This Preliminary Official Statement and the information contained herein are subject to completion or amendment. These securities may not be sold nor may offers to buy be accepted prior to the time the Official Statement is delivered in final form. Under no circumstances shall this Preliminary Official Statement constitute an offer to sell or a solicitation of an offer to buy nor shall there be any sale of these securities in any jurisdiction in which such offer, solicitation or sale would be unlawful prior to registration or qualification under the securities laws of any such jurisdiction.

**PRELIMINARY OFFICIAL STATEMENT DATED MAY 17, 2016**

**NEW ISSUE – BOOK-ENTRY ONLY**

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

*In the opinion of Orrick, Herrington & Sutcliffe LLP, Bond Counsel to the Authority, based upon an analysis of existing laws, regulations, rulings and court decisions, and assuming, among other matters, the accuracy of certain representations and compliance with certain covenants, interest on the 2016 Bonds is excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986, and is exempt from State of California personal income taxes. In the further opinion of Bond Counsel, interest on the 2016 Bonds is not a specific preference item for purposes of the federal individual or corporate alternative minimum taxes, although Bond Counsel observes that such interest is included in adjusted current earnings when calculating corporate alternative minimum taxable income. Bond Counsel expresses no opinion regarding any other tax consequences related to the ownership or disposition of, or the amount, accrual or receipt of interest on, the 2016 Bonds. See "TAX MATTERS."*

# $567,960,000*
# PUBLIC FACILITIES FINANCING AUTHORITY OF THE CITY OF SAN DIEGO
# SUBORDINATED WATER REVENUE BONDS
## (Payable Solely From Subordinated Installment Payments Secured by Net System Revenues of the Water Utility Fund)

**consisting of**

**$39,885,000***
**SUBORDINATED WATER REVENUE BONDS, SERIES 2016A**

**$528,075,000***
**SUBORDINATED WATER REVENUE BONDS, REFUNDING SERIES 2016B**

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

The $39,885,000* Public Facilities Financing Authority of the City of San Diego Subordinated Water Revenue Bonds, Series 2016A (Payable Solely From Subordinated Installment Payments Secured by Net System Revenues of the Water Utility Fund) (the "2016A Bonds") and the $528,075,000* Public Facilities Financing Authority of the City of San Diego Subordinated Water Revenue Bonds, Refunding Series 2016B (Payable Solely From Subordinated Installment Payments Secured by Net System Revenues of the Water Utility Fund) (the "2016B Bonds" and, together with the 2016A Bonds, the "2016 Bonds") are being issued by the Public Facilities Financing Authority of the City of San Diego (the "Authority") pursuant to Article 1 (commencing with Section 6584) of Chapter 5 of Division 7 of Title 1 of the Government Code of the State of California (the "Government Code"), Article 11 (commencing with Section 53580) of Chapter 3 of Part 1 of Division 2 of Title 5 of the Government Code, and an Indenture, dated as of January 1, 2009, as amended and supplemented by a First Supplemental Indenture, dated as of June 1, 2009, a Second Supplemental Indenture, dated as of June 1, 2010, a Third Supplemental Indenture, dated as of April 1, 2012, and a Fourth Supplemental Indenture, dated as of June 1, 2016 (collectively, the "Indenture"), each by and between the Authority and U.S. Bank National Association, as successor trustee (the "Trustee"). The proceeds of the 2016A Bonds, together with other available funds, will be used to (i) finance additional improvements to the Water System and (ii) pay costs of issuance with respect to the 2016A Bonds. The proceeds of the 2016B Bonds, together with other available funds, will be used to (i) advance refund all or a portion of outstanding Water Revenue Bonds and current refund an outstanding Drinking Water State Revolving Fund loan (as described herein) and (ii) pay costs of issuance with respect to the 2016B Bonds. See "PLAN OF FINANCE." Capitalized terms used on this cover page and not otherwise defined shall have the meanings ascribed to them elsewhere in this Official Statement. See in particular "APPENDIX A – SUMMARY OF PRINCIPAL LEGAL DOCUMENTS – Indenture" and "– Installment Purchase Agreement."

The 2016 Bonds are limited obligations of the Authority secured by Subordinated Revenues consisting primarily of 2016 Subordinated Installment Payments to be made by the City of San Diego (the "City") to the San Diego Facilities and Equipment Leasing Corporation (the "Corporation") under the 2016 Supplement (as defined herein) and other assets pledged therefore under the Indenture. The 2016 Subordinated Installment Payments will be assigned by the Corporation to the Authority pursuant to the Assignment Agreement. The pledge and right of payment from Net System Revenues securing the 2016 Subordinated Installment Payments will be subordinate to the payment by the City of Senior Obligations and on parity with Subordinated Obligations. See "SECURITY AND SOURCES OF PAYMENT FOR THE 2016 BONDS" and "APPENDIX A – SUMMARY OF PRINCIPAL LEGAL DOCUMENTS – Installment Purchase Agreement."

**THE 2016 BONDS ARE LIMITED OBLIGATIONS OF THE AUTHORITY PAYABLE SOLELY FROM AND SECURED SOLELY BY THE SUBORDINATED REVENUES PLEDGED THEREFOR AND AMOUNTS ON DEPOSIT IN THE SUBORDINATED BONDS PAYMENT FUND ESTABLISHED UNDER THE INDENTURE. THE OBLIGATION OF THE CITY TO MAKE 2016 SUBORDINATED INSTALLMENT PAYMENTS UNDER THE 2016 SUPPLEMENT DOES NOT CONSTITUTE AN OBLIGATION OF THE CITY FOR WHICH THE CITY IS OBLIGATED TO LEVY OR PLEDGE ANY FORM OF TAXATION OR FOR WHICH THE CITY HAS LEVIED OR PLEDGED ANY FORM OF TAXATION. NEITHER THE FULL FAITH AND CREDIT OF THE AUTHORITY, THE CITY, THE COUNTY OF SAN DIEGO (THE "COUNTY"), THE STATE OF CALIFORNIA (THE "STATE"), OR ANY POLITICAL SUBDIVISION OF THE STATE NOR THE TAXING POWER OF THE CITY, THE COUNTY, THE STATE, OR ANY POLITICAL SUBDIVISION OF THE STATE IS PLEDGED TO THE PAYMENT OF THE PRINCIPAL OF OR INTEREST ON THE 2016 BONDS. THE AUTHORITY HAS NO TAXING POWER. NEITHER THE 2016 BONDS NOR THE OBLIGATION OF THE CITY TO MAKE 2016 SUBORDINATED INSTALLMENT PAYMENTS CONSTITUTES AN INDEBTEDNESS OF THE AUTHORITY, THE CITY, THE COUNTY, THE STATE, OR ANY POLITICAL SUBDIVISION OF THE STATE WITHIN THE MEANING OF ANY CONSTITUTIONAL OR STATUTORY DEBT LIMITATION OR RESTRICTION.**

The 2016 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, 2016. The 2016 Bonds will bear interest at the respective rates set forth on the inside cover page hereof. See "DESCRIPTION OF THE 2016 BONDS – General" and "APPENDIX A – SUMMARY OF PRINCIPAL LEGAL DOCUMENTS."

The 2016 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 2016 Bonds. Ownership interests in the 2016 Bonds may be purchased in book-entry form only. So long as DTC or its nominee is the Owner of the 2016 Bonds, the principal, the redemption premium, if any, and interest on the 2016 Bonds will be made as described in "APPENDIX D – INFORMATION REGARDING THE BOOK-ENTRY ONLY SYSTEM."

**The 2016 Bonds are subject to optional redemption as described herein. See "DESCRIPTION OF THE 2016 BONDS – Redemption of 2016 Bonds."**

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

The 2016 Bonds are offered when, as, and if delivered to and received by the Underwriters, subject to the approval of legality by Orrick, Herrington & Sutcliffe LLP, Bond Counsel. Certain legal matters will be passed upon for the Authority by Orrick, Herrington & Sutcliffe LLP, for the Authority and the City by Jan I. Goldsmith, City Attorney, and for the Underwriters by their counsel, Stradling Yocca Carlson & Rauth, a Professional Corporation, Newport Beach, California. It is anticipated that the 2016 Bonds will be available for delivery through the facilities of DTC in New York, New York on or about June __, 2016.

**J.P. Morgan** **Morgan Stanley**

**Siebert Brandford Shank & Co., L.L.C.** **Ramirez & Co** **The Williams Capital Group, L.P.**

Dated: June __, 2016

* Preliminary, subject to change.

## MATURITY SCHEDULES*

## PUBLIC FACILITIES FINANCING AUTHORITY OF THE CITY OF SAN DIEGO SUBORDINATED WATER REVENUE BONDS, SERIES 2016A

Base CUSIP No.† 79730C

| Maturity Date (August 1,) | Principal Amount | Interest Rate | Price or Yield‡ | CUSIP† | Maturity Date (August 1,) | Principal Amount | Interest Rate | Price or Yield‡ | CUSIP† |
|---|---|---|---|---|---|---|---|---|---|
| 2017 | $ 655,000 | | | | 2029 | $1,140,000 | | | |
| 2018 | 675,000 | | | | 2030 | 1,200,000 | | | |
| 2019 | 700,000 | | | | 2031 | 1,260,000 | | | |
| 2020 | 730,000 | | | | 2032 | 1,325,000 | | | |
| 2021 | 765,000 | | | | 2033 | 1,390,000 | | | |
| 2022 | 805,000 | | | | 2034 | 1,465,000 | | | |
| 2023 | 845,000 | | | | 2035 | 1,540,000 | | | |
| 2024 | 890,000 | | | | 2036 | 1,620,000 | | | |
| 2025 | 935,000 | | | | 2037 | 1,700,000 | | | |
| 2026 | 980,000 | | | | 2038 | 1,790,000 | | | |
| 2027 | 1,030,000 | | | | 2039 | 1,880,000 | | | |
| 2028 | 1,085,000 | | | | | | | | |

$4,050,000 ____% Series 2016A Term Bonds due August 1, 2041 - Yield: ____%‡ CUSIP No. _____†
$9,430,000 ____% Series 2016A Term Bonds due August 1, 2045 - Yield: ____%‡ CUSIP No. _____†

## PUBLIC FACILITIES FINANCING AUTHORITY OF THE CITY OF SAN DIEGO SUBORDINATED WATER REVENUE BONDS, REFUNDING SERIES 2016B

Base CUSIP No.† 79730C

| Maturity Date (August 1,) | Principal Amount | Interest Rate | Price or Yield‡ | CUSIP† | Maturity Date (August 1,) | Principal Amount | Interest Rate | Price or Yield‡ | CUSIP† |
|---|---|---|---|---|---|---|---|---|---|
| 2016 | $30,815,000 | | | | 2028 | $32,150,000 | | | |
| 2017 | 23,450,000 | | | | 2029 | 13,015,000 | | | |
| 2018 | 24,045,000 | | | | 2030 | 13,685,000 | | | |
| 2019 | 24,895,000 | | | | 2031 | 14,385,000 | | | |
| 2020 | 25,920,000 | | | | 2032 | 15,120,000 | | | |
| 2021 | 27,115,000 | | | | 2033 | 15,900,000 | | | |
| 2022 | 21,115,000 | | | | 2034 | 16,710,000 | | | |
| 2023 | 22,205,000 | | | | 2035 | 17,570,000 | | | |
| 2024 | 25,425,000 | | | | 2036 | 18,470,000 | | | |
| 2025 | 28,235,000 | | | | 2037 | 19,420,000 | | | |
| 2026 | 29,085,000 | | | | 2038 | 20,415,000 | | | |
| 2027 | 30,590,000 | | | | 2039 | 18,340,000 | | | |

$_____ ____% Series 2016B Term Bonds due August 1, 20__ - Yield: ____%‡ CUSIP No. _____†

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* Preliminary, subject to change.

‡ Reoffering yields/prices are furnished by the Underwriters. Neither the Authority nor the City takes any responsibility for the accuracy thereof.

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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 2016 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 2016 Bonds. Statements contained in this Official Statement that involve estimates, forecasts or matters of opinion, whether or not expressly so described herein, are intended solely as such and are not to be construed as a representation of facts.

The information set forth herein has been furnished by the City and by other sources that are believed to be reliable including, without limitation, the San Diego County Water Authority and The Metropolitan Water District of Southern California. The Underwriters have provided the following sentence for inclusion in this Official Statement: the Underwriters have reviewed the information in this Official Statement in accordance with, and as part of, their responsibility to investors under the federal securities law as applied to the facts and circumstances of this transaction, but the Underwriters do not guarantee the accuracy or completeness of such information.

The information and expressions of opinion herein are subject to change without notice and neither the delivery of this Official Statement nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of the City, the Authority, the Corporation, or any other parties described herein since the date hereof. All summaries of the 2016 Bonds, the Indenture, the Master Installment Purchase Agreement, the 2016 Supplement, the Assignment Agreement, and other documents summarized herein are made subject to the provisions of such documents respectively and do not purport to be complete statements of any or all of such provisions.

This Official Statement is submitted in connection with the issuance of the 2016 Bonds referred to herein and may not be reproduced or used, in whole or in part, for any other purpose.

The City maintains a website that includes investor information at http://www.sandiego.gov/investorinformation. However, the information presented at such website is not part of this Official Statement, is not incorporated by reference herein, and should not be relied upon in making an investment decision with respect to the 2016 Bonds.

THE 2016 BONDS HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED, IN RELIANCE UPON AN EXEMPTION CONTAINED IN SUCH ACT. THE 2016 BONDS HAVE NOT BEEN REGISTERED OR QUALIFIED UNDER THE SECURITIES LAWS OF ANY STATE.

IN CONNECTION WITH THIS OFFERING, THE UNDERWRITERS MAY OVERALLOT OR EFFECT TRANSACTIONS THAT STABILIZE OR MAINTAIN THE MARKET PRICE OF THE 2016 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 2016 BONDS TO CERTAIN DEALERS AND DEALER BANKS AND BANKS ACTING AS AGENT AT PRICES LOWER THAN THE PUBLIC OFFERING PRICE STATED ON THE INSIDE COVER PAGE HEREOF AND SAID PUBLIC OFFERING PRICE MAY BE CHANGED FROM TIME TO TIME BY THE UNDERWRITERS.

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**CITY OF SAN DIEGO**

---

***Mayor***
Kevin L. Faulconer

***City Council***
(Also serves as Board of Commissioners of the Public Facilities Financing Authority of the City of San Diego)

Sherri S. Lightner, City Council President (*District 1*)
Lorie Zapf (*District 2*)
Todd Gloria (*District 3*)
Myrtle Cole (*District 4*)
Mark Kersey (*District 5*)
Chris Cate (*District 6*)
Scott Sherman (*District 7*)
David Alvarez (*District 8*)
Marti Emerald, City Council President Pro Tem *(District 9)*

***City Attorney***
Jan I. Goldsmith

---

***City Officials***

Scott Chadwick, *Chief Operating Officer*
Mary Lewis, *Chief Financial Officer*
Gail R. Granewich, *City Treasurer*
Eduardo Luna, *City Auditor*
Rolando Charvel, *City Comptroller*
Andrea Tevlin, *Independent Budget Analyst*
Elizabeth S. Maland, *City Clerk*
Halla Razak, *Director of Public Utilities*

---

**SPECIAL SERVICES**

***Bond and Disclosure Counsel***
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Los Angeles, California

***Municipal Advisor***
Public Financial Management, Inc.
Los Angeles, California

***Trustee and Escrow Agent***
U.S. Bank National Association
Los Angeles, California

***Verification Agent***
Causey Demgen & Moore P.C.
Denver, Colorado

## TABLE OF CONTENTS

**Page**


INTRODUCTION ..... 1

General ..... 1
The 2016 Bonds ..... 2
Security and Sources of Payment for the 2016 Bonds ..... 2
Redemption of the 2016 Bonds ..... 3
Rate Covenant ..... 3
No Debt Service Reserve Fund for the 2016 Bonds ..... 4
Outstanding Senior and Subordinated Obligations ..... 4
City of San Diego ..... 5
The Water System ..... 6
The Corporation ..... 6
Forward-Looking Statements ..... 6
Miscellaneous ..... 7

THE AUTHORITY ..... 7

PLAN OF FINANCE ..... 7

ESTIMATED SOURCES AND USES OF BOND PROCEEDS ..... 10

DESCRIPTION OF THE 2016 BONDS ..... 10

General ..... 10
Redemption of 2016 Bonds ..... 11

SECURITY AND SOURCES OF PAYMENT FOR THE 2016 BONDS ..... 13

Pledge of Subordinated Revenues; Subordinated Installment Payments ..... 13
The Water Utility Fund ..... 13
Pledge of Net System Revenues ..... 15
Senior Obligations ..... 17
Subordinated Obligations ..... 18
Rate Covenant ..... 19
No Debt Service Reserve Fund for the 2016 Bonds ..... 19
Issuance of Additional Obligations Under the Master Installment Purchase Agreement ..... 20
Issuance of Additional Bonds Under the Indenture ..... 21

DEBT SERVICE SCHEDULE ..... 23

WATER SYSTEM ORGANIZATION AND MANAGEMENT ..... 25

General ..... 25
Governance and Management of Water System ..... 26

WATER SYSTEM SERVICE AREA AND FACILITIES ..... 29

Water System Service Area ..... 29
Existing Water System Facilities ..... 33
Insurance for the Water System ..... 37
Utility Costs ..... 37

