it shall become due and payable (including accrued interest on any 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 Bonds. No deposit need be made in the Principal Account if the amount contained therein is at least equal to the aggregate amount of principal become due and payable on all Outstanding Bonds. All money in the Principal Account shall be used and withdrawn by the Trustee solely for the purpose of paying the principal of the Bonds as it shall become due and payable.

(d) 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 Bonds pursuant to the Indenture. Any moneys that, pursuant to the Agreement and the related provisions of any Supplements, are to be used to redeem Bonds 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 to the Owners entitled thereto an amount equal to the redemption price of the Bonds to be redeemed on such date.

(e) Any delinquent Installment Payments pledged to the Bonds shall be applied first to the Interest Account for the immediate payment of interest payments past due and then to the Principal

Account for immediate payment of principal payments past due on any Bond. Any remaining money representing delinquent Installment Payments pledged to Bonds 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 hereunder. 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 hereunder 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 hereunder 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 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 Bonds previously issued and delivered, 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 Agreement applicable to the incurrence of Parity or Subordinated Obligations, as applicable, and any additional requirements set forth in the applicable Supplemental Indenture, which are hereby 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 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 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 for all Bonds and Additional Bonds to be then Outstanding;

(d) 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;

(e) 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;

(f) 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

(g) 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.

Proceedings for Execution and Delivery of Additional Bonds. Whenever the Authority shall determine to file its Written Request with the Trustee for the execution and delivery of Additional Bonds, the Authority shall authorize the execution and delivery of a Supplemental Indenture, specifying the aggregate principal amount and describing the forms of Bonds and providing the terms, conditions, distinctive designation, denominations, date, maturity date or dates, interest rate or rates (or the manner of determining same), Interest Payments and payment dates, redemption provisions and place or places of payment of principal or redemption price, if any, and interest represented by such Additional Bonds not inconsistent with the terms of the Indenture.

Before any series of Additional Bonds may be executed and delivered by the Trustee, the Authority shall file the following documents with the Trustee:

(a) An executed copy of the applicable Supplemental Indenture;

(b) A statement of the Authority to the effect that the requirements hereof have been met;

(c) In the case of a Series of Additional Bonds delivered for the purpose described in the Indenture, irrevocable instructions to the Trustee to give notice as provided in the Indenture of redemption of all Bonds to be redeemed in connection therewith; and

(d) An opinion or opinions of Bond Counsel, to the effect that the execution and delivery of the Additional Bonds, the supplement to the Indenture and related supplements or amendments have been duly authorized by the Authority and meet the requirements of the Indenture; and that the execution and delivery of such Additional Bonds will not, in and of themselves, cause the interest on the Tax-Exempt Bonds to become included within the gross income for purposes of federal income taxation.

Covenants of Authority

Punctual Payment and Performance. The Authority shall punctually pay the interest and the principal to become due on every Bond issued hereunder 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 herein 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 nor the Owners shall have any rights in or claims to such money. The Trustee shall make information regarding the investments hereunder 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 hereunder 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 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 the Indenture, "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 2009A Supplement and the Agreement in such Fiscal Year. If the amounts so budgeted are not adequate for the payment of all Parity Installment Payments, Subordinated Installment Payments and all other Obligations due under the Agreement in such Fiscal Year, the Authority 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 S.E.C. 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 the Indenture, failure of the City to comply with a Continuing Disclosure Certificate shall not be considered an Event of Default hereunder 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 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 as provided herein superior to or on a parity with the pledge created hereby 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 herein in regard to questions arising hereunder that the Authority may deem desirable or necessary and not inconsistent herewith 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 herein to or conferred herein 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 Subordinated 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 hereinabove, 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 Section 8.01 of the 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 Agreement and to require the Authority to carry out any other covenant or agreement with Owners of Bonds and to perform its duties hereunder;

(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.

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 hereby 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 which are enforceable by the Trustee may be enforced by it without the possession of any of the Bonds, or the production thereof at the trial or other proceedings relative thereto. Any such suit, action or proceedings instituted by the Trustee 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 hereunder (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:

(i) – 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;

(ii) – 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

(iii) – 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 herein, 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 hereto 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 which 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.

INSTALLMENT PURCHASE AGREEMENT

The Installment Purchase Agreement (herein, the "Agreement") sets forth certain terms and conditions of the purchase of the Project by the City. Certain definitions under and provisions of the Installation Purchase Agreement are given and summarized below. Other provisions are summarized in the Official Statement under the caption "SECURITY FOR THE SERIES 2009A BONDS."

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 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 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 "Defaulted 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.

Event of Default

The term "Event of Default" means any occurrence or event described as in the Agreement, as further described below.

Feasibility Report

The term "Feasibility Report" means a report of a Consultant with special expertise on the construction and operation of water systems similar to the Water System, delivered in connection with the incurrence of Additional Obligations.

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 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 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” shall mean any indenture, trust agreement, loan agreement, lease, installment purchase agreement or the 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 are or have the characteristics of commercial paper and which are not intended at the time of issuance to be retired from the sale of a corresponding amount of Parity Obligations, and including any scheduled mandatory redemption or prepayment of Parity Obligations on the basis of accreted value due upon such redemption or prepayment, and for such purpose, the redemption payment or prepayment shall be deemed a principal payment; 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 rate 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 an Issuing Instrument are permissible for the investment of funds received from the sale of Obligations pursuant to the Issuing Document or from other funds held pursuant to the Issuing Document.

Project; 1998 Project

The term "Project" means the construction, replacement and improvements to the Water System described in Exhibit A thereto, as it may be modified from time to time in conformance with the Installment Purchase Agreement. The term "1998 Project" means the Components of the Project initially financed under the Agreement.

Purchase Price

The term "Purchase Price" means the principal amount, plus interest thereon, owed by the City to the Corporation under the terms hereof for the purchase of Project Components, as specified in the 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 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 provisions of the Installment Purchase Agreement.

Rate Stabilization Fund

The term "Rate Stabilization Fund" means the fund by that name established pursuant to the Agreement.

Rebate Requirement

The term "Rebate Requirement" shall have the meaning specified in any Tax Certificate.

Reserve Fund

The term "Reserve Fund" shall refer to the fund by that name established under in an Issuing 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" shall mean 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 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.

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[*] These items of System Revenue may not be used to pay Maintenance and Operation Costs of the Water System.
[†] These items of System Revenue may not be used to pay Maintenance and Operation Costs of the Water System.

<u>Tax-Exempt Installment Payment Obligations</u>

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.

<u>Tender Indebtedness</u>

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.

<u>Term Parity Obligations</u>

The term "Term Parity Obligations" means Term Obligations which are Parity Installment Obligations or are payable on a parity with Parity Installment Obligations.

<u>Term Obligations</u>

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.

<u>Variable Rate Indebtedness</u>

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.

<u>Water Service</u>

The term "Water Service" means the collection, conservation, production, storage, treatment, transmission, furnishing and distribution services made available or provided by the Water System.

<u>Water Utility Fund</u>

The term "Water Utility Fund" means the fund by that name established under the Charter.

Acquisition and Construction of the Project

Acquisition and Construction of the Project; Components. (a) The Corporation agrees to cause the Project to be constructed, acquired and installed by the City, as agent of the Corporation. The City shall enter into contracts and provide for, as agent of the Corporation, the complete construction, acquisition and installation of the Project. The City agrees that it will cause the construction, acquisition and installation of the Project to be diligently performed.

(a) It is expressly understood and agreed that, except to the extent of proceeds of Obligations which are deposited in an Acquisition Fund, the Corporation shall be under no liability of any kind or character whatsoever for the payment of any cost of any Components. In the event the proceeds of Obligations deposited in an Acquisition Fund are insufficient to complete the construction, acquisition and installation of the designated Components, the City shall cause to be deposited in such Acquisition Fund (or shall otherwise appropriate and encumber) from and to the extent of available amounts on deposit in the Water Utility Fund (or other lawfully available moneys) an amount equal to that necessary to complete the construction, acquisition and installation of such Components.

(b) The Corporation will not undertake to cause any Component of the Project to be constructed, acquired or installed unless and until the City and the Corporation have entered into a Supplement specifying the Components of the Project to be installed, the date of completion, the purchase price to be paid by the City hereunder for that Component of the Project, and the Installment Payments or the method of calculating Installment Payments.

Changes to the Project. (a) From time to time and at any time, subject to the restrictions set forth in paragraph (b) below, the City may modify or amend the description of the Project, to eliminate any part thereof and/or to add or substitute another Component or Components, all without obtaining any consent, by filing an amended Exhibit A with the Corporation and the Trustee under the related Issuing Instrument; provided however, that no such amendment shall add or substitute a Component or Components which are not to be accounted for as an asset of the Water Utility Fund or shall in any way impair the obligations of the City contained in any Supplement executed and delivered prior to any such amendment.

(b) The City may substitute other improvements for those listed as Components in any Supplement, but only if the City first files with the Corporation and the Trustee a certificate of an Authorized City Representative:

(i) identifying the Components to be substituted and the Components they replace;

(ii) stating that the substituted Components will be accounted for as an asset of the Water Utility Fund; and

(iii) stating that with respect to Components financed with Tax-Exempt Installment Payment Obligations, the estimated costs of construction, acquisition and installation of the substituted improvements are not less than such costs for the improvements previously included in such Supplement, that any excess amounts will be applied to the payment of principal evidenced by the related Obligations or any Additional Obligations, and that said substitution will not violate any provision of the related Tax Certificate.

(c) Substituted Components may include or consist of an undivided interest in such Components, in which event the costs associated with the substituted Components over and above the undivided interest need not be deposited in the Acquisition Fund (or otherwise appropriated and encumbered); provided, however, that the certificate of an Authorized City Representative specifies that the funds necessary to complete the substituted Components are on deposit in the Acquisition Fund or otherwise appropriated and encumbered.

Installment Payments

Purchase Price. (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 hereto, 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 on 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 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 Agreement), the City will not discontinue or suspend any Installment Payments required to be made by it under the 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 herein; provided, however, that out of Net System Revenues there may be apportioned such sums for such purposes as are expressly permitted by the 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 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 Agreement.

(c) After the initial issuance of Parity Obligations under the 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:

(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 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

(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, 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

(iii) 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 Agreement and thereof; and will faithfully observe and perform all the agreements, conditions, covenants and terms contained herein 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 herein required to be observed and performed by it, whether express or implied, or any duty, liability or obligation arising out of or connected herewith 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 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 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 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 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 Agreement. Further, the City will not, except as otherwise provided herein, enter into any agreement or lease which 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 which 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 the most probable price 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 under Section 5.03(c)(2)(B) of the Installment Purchase Agreement, 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 hereof, 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 in 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 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 hereunder.

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, 1998), 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 hereafter 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 hereunder. 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 herein 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 herein to the contrary notwithstanding; provided, that with respect to a Series of Parity Installment Obligations which 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.