WATER SUPPLY ..... 37

Current Water Supply ..... 38

**TABLE OF CONTENTS**
(continued)

**Page**


San Diego County Water Authority....40
The Metropolitan Water District of Southern California....43
Recent CWA and MWD Actions in Response to Drought Conditions....54
Recent City Actions in Response to Drought Conditions....57
City Planning and Resource Management....58
Pure Water Program....61
Future City Water Demand....66

WATER SYSTEM REGULATORY REQUIREMENTS....67

General....67
Federal Requirements....68
State Regulations....68
Proposed Regulations....69
Compliance Order by the California Department of Public Health/DDW....69
Permits and Licenses....70
Dam Licensing and Safety Issues....70

WATER SYSTEM CAPITAL IMPROVEMENT PROGRAM....70

The Capital Improvement Program....70
Description of Major Projects....71
Capital Improvement Financing Plan....73
Environmental Compliance....75
Project Management for the Water System Capital Improvement Program....75
Contract Disputes....76

WATER SYSTEM FINANCIAL OPERATIONS....76

Establishment of Water Service Charges....76
Collection of Water Service Charges....80
Accounts Receivable....80
Revenues....82
Management's Discussion and Analysis....85
Water Utility Fund Reserves....85
Financial Projections and Modeling Assumptions....88
Outstanding Indebtedness....91
Anticipated Additional Obligations....92
Labor Relations....93
Insurance and Liability Claims....95
Investment of Funds....96
San Diego City Employees' Retirement System....98
Other Retirement Plans....107
Postemployment Healthcare Benefits....108
Retiree Medical Trust....111

RISK FACTORS....111

Limited Obligations....112
Subordinate Obligations....112
Water System Expenses, Collections, and Future Rates....113
Water System Demand....113

**TABLE OF CONTENTS**
(continued)

**Page**


Rate-Setting Process Under Proposition 218 ..... 113
Pure Water Program ..... 114
Statutory and Regulatory Compliance ..... 115
Risks Relating to the Water Supply ..... 115
Acceleration; Limitations on Remedies ..... 118
Dam Safety ..... 119
Future Legislation ..... 119
Potential Impact of Climatic Change ..... 119
Uncertainties of Projections, Forecasts and Assumptions ..... 120
Absence of Market for the 2016 Bonds ..... 120
Loss of Tax Exemption on 2016 Bonds ..... 120
Economic, Political, Social, and Environmental Conditions ..... 120

CONSTITUTIONAL LIMITATIONS ON TAXES AND WATER RATES AND CHARGES ..... 121

Article XIIIA ..... 121
Article XIIIB ..... 121
Article XIIIC ..... 122
Article XIIID ..... 123
Proposition 26 ..... 124
Initiative, Referendum and Charter Amendments ..... 125

TAX MATTERS ..... 125

CONTINUING DISCLOSURE ..... 127

LITIGATION ..... 128

CERTAIN LEGAL MATTERS ..... 130

INVESTMENT ADVISOR ..... 131

VERIFICATION ..... 131

RATINGS ..... 131

UNDERWRITING ..... 131

MUNICIPAL ADVISOR ..... 132

INFORMATION CONCERNING THE METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA AND THE SAN DIEGO COUNTY WATER AUTHORITY ..... 132

FINANCIAL STATEMENTS ..... 132

MISCELLANEOUS ..... 133

APPENDIX A - SUMMARY OF PRINCIPAL LEGAL DOCUMENTS ..... A-1

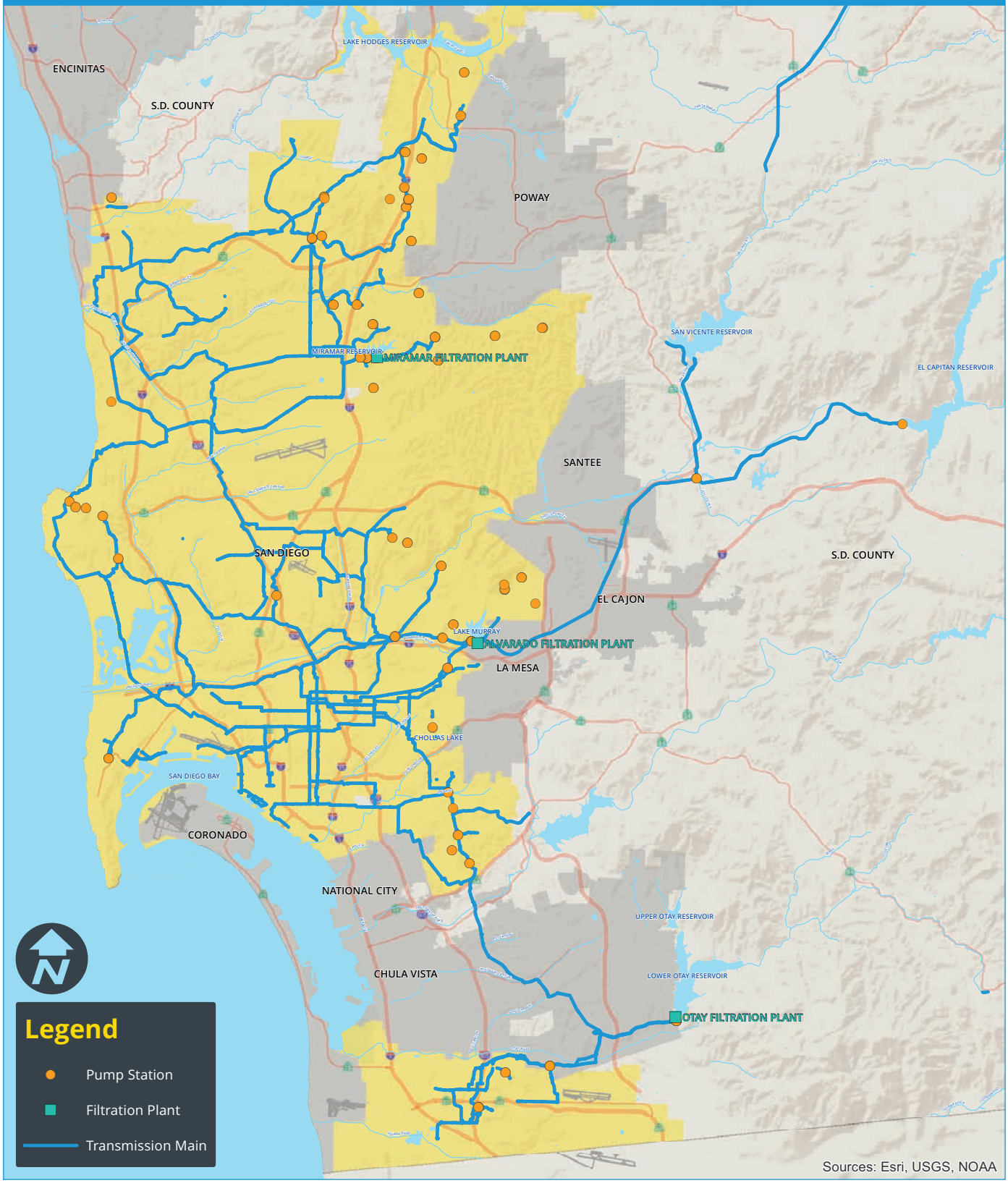
APPENDIX B - FORM OF BOND COUNSEL OPINION ..... B-1

APPENDIX C - FORM OF CONTINUING DISCLOSURE CERTIFICATE ..... C-1

APPENDIX D - INFORMATION REGARDING THE BOOK-ENTRY ONLY SYSTEM ..... D-1

# City of San Diego Water System

## Existing Facilities

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**OFFICIAL STATEMENT**

**$567,960,000***
**PUBLIC FACILITIES FINANCING AUTHORITY OF**
**THE CITY OF SAN DIEGO**
**SUBORDINATED WATER REVENUE BONDS**
**(Payable Solely From Subordinated Installment Payments**
**Secured by Net System Revenues of the Water Utility Fund)**

**consisting of**

| **$39,885,000*** | **$528,075,000*** |
|---|---|
| **SUBORDINATED WATER REVENUE BONDS, SERIES 2016A** | **SUBORDINATED WATER REVENUE BONDS, REFUNDING SERIES 2016B** |

## INTRODUCTION

*This introduction is not a summary of this Preliminary 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 Preliminary Official Statement, including the cover page, the inside cover page and appendices hereto and the documents described herein. All statements contained in this introduction are qualified in their entirety by reference to the entire Preliminary Official Statement. References to and summaries of the laws of the State of California and any documents, reports, and other instruments referred to herein do not purport to be complete and such references are qualified in their entirety by reference to each such law, document, report, or instrument. All capitalized terms used in this Preliminary Official Statement and not otherwise defined herein have the meanings set forth in the Indenture or the Master Installment Purchase Agreement, each as defined herein. See "APPENDIX A – SUMMARY OF PRINCIPAL LEGAL DOCUMENTS – Indenture" and "– Installment Purchase Agreement."*

### General

The $39,885,000* Public Facilities Financing Authority of the City of San Diego Subordinated Water Revenue Bonds, Series 2016A (Payable Solely From Subordinated Installment Payments Secured by Net System Revenues of the Water Utility Fund) (the "2016A Bonds") and the $528,075,000* Public Facilities Financing Authority of the City of San Diego Subordinated Water Revenue Bonds, Refunding Series 2016B (Payable Solely From Subordinated Installment Payments Secured by Net System Revenues of the Water Utility Fund) (the "2016B Bonds" and, together with the 2016A Bonds, the "2016 Bonds") are being issued by the Public Facilities Financing Authority of the City of San Diego (the "Authority") pursuant to Article 1 (commencing with Section 6584) of Chapter 5 of Division 7 of Title 1 of the Government Code of the State of California (the "Government Code"), Article 11 (commencing with Section 53580) of Chapter 3 of Part 1 of Division 2 of Title 5 of the Government Code, and an Indenture, dated as of January 1, 2009, as amended and supplemented by a First Supplemental Indenture, dated as of June 1, 2009, a Second Supplemental Indenture, dated as of June 1, 2010, a Third Supplemental Indenture, dated as of April 1, 2012, and a Fourth Supplemental Indenture, dated as of June 1, 2016 (collectively, the "Indenture"), each by and between the Authority and U.S. Bank National Association, as successor trustee (the "Trustee").

* Preliminary, subject to change.

The proceeds of the 2016A Bonds, together with other available funds, will be used to (i) finance additional improvements to the Water System and (ii) pay costs of issuance with respect to the 2016A Bonds. See "PLAN OF FINANCE – The 2016 Project." The proceeds of the 2016B Bonds, together with other available funds, will be used to (i) advance refund all or a portion of the outstanding 2009A Bonds, 2009B Bonds, and 2010A Bonds (each as defined herein) and current refund one of the Department's outstanding Drinking Water State Revolving Fund ("SRF") loans (as described herein) from the State Water Resources Control Board ("SWRCB") and (ii) pay costs of issuance with respect to the 2016B Bonds. See "PLAN OF FINANCE – The Refunding Plan."

**The 2016 Bonds**

The 2016 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, 2016 (each, an "Interest Payment Date"). The 2016 Bonds will bear interest at the rates set forth on the inside cover page hereof. See "DESCRIPTION OF THE 2016 BONDS – General" and "APPENDIX A – SUMMARY OF PRINCIPAL LEGAL DOCUMENTS."

The 2016 Bonds are being issued only in fully-registered form in denominations of $5,000 and any integral multiple thereof and, when issued, will be registered in the name of Cede & Co., as the nominee of The Depository Trust Company, New York, New York ("DTC"). DTC will act as securities depository for the 2016 Bonds. Ownership interests in the 2016 Bonds may be purchased in book-entry form only. So long as DTC or its nominee is the Owner of the 2016 Bonds, the principal, the redemption premium, if any, and interest on the 2016 Bonds will be made as described in "APPENDIX D – INFORMATION REGARDING THE BOOK-ENTRY ONLY SYSTEM."

**Security and Sources of Payment for the 2016 Bonds**

The 2016 Bonds are limited obligations of the Authority secured by Subordinated Revenues (as defined herein) and other assets pledged therefore under the Indenture. The Subordinated Revenues will consist primarily of 2016 Subordinated Installment Payments (as defined herein) to be made by the City of San Diego (the "City") to the San Diego Facilities and Equipment Leasing Corporation (the "Corporation") under the 2016 Supplement to Amended and Restated Master Installment Purchase Agreement, dated as of June 1, 2016 (the "2016 Supplement"), supplementing the Amended and Restated Master Installment Purchase Agreement, dated as of January 1, 2009 (the "Master Installment Purchase Agreement"), as previously supplemented and as supplemented by the 2016 Supplement), each by and between the City and the Corporation. The Master Installment Purchase Agreement, together with the 2016 Supplement and all other supplements thereto, is referred to in this Official Statement as the "Installment Purchase Agreement." The 2016 Subordinated Installment Payments will be assigned by the Corporation to the Authority pursuant to the Assignment Agreement, dated as of June 1, 2016 (the "Assignment Agreement"), by and between the Corporation and the Authority. See "SECURITY AND SOURCES OF PAYMENT FOR THE 2016 BONDS."

The Installment Purchase Agreement provides for the payment by the City of Senior Obligations and Subordinated Obligations in amounts sufficient to make payments of the principal of and interest on Bonds of the Authority. The 2016 Supplement provides for the payment by the City of Subordinated Installment Payments (the "2016 Subordinated Installment Payments") in amounts sufficient to make payments of the principal of and interest on the 2016 Bonds. The 2016 Subordinated Installment Payments securing payment of the 2016 Bonds are payable from Net System Revenues on a basis that is subordinate to the right of payment by the City of its Senior Obligations (as defined herein) under the Installment Purchase Agreement and on parity with the 2012 Subordinated Installment Payments securing payment of the Public Facilities Financing Authority of the City of San Diego Subordinated Water

Revenue Bonds, Refunding Series 2012A (Payable Solely From Subordinated Installment Payments Secured by Net System Revenues of the Water Utility Fund), of which $135,970,000 is currently outstanding (the "2012A Subordinated Bonds"), and any Subordinated Obligations which may be incurred in the future. The pledge and right of payment from Net System Revenues securing the 2016 Subordinated Installment Payments will be Subordinated Obligations, subordinate to the payment of certain Senior Obligations and on parity with Subordinated Obligations. See "Outstanding Senior and Subordinated Obligations" below.

**THE BONDS ARE LIMITED OBLIGATIONS OF THE AUTHORITY PAYABLE SOLELY FROM AND SECURED SOLELY BY THE SUBORDINATED REVENUES PLEDGED THEREFOR AND AMOUNTS ON DEPOSIT IN THE SUBORDINATED BONDS PAYMENT FUND ESTABLISHED UNDER THE INDENTURE. THE OBLIGATION OF THE CITY TO MAKE 2016 SUBORDINATED INSTALLMENT PAYMENTS UNDER THE 2016 SUPPLEMENT DOES NOT CONSTITUTE AN OBLIGATION OF THE CITY FOR WHICH THE CITY IS OBLIGATED TO LEVY OR PLEDGE ANY FORM OF TAXATION OR FOR WHICH THE CITY HAS LEVIED OR PLEDGED ANY FORM OF TAXATION. NEITHER THE FULL FAITH AND CREDIT OF THE AUTHORITY, THE CITY, THE COUNTY OF SAN DIEGO (THE "COUNTY"), THE STATE OF CALIFORNIA (THE "STATE"), OR ANY POLITICAL SUBDIVISION OF THE STATE NOR THE TAXING POWER OF THE CITY, THE COUNTY, THE STATE, OR ANY POLITICAL SUBDIVISION OF THE STATE IS PLEDGED TO THE PAYMENT OF THE PRINCIPAL OF OR INTEREST ON THE BONDS. THE AUTHORITY HAS NO TAXING POWER. NEITHER THE BONDS NOR THE OBLIGATION OF THE CITY TO MAKE 2016 SUBORDINATED INSTALLMENT PAYMENTS CONSTITUTES AN INDEBTEDNESS OF THE AUTHORITY, THE CITY, THE COUNTY, THE STATE, OR ANY POLITICAL SUBDIVISION OF THE STATE WITHIN THE MEANING OF ANY CONSTITUTIONAL OR STATUTORY DEBT LIMITATION OR RESTRICTION.**

**Redemption of the 2016 Bonds**

The 2016 Bonds are subject to optional redemption prior to maturity as described herein. See "DESCRIPTION OF THE 2016 BONDS – Redemption of 2016 Bonds."