The Owners of Subordinated Obligations may enforce the provisions of the 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.

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 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 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 hereunder 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 Agreement.

Miscellaneous

Liability of City Limited to System Revenues.

(a) Notwithstanding anything contained in the Installment Purchase Agreement, the City shall not be required to advance any moneys derived from any source of income other than the Net System Revenues and the other funds provided herein for the payment of the Installment Payments or for the performance of any other agreements or covenants required to be performed by it contained herein. The City may, however, but in no event shall be obligated to, advance moneys for any such purpose so long as such moneys are derived from a source legally available for such purpose and may be legally used by the City for such purpose.

(b) The obligation of the City to make the Installment Payments is a special obligation of the City payable solely from such Net System Revenues and other funds provided for herein, and does not constitute a debt of the City or of the State of California or of any political subdivision thereof within the meaning of any constitutional or statutory debt limitation or restriction.

Amendments. (a) The 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 Agreement without the prior written consent of each of the Owners so affected.

(b) The 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 hereof or supplement hereto which shall not adversely affect the interests of the Owners of the Installment Payment Obligations and which 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 Agreement and is not inconsistent with the 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 Agreement other covenants and agreements thereafter to be observed or to surrender any right or power herein reserved to or conferred upon the Corporation or the City;

(2) to cure, correct or supplement any ambiguous or defective provision contained in the Agreement or in regard to questions arising under the Agreement, as the Corporation or the City may deem necessary or desirable;

(3) to make other amendments or modifications which 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 Agreement shall be deemed and construed to be a net contract, and the City shall pay absolutely net during the term hereof the Installment Payments arid all other payments required hereunder, free of any deductions and without abatement, diminution or setoff whatsoever.

2009A SUPPLEMENT TO MASTER INSTALLMENT AGREEMENT

The 2009A Supplement to Master Installment Agreement sets forth certain terms and conditions of the purchase of the Refunded Components of the Project by the City. Certain definitions and provisions of the 2009A Supplement are given and summarized below.

Selected Definitions

2009A Installment Payment Date

The term "2009A Installment Payment Date" means the 15th day of the calendar month immediately preceding each Interest Payment Date for the 2009A Bonds.

Interest Portion

The term "Interest Portion" means the interest portion of 2009A Installment Payments specified in the 2009A Supplement.

Principal Portion

The term "Principal Portion" means the principal portion of 2009A Installment Payments specified in the 2009A Supplement.

Purchase Price

The term "Purchase Price" means the purchase price of the Refunded Components.

Refunded Components

The term "Refunded Components" means the Components of the Project specified in Exhibit A attached to the 2009A Supplement, originally comprising portions of the 1998 Project and the 2007A Project, for some of which the City will be making 2009A Installment Payments.

2009A Installment Payments

The term "2009A Installment Payments" means the Installment Payments specified in the 2009A Supplement which are to pay the Purchase Price of the Refunded Components in accordance with the terms the 2009A Supplement.

Subordinated Supplements

The term "Subordinated Supplements" means the 2002 Supplement to Master Installment Purchase Agreement, dated as of October 1, 2002, the 2007A Supplement to Master Installment Purchase Agreement, dated as of January 1, 2007, the 2008A Supplement to Master Installment Purchase Agreement, dated as of February 1, 2008, each by and between the City and the Corporation, and each being a supplement to the Agreement, and any additional supplements to the Agreement.

General. Pursuant to the 2009A Supplement, the City agrees to purchase the Refunded Components from the Corporation, and to pay the 2009A Installment Payments therefor. See the caption, "SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2009A BONDS – 2009A INSTALLMENT PAYMENTS" in this Official Statement.

Additional Covenants relating to Tax Exemption.

(a) The City shall not directly or indirectly use or permit the use of any proceeds of the 2009A 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 2009A 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 covenants 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 2009A Bonds under section 103 of the Code. The City shall not directly or indirectly use or permit the use of any proceeds of the 2009A Bonds or any other funds of the City, or take or omit to take any action, that would cause the 2009A Bonds to be "arbitrage bonds" within the meaning of section 148(a) of the Code.

(c) Without limiting the generality of the foregoing, the City agrees 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 as may be applicable to the 2009A Bonds from time to time. The City hereby specifically covenants 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 in connection with the execution and delivery of the 2009A Bonds.

(d) Notwithstanding any provision of the 2009A Supplement, 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 2009A Bonds pursuant to section 103 of the Code, then the City may rely conclusively on such opinion in complying with the provisions the 2009A Supplement, and the covenants under the 2009A Supplement shall be deemed to be modified to that extent.

Continuing Disclosure. The City covenants and agrees that it will comply with and carry out all of the provisions of the Continuing Disclosure Certificate delivered in connection with the 2009A Bonds. Notwithstanding any other provision of the 2009A Supplement, failure of the City to comply with the Continuing Disclosure Certificate shall not be considered a default of any kind under the 2009A Supplement or the Continuing Disclosure Certificate; however, 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 2009A 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 the 2009A Supplement.

ASSIGNMENT AGREEMENT

The Assignment Agreement providers for the transfer, assignment and setting over by the Corporation to the Trustee, for the benefit of the Owners of the 2009A Bonds, all of the Corporation's rights under the 2009A Supplement, excepting only certain rights of the Corporation to be indemnified by the City, but including (a) the right to receive and collect all of the 2009A Installment Payments and prepayments from the City, (b) the right to receive and collect any proceeds of any insurance of the Water System maintained pursuant to the Installment Purchase Agreement, or any proceeds of sale of portions of the Water System, permitted pursuant to the Installment Purchase Agreement, and (c) the right to exercise such rights and remedies conferred on the Corporation by the 2009A Supplement as may be necessary or convenient to (1) enforce payment of the 2009A Installment Payments, prepayments and any other amounts required to be deposited into the Payment Fund, the Redemption Account or otherwise under the Indenture, or (2) otherwise protect the interests of the Corporation in the event of a default by the City under the Installment Purchase Agreement. The Trustee accepts such assignment, subject to the provisions of the Indenture.

APPENDIX F

FORM OF BOND COUNSEL OPINION

_________, 2009

Public Facilities Financing Authority of the City of San Diego
202 C Street, 7th Floor
San Diego, California 92101

Re: $157,190,000 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)

Ladies and Gentlemen:

In our role as Bond Counsel to the Public Facilities Financing Authority of the City of San Diego (the "Authority"), we have examined certified copies of the proceedings taken in connection with the issuance by the Authority of $157,190,000 aggregate principal amount of its Water Revenue Bonds, Refunding Series 2009A (Payable Solely from Installment Payments Secured by Net System Revenues of the Water Utility Fund) (collectively, the "Bonds"). We have also examined supplemental documents furnished to us and have obtained such certificates and documents from public officials as we have deemed necessary for the purposes of this opinion. The Bonds are issued under Article 4 of Chapter 5 of Division 7 of Title 1 of the California Government Code (the "Bond Law"), pursuant to an Indenture (the "Indenture"), dated as of January 1, 2009, by and between the Authority and Wells Fargo Bank, National Association, as trustee (the "Trustee"), and pursuant to Resolution No. FA-2008-3 of the Board of Commissioners of the Authority, adopted November 21, 2008. The City of San Diego (the "City") has entered into a 2009A Supplement to Amended and Restated Master Installment Purchase Agreement with the San Diego Facilities and Equipment Leasing Corporation (the "Corporation"), dated as of January 1, 2009 (the "2009A Supplement"), which supplemented the Amended and Restated Master Installment Purchase Agreement, by and between the City and the Corporation, dated as of January 1, 2009 (the "Master Agreement," and together with the 2009A Supplement, the "Installment Purchase Agreement"). Capitalized terms used herein and not otherwise defined shall have the meanings assigned to them in the Indenture and the Installment Purchase Agreement, as applicable.

As bond counsel, we have examined copies certified to us as being true and complete copies of the proceedings of the Authority, the City and the Corporation for the authorization and issuance of the Bonds, including the Indenture, the Installment Purchase Agreement and the Tax Exemption Certificate of the Authority and the City, dated the date hereof (the "Tax Certificate"). Our services as bond counsel were limited to an examination of such proceedings and to the rendering of the opinions set forth below. In this connection, we have also examined such certificates of public officials and officers of the Authority, the City and the Corporation as we have considered necessary for the purposes of this opinion.

Certain agreements, requirements and procedures contained or referred to in the Indenture, the Installment Purchase Agreement, the Tax Certificate and other relevant documents may be changed and certain actions (including, without limitation, defeasance of the Bonds) may be taken or omitted under the circumstances and subject to the terms and conditions set forth in such documents. No opinion is expressed herein as to any Bond or the tax treatment under federal law or the laws of the State of

California of the interest thereon if any such change occurs or action is taken or omitted upon the advice or approval of counsel other than ourselves.

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 or events are taken or do occur. 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 any parties other than the Authority, the City and the Corporation. We have not undertaken to verify independently, and have assumed, the accuracy of the factual matters represented, warranted or certified in the documents referred to in the second paragraph hereof. Furthermore, we have assumed compliance with all covenants and agreements contained in the Indenture, the Installment Purchase Agreement 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 Installment Purchase Agreement and the Tax Certificate 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 in the State of California. We express no opinion with respect to any indemnification, contribution, choice of law, choice of forum or waiver provisions contained in the foregoing documents. We express no opinion and make no comment with respect to the sufficiency of the security or the marketability of the Bonds. 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 upon the foregoing, we are of the opinion that:

(a) The Indenture has been duly and validly authorized, executed and delivered by the Authority and, assuming such Indenture constitutes the legally valid and binding obligation of the Trustee, constitutes the legally valid and binding obligation of the Authority, enforceable against the Authority in accordance with its terms, and the Bonds are entitled to the benefits of the Indenture.

(b) The Installment Purchase Agreement has been duly and validly authorized, executed and delivered by the City and, assuming such Installment Purchase Agreement constitutes the legally valid and binding obligation of the Corporation, constitutes the legally valid and binding obligation of the City, enforceable against the City in accordance with its terms.

(c) The proceedings for the issuance of the Bonds have been taken in accordance with the laws and Constitution of the State of California, and the Bonds, having been issued in duly authorized form and executed by the proper officials and delivered to and paid for by the purchasers thereof, constitute legal and binding special obligations of the Authority enforceable in accordance with their terms.

(d) The Bonds are payable from the Revenues, subject to the application thereof on the terms and conditions as set forth in the Indenture and the Installment Purchase Agreement.