**Rate Covenant**

The City has covenanted in the Master Installment Purchase Agreement to fix, prescribe, and collect rates and charges for the City's water service, as described below (the "Water Service"), which will be at least sufficient to yield the greater of (i) Net System Revenues (as defined herein) sufficient to pay during each Fiscal Year (as defined herein) all Obligations (as defined herein)(including the 2016 Subordinated Installment Payments and loan payments due on SRF loans) payable in such Fiscal Year, or (ii) Adjusted Net System Revenues (as defined herein) during each Fiscal Year equal to 120% of the Adjusted Debt Service (as defined herein) for such Fiscal Year. Adjusted Debt Service does **not** include debt service on Subordinated Obligations, such as the 2016 Subordinated Installment Payments. The City's fiscal year, which begins on July 1 of each year and ends on June 30 of the following year, is referred to herein as the "Fiscal Year." The Water Service rendered by the City includes the collection, conservation, production, storage, treatment, transmission, furnishing, and distribution services made available or provided by the City's water system (the "Water System"). See "SECURITY AND SOURCES OF PAYMENT FOR THE 2016 BONDS – Rate Covenant" and "WATER SYSTEM FINANCIAL OPERATIONS – Rate Stabilization Fund; Other Funds and Accounts." In addition, for information on the possible limitation on the City's ability to comply with the rate covenant as a consequence of Proposition 218 (as defined herein), see "RISK FACTORS – Rate-Setting Process Under

Proposition 218" and "CONSTITUTIONAL LIMITATIONS ON TAXES AND WATER RATES AND CHARGES – Article XIIIC" and "– Article XIIID."

**No Debt Service Reserve Fund for the 2016 Bonds**

No debt service reserve fund will be created or funded to secure the 2016 Bonds. Debt service reserve funds were created in connection with the issuance of the 2009A Bonds, 2009B Bonds, 2010A Bonds and 2012A Subordinated Bonds and under the funding agreements for the SRF loans. Amounts on deposit in, or to be on deposit in, such debt service reserve funds are not available to secure the 2016 Bonds. See "SECURITY AND SOURCES OF PAYMENT FOR THE 2016 BONDS – No Debt Service Reserve Fund for the 2016 Bonds."

**Outstanding Senior and Subordinated Obligations**

The 2016 Subordinated Installment Payments securing payment of the 2016 Bonds are payable from Net System Revenues on a basis that is subordinate to the right of payment by the City of its Senior Obligations (as defined herein) then outstanding under the Installment Purchase Agreement. As of April 30, 2016, Senior Obligations included Installment Payments securing the payment of $565,055,000 aggregate principal amount of Senior Bonds (of which $565,055,000* aggregate principal amount will be refunded with proceeds of the 2016B Bonds) and $53,565,692 representing five SRF loans (the "Senior SRF Loans"). As defined in the Indenture, the term "Senior Bonds" means the 2009A Bonds, the 2009B Bonds, the 2010A Bonds and any other Bonds secured by pledge of Revenues on a parity with such Bonds. As of April 30, 2016, the aggregate principal amount of Outstanding Subordinated Obligations was $147,533,770 (comprised of the 2012A Subordinated Bonds (as defined herein) of which $135,970,000 aggregate principal amount is outstanding) and one SRF loan (the Earl Thomas Reservoir SRF Loan) in the amount of $11,563,770 (the "Subordinate SRF Loan" herein) which Subordinate SRF Loan will be refunded with proceeds of the 2016B Bonds), payable from Net System Revenues on parity with the Net System Revenues securing the 2016 Subordinated Installment Payments. As used herein, the term "Subordinated Bonds" means the 2016 Bonds and any other Bonds secured by a pledge of Subordinated Revenues on a parity with such 2016 Bonds, including the 2012A Subordinated Bonds. See "SECURITY AND SOURCES OF PAYMENT FOR THE 2016 BONDS – Senior Obligations" and "– Subordinated Obligations" and "WATER SYSTEM FINANCIAL OPERATIONS – Outstanding Indebtedness."

The City entered into a Master Lease Agreement, dated as of July 2, 2012, as amended (the "Equipment Lease"), with JPMorgan Chase Bank, N.A., in connection with the lease-purchase of certain equipment and vehicles used by the City, including the Public Utilities Department (the "Department"). The Department utilized the Equipment Lease to finance approximately $2.6 million of improvements to its advanced metering infrastructure program (the "AMI Program"). Approximately 50% (or $1.3 million) of the lease payments owed by the Department with respect to the AMI Program are payable from the Water Utility Fund, with the remainder payable from the City's Sewer Revenue Fund. The lease payments payable from the Water Utility Fund are not secured by a pledge of or lien on Net System Revenues and therefore are neither a Senior Obligation nor a Subordinated Obligation. The lease payments allocated to the Water Utility Fund are made from any available moneys in the Water Utility Fund. Final payment of the lease payments is due on July 1, 2021. As of the date of this Official Statement, other than the obligations under the Equipment Lease, the Department has not entered into any direct bank loans or issued any direct placement debt.

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* Preliminary, subject to change.

The following table illustrates current outstanding indebtedness payable from Net System Revenues as of April 30, 2016 (not including the Department's payment obligation under the Equipment Lease which are not secured by a pledge of or lien on Net System Revenues).

| | |
|---|---|
| Senior Obligations: | |
| 2009A Bonds* | $148,055,000 |
| 2009B Bonds* | 293,925,000 |
| 2010A Bonds* | 123,075,000 |
| Total Senior Bonds* | $565,055,000 |
| Senior SRF Loans | |
| Miramar Water Treatment Plant | $ 16,262,969 |
| Alvarado Water Treatment Plant | 9,758,739 |
| Otay Water Treatment Plant | 15,078,286 |
| Harbor Drive Pipeline Replacement | 9,508,887 |
| Lindbergh Field Pipeline Replacement | 2,956,811 |
| Total SRF Loans | $ 53,565,692 |
| Total Senior Obligations* | $618,620,692 |
| Subordinated Obligations: | |
| 2012A Subordinated Bonds | $135,970,000 |
| Earl Thomas Reservoir SRF Loan* | 11,563,770 |
| Total Subordinated Obligations* | $147,533,770 |

* All or a portion of the Senior Bonds and the Subordinate SRF Loan may be refunded by the 2016B Bonds. Amounts shown do not reflect such refunding. See "PLAN OF FINANCE – The Refunding Plan."

The proceeds of the 2016B Bonds, together with other available funds, will be used to advance refund all or a portion of the outstanding 2009A Bonds, 2009B Bonds, and 2010A Bonds and current refund the Subordinate SRF Loan. The plan of refunding anticipates the advance refunding of all outstanding Senior Bonds, however Senior Obligations will remain in the form of current and future SRF loans payable from Net System Revenues on a parity therewith, and potential additional Senior Bonds and Senior Obligations as may be hereafter executed and delivered in accordance with the Installment Purchase Agreement and the Indenture.

Pursuant to the Master Installment Purchase Agreement, the City may incur additional Obligations, payments with respect to which will be senior to, or on parity with, the City's obligation to make 2016 Subordinated Installment Payments, subject to satisfaction of the conditions specified in the Master Installment Purchase Agreement. See "SECURITY AND SOURCES OF PAYMENT FOR THE 2016 BONDS – Issuance of Additional Obligations Under the Master Installment Purchase Agreement," "WATER SYSTEM CAPITAL IMPROVEMENT PROGRAM – Financing Plans for the CIP," and "WATER SYSTEM FINANCIAL OBLIGATIONS – Anticipated Additional Obligations." Additional obligations are expected to include additional SRF loans received from the SWRCB, payments with respect to which are expected to be senior in right of payment to the City's obligation to make 2016 Subordinated Installment Payments.

**City of San Diego**

The City, with a total population of approximately 1.4 million as of January 1, 2016 and a land area of approximately 342 square miles, is the eighth largest city in the nation by population, and the

second largest city by population (and land area) in California. The City is the county seat for the County of San Diego. Major components of the City's diversified economy include defense, tourism, biotechnology/biosciences, financial and business services, software and telecommunications. The City's economic base is also anchored by higher education and major scientific research institutions, including the University of California, San Diego, San Diego State University, Scripps Research Institute, the Salk Institute for Biological Studies, and the San Diego Supercomputer Center.

The City was incorporated in 1850. The City operates under and is governed by the laws of the State of California (the "State") and the City Charter, as periodically amended since its adoption by the electorate in 1931. The City has been operating under a "Strong Mayor" form of government since January 1, 2006. Under the Strong Mayor form of government, the Mayor is the Chief Executive Officer of the City and has direct oversight over all City functions and services except for the City Council, Personnel, City Clerk, Independent Budget Analyst, Ethics Commission, City Attorney and City Auditor's departments.

**The Water System**

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

**The Corporation**

The Corporation is a nonprofit charitable corporation duly organized and existing under and by virtue of the laws of the State. The Corporation was organized to acquire, lease, and/or sell to the City real and personal property to be used in the municipal operations of the City. The Corporation was formed at the request of the City to assist in financings such as the installment purchase financing described herein and is governed by its own Board of Directors. The Corporation is prohibited from engaging in any business or activities other than those incidental to its sole purpose, and no part of its net earnings may accrue to the benefit of any person or entity other than the City.

The Corporation has no liability to the owners or Beneficial Owners of any 2016 Bonds, and has pledged none of its moneys, funds or assets to any Installment Payments including, without limitation, the 2016 Subordinated Installment Payments or any payments under the 2016 Bonds. Pursuant to the Assignment Agreement, the Corporation has assigned its right to receive the 2016 Subordinated Installment Payments to the Authority.

**Forward-Looking Statements**

Certain statements contained in this Preliminary Official Statement reflect not historical facts but forecasts and "forward-looking statements." All forward-looking statements are predictions and are subject to known and unknown risks and uncertainties. No assurance can be given that the future results discussed herein will be achieved, and actual results may differ materially from the forecasts described herein. In this respect, the words "estimate," "project," "anticipate," "expect," "intend," "believe" and similar expressions are intended to identify forward-looking statements. All projections, forecasts, assumptions, expressions of opinions, estimates and other forward-looking statements are expressly qualified in their entirety by the cautionary statements set forth in this Preliminary Official Statement. The achievement of certain results or other expectations contained in such forward-looking statements

involves known and unknown risks, uncertainties, and other factors that may cause the actual results, performance, or achievements described to be materially different from any future results, performance, or achievements expressed or implied by such forward-looking statements. No updates or revisions to these forward-looking statements are expected to be issued if or when the expectations, events, conditions, or circumstances on which such statements are based change. **INVESTORS ARE CAUTIONED NOT TO PLACE UNDUE RELIANCE ON SUCH FORWARD-LOOKING STATEMENTS, WHICH SPEAK ONLY AS OF THE DATE HEREOF.**

**Miscellaneous**

Copies of the Indenture, the Installment Purchase Agreement, the Assignment Agreement, and other financing documents may be obtained upon request from the Trustee at U.S. Bank National Association, 633 West Fifth Street, 24th Floor, Los Angeles, California 90071.

## THE AUTHORITY

The Authority is a California joint exercise of powers authority established pursuant to the Third Amended and Restated Joint Exercise of Powers Agreement, dated as of January 1, 2013, by and among the City, the City solely in its capacity as the designated successor agency (the "Successor Agency") to the former Redevelopment Agency of the City of San Diego (the "Former RDA"), and the Housing Authority of the City of San Diego (the "Housing Authority"). The Authority is organized, in part, to finance certain public capital improvements of the City, the Successor Agency or the Housing Authority.

Except as provided in the Indenture, the Authority has no liability to the owners or Beneficial Owners of any of the 2016 Bonds and has pledged none of its moneys, funds or assets toward the payment of any amount due in connection with the 2016 Bonds. The Indenture provides that the Authority transfers, conveys and assigns to the Trustee, for the benefit of the Owners, all of the Authority's rights under the Master Installment Purchase Agreement, including the right to receive the 2016 Subordinated Installment Payments from the City, the right to receive any proceeds of insurance maintained thereunder or any condemnation award rendered with respect to the related Components, and the right to exercise any remedies provided therein in the event of a default by the City under the Master Installment Purchase Agreement.

The Authority is governed by its own Board of Commissioners consisting of the members of the San Diego City Council. The Authority is dependent upon the officers and employees of the City to administer its programs.

## PLAN OF FINANCE *

**The 2016 Project**. The net proceeds of the 2016A Bonds, together with other available funds, will be applied to finance additional improvements to the Water System including, without limitation, the reimbursement of expenditures paid from amounts on deposit in the Water Utility Fund during Fiscal Year 2016 prior to the date of issuance of the 2016A Bonds. See "WATER SYSTEM CAPITAL IMPROVEMENT PROGRAM – Capital Improvement Financing Plan."

**The Refunding Plan**.* The net proceeds of the 2016B Bonds, together with other available funds, will be applied to advance refund all or a portion of the outstanding Public Facilities Financing Authority of the City of San Diego Water Revenue Bonds, Refunding Series 2009A (Payable Solely

* Preliminary, subject to change.

From Installment Payments Secured by Net System Revenues of the Water Utility Fund), of which $148,055,000 is currently outstanding (the "2009A Bonds"); the Public Facilities Financing Authority of the City of San Diego Water Revenue Bonds, Series 2009B (Payable Solely From Installment Payments Secured by Net System Revenues of the Water Utility Fund), of which $293,925,000 is currently outstanding (the "2009B Bonds"); and the Public Facilities Financing Authority of the City of San Diego Water Revenue Bonds, Refunding Series 2010A (Payable Solely From Installment Payments Secured by Net System Revenues of the Water Utility Fund), of which $123,075,000 is currently outstanding (the "2010A Bonds" and, together with the 2009A Bonds and the 2009B Bonds, the "Refunded Bonds") as described below and current refund the Subordinate SRF Loan promptly following the issuance of the 2016 Bonds. Some or all of the maturities of the Refunded Bonds set forth in the tables below will be refunded with a portion of the proceeds of the 2016B Bonds as determined by the City, and redeemed on the respective dates set forth in the respective table below at redemption prices equal to the principal amount thereof plus interest accrued thereon in accordance with the terms of the Indenture.

2009A Senior Bonds*

| Maturity Date August 1 | Principal Amount | Interest Rate | Redemption Date | CUSIP No. |
|---|---|---|---|---|
| 2016 | $15,015,000 | 5.000% | 8/1/2018 | 79730CCH5 |
| 2017 | 15,780,000 | 5.000 | 8/1/2018 | 79730CCJ1 |
| 2018 | 16,590,000 | 5.000 | 8/1/2018 | 79730CCK8 |
| 2019 | 9,650,000 | 4.000 | 8/1/2018 | 79730CCL6 |
| 2019 | 7,740,000 | 5.000 | 8/1/2018 | 79730CCM4 |
| 2020 | 3,570,000 | 4.000 | 8/1/2018 | 79730CCN2 |
| 2020 | 14,645,000 | 5.000 | 8/1/2018 | 79730CCP7 |
| 2021 | 2,545,000 | 4.250 | 8/1/2018 | 79730CCQ5 |
| 2021 | 16,575,000 | 5.000 | 8/1/2018 | 79730CCR3 |
| 2026 | 9,670,000 | 5.000 | 8/1/2018 | 79730CCS1 |
| 2029 | 7,070,000 | 5.000 | 8/1/2018 | 79730CCT9 |
| 2038 | 29,205,000 | 5.250 | 8/1/2018 | 79730CCU6 |

* Preliminary, subject to change.

2009B Senior Bonds*

| Maturity Date August 1, | Principal Amount | Interest Rate | Redemption Date | CUSIP No. |
|---|---|---|---|---|
| 2016 | $ 6,490,000 | 4.000% | 8/1/2019 | 79730CDB7 |
| 2017 | 6,790,000 | 5.000 | 8/1/2019 | 79730CDC5 |
| 2018 | 7,105,000 | 4.125 | 8/1/2019 | 79730CDD3 |
| 2019 | 7,435,000 | 5.000 | 8/1/2019 | 79730CDE1 |
| 2020 | 7,820,000 | 5.000 | 8/1/2019 | 79730CDF8 |
| 2021 | 535,000 | 4.500 | 8/1/2019 | 79730CDG6 |
| 2021 | 7,680,000 | 5.000 | 8/1/2019 | 79730CDT8 |
| 2022 | 8,635,000 | 5.000 | 8/1/2019 | 79730CDH4 |
| 2023 | 2,485,000 | 4.750 | 8/1/2019 | 79730CDJ0 |
| 2023 | 6,590,000 | 5.000 | 8/1/2019 | 79730CDU5 |
| 2024 | 9,540,000 | 5.000 | 8/1/2019 | 79730CDK7 |
| 2025 | 10,030,000 | 5.000 | 8/1/2019 | 79730CDL5 |
| 2026 | 10,540,000 | 5.000 | 8/1/2019 | 79730CDM3 |
| 2027 | 11,085,000 | 5.000 | 8/1/2019 | 79730CDN1 |
| 2028 | 11,660,000 | 5.125 | 8/1/2019 | 79730CDP6 |
| 2029 | 12,270,000 | 5.125 | 8/1/2019 | 79730CDS0 |
| 2034 | 72,220,000 | 5.375 | 8/1/2019 | 79730CDQ4 |
| 2035 | 16,955,000 | 5.750 | 8/1/2019 | 79730CDV3 |
| 2039 | 78,060,000 | 5.500 | 8/1/2019 | 79730CDR2 |

2010A Senior Bonds*

| Maturity Date August 1, | Principal Amount | Interest Rate | Redemption Date | CUSIP No. |
|---|---|---|---|---|
| 2022 | $12,510,000 | 5.000% | 8/1/2020 | 79730CDX9 |
| 2023 | 13,150,000 | 5.000 | 8/1/2020 | 79730CDY7 |
| 2024 | 15,910,000 | 5.000 | 8/1/2020 | 79730CDZ4 |
| 2025 | 18,815,000 | 5.000 | 8/1/2020 | 79730CEA8 |
| 2026 | 19,805,000 | 5.250 | 8/1/2020 | 79730CEB6 |
| 2027 | 20,880,000 | 5.250 | 8/1/2020 | 79730CEC4 |
| 2028 | 22,005,000 | 5.250 | 8/1/2020 | 79730CED2 |

Subordinate SRF Loan*

| Project | Final Maturity Date | Principal Outstanding as of 4/30/2016 | Interest Rate |
|---|---|---|---|
| 2004 Earl Thomas Reservoir Loan (Subordinated Lien) | July 1, 2025 | $11,563,780 | 2.5132% |

On the date of issuance of the 2016 Bonds, a portion of the proceeds of the sale of the 2016B Bonds, together with certain moneys currently on deposit in the funds and accounts established under the Indenture, will be deposited in an account for each series of Refunded Bonds to be established under an Escrow Agreement, dated as of June 1, 2016 (the "Escrow Agreement"), by and between the Authority and U.S. Bank National Association, as successor prior trustee and escrow agent (the "Escrow Agent"). Such amounts held under the Escrow Agreement, will be held in escrow (each, an "Escrow Account" and, together, in the "Escrow Fund") and invested in direct obligations of the United States Treasury (the "Escrow Securities"), the principal of and interest on which will be used to redeem the related series of Refunded Bonds. If the City purchases open market securities to be held in the Escrow Fund, Raymond

* Preliminary, subject to change.