(e) It is further our opinion, based upon the foregoing, that pursuant to section 103 of the Internal Revenue Code of 1986, as amended and in effect on the date hereof (the "Code"), and existing regulations, published rulings, and court decisions thereunder, and assuming continuing compliance with the provisions of the Indenture and in reliance upon representations and certifications of the Corporation made in the Tax Certificate of even date herewith pertaining to the use, expenditure, and investment of the proceeds of the Bonds, when the Bonds are delivered to and paid for by the initial purchasers thereof, interest on the Bonds (1) will be excludable from the gross income, as defined in section 61 of the Code, of the owners thereof for federal income tax purposes, and (2) will not be included in computing the alternative minimum taxable income of the owners thereof who are individuals or, except as described below, corporations, for federal income tax purposes. We call to your attention that, with respect to our opinion in clause (2) above, interest on all tax-exempt obligations, such as the Bonds, owned by a corporation will be included in such corporation's adjusted current earnings for purposes of calculating the alternative minimum taxable income of such corporation, other than an S corporation, a qualified mutual fund, a real estate mortgage investment conduit (REMIC), a financial asset securitization investment trust (FASIT), or a real estate investment trust (REIT). A corporation's alternative minimum taxable income is the basis on which the alternative minimum tax imposed by section 55 of the Code is computed.

(f) In our opinion, under existing law, interest on the Bonds is exempt from personal income taxes of the State of California.

We express no other opinion with respect to any other federal, state, or local tax consequences under present law or any proposed legislation resulting from the receipt or accrual of interest on, or the acquisition or disposition of, the Bonds. Ownership of tax-exempt obligations such as the Bonds may result in collateral federal tax consequences to, among others, financial institutions, life insurance companies, property and casualty insurance companies, certain S corporations with subchapter C earnings and profits, certain foreign corporations doing business in the United States, owners of an interest in a FASIT, individuals otherwise qualifying for the earned income tax credit, individual recipients of Social Security or Railroad Retirement benefits, and taxpayers who may be deemed to have incurred or continued indebtedness to purchase or carry, or who have paid or incurred certain expenses allocable to, tax-exempt obligations.

Our opinions are based on existing law, which is subject to change. Such opinions are further based on our knowledge of facts as of the date hereof. We assume no duty to update or supplement our opinions to reflect any facts or circumstances that may thereafter come to our attention or to reflect any changes in any law that may thereafter occur or become effective.

Moreover, our opinions are not a guarantee of result and are not binding on the Internal Revenue Service or the State of California Franchise Tax Board; rather, such opinions represent our legal judgment based upon our review of existing law that we deem relevant to such opinions and in reliance upon the representations and covenants referenced above.

Respectfully submitted,

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APPENDIX G

FORM OF CONTINUING DISCLOSURE CERTIFICATE

This Continuing Disclosure Certificate, dated as of January 1, 2009 (the "Disclosure Certificate") is executed and delivered by The City of San Diego (the "City") in connection with the issuance of $157,190,000 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 "Series 2009A Bonds"). The Series 2009A Bonds are being issued pursuant to that certain Indenture, dated as of January 1, 2009 (the "Indenture"), by and between the Public Finance Authority of the City of San Diego (the "Authority") and Wells Fargo Bank, National Association, as trustee. The proceeds of the Series 2009A Bonds are being used to prepay a portion of the Outstanding Obligations (as defined in the Indenture), fund the reserve fund for the Series 2009A Bonds and pay costs of issuance with respect to the Series 2009A Bonds. In connection therewith, the City, as an "obligated person" with respect to the Series 2009A 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 Series 2009A 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.

"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 Trustee a written acceptance of such designation.

"Listed Events" shall mean any of the events listed in Section 5(a) of this Disclosure Certificate.

"MSRB" shall mean the Municipal Securities Rulemaking Board established pursuant to Section 15B(b)(1) of the Securities Exchange Act of 1934, as amended.

"National Repository" shall mean any Nationally Recognized Municipal Securities Information Repository for purposes of the Rule. The National Repositories currently recognized by the Securities and Exchange Commission are currently set forth in the SEC website located at http://www.sec.gov/info/municipal/nrmsir.htm. Effective July 1, 2009, National Repository shall mean the MSRB and information to be submitted pursuant to this Disclosure Certificate shall be submitted to the MSRB instead of to one or multiple nationally recognized municipal securities information repositories and state information depositories.

"Official Statement" means the Official Statement, dated January 13, 2009, relating to the Series 2009A Bonds.

"Participating Underwriter" shall mean any of the original Underwriters of the Series 2009A Bonds required to comply with the Rule in connection with offering of the Series 2009A Bonds.

"Repository" shall mean each National Repository and each State Repository, if any.

"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.

"State Repository" shall mean any public or private repository or entity designated by the State of California as a state repository for the purpose of the Rule and recognized as such by the Securities and Exchange Commission. As of the date of this Disclosure Certificate, there is no State Repository. Effective July 1, 2009, information to be submitted pursuant to this Continuing Disclosure shall be submitted, without duplication, to the MSRB instead of to a State Repository, if any.

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 30th), commencing with the report for the 2007-08 Fiscal Year (each, a "Filing Date"), provide to each Repository an Annual Report which is consistent with the requirements of Section 4 of this Disclosure Certificate for so long as the Series 2009A Bonds remain outstanding. 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 Repositories an Annual Report by the date required in subsection (a), the City shall send a notice to the Municipal Securities Rulemaking Board and any appropriate State Repository in substantially the form attached as Exhibit A.

(c) The Dissemination Agent shall:

(i) determine each year prior to the Filing Date the name and address of each National Repository and each State Repository, if any; 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 pursuant to this Disclosure Certificate, stating the date it was provided and listing all the Repositories to which it was 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 filed pursuant to Section 3(a), the Annual Report shall contain unaudited financial statements in a format similar to the financial statements contained in the final Official Statement, and the audited financial statements shall be filed in the same manner as the Annual Report when they become available.