James & Associates, Inc. will act as registered investment advisor to the City in its capacity as bidding agent in conducting a competitive bid procurement process for such securities. See "INVESTMENT ADVISOR." Causey Demgen & Moore P.C. will verify the accuracy of the mathematical computation concerning the adequacy of the maturing principal amounts of and interest earned on the Escrow Securities to be purchased and held in the Escrow Fund. See "VERIFICATION."

Also, on the date of issuance of the 2016 Bonds, a portion of the proceeds of the sale of the 2016B Bonds, will be deposited in the SRF Refunding Fund to be established under the Indenture and held by the Trustee. Amounts held therein will be applied to current refund the Subordinate SRF Loan on or about the date of issuance of the 2016 Bonds.

The funds deposited in the Escrow Fund and in the SRF Refunding Fund will not be available for the payment of debt service on to the 2016 Bonds.

## ESTIMATED SOURCES AND USES OF BOND PROCEEDS

The following table details the estimated sources and uses of the proceeds of the sale of the 2016 Bonds and other available funds.

| | 2016A Bonds | 2016B Bonds | Total |
|---|---|---|---|
| **Estimated Sources:** | | | |
| Principal Amount of the 2016 Bonds | | | |
| Net Original Issue Premium | | | |
| Amounts released from the Reserve Fund established for the Senior Bonds | | | |
| Total Sources | | | |
| **Estimated Uses:** | | | |
| Escrow Fund Deposit | | | |
| SRF Refunding Fund Deposit | | | |
| Acquisition Fund Deposit | | | |
| Payment of Costs of Issuance [(1)] | | | |
| Total Uses | | | |

[(1)] Costs of Issuance for the 2016 Bonds to cover all eligible costs, including underwriters' discount.

## DESCRIPTION OF THE 2016 BONDS

### General

The 2016 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 2016 Bonds. Ownership interests in the 2016 Bonds may be purchased in book-entry form only. So long as DTC or its nominee is the Owner of the 2016 Bonds, principal of, redemption premium, if any, and interest on the 2016 Bonds will be made as described in "APPENDIX D – INFORMATION REGARDING THE BOOK-ENTRY ONLY SYSTEM."

The 2016 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, 2016. The 2016 Bonds will bear interest at the respective rates set forth on the inside cover page hereof. Interest on the 2016 Bonds shall be calculated on the basis of a 360-day year, comprised of twelve 30-day months. Interest coming due on a date that is not a Business Day shall be payable on the immediately following Business Day.

**Redemption of 2016 Bonds**

***Optional Redemption***. The 2016A Bonds maturing on and after August 1, 20__ 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, 20__, at any time, from and to the extent of prepaid 2016 Subordinated Installment Payments paid pursuant to the 2016 Supplement, at a redemption price equal to the principal amount of 2016A Bonds called for redemption, together with interest accrued thereon to the date fixed for redemption, without premium.

The 2016B Bonds maturing on and after August 1, 20__ 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, 20__, at any time, from and to the extent of prepaid 2016 Subordinated Installment Payments paid pursuant to the 2016 Supplement, at a redemption price equal to the principal amount of 2016B Bonds called for redemption, together with interest accrued thereon to the date fixed for redemption, without premium.

***Mandatory Sinking Fund Redemption***. The 2016A Term Bonds maturing on August 1, 20__, 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:

2016A Bonds Maturing August 1, 20__

| Sinking Fund Payment Dates (August 1) | Principal Amount |
|---|---|
| 20__ | |
| 20__* | |

* Final maturity.

The 2016A Term Bonds maturing on August 1, 20__, 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:

2016A Bonds Maturing August 1, 20__

| Sinking Fund Payment Dates (August 1) | Principal Amount |
|---|---|
| 20__ | |
| 20__ | |
| 20__ | |
| 20__* | |

* Final maturity.

The 2016B Term Bonds maturing on August 1, 20__, 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:

2016B Bonds Maturing August 1, 20__

| Sinking Fund Payment Dates (August 1) | Principal Amount |
|---|---|
| 20__ | |
| 20__ | |
| 20__ | |
| 20__* | |

* Final maturity.

The Authority 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.

***Notice of Redemption***. So long as DTC is acting as securities depository for the 2016 Bonds, notice of redemption, containing the information required by the Indenture, will be mailed by first class mail, postage prepaid, by the Trustee to DTC (not to the Beneficial Owners of any 2016 Bonds designated for redemption) not more than 60 days nor less than 30 days prior to the redemption date and shall state the date of such notice, the redemption price (including the name and appropriate address of the Trustee), and, in the case of 2016 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 2016 Bonds the principal amount thereof and, in the case of a 2016 Bond to be redeemed in part only, the specified portion of the principal amount thereof to be redeemed, together with interest accrued thereon to the redemption date, and that from and after such redemption date, interest thereon shall cease to accrue, and shall require that such 2016 Bonds be then surrendered at the address of the Trustee specified in the redemption notice. Notice of redemption may be conditioned upon the occurrence of future events, including but not limited to the issuance of refunding bonds, and may be given and rescinded by the Trustee prior to the redemption date, upon written instruction of the Authority.

***Selection for Redemption***. If less than all of the outstanding 2016 Bonds are to be redeemed prior to maturity, the Authority (at the direction of the City) shall select the specific maturity and interest rate (or maturities of bonds and interest rates) of 2016 Bonds, or portions thereof equal to $5,000 or any integral multiple thereof, including any specified reduction in any sinking account payments required to be made with respect to such outstanding 2016 Bonds, to be redeemed. If less than all of the 2016 Bonds of like maturity are to be redeemed, the Trustee will select the particular 2016 Bonds or portions of 2016 Bonds to be redeemed at random in such manner as the Trustee in its discretion may deem fair and appropriate.

***Effect of Redemption***. If notice of redemption has been duly given as provided in the Indenture and money for the payment of the redemption price of the 2016 Bonds called for redemption is held by the Trustee, then on the redemption date designated in such notice, the 2016 Bonds shall become due and payable, and from and after the date so designated, interest on the 2016 Bonds so called for redemption shall cease to accrue, and the Owners of such 2016 Bonds shall have no rights in respect thereof except to

receive payment of the redemption price thereof. The insufficiency of any such notice shall not affect the sufficiency of the proceedings for redemption. If said moneys are not so available on the redemption date, such 2016 Bonds or portions thereof will continue to bear interest until paid at the same rate as they would have borne had they not been called for redemption. If there is selected for redemption a portion of a 2016 Bond, the Authority will execute and the Trustee for that 2016 Bond will authenticate and deliver, upon the surrender of such 2016 Bond, without charge to the Owner thereof, for the unredeemed balance of the principal amount of the 2016 Bond so surrendered, a 2016 Bond of like maturity and interest rate in any authorized denomination.

## SECURITY AND SOURCES OF PAYMENT FOR THE 2016 BONDS

### Pledge of Subordinated Revenues; Subordinated Installment Payments

Pursuant to the Indenture, the 2016 Bonds are limited obligations of the Authority payable solely from the Subordinated Revenues and amounts on deposit in the Subordinated Bonds Payment Fund established under the Indenture. The term "Subordinated Revenues," as applied to the 2016 Bonds, means all 2016 Subordinated Installment Payments received by or due to be paid to the Corporation pursuant to the 2016 Supplement and the interest or profits from the investment of money in the Subordinated Bonds Payment Fund pursuant to the Indenture. The 2016 Subordinated Installment Payments will be assigned by the Corporation to the Authority pursuant to the Assignment Agreement. To secure the pledge of the Subordinated Revenues, the Authority will transfer, convey, and assign to the Trustee, for the benefit of the Owners, all of the Authority's right to receive 2016 Subordinated Installment Payments from the City. See "APPENDIX A – SUMMARY OF PRINCIPAL LEGAL DOCUMENTS – Indenture."

### The Water Utility Fund

The City accounts for its water operations through an enterprise fund known as the "Water Utility Fund." The Water Utility Fund was established pursuant to an amendment to the City Charter effective February 11, 1963, and is accounted for separately from other funds of the City. The City has agreed and covenanted in the Master Installment Purchase Agreement that all System Revenues shall be received by the City in trust and shall be deposited when and as received in the Water Utility Fund, which fund the City agrees and covenants to maintain so long as any Obligations remain unpaid, and all moneys in the Water Utility Fund shall be so held in trust and applied and used solely as provided in the Master Installment Purchase Agreement. The City further has agreed to pay from the Water Utility Fund: (1) directly or as otherwise required all Maintenance and Operation Costs of the Water System; and (2) to the Trustee, for deposit in the Payment Fund for Senior Obligations, including Reserve Fund Obligations that are Senior Obligations, the amounts specified in any Issuing Instrument, as payments due on account of Senior Obligations (including any Credit Provider Reimbursement Obligations that are Senior Obligations). In the event there are insufficient Net System Revenues to make all of the payments contemplated by clause (2) of the immediately preceding sentence, then said payments shall be made as nearly as practicable, *pro rata*, based upon the respective unpaid principal amounts of said Senior Obligations. See "Pledge of Net System Revenues" below for additional detail and defined terms. Included among Senior Obligations are the Senior SRF Loans. Each Senior SRF Loan includes terms for the funding and reimbursement of a debt service reserve fund established for such Senior SRF Loan.

After the payments described in the preceding paragraph have been made, and in any event not less frequently than January 15 and July 15 of each year, any remaining Net System Revenues shall be used to make up any deficiency in the Reserve Funds for Senior Obligations. Notwithstanding the use of a Reserve Fund Credit Facility in lieu of depositing funds in the related Reserve Fund for Senior 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 Senior 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 Senior 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 Senior 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 such as the 2016 Subordinated Installment Payments and the 2012 Subordinated Installment Payments (including any Reserve Fund Obligations for Subordinated Obligations, any Credit Provider Reimbursement Obligations that are Subordinated Obligations, and any Subordinated Credit Provider Reimbursement Obligations), provided the following conditions are met: (1) all Maintenance and Operation Costs of the Water System are being and have been paid and are then current; and (2) all deposits and payments contemplated by clause (2) of the preceding paragraph shall have been made in full and no deficiency in any Reserve Fund for Senior Obligations shall exist, and there shall have been paid, or segregated within the Water Utility Fund, the amounts payable during the current month pursuant to clause (2) of the preceding paragraph.

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

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

On or before each Principal Payment Date, the Trustee shall transfer from the Senior Bonds Payment Fund and deposit in the Senior Bonds Principal Account that amount of money that, together with any money contained in the Senior Bonds Principal Account, equals the aggregate principal becoming due and payable on all Outstanding Senior Bonds. No deposit need be made in the Senior Bonds Principal Account if the amount contained therein is at least equal to the aggregate amount of principal become due and payable on Outstanding Senior Bonds. All money in the Senior Bonds Principal Account shall be used and withdrawn by the Trustee solely for the purpose of paying the principal of the Senior Bonds as it shall become due and payable. Within the Senior Bonds Payment Fund, there is established a special account designated the "Senior Bonds Redemption Account." All money in the Senior Bonds Redemption Account shall be held in trust by the Trustee and shall be applied, used, and withdrawn to redeem Senior Bonds.

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

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

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

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

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

**Pledge of Net System Revenues**

The Installment Purchase Agreement provides for the payment by the City of Senior Obligations and Subordinated Obligations in amounts sufficient to make payments of the principal of and interest on Bonds of the Authority. Pursuant to the Installment Purchase Agreement, the City agrees to make Installment Payments (including the 2016 Subordinated Installment Payments) solely from Net System Revenues. The 2016 Subordinated Installment Payments shall be Subordinated Obligations under the Installment Purchase Agreement and the payment of the 2016 Subordinated Installment Payments shall be on parity in right of payment to the 2012 Subordinated Installment Payments under the Installment Purchase Agreement. No Owner of the Obligations shall have any right to take any action or enforce any right that has a materially adverse effect on the interests of the Owners of the Installment Payment Obligations. The City agrees to make Installment Payments solely from Net System Revenues until such time as the Purchase Price for any Components has been paid in full (or provision for the payment thereof has been made pursuant to the Installment Purchase Agreement).

The 2016 Supplement provides for the payment by the City of 2016 Subordinated Installment Payments in amounts sufficient to make payments of the principal of and interest on the 2016 Bonds. The

2016 Subordinated Installment Payments securing payment of the 2016 Bonds are payable from Net System Revenues on a basis that is subordinate to the right of payment by the City of its Outstanding Senior Obligations (as defined herein) under the Installment Purchase Agreement and on parity with the 2012A Subordinated Bonds.

The City will not discontinue or suspend any Installment Payments (including the 2016 Subordinated Installment Payments ) required to be made by the City under the Installment Purchase Agreement, whether or not the Project or any part thereof is operating or operable or has been completed, or its use is suspended, interfered with, reduced, curtailed, or terminated, in whole or in part, and such Installment Payments (including the 2016 Subordinated Installment Payments) shall not be subject to reduction, whether by offset or otherwise, and will not be conditioned upon the performance or nonperformance by any party of any agreement for any cause whatsoever.

The term "Net System Revenues" is defined in the Master Installment Purchase Agreement as, for any Fiscal Year, the System Revenues for such Fiscal Year, less the Maintenance and Operation Costs of the Water System for such Fiscal Year.

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

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

salaries and wages of employees of the Water System, payments to such employees' retirement systems (to the extent paid from System Revenues), overhead, taxes (if any), fees of auditors, accountants, attorneys or engineers, and insurance premiums, and including all other reasonable and necessary costs of the City or charges required to be paid by it to comply with the terms of the Obligations, including the Installment Purchase Agreement, including any amounts required to be deposited in the Rebate Fund pursuant to a Tax Certificate, and fees and expenses payable to any Credit Provider.

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

The term "Qualified Take or Pay Obligation" is defined in the Master Installment Purchase Agreement as the obligation of the City to make use of any facility, property, or services, or some portion of the capacity thereof, or to pay therefor from System Revenues, or both, whether or not such facilities, properties, or services are ever made available to the City for use, and there is provided to the City a certificate of the City or of an Independent Engineer to the effect that the incurrence of such obligation will not adversely affect the ability of the City to comply with the rate covenant contained in the Installment Purchase Agreement. As of the date of issuance of the 2016 Bonds, there will be no outstanding Qualified Take or Pay Obligations.

**Senior Obligations**

As of April 30, 2016, the pledge and right of payment from Net System Revenues securing the 2016 Subordinated Installment Payments (which, in turn, secure the payment of the 2016 Bonds) will be subordinate to the pledge and right of payment from Net System Revenues securing the Installment Payments payable on a senior basis and which, in turn, secure the payment of the following Senior Obligations outstanding as of April 30, 2016: the 2009A Bonds, outstanding in the aggregate principal

amount of $148,055,000, the 2009B Bonds, outstanding in the aggregate principal amount $293,925,000, the 2010A Bonds, outstanding in the aggregate principal amount of $123,075,000, and the Senior SRF Loans. The total principal amount of the Senior SRF Loans, as of April 30, 2016, was $53,565,692. See "INTRODUCTION – Outstanding Senior and Subordinated Obligations" above and "WATER SYSTEM FINANCIAL OPERATIONS – Outstanding Indebtedness." See "WATER SYSTEM FINANCIAL OBLIGATIONS – Anticipated Additional Obligations."

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

The term "Obligations" is defined in the Master Installment Purchase Agreement as (i) obligations of the City for money borrowed (such as bonds, notes, or other evidences of indebtedness) or as installment purchase payments under any contract (including Installment Payments), or as lease payments under any financing lease (determined to be such in accordance with generally accepted accounting principles), the principal of and interest on which are payable from Net System Revenues; (ii) obligations to replenish any debt service reserve funds with respect to such obligations of the City; (iii) obligations secured by or payable from any of such obligations of the City; and (iv) obligations of the City payable from Net System Revenues under (a) any contract providing for payments based on levels of, or changes in, interest rates, currency exchange rates, stock or other indices, (b) any contract to exchange cash flows or a series of payments, or (c) any contract to hedge payment, currency, rate spread, or similar exposure, including but not limited to interest rate cap agreements.

**Subordinated Obligations**

The Master Installment Purchase Agreement permits the issuance of Obligations secured by a lien on and pledge of Net System Revenues, which lien and pledge is subordinate to the lien on and pledge of Net System Revenues securing Senior Obligations (each, a "Subordinated Obligation"). On May 3, 2012, the Authority issued its $188,610,000 aggregate principal amount of 2012A Subordinated Bonds pursuant to the Indenture. The 2016 Subordinated Installment Payments shall be Subordinated Obligations under the Installment Purchase Agreement and the payment of the 2016 Subordinated Installment Payments will be on parity with the right of payment of $135,970,000 aggregate principal amount of other Outstanding Subordinated Obligations under the Master Installment Purchase Agreement, as of April 30, 2016, securing the 2012A Subordinated Bonds, and the Subordinate SRF Loan in the amount of $11,563,770 (to be refunded with proceeds of the 2016B Bonds), for a total of $147,533,770. Currently, no additional SRF loans are anticipated to be executed as subordinate liens. See "PLAN OF FINANCE – The Refunding Plan" and "WATER SYSTEM FINANCIAL OPERATIONS – Outstanding Indebtedness."

Nothing contained in the Master Installment Purchase Agreement limits the ability of the City to grant a lien on and pledge of the Net System Revenues that is subordinate to any liens on and pledges of Net System Revenues for the benefit of Subordinated Obligations, including the 2016 Subordinated Installment Payments. See "APPENDIX A – SUMMARY OF PRINCIPAL LEGAL DOCUMENTS."

**Rate Covenant**

The City has covenanted in the Master Installment Purchase Agreement to fix, prescribe, and collect rates and charges for the Water Service that will be at least sufficient to yield the greater of (i) Net System Revenues sufficient to pay during each Fiscal Year all Obligations (including the 2016 Subordinated Installment Payments and loan payments due on SRF loans) payable in such Fiscal Year or (ii) Adjusted Net System Revenues during each Fiscal Year equal to 120% of the Adjusted Debt Service for such Fiscal Year. The City may make adjustments from time to time in such rates and charges and may make such classification thereof as it deems necessary, but the City will not reduce the rates and charges then in effect unless the Net System Revenues from such reduced rates and charges will at all times be sufficient to meet the requirements of the Installment Purchase Agreement. The term "Adjusted Net System Revenues" is defined in the Master Installment Purchase Agreement as, for any Fiscal Year, the Net System Revenues for such Fiscal Year, minus an amount equal to earnings from investments in any Reserve Fund securing Obligations for such Fiscal Year. The term "Adjusted Debt Service" is defined in the Master Installment Purchase Agreement as, for any Fiscal Year, Debt Service on Senior Obligations for such Fiscal Year, minus an amount equal to earnings from investments in any Reserve Fund for Senior Obligations for such Fiscal Year. Adjusted Debt Service does **not** include debt service on Subordinated Obligations, such as the 2016 Subordinated Installment Payments. Net System Revenues (and, therefore, Adjusted Net System Revenues) may be increased or reduced by transfers in to or out of the Rate Stabilization Fund or the Secondary Purchase Fund. See "– Pledge of Net System Revenues" above. For information on the possible limitation on the City's ability to comply with the rate covenant described above as a consequence of Proposition 218, see "RISK FACTORS – Rate-Setting Process Under Proposition 218" and "CONSTITUTIONAL LIMITATIONS ON TAXES AND WATER RATES AND CHARGES – Article XIIIC" and "– Article XIIID." For a description of the reserve funds established by the City within the Water Utility Fund, see "WATER SYSTEM FINANCIAL OPERATIONS – Rate Stabilization Fund; Other Funds and Accounts."

**No Debt Service Reserve Fund for the 2016 Bonds**

The Fourth Supplemental Indenture specifies no debt service reserve fund in connection with the issuance of the 2016 Bonds, and no debt service reserve fund will be created or funded to secure the 2016 Bonds. Debt service reserve funds were created under the Indenture in connection with the issuance of the 2009A Bonds, 2009B Bonds, 2010A Bonds and 2012A Subordinated Bonds. Amounts on deposit in, or to be on deposit in, such debt service reserve funds are not available to secure the 2016 Bonds.

The 2012A Subordinated Bonds are secured by amounts on deposit in the Common Subordinated Bonds Reserve Fund. With respect to the issuance of any series of Subordinated Bonds, the Indenture permits the City to elect to provide for a Common Subordinated Bonds Reserve Fund, series specific Separate Subordinated Bonds Reserve Bonds or no debt service reserve fund. With respect to the 2016 Bonds, the City has elected to cause the issuance of the 2016 Bonds to not be secured by any debt service reserve fund.

The Senior Bonds debt service reserve fund under the Indenture was funded and its amount on deposit increased in connection with the issuance of Senior Bonds to date: the 2009A Bonds, 2009B Bonds, and 2010A Bonds. The City does not expect future series of Senior Bonds, if any, to be secured by a debt service reserve fund, and the Fourth Supplemental Indenture includes amendments to permit the establishment of a Common Senior Bonds Reserve Fund, series specific Separate Senior Bonds Reserve Bonds, or no debt service reserve fund in connection with the issuance of additional Senior Bonds. Such amendments will be effective as of their Amendment Effective Date and will not impact the Reserve Fund that secures 2009A Bonds, 2009B Bonds, and 2010A Bonds which will remain outstanding after the issuance of the 2016B Bonds, or any required reimbursement thereof. The Amendment Effective Date

shall mean the date of following delivery of the Fourth Supplemental Indenture and the requisite consent of the Owners of 51% in aggregate principal amount of the Senior Bonds then Outstanding and the written consents of the Owners of 51% in aggregate principal amount of the Subordinated Bonds then Outstanding has been received.

Amounts on deposit in, or to be on deposit in, such debt service reserve funds, or in reserve funds established or to be established under the funding agreements for the SRF loans, are not available to secure the 2016 Bonds. No debt service reserve fund will be created or funded to secure the 2016 Bonds.

**Issuance of Additional Obligations Under the Master Installment Purchase Agreement**

Pursuant to the Master Installment Purchase Agreement, the City may incur additional Obligations, payments with respect to which will be senior to, or on parity with, the City's obligation to make 2016 Subordinated Installment Payments, subject to satisfaction of the conditions specified in the Master Installment Purchase Agreement, as described below.

***Issuance of Senior Obligations***. The City may not create any Obligations, the payments of which are senior or prior in right to the payment by the City of the outstanding Senior Obligations and obligations payable from Net System Revenues on a parity therewith (collectively, the "Senior Obligations"). The City may issue or create any other Senior Obligations, provided that (i) there shall not have occurred and be continuing an Event of Default under the terms of the Installment Purchase Agreement, any Issuing Instrument, or any Credit Support Instrument and (ii) the City obtains or provides a certificate or certificates, prepared by the City or at the City's option by a Consultant, showing that:

(1) the Net System Revenues as shown by the books of the City for any 12 consecutive month period within the 18 consecutive months ending immediately prior to the incurring of such additional Senior Obligations shall have amounted to or exceeded the greater of (i) at least 1.20 times the Maximum Annual Debt Service on all Senior Obligations to be Outstanding immediately after the issuance of the proposed Senior 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 Senior Obligations; or

(2) the estimated Net System Revenues for the five Fiscal Years following the earlier of (a) the end of the period during which interest on those Senior Obligations is to be capitalized or, if no interest is to be capitalized, the Fiscal Year in which the Senior Obligations are issued, or (b) the date on which substantially all new Components to be financed with such Senior Obligations are expected to commence operations, will be at least equal to 1.20 times the Maximum Annual Debt Service for all Senior Obligations that will be Outstanding immediately after the issuance of the proposed Senior Obligations.

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

conditions for the issuance of the Senior Obligations under the Master Installment Purchase Agreement, see "APPENDIX A – SUMMARY OF PRINCIPAL LEGAL DOCUMENTS."

***Issuance of Subordinated Obligations***. Pursuant to the Master Installment Purchase Agreement, if (i) no Event of Default has occurred and is continuing, and (ii) no event of default or termination event attributable to an act of or failure to act by the City under any Credit Support Instrument has occurred and is continuing, the City may issue or incur additional Subordinated Obligations, and such Subordinated Obligations shall be paid in accordance with the provisions of the Master Installment Purchase Agreement, provided that the City obtains or provides a certificate or certificates, prepared by the City or at the City's option by a Consultant, showing that:

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

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

The certificate or certificates described in clauses (1) and (2) above will not be required if the Subordinated Obligations being issued are for the purpose of refunding (i) then-Outstanding Senior Obligations or Subordinated Obligations if at the time of the issuance of such Subordinated Obligations a certificate of an Authorized City Representative is delivered showing that the sum of Debt Service for all remaining Fiscal Years on all Senior 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 Senior Obligations and Subordinated Obligations Outstanding prior to the issuance of such refunding Subordinated Obligations; or (ii) then-Outstanding Balloon Indebtedness, Tender Indebtedness, or Variable Rate Indebtedness, but only to the extent that the principal amount of such indebtedness has been put, tendered to, or otherwise purchased by a standby purchase agreement or other liquidity facility relating to such indebtedness. For additional information relating to the terms and conditions for the issuance of the Subordinated Obligations under the Master Installment Purchase Agreement, see "APPENDIX A – SUMMARY OF PRINCIPAL LEGAL DOCUMENTS."

**Issuance of Additional Bonds Under the Indenture**

Pursuant to the Indenture, the Trustee may, upon Written Request of the Authority, by a supplement to the Indenture, establish one or more other series of bonds, which may include Additional Senior Bonds and Additional Subordinated Bonds (collectively, the "Additional Bonds"). As defined in the Indenture, the term "Additional Senior Bonds" means those Bonds authorized and issued pursuant to the Indenture on a parity with the 2009A Bonds, the 2009B Bonds and the 2010A Bonds. The term "Additional Subordinated Bonds" means those Bonds authorized and issued pursuant to the Indenture on a parity with the 2012A Subordinated Bonds and the 2016 Bonds.

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

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

(b) The Supplemental Indenture providing for the execution and delivery of such Additional Bonds shall specify the purposes for which such Additional Bonds are then proposed to be delivered, which shall be one or more of the following: (i) to provide moneys needed to provide for Project Costs by depositing into the Acquisition Fund the proceeds of such Additional Bonds to be so applied; (ii) to provide for the payment or redemption of Bonds then Outstanding hereunder, by depositing with the Trustee moneys and/or investments required for such purpose under the defeasance provisions set forth in the Indenture; or (iii) to provide moneys needed to refund or refinance all or part of any other current or future obligations of the City with respect to the funding of the Water System. Such Supplemental Indenture may, but shall not be required to, provide for the payment of expenses incidental to such purposes, including the Costs of Issuance of such Additional Bonds, capitalized interest with respect thereto for any period authorized under the Code (in the case of Tax-Exempt Bonds) and, in the case of any Additional Bonds intended to provide for the payment or redemption of existing Bonds, or other Obligations of the City, expenses incident to calling, redeeming, paying or otherwise discharging the Obligations to be paid with the proceeds of the Additional Bonds;

(c) The Supplemental Indenture providing for the execution and delivery of such Additional Bonds shall state whether such Additional Bonds shall be Senior Bonds or Subordinated Bonds;

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

(e) Prior to the Amendment Effective Date, if such Additional Bonds are Senior Bonds, the Authority shall deliver or cause to be delivered to the Trustee, from the proceeds of such Additional Bonds or from any other lawfully available source of moneys, an amount (or a Surety Bond in an amount) sufficient to increase the balance in the Reserve Fund established for the Senior Bonds to the applicable Reserve Fund Requirement;

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

(g) After the Amendment Effective Date, if such Additional Bonds are Senior Bonds to be secured by a Separate Senior Bonds Reserve Fund, the Authority shall deliver or cause to be delivered by the Trustee, from the proceeds of such Additional Bonds or from any other lawfully available source of moneys, an amount (or a Surety Bond in an amount) sufficient to increase the balance in such Separate Senior Bonds Reserve Fund to the Separate Senior Bonds Reserve Fund for such Series of Senior Bonds;

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

increase the balance of the Common Subordinated Bonds Reserve Fund to the Common Subordinated Bonds Reserve Fund Requirement;

(i) If such Additional Bonds are Subordinated Bonds to be secured by a Separate Subordinated Bonds Reserve Fund, the Authority shall deliver or cause to be delivered by the Trustee, from the proceeds of such Additional Bonds or from any other lawfully available source of moneys, an amount (or a Surety Bond in an amount) sufficient to increase the balance in such Separate Subordinated Bonds Reserve Fund to the Separate Subordinated Bonds Reserve Fund for such Series of Subordinated Bonds;

(j) 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;

(k) 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;

(l) 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

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

Such conditions include terms for the establishment of a Common Subordinated Bonds Reserve Fund, series specific Separate Subordinated Bonds Reserve Bonds or no debt service reserve fund. Debt service reserve funds were created in connection with the issuance of the 2009A Bonds, 2009B Bonds, 2010A Bonds and the 2012A Subordinated Bonds, and under the funding agreements for the SRF loans. As described elsewhere in this Official Statement, amounts on deposit in, or to be on deposit in, such debt service reserve funds, and as established or may hereafter be established including under the funding agreements for SRF loans, are not available to secure the 2016 Bonds. No debt service reserve fund will be created or funded to secure the 2016 Bonds. See "SECURITY AND SOURCES OF PAYMENT FOR THE 2016 BONDS – No Debt Service Reserve Fund for the 2016 Bonds."

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

## DEBT SERVICE SCHEDULE

The following table sets forth the amounts required in each Fiscal Year for the payment of principal of and interest on Outstanding Senior Obligations and Subordinated Obligations payable from the Water Utility Fund. The final Official Statement will set forth a revised schedule, after giving effect to the issuance of the 2016 Bonds, the advance refunding of all or a portion of the 2009A Bonds, 2009B Bonds, and 2010A Bonds, and the current refunding of the Subordinate SRF Loan. See "PLAN OF FINANCE – The Refunding Plan."

## TABLE 1
## DEBT SERVICE ON ALL OUTSTANDING OBLIGATIONS[1]

| | | | 2016A Bonds | | | 2016B Bonds | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Fiscal Year | Total Senior Obligations Debt Service[2] | Outstanding Subordinated Obligations Debt Service[3] | Principal | Interest | Total Principal and Interest | Principal | Interest | Total Principal and Interest | Total Debt Service on Subordinated Obligations | Total Debt Service |
| 2017 | $53,680,890 | $13,209,772 | | | | | | | | $ 66,890,663 |
| 2018 | 53,930,396 | 13,206,922 | | | | | | | | 67,137,318 |
| 2019 | 53,929,856 | 13,211,572 | | | | | | | | 67,141,428 |
| 2020 | 53,926,190 | 13,204,822 | | | | | | | | 67,131,012 |
| 2021 | 53,930,790 | 13,207,947 | | | | | | | | 67,138,737 |
| 2022 | 53,925,271 | 13,210,022 | | | | | | | | 67,135,293 |
| 2023 | 48,235,528 | 13,211,472 | | | | | | | | 61,447,000 |
| 2024 | 48,234,884 | 13,206,597 | | | | | | | | 61,441,481 |
| 2025 | 50,271,990 | 13,203,472 | | | | | | | | 63,475,462 |
| 2026 | 52,310,615 | 12,522,236 | | | | | | | | 64,832,851 |
| 2027 | 52,302,109 | 11,831,000 | | | | | | | | 64,133,109 |
| 2028 | 52,314,253 | 11,832,500 | | | | | | | | 64,146,753 |
| 2029 | 52,312,734 | 11,831,500 | | | | | | | | 64,144,234 |
| 2030 | 29,726,146 | 11,831,875 | | | | | | | | 41,558,021 |
| 2031 | 29,728,843 | 11,832,375 | | | | | | | | 41,561,218 |
| 2032 | 28,725,856 | 11,831,750 | | | | | | | | 40,557,606 |
| 2033 | 26,571,531 | 11,833,625 | | | | | | | | 38,405,156 |
| 2034 | 26,574,975 | -- | | | | | | | | 26,574,975 |
| 2035 | 26,571,078 | -- | | | | | | | | 26,571,078 |
| 2036 | 26,574,300 | -- | | | | | | | | 26,574,300 |
| 2037 | 26,183,942 | -- | | | | | | | | 26,183,942 |
| 2038 | 25,808,006 | -- | | | | | | | | 25,808,006 |
| 2039 | 25,808,288 | -- | | | | | | | | 25,808,288 |
| 2040 | 21,736,763 | -- | | | | | | | | 21,736,763 |
| Total[4]: | $973,315,234 | $214,219,460 | | | | | | | | $1,187,534,694 |

(1) Includes current debt service on Outstanding Obligations, the Senior SRF Loans and the Subordinate SRF Loan; does not include the Equipment Lease or any additional SRF loans or potential indebtedness discussed herein. This table assumes no redemption or prepayment of obligations prior to their scheduled maturity.