(b) Financial information and operating data with respect to the City, as such information and data relate to the City's Water 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 Top Governmental Customers") of the Official Statement for the most recently completed fiscal year;

(iii) An update of the information contained in Table 6 (entitled "Summary of Projected CIP Projects") of the Official Statement as of the end of the most recently completed fiscal year;

(iv) An update of the information contained in Table 7 (entitled "Five-Year Water Service Charge History for Single Family Residential Units and Other Domestic, Commercial, Industrial and Irrigation/Temporary Construction") of the Official Statement for the most recently completed fiscal year;

(v) An update of the information contained in Table 10 (entitled "Recent Rate History for Capacity Charges") of the Official Statement for the most recently completed fiscal year;

(vi) An update of the information contained in Table 11 (entitled "Water Utility Fund Historical Capacity Charge Revenues") of the Official Statement for the most recently completed fiscal year;

(vii) An update of the information contained in Table 12 (entitled "Water Customer Accounts Receivable and Shut-Offs by Fiscal Year") of the Official Statement for the most recently completed fiscal year;

(viii) An update of the information contained in Table 13 (entitled "Historical Sources of Water Service Revenues") of the Official Statement for the most recently completed fiscal year;

(ix) Information contained in Table 14 (entitled "Revenues, Expenses, Changes in Fund Net Assets") of the Official Statement for the most recently completed fiscal year;

(x) Information contained in Table 15 (entitled "Calculation of Historic Debt Service Coverage") of the Official Statement for the most recently completed fiscal year;

(xi) Information contained in Table 16 (entitled "Water Utility Fund Reserves") of the Official Statement for the most recently completed fiscal year;

(xii) An update of the information contained in Table 21 (entitled "City of San Diego Pooled Investment Fund") of the Official Statement as of the most recently completed fiscal year;

(xiii) Information contained in Table 22 (entitled "City of San Diego Schedule of Funding Progress") of the Official Statement for the most recently completed fiscal year;

(xiv) Information contained in Table 23 (entitled "City of San Diego and Water Department Pension Contribution") of the Official Statement for the most recently completed fiscal year;

(xv) Information contained in Table 24 (entitled "Water Department Retiree Health Contribution") of the Official Statement for the most recently completed fiscal year; and

(xvi) An update of the information contained in the Official Statement under the heading "Water System Financial Operations – Labor Relations – General" for the most recently completed fiscal year.

Any or all of the items listed above may be included by specific reference to other documents, including official statements of debt issues of the City or related public entities, which have been submitted to each of the Repositories or the Securities and Exchange Commission. If the document included by reference is a final official statement, it must be available from the Repositories. The City shall clearly identify each such other document so included by reference.

Section 5. Reporting of Significant Events.

(a) Pursuant to the provisions of this Section 5, the City shall give, or cause to be given, notice of the occurrence of any of the following events with respect to the Series 2009A Bonds, if material:

(i) Principal and interest payment delinquencies.
(ii) Non–payment related defaults.
(iii) Unscheduled draws on debt service reserves reflecting financial difficulties.
(iv) Unscheduled draws on credit enhancements reflecting financial difficulties.
(v) Substitution of credit or liquidity providers, or their failure to perform.
(vi) Adverse tax opinions or events affecting the tax–exempt status of the Series 2009A Bonds.
(vii) Modifications to rights of Bondholders.
(viii) Contingent or unscheduled Bond calls.
(ix) Defeasances.
(x) Release, substitution, or sale of property securing repayment of the Series 2009A Bonds.
(xi) Rating changes.

(b) Whenever the City obtains knowledge of the occurrence of a Listed Event, the City shall as soon as possible determine if such event would be material under applicable Federal securities law.

(c) If the City determines that knowledge of the occurrence of a Listed Event would be material under applicable Federal securities law, the City shall promptly file a notice of such occurrence with the Repositories. Notwithstanding the foregoing, notice of Listed Events described in subsections (a)(viii) and (ix) need not be given under this subsection any earlier than the notice (if any) of the underlying event is given to holders of affected Bonds pursuant to the Indenture.

(d) If the Dissemination Agent has been instructed by the City to report the occurrence of a Listed Event, the Trustee shall file a notice of such occurrence with the Repositories with a copy to the City. Notwithstanding the foregoing notice of Listed Events described in subsections (a)(viii) and (ix) need not be given under this subsection any earlier than the notice (if any) of the underlying event is given to the holders of affected Bonds pursuant to the Indenture.

Section 6. 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 Series 2009A Bonds. If such termination occurs prior to the final maturity of the Series 2009A Bonds, the City shall give notice of such termination in the same manner as for a Listed Event under Section 5(c).

Section 7. 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 days written notice to the City and the Trustee. 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.

The City may satisfy its obligations hereunder to file any notice, document or information with a National Repository or State Repository by filing the same with any dissemination agent or conduit, including any "central post office" or similar entity, assuming or charged with responsibility for accepting notices, documents or information for transmission to such National Repository or State Repository, to the extent permitted by the SEC or SEC staff or required by the SEC. For this purpose, permission shall be deemed to have been granted by the SEC staff if and to the extent the dissemination agent or conduit has received an interpretive letter, which has not been revoked, from the SEC staff to the effect that using the agent or conduit to transmit information to the National Repository and State Repository will be treated for purposes of the Rule as if such information were transmitted directly to the National Repository and State Repository.