(2) Debt service on the 2009A Bonds, 2009B Bonds, 2010A Bonds and the Senior SRF Loans, prior to the refunding and defeasance of the Refunded Bonds and prepayment of the Subordinate SRF Loan. See "PLAN OF FINANCE – The Refunding Plan."

(3) Debt service on the 2012A Subordinated Bonds and the Subordinate SRF Loan, prior to the prepayment of such Subordinate SRF Loan, if any. See "PLAN OF FINANCE – The Refunding Plan."

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

Source: Debt Management Department, City of San Diego.

## WATER SYSTEM ORGANIZATION AND MANAGEMENT

*Certain of the information set forth under this caption has been obtained from publicly available sources other than the City and the Department, which the City and the Authority have no reason to believe is not accurate, including, without limitation, the comprehensive annual financial reports ("CAFRs") and other public financial documents of the San Diego County Water Authority ("CWA") and The Metropolitan Water District of Southern California ("MWD"). As described herein, typically an average of 85-90% of annual water deliveries are obtained from imported water supplied to the Water System. Accordingly, certain of the information set forth under this caption has been included because it provides additional detail with respect to such sources of supply that may be considered relevant to an informed evaluation and analysis of the 2016 Bonds, the Water System and the Department. However, such information is not guaranteed by the City or the Authority as to its accuracy or completeness and no representation is made as to the absence of material adverse changes in such information subsequent to the date of the respective publicly available source document. Neither the CWA nor MWD has participated in the preparation of this Official Statement. Neither is obligated in any way to the owners or Beneficial Owners of any 2016 Bonds and neither has pledged any of its moneys, funds or assets toward the payment of any amount due in connection with the 2016 Bonds.*

### General

The 1.4 million people living in the City and the cities of Del Mar, Coronado and Imperial Beach were provided by the Department an average of approximately 171 million gallons per day ("mgd"), or about 192,000 acre feet ("AF") for the year ("AFY") of potable water in Fiscal Year 2015 resulting in approximately $431.5 million in water sales revenue. The balance of the total water sales amount of $439.7 million was made up of recycled and raw water sales. Based on statistics provided by the San Diego Association of Governments ("SANDAG"), the City's population is projected to increase approximately 22% in the next 20 years. The Department's Long Range Planning and Water Resources Division, with input from other Department staff and its consultants, expects that this projected growth will increase demand for potable water ranging from 18% to 22%, depending on the variables of future weather and conservation level assumptions.

The Department has typically provided potable water to its customers primarily from two water sources: (1) by collecting, on average, approximately 10 - 15% of its water needs through local supplies, and (2) by purchasing approximately 85 - 90% of its water from the CWA. However, due to recent drought conditions, local supply is not sufficient to provide 10-15% of annual water deliveries. Projected local supplies for potable use is estimated at 6% in Fiscal Year 2016; thereafter projected amounts of potable use range from 0% in Fiscal Year 2017, to approximately 3% in Fiscal Years 2018 and 2019, then returning to about 12% in Fiscal Year 2020. The CWA, a wholesale water agency that provided 494,983 AF of imported water to its member agencies in the County in Fiscal Year 2015, 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 United States Bureau of Reclamation and from northern California, via the State Water Project (the "SWP"), through the California Department of Water Resources ("DWR"). MWD is one of 29 public water agencies (the "SWP Contractors") that have long-term contracts for water service from DWR (each a "State Water Contract") and it is the largest agency in terms of the number of people it serves (approximately 18.5 million), the share of SWP water that it has contracted to receive (approximately 46%), and the percentage of total annual payments made to DWR by agencies with State water contracts (approximately 54% for 2014). In Fiscal Year 2015, MWD sold approximately 1.9 million AF of imported water to its customers. Both the CWA and MWD are developing storage and additional supplies, such as water transfers, to augment their imported water. See "WATER SUPPLY – Current Water Supply."

**Governance and Management of Water System**

***General***. The Water System is owned by the City and operated by the City through the Department. The Department is comprised of the following branches that are funded by both the Water Utility Fund and the Sewer Revenue Fund, depending upon which system benefits from the tasks completed. Though the different branches cover all tasks required by the Department, separate accounting is kept for each fund. The Department ultimately reports to the Mayor, who has operational authority over the Department and appoints managers and directors who are charged with the operations of the Department. The Director of Public Utilities, who reports to the Deputy Chief Operating Officer, oversees the Department. The day-to-day operational responsibility for the Department rests with the Assistant Director of the Business Support Branch, the Assistant Director of the Water Quality Branch, the Assistant Director of the Distribution and Collection Branch, and the Assistant Director of the Potable Reuse Branch, each of whom reports to the Director of Public Utilities. The Department's management team is further comprised of Deputy Directors who head each of the divisions, plus Program Managers who provide assistance to the management team. The Department also has an Employee Services and Quality Assurance Division that provides employee management, and administrative services, as well as safety, security, training and quality assurance. The External Affairs section within the Department provides public information and outreach, as well as policy and legislative strategy.

The City Council of the City (the "City Council") has the authority to approve the Department's budget, to set rates and charges of the Water System, and to approve execution of certain contracts. For information on how the City sets the rates and charges of the Water System see "WATER SYSTEM FINANCIAL OPERATIONS – Establishment, Calculation and Collection of Water Charge Revenue." In accordance with the provisions of the City Municipal Code, the Water System funds are administered in an enterprise account separate from the City's General Fund.

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

*Halla Razak*. Ms. Razak is the City's Director of Public Utilities and is responsible for both the daily operation of the City's Water, Wastewater and regional wastewater sub-system as well as planning to ensure the future reliability of these services. She holds a Bachelor of Science degree in Civil Engineering from the University of Dayton and a Master's degree in Engineering from San Diego State University. Ms. Razak has an extensive background in engineering and public utilities and is a Registered Professional Engineer in the State of California. Prior to rejoining the City in November 2013, she worked for eight years as the Colorado River Program Director for the San Diego County Water Authority and 18 years prior to that as Chief Deputy Director for the City's Engineering and Capital Projects Department.

*Rania Amen.* Ms. Amen currently serves as the Assistant Director of the Water Quality Branch which includes oversight of the day-to-day operation and maintenance of the wastewater and water treatment facilities, potable and recycled distribution systems, and the raw water supply system, as well as ensuring environmental compliance under State and federal regulations. Ms. Amen holds a Bachelor of Science degree in Civil Engineering from the University of Alexandria and is a Registered Professional Engineer in the State of California. Her 24 year professional background in engineering services includes the operation, planning, design and construction of water, wastewater, stormwater and renewable energy facilities, buildings, and transportation. During her 17-year tenure with the City, Ms. Amen has experience in Operation and Maintenance processes and the City's Capital Improvement Program.

*Stan Griffith*. Mr. Griffith currently serves as the Assistant Director of the Distribution and Collection Branch and oversees the day-to-day operational activities of the Wastewater Collection

Division, which maintains the wastewater collection system, and the Water Construction and Maintenance Division, which provides construction, maintenance and emergency response for the potable water system. He has been an employee of the City for 28 years and has served in various management capacities including Labor Relations officer for the City, Assistant Deputy Director of the Environmental Monitoring and Technical Services Division, Assistant Deputy Director of the Customer Support Division and Deputy Director of the Wastewater Collection Division. Mr. Griffith earned a Bachelor of Science in Education from the University of Wisconsin at Oshkosh and has completed substantial coursework toward a Master's degree in Public Administration.

*John Helminski*. Mr. Helminski currently serves as the Assistant Director of the Potable Reuse Branch which includes oversight of engineering and consulting staff dedicated to the development and implementation of the Pure Water San Diego Program (the "Pure Water Program"). Additionally, he oversees the Department's Engineering and Program Management Division. Mr. Helminski holds a Bachelor of Science in Civil/Construction Engineering from the New Jersey Institute of Technology, Newark College of Engineering. Prior to joining the Department in December 2014, Mr. Helminski worked in various City departments holding several Engineering Project and Program Management positions. His 25-year professional background also includes experience in Operation and Maintenance of Right of Way Infrastructure as well as the City's Right of Way Infrastructure Capital Improvement Program.

*Lee Ann Jones-Santos*. Ms. Jones-Santos currently serves as the Assistant Director of the Business Support Branch. In her capacity as Assistant Director, she oversees the day-to-day operations of all business support activities which include finance, information technology, customer service, and long range planning. Ms. Jones-Santos holds a Bachelor of Science degree in Accounting from California State University in San Marcos. During her 17-year tenure with the City, Ms. Jones-Santos worked in the Office of the City Comptroller for 9 years before joining the Department. Her background includes knowledge in enterprise financial statement reporting, extensive knowledge of City operations and she has worked on high-profile projects including the SAP implementation.

***Branches.*** The Department is composed of the following branches: Water Quality, Distribution and Collection, Potable Reuse, and Business Support.

The Water Quality Branch is composed of the following divisions:

*Wastewater Treatment and Disposal*. This division operates and maintains a wastewater treatment plant, two water reclamation plants, a bio-solids processing facility, and eight large wastewater pump stations. With these facilities, the division provides regional wastewater treatment and disposal services to the City, as well as 12 surrounding cities and special districts.

*Water System Operations*. This division operates and maintains the City's raw water supply system, potable water treatment and distribution system, and the recycled water distribution system. The division also manages the recreational program at the City's raw water reservoirs (lakes).

*Environmental Monitoring and Technical Services*. This division is responsible for monitoring and assessing the quality of drinking water, recycled water, wastewater, and the natural environment in order to determine regulatory compliance and to preserve and protect environmental and public health. Additional responsibilities include managing regulatory permits, running an industrial wastewater pre-treatment program, and assessing the Department's facilities for air quality and storm water compliance.

The Distribution and Collection Branch is composed of the following divisions:

*Wastewater Collection*. This division provides efficient operations and maintenance of the wastewater collection system, which consists of over 3,000 miles of sewer mains and 73 small municipal pump stations. The division also administers the Food Establishment Wastewater Discharge Permitting Program which permits and monitors over 5,000 food establishments to minimize the discharge of fats, oils, and grease into the wastewater collection system.

*Water Construction and Maintenance*. This division provides construction, maintenance, and emergency response for the potable water system. The division maintains approximately 280,000 metered service connections, over 25,000 fire hydrants and more than 83,000 total water system valves. The division performs construction activities for the potable and recycled distribution system; provides 24-hour emergency response, water main repair, Capital Improvement Program support; and performs maintenance, installation, and replacement of water meters throughout the City.

The Potable Reuse Branch is composed of the following division and program:

*Engineering and Program Management*. This division provides engineering services for the water, wastewater and recycled water systems to ensure new facilities, repairs and upgrades are planned and implemented in a fiscally-sound manner to meet regulatory and environmental standards. The division also provides long-range master planning, condition assessment, water and wastewater modeling, planning and pre-design for infrastructure, energy management, environmental support, and oversight of the implementation of the water, wastewater, and recycled water system's Capital Improvement Program.

*Pure Water Program*. This program is responsible for a focused and coordinated effort to develop and implement full-scale potable reuse to create 83 mgd by the end of calendar year 2035 of locally controlled, reliable water and to identify a solution for future Point Loma Discharge Permit renewals. See "WATER SUPPLY – Pure Water Program" for additional information on the Pure Water Program.

The Business Support Branch is composed of the following divisions:

*Long-Range Planning and Water Resources*. This division provides long-range water resources planning and development, watershed and resource protection, policy and regulatory analysis on wide-ranging water and wastewater issues, and management of the City's water conservation and non-potable recycled water programs.

*Finance and Information Technology*. This division provides administrative support in the areas of information systems; budget development and monitoring; accounts payable; rate setting and finance; federal and State grants and the administration of interagency agreements.

*Customer Support*. This division provides customer service to Department patrons, handles customer phone interactions via a variety of contact channels, and is responsible for customer billing and payment processing, meter reading and code enforcement, customer compliance with State backflow device requirements, and public information.

***Oversight***. The Independent Rates Oversight Committee ("IROC") was established by City ordinance in 2007 to assume and expand upon the oversight previously undertaken by the Public Utilities Advisory Commission, which no longer exists. There are 11 members on IROC, all of whom are appointed by the Mayor and confirmed by the City Council. The membership of IROC consists of representatives of each ratepayer class and professional experts in such fields as finance, engineering,

construction, and the environment. In addition to the 11 members, IROC includes two ex-officio members, one representing and appointed by the Metropolitan Wastewater Joint Powers Authority, and one representing and appointed by the ten-member City representatives to the San Diego County Water Authority. IROC serves as an official advisory body to the Mayor and the City Council on policy issues relating to the oversight of Department operations, including, but not limited to, resource management, revenue and expenditures projections, service delivery methods, public awareness and outreach efforts, and efforts to achieve high quality and affordable utility services provided by the Department. IROC's duties and functions include reviewing reports from staff, reviewing rate and bond proceed expenditures, advising on the efficiency and performance of the Water System and the Wastewater System, advising on future rate increases and cost of service studies, and the preparation of an annual public report on such issues to the Mayor and City Council. IROC meets at least every other month with additional meetings convened as necessary and as determined by the Committee Chair.

On January 19, 2016, IROC issued its annual report on the Department for Fiscal Year 2015 (the "2015 IROC Report"). The 2015 IROC Report included the following summarized key recommendations: (1) staff regularly report to IROC with information regarding sales, revenues, local supply availability and expenditures and how these track with cost of service assumptions; (2) continue to review alternative rates and rate structures, including for recycled water; (3) the Department continue to perform condition assessments to prioritize repair or replacement of major components, while continuing routine replacement programs for the components with predictable service lives; (4) continue to improve the Water System Capital Improvement Program ("CIP") process to facilitate project visibility and enable appropriate oversight; (5) regularly assess long-term water supply needs given the successes of recent conservation initiatives and to adopt a clear policy with decision criteria to guide the City Council and Mayor to more quickly and decisively implement voluntary/mandatory water use reductions, if necessary; (6) the Department continue to pursue all options in order to get regulatory certainty that the Pure Water Program will suffice to offset the requirement to move up to secondary treatment; (7) continue outreach efforts to promote the Pure Water Program to all communities within San Diego. Recommendations are advisory in nature, the Department has implemented certain recommendations and intends to partially implement recommendations that were agreed to in part but have not already been implemented. See "WATER SYSTEM CAPITAL IMPROVEMENT PROGRAM" and "– Capital Improvement Financing Plan" under that heading, and "WATER SUPPLY – Pure Water Program."

## WATER SYSTEM SERVICE AREA AND FACILITIES

### Water System Service Area

The Water System serves the City and certain surrounding areas, including retail, wholesale, and recycled water customers. The Water System's service area covers 404 square miles, including 342 square miles in the City, and a population of approximately 1.4 million people as of January 1, 2016. The map that follows the Table of Contents of this Official Statement shows the boundaries of the service area of the Water System.

***Retail Customer Base.*** The City has five types of retail customer groups, consisting of Single Family Residential ("SFR"), Multi-Family, Commercial and Industrial, Temporary Construction, and Irrigation. For information relating to recycled water customers, see "– *Reclaimed Water Customer Base*" below. For Fiscal Year 2015 retail customers accounted for approximately 94% of total water deliveries and represented approximately 96% of the revenues from total water sales. Of the Water System's nearly 280,000 retail service connections, approximately 91% are SFR and Multi-Family residential accounts, with the balance from Commercial/Industrial, and other users. For Fiscal Year 2015, SFR and Multi-Family residential accounts comprised approximately 60% of total water sales revenue, with the balance

for Commercial/Industrial and other users. Some of the SFR, Multi-Family, Commercial and Industrial accounts have been classified as Irrigation, as described below.

*Single Family Residential.* SFR refers to individual dwelling units served by a separate meter, and accounted for approximately 40.2% of total water sales revenues in Fiscal Year 2015.

*Multi-Family*. Multi-Family encompasses multi-family dwellings such as apartment or condominium complexes, in which two or more dwelling units share a meter, and accounted for approximately 19.6% of total water sales revenues in Fiscal Year 2015.

*Commercial and Industrial*. Commercial and Industrial user classes are comprised of a diverse group of customers and accounted for 22.7% of total water sales revenues in Fiscal Year 2015. These customers are treated equivalently in cost calculations and are assigned the same peaking factors. These customers also typically have lower peaking factors than residential customers due to their relatively consistent usage trend.

*Irrigation*. Prior to July 2007, the City did not recognize "Irrigation" as a separate customer class. As there is sufficient data to separate these users into such a class, such a class was created by separating the SFR, Multi-Family, and Commercial and Industrial accounts that are used solely for irrigation into a new class. These customers use water primarily to irrigate personal or business landscaping. This diverse group of customers accounted for 11.6% of total water sales revenue for Fiscal Year 2015.

*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 0.6% of total water sales revenue for Fiscal Year 2015.

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. Peak usage is more costly to deliver than constant usage.

The following table sets forth the historical number of retail connections to the Water System for each year from Fiscal Years 2011 through 2015.

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**TABLE 2**
**HISTORICAL NUMBER OF RETAIL CONNECTIONS TO WATER SYSTEM**
**Fiscal Years 2011 through 2015**
**(Unaudited)**

| Customer Type | 2011 | 2012 | 2013 | 2014 | 2015 |
|---|---|---|---|---|---|
| Single Family Residential | 221,863 | 221,949 | 222,417 | 223,006 | 223,629 |
| Multi-Family | 29,167 | 30,159 | 30,122 | 30,159 | 30,202 |
| Commercial[1] | 15,631 | 16,841 | 16,955 | 16,985 | 17,069 |
| Industrial[1] | 185 | -- | -- | -- | -- |
| Outside City[1] | 44 | -- | -- | -- | -- |
| Irrigation | 7,480 | 7,497 | 8,111 | 8,130 | 8,262 |
| Temporary Construction | 308 | 347 | 357 | 414 | 463 |
| **Total** | 274,678 | 276,793 | 277,962 | 278,694 | 279,625 |
| Percent Growth | 0.23% | 0.77% | 0.42% | 0.26% | 0.33% |

(1) Commercial, Industrial and Outside City customers have been combined into one customer type as of Fiscal Year 2012.
Source: Public Utilities Department, City of San Diego.

The following table sets forth the 10 major retail customers of the Water System for Fiscal Year 2015. These customers provided approximately 12% of the total sales revenues for such Fiscal Year.

**TABLE 3**
**MAJOR RETAIL CUSTOMERS**
**Fiscal Year 2015**
**(Unaudited)**

| Customers | Millions of Cubic Feet | Billings | % of Total Sales Revenues |
|---|---|---|---|
| City of San Diego | 447.86 | $19,426,645 | 4.42% |
| United States Navy | 328.63 | 15,196,946 | 3.46 |
| University of California at San Diego | 86.16 | 3,885,994 | 0.88 |
| San Diego Unified School District | 47.71 | 2,726,536 | 0.62 |
| California Department of Transportation | 43.92 | 2,221,768 | 0.51 |
| All Federal Agencies [1] | 45.72 | 2,102,860 | 0.48 |
| The Irvine Co. | 38.94 | 1,977,439 | 0.45 |
| CP Kelco | 41.58 | 1,814,194 | 0.41 |
| San Diego Zoo | 27.67 | 1,209,542 | 0.28 |
| San Diego State University | 25.71 | 1,170,874 | 0.27 |
| **Total [2]** | **1,133.90** | **$51,732,798** | **11.78%** |

(1) Category includes several federal agencies, including, but not limited to, the United States Postal Service, the United States Marine Corps and the United States Coast Guard.
(2) Figures may not add to total due to independent rounding.
Source: Public Utilities Department, City of San Diego.

***Wholesale Customer Base***. For Fiscal Year 2015, wholesale customers accounted for approximately 7.8% of total water deliveries, including recycled deliveries, and such sales represented approximately 4.1% of the revenues from total sales of water. The City currently sells and delivers or

treats and delivers water on a wholesale basis to four wholesale customers: (1) the California-American Water Company ("Cal-American"), (2) the Santa Fe Irrigation District, (3) the San Dieguito Water District (together with the Santa Fe Irrigation District, the "SFSD Water Districts"), and (4) the Otay Water District (the "OWD").

*California-American Water Company (Cal-American)*. Since 1912, the City has been selling and delivering treated water to Cal-American, which in turn provides water to the cities of Coronado and Imperial Beach, as well as a portion of the City. The City's obligation to sell and deliver water to Cal-American and its customers was assumed by the City upon its original acquisition of the Water System. The City's agreement with Cal-American has been subsequently amended to establish minimum and maximum amounts of treated water that may be purchased by Cal-American from the City, an average system delivery and a supply price methodology, which incorporates all of the City's integrated system-wide costs (*i.e.*, the costs associated with treatment, storage and pumping of the treated water supplied to Cal-American), including 60% of the water purchase replacement costs, 17% of the transmission and distribution costs associated with usage of mains that are 16 inches and larger, and a proportionate share of debt service for capital costs of the Water System. For Fiscal Year 2015, the City made approximately 5.4% of its total water deliveries to Cal-American and such sales represented approximately 3.5% of the revenues from total sales of water. The rates established within the City's agreement with Cal-American are adjusted at the same rate, and for the same period of time, as the rate and term set for City rate payers under the current rate case.

*SFSD Water Districts*. Pursuant to an existing contract between the City and the SFSD Water Districts, which runs in perpetuity, the City and the SFSD Water Districts equally share local water inflow to Lake Hodges Reservoir. The contract sets the terms and cost sharing for local water shared. Operation and maintenance expenditures and capital improvement costs are shared per provisions of the contract. For Fiscal Year 2015 the amount of water delivered to the SFSD Water Districts represented less than one tenth of one percent of total water deliveries and revenues.

*Otay Water District (OWD)*. The City's Otay Water Treatment Plant (the "OWTP") is capable of producing treated water in excess of the amounts needed by the Water System customer base traditionally serviced by the OWTP. In 1999, the City entered into an agreement with OWD to deliver up to 10 mgd of surplus treated water, which deliveries began in November 2005. The amounts paid by OWD for such treated water are determined in part by allocating to the City and OWD, based on the amount of treated water produced for each, the projected costs and expenses of all operations, maintenance and overhead, capital improvements, repairs and replacements under $100,000 to be incurred for, or at, the OWTP. This cost per AF, as determined pursuant to the preceding sentence, is added to the raw water rate, to determine the projected actual cost to OWD for the next succeeding Fiscal Year. Pursuant to the agreement, OWD may elect to pay its proportional share of costs to expand the OWTP to meet its future treated water demands, estimated to be from 10 to 20 mgd. Any expansion would be subject to the City's discretion and the execution of a separate agreement. To date OWD has purchased excess water sparingly. In Fiscal Year 2015, OWD purchased 338.50 AF of potable water, which represents less than 0.2% of total deliveries. See "LITIGATION – Ratepayers Proposition 26 and 218 Litigation and Claims."

***Reclaimed Water Customer Base***. Reclaimed water (also referred to as recycled water) is produced from wastewater processed at water reclamation plants owned and operated by the City as part of the City's Wastewater System. Since 1997, the recycled water produced by the City has been carefully monitored by City and State health officials and water quality-control agencies to ensure that it meets all federal, State, and local water quality standards, including the safety standards applicable to water coming into human contact set forth under Title 22 of the California Code of Regulations, and is suitable for irrigation, industrial, and other non-potable uses. The City began billing OWD and the Olivenhain

Municipal Water District for recycled water in Fiscal Year 2007. The City also provides recycled water to the City of Poway under the terms of an agreement entered into in 1998. From Fiscal Year 2011 to December 31, 2015, the number of Reclaimed Water System connections increased from 532 to 680 (675 retail and five wholesale). For Fiscal Year 2015, retail and wholesale recycled water customers accounted for approximately 1.8% of the revenues from total sales of water.

**Existing Water System Facilities**

The Water System consists of nine raw water storage reservoirs, three water treatment plants, 29 treated water storage facilities, and over 3,300 miles of water transmission and distribution lines. Water is transported through 49 water-pumping stations and approximately 280,000 metered service connections.

***Raw Water Reservoirs***. The City has nine reservoirs with a total capacity of 569,021 AF, of which, the City has rights to 376,042 AF of total storage (the remaining 192,979 AF of capacity belonging to the CWA and other local water agencies). As of April 4, 2016, the City has 129,005 AF of water in storage, or 34% of total City storage capacity of 376,042 AF. However, this current amount of City water in storage represents approximately 62% of historical average storage levels. The following table outlines each of the nine reservoirs total capacity, City owned capacity, current City storage, and historical storage levels. See "Reservoir Storage Rights" immediately following this table.

**TABLE 4**
**RAW WATER RESERVOIRS**
**(As of April 4, 2016)**
**(Amounts in AF)**

| Reservoir | Total Storage Capacity | City Storage Capacity | Current City Storage Levels | Current City Percent Full | Average Total Storage Levels[1] | Percentage of Average Total Storage Levels[1] |
|---|---|---|---|---|---|---|
| Barrett | 34,806 | 34,806 | 2,148 | 6% | 17,677 | 12% |
| El Capitan[2] | 112,807 | 102,807 | 24,790 | 24 | 43,884 | 56 |
| Lake Hodges[3] | 30,633 | 5,317 | 2,704 | 51 | 18,486 | 15 |
| Lake Murray | 4,684 | 4,684 | 4,060 | 87 | 3,823 | 106 |
| Lower Otay | 49,849 | 49,849 | 36,161 | 73 | 30,851 | 117 |
| Miramar | 6,682 | 6,682 | 5,424 | 81 | 5,726 | 95 |
| Morena | 50,694 | 50,694 | 1,404 | 3 | 21,380 | 7 |
| San Vicente[4] | 249,358 | 91,695 | 49,836 | 54 | 59,699 | 83 |
| Sutherland | 29,508 | 29,508 | 2,478 | 8 | 7,803 | 32 |
| **Total** | **569,021** | **376,042** | **129,005[5]** | **34%** | **209,329** | **62%** |

(1) The average for each reservoir was calculated back to the introduction of each reservoir into the Water System ranging from 1911 to 1960.

(2) The Helix Water District has storage rights of up to 10,000 AF in El Capitan Reservoir.

(3) The City's storage rights in Lake Hodges were reduced in 2014 as a result of the Emergency Storage Project agreement between the City and the CWA, which provided CWA with storage rights of 20,000 AF in Lake Hodges. Additionally, SFSD Districts have 5,317 AF of storage rights in Lake Hodges. The Average Total Storage Level for Lake Hodges still reflects levels before the reduction in City's storage capacity in 2014.

(4) As a result of the Emergency Storage Project between the City and the CWA completed in September 2014, the CWA now has storage rights to 157,663 AF in the San Vicente Reservoir.

(5) Figure includes approximately 2% - 5% of total amount of water in storage that is inaccessible due to reservoir outlets being abandoned, blind flagged, or silted.

Source: Public Utilities Department, City of San Diego.

***Reservoir Storage Rights***. The City has storage capacity rights agreements for the Lake Hodges Reservoir, San Vicente Reservoir, and the El Capitan Reservoir between other various water districts and the CWA.

In 1998, the CWA approved a $1.5 billion Emergency Storage Project ("ESP") to increase local storage and provide a more flexible conveyance system and water reliability to the region. The ESP is a system of reservoirs, pipelines and other facilities that connect existing sources of water in San Diego County. The ESP culminated with the completion of the San Vicente Reservoir ("SVR") Dam Raise project in September, 2014, which consisted of raising the existing 220-foot-high dam by 117 feet and resulted in CWA owning all 157,663 AF of the new reservoir capacity, while the City retains the original capacity of 91,695 AF. The City and the CWA had agreed throughout the process of developing and implementing the ESP that both parties would benefit from the agreement. Prior to this agreement, the City had no infrastructure connecting Lake Hodges to the rest of its system and therefore was unable to use the water for anything other than recreation. The City derives substantial benefits from the CWA's expansion of the SVR, the construction of the San Vicente Pipeline ("SVP") and Pump Station ("SVPS"), the construction of the Lake Hodges Pipeline and Pump Station, and the Olivenhain Pump Station. Coupled together with the existing Olivenhain Pipeline and the Second San Diego Aqueduct, the City is able to make greater use of its own storage, with the potential for substantial cost savings. Via this agreement, the City additionally receives and attains ownership of new recreational facilities at SVR, a new and larger inlet/outlet facility allowing more than double the current rates of inflow and outflow from SVR, and an essentially new dam structure that will extend the useful life of the original dam at least 50 years. In addition, the City will continue to receive funding from the CWA for a proportionate share of all future costs for operation, maintenance, rehabilitation and replacement of SVR, including the cost of water lost to evaporation and seepage. During wet years, the City will realize the ability to sell excess local water to the CWA to avoid losing the water to spilling, while during dry years, the City will see improved water quality and higher reservoir levels in SVR and Lake Hodges than would be experienced without the ESP improvements. Beginning in March 2012, the Department was able to access Lake Hodges water for the first time. The Department operates the reservoir to maximize local water use and typically drafts its share often leaving the City's balance near zero. The CWA and its member agencies will derive substantial benefits from the expansion of the San Vicente Reservoir and the granting of 20,000 AF in storage rights in Lake Hodges. The combined storage rights in Lake Hodges and San Vicente Reservoir has allowed the CWA to avoid the expense and extensive regulatory requirements of building new storage reservoirs. Finally, per agreement between the City and Helix Water District ("Helix"), Helix can have in storage up to 10,000 AF of water in El Capitan Reservoir as captured from runoff and water transfers from Cuyamaca Reservoir.

The Lower Otay Reservoir, Barrett Reservoir and Morena Reservoir (135,349 AF combined total capacity) service the OWTP in south San Diego; the El Capitan Reservoir, San Vicente Reservoir, Sutherland Reservoir and Lake Murray Reservoir (396,357 AF combined total capacity) service the Alvarado Water Treatment Plant (the "AWTP") in central San Diego; and the Miramar Reservoir (6,682 AF total capacity) services the Miramar Water Treatment Plant (the "MWTP") in north San Diego. Lake Hodges Reservoir can service all three City water treatment plants, and San Vicente Reservoir can also service the OWTP and MWTP via CWA aqueduct facilities.

According to City Council policy, the City shall have approximately 7.2 months of the annual (rolling 12 months) requirement of the City's demand available in primary water storage facilities. For Fiscal Year 2016 the requirement ranges from 106,000 – 125,000 AF. This water is to be used during emergencies, in the event of substantial disruption or interruption of imported water service. The City has maintained, and continues to maintain amounts at or above the requirement.

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

***Water Treatment Plants***. The Department maintains and operates three water treatment plants with a combined rated capacity of 378 mgd through which potable water is supplied. Supplemental treated supplies from the CWA are used to help operate the distribution system reliably and efficiently. While all three plants have been upgraded, only the Alvarado Plant has been permitted to its new rated capacity. The Miramar and Otay plants, although substantially complete, require some additional improvements, studies and certification from the SWRCB's Division of Drinking Water ("DDW") before they can be rated as such. The increased capacity will improve the City's ability to treat raw water, thereby further reducing the need to purchase treated water, while providing capacity for customer growth. Of the total of approximately 192,000 AF of water purchased from the CWA during Fiscal Year 2015, approximately 14,000 AF was treated water.

*Alvarado Water Treatment Plant*. The AWTP was originally constructed in 1951. Several hydraulic improvements constructed in the mid-1970's and additional upgrades completed recently increased the plant's rated capacity from 120 mgd to 200 mgd. The AWTP is located next to Lake Murray Reservoir near Interstate 8 and serves the general area from National City to the San Diego River.

*Miramar Water Treatment Plant*. The MWTP was originally constructed in 1962 and has a current rated capacity of 144 mgd. The MWTP is located next to Miramar Reservoir off Interstate 15. The MWTP provides drinking water to an estimated 500,000 people in the general area north of the San Diego River. To address future demands, the various upgrades to the MWTP, with some additional improvements and supporting studies will enable the City to increase the MWTP's capacity to 215 mgd, upon the approval of the DDW. The current rated capacity is sufficiently meeting the current demand. Expansion of the raw water aqueducts by the CWA has provided the MWTP access to water from San Vicente and Lake Hodges Reservoirs.

*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. Further studies and potentially additional upgrades to the plant may be required to increase its rated capacity to 40 mgd.

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

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**TABLE 5**
**CAPACITY AND DEMAND OF WATER SYSTEM WATER TREATMENT PLANTS**
**(In Million Gallons Daily (mgd))**
**As of December 31, 2015**

| Water Treatment Plant | Original Design Capacity | Current Rated Capacity | Future Rated Capacity[1] | Current Average Demand[2] | Current Peak/Max Demand[2] |
|---|---|---|---|---|---|
| Alvarado | 66 | 200 | 200 | 73.48 | 97.87 |
| Miramar | 100 | 144 | 215 | 56.91 | 80.20 |
| Otay | 40 | 34 | 40 | 12.41 | 18.54 |
| **Total** | **206** | **378** | **455** | **142.80** | **196.61[3]** |

(1) The Otay and Miramar plants require additional improvements, and/or further studies, followed by approval by the DDW to reach their Future Rated Capacity.
(2) Current Demand data calculated from January 1, 2015 to December 31, 2015 and reflects mandatory drought restrictions.
(3) Total is not intended to reflect the aggregate peak/maximum demand supported by all water treatment plants, because such plants do not all reach the peak/maximum demand simultaneously.
Source: Public Utilities Department, City of San Diego.

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

***Delivery System***. The Water System consists of approximately 3,300 miles of transmission and distribution pipelines, including transmission lines up to 84 inches in diameter and distribution lines as small as four inches in diameter. Transmission lines are pipelines with larger diameters that convey raw water to the water treatment plants and convey treated water from the water treatment plants to the treated water storage facilities. Distribution lines are pipelines with smaller diameters that directly service the retail users connected to a meter.

The Department also maintains and operates 49 water pump stations that deliver treated water from the water treatment plants to approximately 280,000 metered service connections in over 130 different pressure zones. The Department also treats and delivers the water provided by the CWA for the City of Del Mar ("Del Mar"). Del Mar pays the CWA directly for the untreated water and pays the Department for its treatment and delivery services based on negotiated contract pricing. In addition, the Department maintains several emergency connections to and from neighboring water agencies, including the Santa Fe Irrigation District, the Poway Municipal Water District, Cal-American, the Sweetwater Authority ("SWA") and the OWD.