Section 8. 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 Series 2009A Bonds, or type of business conducted;

(b) the undertakings herein, as proposed to be amended or waived, 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 Series 2009A Bonds, after taking into account any amendments or interpretations of the Rule, as well as any change in circumstances; and

(c) the proposed amendment or waiver either (i) is approved by holders of the Series 2009A Bonds in the manner provided in the Indenture for amendments to the Indenture with the consent of holders, or (ii) does not, in the opinion of nationally recognized bond counsel, materially impair the interests of the holders or beneficial owners of the Series 2009A Bonds.

If the annual financial information or operating data to be provided in the Annual Report is amended pursuant to the provisions hereof, the first annual financial information filed pursuant hereto containing the amended operating data or financial information shall explain, in narrative form, the reasons for the amendment and the impact of the change in the type of operating data or financial information being provided.

If an amendment is made to the undertaking specifying the accounting principles to be followed in preparing financial statements, the annual financial information for the year in which the change is made shall present a comparison between the financial statements or information prepared on the basis of the new accounting principles and those prepared on the basis of the former accounting principles. The comparison shall include a qualitative discussion of the differences in the accounting principles and the impact of the change in the accounting principles on the presentation of the financial information, in order to provide information to investors to enable them to evaluate the ability of the City to meet its obligations. To the extent reasonably feasible, the comparison shall be quantitative. A notice of the change in the accounting principles shall be sent to the Repositories in the same manner as for a Listed Event under Section 5(c).

Section 9. Additional Information. Nothing in this Disclosure Certificate shall be deemed to prevent the City from disseminating any other information, using the means of dissemination set forth in this Disclosure Certificate or any other means of communication, or including any other information in any Annual Report or notice of occurrence of a Listed Event, in addition to that which is required by this Disclosure Certificate. If the City chooses to include any information in any Annual Report or notice of occurrence of a Listed Event in addition to that which is specifically required by this Disclosure Certificate, the City shall have no obligation under this Disclosure Certificate to update such information or include it in any future Annual Report or notice of occurrence of a Listed Event.

Section 10. 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 Series 2009A 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 11. Duties, Immunities and Liabilities of Dissemination Agent. The Dissemination Agent shall have only such duties as are specifically set forth in this Disclosure Certificate, and the City agrees to indemnify and save the Dissemination Agent, its officers, directors, employees and agents, harmless against any loss, expense and liabilities which it may incur arising out of or in the exercise or performance of its powers and duties hereunder, including the costs and expenses (including attorneys fees) of defending against any claim of liability, but excluding liabilities due to the Dissemination Agent's negligence or willful misconduct. The 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 Series 2009A Bondholders, 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 Series 2009A Bondholders 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 Series 2009A Bonds.

Section 12. Beneficiaries. This Disclosure Certificate shall inure solely to the benefit of the City, the Dissemination Agent, the Participating Underwriter and holders and beneficial owners from time to time of the Series 2009A Bonds, and shall create no rights in any other person or entity.

THE CITY OF SAN DIEGO

By: ___________________________________
Authorized Signatory

Attest:

____
City Clerk

APPROVED AS TO FORM:
JAN I. GOLDSMITH, City Attorney

By: ___________________________
Name:______________
Deputy City Attorney

EXHIBIT A

FORM OF NOTICE TO REPOSITORIES OF FAILURE TO FILE ANNUAL REPORT

Name of Issuer:	The City of San Diego
Name of Issue:	$157,190,000 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 "Bonds").
Date of Issuance:	January 29, 2009

NOTICE IS HEREBY GIVEN that the City of San Diego has not provided an Annual Report with respect to the above-named Bonds as required by Section 3 of the Continuing Disclosure Certificate dated as of January 1, 2009 executed and delivered by the City. [The City anticipates that the Annual Report will be filed by ____________________.]

Dated: ____________________

THE CITY OF SAN DIEGO

By: ________________________________

Title:________________________________

APPENDIX H

INFORMATION REGARDING THE BOOK-ENTRY ONLY SYSTEM

THE INFORMATION IN THIS APPENDIX H CONCERNING THE DEPOSITORY TRUST COMPANY, NEW YORK, NEW YORK AND ITS BOOK-ENTRY SYSTEM HAS BEEN OBTAINED FROM SOURCES THAT THE CITY, THE AUTHORITY AND THE UNDERWRITERS BELIEVE TO BE RELIABLE, BUT THE CITY, THE AUTHORITY AND THE UNDERWRITERS TAKE NO RESPONSIBILITY FOR THE ACCURACY THEREOF.

The Depository Trust Company ("DTC"), New York, New York, will act as securities depository for the Public Facilities Financing Authority of the City of San Diego Water Revenue Bonds, Refunding Series 2009A (Payable Solely From Installment Payments Secured by Net System Revenues of the Water Utility Fund) (the "Series 2009A Bonds"). The Series 2009A Bonds will be issued as fully-registered securities registered in the name of Cede & Co. (DTC's partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully-registered bond certificate will be issued for each maturity of each Series of the Series 2009A Bonds, each in the aggregate principal amount of such maturity, and will be deposited with DTC.

DTC, the world's largest securities depository, is a limited-purpose trust company organized under the New York Banking Law, a "banking organization" within the meaning of the New York Banking Law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code, and a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for over 3.5 million issues of U.S. and non-U.S. equity issues, corporate and municipal debt issues, and money market instruments (from over 100 countries) that DTC's participants ("Direct Participants") deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities, through electronic computerized book-entry transfers and pledges between Direct Participants' accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation ("DTCC"). DTCC is the holding company for DTC, National Securities Clearing Corporation and Fixed Income Clearing Corporation, all of which are registered clearing agencies. DTCC is owned by the users of its regulated subsidiaries. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly ("Indirect Participants"). DTC has Standard & Poor's highest rating: AAA. The DTC Rules applicable to its Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at www.dtcc.com and www.dtc.org.

Purchases of the Series 2009A Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Series 2009A Bonds on DTC's records. The ownership interest of each actual purchaser of each Series 2009A Bond ("Beneficial Owner") is in turn to be recorded on the Direct and Indirect Participants' records. Beneficial Owners will not receive written confirmation from DTC of their purchase. Beneficial Owners are, however, expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the Series 2009A Bonds are to be accomplished by entries made on the books of Direct and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in the Series 2009A Bonds, except in the event that use of the book-entry system for the Series 2009A Bonds is discontinued.

To facilitate subsequent transfers, all Series 2009A Bonds deposited by Direct Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co., or such other name as may be requested by an authorized representative of DTC. The deposit of the Series 2009A Bonds 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 Series 2009A Bonds; DTC's records reflect only the identity of the Direct Participants to whose accounts such Series 2009A Bonds are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. The City and the Authority will not have any responsibility or obligation to such Direct Participants and Indirect Participants or the persons for whom they act as nominees with respect to the Series 2009A Bonds. Beneficial Owners of the Series 2009A Bonds may wish to take certain steps to augment the transmission to them of notices of significant events with respect to the Series 2009A Bonds, such as redemptions, tenders, defaults, and proposed amendments to the Series 2009A Bond documents. For example, Beneficial Owners of the Series 2009A Bonds may wish to ascertain that the nominee holding the Series 2009A Bonds for their benefit has agreed to obtain and transmit notices to Beneficial Owners. In the alternative, Beneficial Owners may wish to provide their names and addresses to the registrar and request that copies of notices be provided directly to them.

Redemption notices shall be sent to DTC. The conveyance of notices and other communications by DTC to DTC Participants, by DTC Participants to Indirect Participants and by DTC Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. Any failure of DTC to advise any DTC Participant, or of any DTC Participant or Indirect Participant to notify a Beneficial Owner, of any such notice and its content or effect will not affect the validity of the redemption of the Series 2009A Bonds called for redemption or of any other action premised on such notice. Redemption of portions of the Series 2009A Bonds by the Authority will reduce the outstanding principal amount of Series 2009A Bonds held by DTC. In such event, DTC will implement, through its book-entry system, a redemption by lot of interests in the Series 2009A Bonds held for the account of DTC Participants in accordance with its own rules or other agreements with DTC Participants and then DTC Participants and Indirect Participants will implement a redemption of the Series 2009A Bonds for the Beneficial Owners.

Redemption notices shall be sent to DTC. If less than all of the Series 2009A Bonds within an issue are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such issue to be redeemed.

Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to the Series 2009A Bonds unless authorized by a Direct Participant in accordance with DTC's MMI Procedures. Under its usual procedures, DTC mails an Omnibus Proxy to the Trustee as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts the Series 2009A Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Payments of principal of, premium, if any, and interest on the Series 2009A Bonds will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts upon DTC's receipt of funds and corresponding detail information from the Trustee, on payable dates in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of such Participant and not of DTC nor its nominee, or the Trustee, subject to any statutory, or regulatory requirements as may be in effect from time to time. Payments of principal of, premium, if any, and interest on the Series 2009A Bonds to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the Trustee, disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners will be the responsibility of Direct and Indirect Participants.

NONE OF THE CITY, THE AUTHORITY OR THE TRUSTEE WILL HAVE ANY RESPONSIBILITY OR OBLIGATION TO DTC PARTICIPANTS, INDIRECT PARTICIPANTS OR BENEFICIAL OWNERS WITH RESPECT TO THE PAYMENTS OR THE PROVIDING OF NOTICE TO DTC PARTICIPANTS, INDIRECT PARTICIPANTS OR BENEFICIAL OWNERS OR THE SELECTION OF BONDS FOR PREPAYMENT.

DTC may discontinue providing its services as depository with respect to the Series 2009A Bonds at any time by giving reasonable notice to the City, the Authority or the Trustee. Under such circumstances, in the event that a successor depository is not obtained, bond certificates are required to be printed and delivered.

The City and the Authority may decide to discontinue use of the system of book-entry-only transfers through DTC (or a successor securities depository). In that event, bond certificates will be printed and delivered to DTC.

In the event that the book-entry system is discontinued as described above, the requirements of the Indenture will apply. The information in this section concerning DTC and DTC's book-entry system has been obtained from sources that District believes to be reliable, but District takes no responsibility for the accuracy thereof.

None of the City, the Authority, the Trustee or the Underwriters can and do not give any assurances that DTC, the Participants or others will distribute payments of principal of, premium, if any, and interest on the Series 2009A Bonds paid to DTC or its nominee as the registered owner, or will distribute any prepayment notices or other notices, to the Beneficial Owners, or that they will do so on a timely basis or will serve and act in the manner described in this Official Statement. None of the City, the Authority, the Trustee or the Underwriters are responsible or liable for the failure of DTC or any Participant to make any payment or give any notice to a Beneficial Owner with respect to the Series 2009A Bonds or an error or delay relating thereto.

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PUBLIC FACILITIES FINANCING AUTHORITY OF THE CITY OF SAN DIEGO • WATER REVENUE BONDS, REFUNDING SERIES 2009A

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