As of December 31, 2015, the City's average daily water use, including Del Mar and Cal-American deliveries, was approximately 155 mgd, with peak day demands as high as 195 mgd. These amounts are significantly lower than the recent past due to the unprecedented amount of conservation achieved by the citizens of San Diego brought on by the extended drought. The City's three Water Treatment Plants provided 143 mgd, or 92%, of average demand and 175 mgd, or 90%, 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 Department-treated water and treated water supplied by the CWA primarily through four metered treated water connections.

**Insurance for the Water System**

The City participates in the joint purchase of property insurance and flood insurance through the California State Association of Counties-Excess Insurance Authority ("CSAC-EIA") pool (policy term March 31, 2016 through March 31, 2017), which includes flood coverage for scheduled locations, including bond financed locations of the Water System. The City is not required to provide flood insurance for other City property, and in its discretion, may elect to modify the designation of covered properties in the future.

This joint purchase of the City's "All Risk" property insurance through the CSAC-EIA pool insures approximately $4.6 billion of City property and provides coverage for loss to City property under the primary policy up to approximately $25 million per occurrence, with a $25,000 deductible.

The City maintains casualty insurance on many of the assets of the Water System, including, among other assets, treatment plants, pump stations, administration buildings, garages, warehouses, concession buildings, and labs. The City does not maintain any insurance for the pipelines of the Water System because such insurance is not available at commercially reasonable rates. The City is not obligated under the Master Installment Purchase Agreement to procure and maintain, or cause to be procured and maintained, earthquake insurance on the Water System. See Note 14 "– RISK MANAGEMENT" contained in the City's CAFR for Fiscal Year 2015 for additional information on the City's insurance coverages. The City's CAFR for Fiscal Year 2015, which includes the City's audited basic financial statements as of and for the fiscal year ended June 30, 2015, is available through EMMA, which information is incorporated by reference in this Official Statement and shall be deemed to be a part hereof. See "FINANCIAL STATEMENTS" herein.

For additional information relating to Insurance, see "WATER SYSTEM FINANCIAL OPERATIONS – Insurance and Liability Claims."

**Utility Costs**

The Water System is supplied with gas and electricity by San Diego Gas & Electric Company ("SDG&E"). Although SDG&E's electric rates have increased slightly more than 6% per year since 2010, the Department's overall gas and electric expenses have remained consistent at approximately 1.5% of total operating expenditures. Based on the Fiscal Year 2017 Proposed Budget, such expenditures are budgeted at approximately 1.6% of the total operating budget.

## WATER SUPPLY

*Certain of the information set forth under this caption has been obtained from publicly available sources other than the City and the Department, which the City and the Authority have no reason to believe is not accurate, including, without limitation, the CAFRs and other public financial documents of the CWA and MWD. Such information necessarily represents abbreviated and summarized forms of such other sources of information. Such information is not guaranteed by the City or the Authority as to its accuracy or completeness and no representation is made as to the sufficiency of such information for all purposes or the absence of material adverse changes in such information subsequent to the date of the respective publicly available source document. Neither the CWA nor MWD has participated in the preparation of this Official Statement. Neither is obligated in any way to the owners or Beneficial Owners of any 2016 Bonds and neither has pledged any of its moneys, funds or assets toward the payment of any amount due in connection with the 2016 Bonds.*

**Current Water Supply**

The Water System typically receives approximately 85-90% of its water supply from water imported by the CWA, with the balance coming from local runoff, non-potable recycled water and groundwater. The CWA's current largest source of imported water is MWD (57%), which obtains its water supply from two primary sources: the Colorado River and the State Water Project. The CWA also imports Colorado River water consisting of conserved agricultural water transferred from the Imperial Irrigation District ("IID"), currently 100,000 AFY, and water made available through the lining of the Coachella Canal and the All American Canal (currently approximately 80,000 AFY). These supplies were made possible with the 2003 signing of the Quantification Settlement Agreement ("QSA"). The QSA establishes Colorado River water use limits for IID, Coachella Valley Water District ("CVWD"), and MWD, provides for specific acquisitions of conserved water and water supply arrangements, for up to 75 years for the CWA/IID water transfer and other transfers, and 110 years for the canal lining water, and allows the take surplus water pursuant to the terms of Interim Surplus Guidelines which determine when surplus water is available for California, Arizona and Nevada. Starting in 2018, the 100,000 AFY of IID transfers are scheduled to ramp up to 200,000 AFY by 2021. Combined with the canal lining supplies, total QSA deliveries are expected to provide 280,000 AFY.

Additionally, a significant milestone in local supply development was reached at the end of 2012, when the CWA Board of Directors approved a long-term Water Purchase Agreement with Poseidon Water, a water project development company, for the purchase of 48,000 to 56,000 AFY of desalinated seawater from the Carlsbad Desalination Project ("Carlsbad Project"). The CWA invested in this newly commissioned seawater desalination project, the Carlsbad Desalination Plant, which opened on December 14, 2015 that further diversifies the region's portfolio with up to 56,000 AFY of new drought-proof water supplies. Together with the extraordinary conservation achieved as a result of the 2015-16 emergency conservation regulations, MWD supplies are expected to represent 19% or less of the regional supply portfolio by 2025. The MWD Act provides a preferential right for the purchase of water by each of its constituent agencies. This preferential right is calculated using a formula. Based on the formula, the CWA has a statutory preferential right to approximately 18.42% of MWD's total supply as of June 30, 2015. MWD has represented to the CWA that it will provide reliable water supplies notwithstanding preferential rights.

In addition to the CWA's efforts to diversify water supply sources was an effort to increase local storage of freshwater supplies known as the Emergency Storage Program ("ESP"). Completed in 2014, the CWA raised the dam at the City's San Vicente reservoir by 117 feet to expand storage at the reservoir by more than 157,000 AF. Despite drought conditions, the CWA is in the process of filling the reservoir, in large part due to the success of its long-term supply diversification strategy. The ESP also provided for the construction (in 2003) of additional storage at the Olivenhain reservoir (24,000 AF of emergency storage) and the CWA executed an out-of-region groundwater basin storage rights agreement with the Semitropic Water Storage District, one of the largest groundwater banking systems in the world. The CWA has storage rights at Semitropic's Original Water Bank (OWB – 30,000 AF) and Semitropic-Rosamond Water Bank Authority (Bank Authority – 40,000 AF). Currently, the CWA has 16,117 AF of water stored in the OWB and no water stored in the Bank Authority. Additionally, MWD completed construction of the Diamond Valley Lake reservoir in 1999, providing an additional 810,000 AF of regional storage. The combined increase of water storage in the region along with supply diversification strategies at both the local and regional levels has contributed to much greater water supply reliability in the San Diego region than would have otherwise been possible.

**TABLE 6**
**CWA WATER SUPPLY RATES[1]**
**Calendar Years 2012 through 2016**
**(Per AF)**

| | Municipal & Industrial (M&I) Rates | | |
|---|---|---|---|
| **Calendar Year** | **Untreated** | **Treated** | **Transportation Rate** |
| 2012 | $638 | $872 | $85 |
| 2013 | 714 | 970 | 93 |
| 2014 | 732 | 1,006 | 97 |
| 2015 | 764 | 1,042 | 101 |
| 2016 | 780 | 1,060 | 105 |

(1) Rates shown are for volumetric charges only and do not include the additional fixed charges displayed in the following table.
Source: San Diego County Water Authority Board Meeting Documents.

In addition to the volumetric charges the City pays for imported water, the CWA and MWD also levy fixed charges on their member agencies. The following table demonstrates the fixed charges, which are component costs of imported water, paid, or to be paid, by the City to MWD and the CWA between calendar years 2012 and 2016.

**TABLE 7**
**MWD AND CWA FIXED WATER SUPPLY COSTS**
**Calendar Years 2012 through 2016**
**($ Amounts in Thousands)**

| Calendar Year | 2012 | 2013 | 2014 | 2015 | 2016 |
|---|---|---|---|---|---|
| **MWD Fixed Charges** | | | | | |
| Capacity Reservation Charges | $ 2,718 | $ 2,479 | $ 3,124 | $ 3,912 | $ 4,338 |
| Readiness-to-Serve Charge [1] | 9,808 | 10,255 | 10,657 | 10,720 | 9,346 |
| **CWA Fixed Charges** | | | | | |
| Customer Service | 9,645 | 10,008 | 10,198 | 10,170 | 9,781 |
| Emergency Storage Charge | 22,310 | 25,247 | 26,758 | 26,730 | 25,768 |
| Infrastructure Access Charge | 12,153 | 12,498 | 12,664 | 13,131 | 13,173 |
| Supply Reliability Charge [2] | -- | -- | -- | -- | 10,798 |
| In Lieu Tax Payment [1] | 1,642 | 1,593 | 1,755 | 1,898 | 2,000 |
| **Total Fixed Charges** | **$58,276** | **$62,080** | **$65,156** | **$66,561** | **$75,204** |

(1) Fiscal Year charge.
(2) A new fixed charge approved by the CWA Board and Member Agencies, designed to increase the fixed portion of the CWA's water sales revenues to address their commitments to "Take or Pay" agreements for IID transfers and desalination minimum purchases. This charge acts as a revenue offset to the CWA's volumetric charges, i.e., it mitigates the volumetric charge increases, so that the total CWA revenue collected from rates is revenue neutral.
Source: San Diego County Water Authority Board Meeting Documents and Public Utilities Department, City of San Diego.

The following table sets forth the City's local water production and CWA supplied water for Fiscal Years 2011 through 2015.

**TABLE 8**
**WATER SUPPLIES FOR THE CITY OF SAN DIEGO**
**Fiscal Years 2011 through 2015**
**(In AF)**

| Fiscal Year | Local Supplies | CWA Water Supplies | Total |
|---|---|---|---|
| 2011 | 27,841 | 161,552 | 189,393 |
| 2012 | 28,408 | 164,838 | 193,246 |
| 2013 | 22,371 | 180,077 | 202,448 |
| 2014 [(1)] | 38,623 | 171,253 | 209,876 |
| 2015 [(2)] | 7,181 | 184,493 | 191,674 |

(1) 14,770 AF of local supplies was water purchased from the CWA, and placed into storage resulting in a net of 23,853 AF of local supply being used.
(2) The 7,181 AF of local supply was purchased earlier in the year from the CWA, put into storage, then drafted later in the year to satisfy demand.
Source: San Diego County Water Authority Comprehensive Annual Financial Reports.

**San Diego County Water Authority**

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

The CWA's 24 member agencies deliver water to approximately 97% of San Diego County's 3.23 million residents throughout a service area that encompasses approximately 951,000 acres (1,486 square miles), covering the foothills and coastal areas of the westerly third of San Diego County. The City of San Diego represents the largest land area (approximately 22%), the largest population (approximately 42%), and the highest assessed property value (approximately 49%) within the CWA's service area. When the CWA was established in 1944, its service area consisted of 94,707 acres. Growth has primarily resulted from the addition and annexation of additional service areas by member agencies.

The decision-making body of the CWA is its 36-member Board of Directors. Each of the 24 member agencies of the CWA has at least one representative on the CWA Board of Directors. Member agencies may appoint one additional representative for each additional 5% of total assessed value of property taxable by the CWA for purposes within the public agency's boundaries. As a result, the City is entitled to representation by 10 directors (with 48.75% of the assessed property values). The City's current membership on the CWA Board of Directors includes its Director of Public Utilities, Halla Razak.

Under the CWA Act, a member agency's vote is based on its "total financial contribution" to the CWA since the CWA's organization in 1944. Total financial contribution includes all amounts paid in

taxes, assessments, fees, and charges to or on behalf of the CWA or MWD. The CWA Act authorizes each CWA Board of Directors member to cast one vote for each $5,000,000, or major fractional part thereof, of the total financial contribution paid by the member agency. Based on this formula, the City is entitled to 39.85% of the total vote in calendar year 2016. For comparison, the Helix Water District has the second highest voting entitlement, with 6.88% of the vote in calendar year 2016.

As a wholesaling entity, the CWA has no retail customers, but serves only its member agencies. Water supplies utilized within the CWA service area currently originate from five sources: (1) water imported by the CWA from MWD; (2) conserved Colorado River water purchased from the Imperial Irrigation District; (3) conserved Colorado River water achieved as a result of projects to line the All-American and Coachella canals; (4) desalinated seawater from the Carlsbad Desalination Plant; and, (5) local supplies (such as local runoff into surface water reservoirs, groundwater, non-potable recycling, seawater desalination, conservation, and, prospectively, purified water), with the water imported from MWD currently representing the principal source of water supply. MWD obtains its water supply from two primary sources: the Colorado River, via the Colorado River Aqueduct ("CRA") owned by MWD, and the State of California Department of Water Resources' SWP, via the Edmund G. Brown California Aqueduct. MWD has also established a program with Palo Verde Irrigation District customers to pay for conserved Colorado River water as a result of temporary fallowing of fields.

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. The QSA was enacted in October 2003 to provide the State the means to implement water transfers and supply programs that will allow the State to live within the 4.4 million AF basic annual apportionment of Colorado River water. The QSA and its related water transfers and other agreements were signed by the United States Secretary of the Interior and representatives of various Indian tribes, the United States Bureau of Reclamation, the Coachella Valley Water District, the IID, MWD, and the CWA. The QSA outlined how the State would reduce its overuse of Colorado River water over a fifteen year period, however California has not taken any surplus water supplies since 2003, living within its 4.4 million AFY allocation. The CWA's Colorado River Program manages the implementation of the CWA's agreements under the QSA, including the water transfer agreement with the IID and the concrete lining of portions of the All-American and Coachella Canals. Under the QSA, the CWA projects to receive 46% of its water supply from the water transfer and canal lining projects by 2025 while reducing its purchases from MWD to just 19%.

Pursuant to the QSA and its related agreements, the CWA is able to purchase up to 200,000 AFY of conserved water from IID. 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 the IID's Colorado River Water Priority 3 allocation. See the table entitled "Priorities under the 1931 California Seven-Party Agreement" under "– The Metropolitan Water District of Southern California" below. These priorities are higher than MWD's fourth priority allocation of 550,000 AFY. This means that water will likely remain available for transfer even during drought periods. Implementation of the water transfer began in calendar year 2003 with a transfer of 10,000 AF of water. The quantities of water transferred will increase according to an agreed-upon delivery schedule, ultimately providing up to 200,000 AF of water in calendar year 2021. This amount will continue to be transferred between 2021 and as late as 2077. In calendar year 2016, the CWA is projected to purchase 100,000 AF from the IID as part of the ramped-up schedule of deliveries.

Also pursuant to the QSA, the CWA receives approximately 80,000 AFY of water conserved as a result of recently completed construction projects lining portions of the previously earthen All-American and Coachella Canals. The All-American Canal Lining Project will yield approximately 56,200 AF of Colorado River water transfers per year to the CWA and the Coachella Canal Lining Project will yield

approximately 21,500 AFY to the CWA. The canal lining projects will reduce the loss of water that occurred through seepage and that conserved water will be delivered to the CWA. The Coachella Canal Lining Project was completed in December 2006. The All-American Canal Lining Project began construction in June 2007 and was completed in April 2010, when its full yield of 67,700 AFY was made available to project beneficiaries. The IID has certain limited call rights to a portion of the conserved water, but exercise of call rights would extend the term of the deliveries to the CWA. The cost of the canal lining projects was in large part paid by State funds.

***CWA Action on Supply Costs.*** On June 11, 2010, the CWA filed a complaint, *San Diego County Water Authority v. The Metropolitan Water District of Southern California; et al,* alleging that the rates adopted by MWD's Board of Directors on April 13, 2010, misallocate State Water Contract costs to the System Access Rate and the System Power Rate, and thus to charges for transportation of water, and that this results in an overcharge to the CWA by at least $24.5 million per year. In April 2014, San Francisco Superior Court Judge Curtis E.A. Karnow issued a final Statement of Decision in Phase 1 of the CWA's legal challenge to rates set by MWD. Judge Karnow ruled that MWD's rates for 2011, 2012, 2013 and 2014 violate the cost of service requirements of California's Constitution, statutes, and common law. Specifically, Judge Karnow determined MWD's rates violate: Proposition 26 (2013-14 rates only); the State wheeling statute: Government Code Section 549997(a); and, common law rules that apply to rate-making. In August 2015, Judge Karnow issued a final Statement of Decision in Phase 2 of the litigation awarding the CWA $188,295,602, plus interest, as damages and also determining that the CWA is awarded greater preferential rights to MWD water. For detailed information on the CWA's rate litigation, see "LITIGATION – San Diego County Water Authority v. The Metropolitan Water District of Southern California" or visit: http://www.sdcwa.org/MWDrate-challenge; provided that nothing contained in such website is incorporated into this Official Statement.

***Local supply and storage programs***. MWD and the CWA have encouraged the development of additional water supply projects such as water recycling and groundwater projects through the award of Local Resources Program (LRP) incentives of up to $340* per AF within MWD's service territory and Local Water Supply Development ("LWSD") incentives of up to $200 per AF for recycled water and groundwater produced and beneficially reused within the CWA's service area. The purpose of the LRP and LWSD Programs is to promote the development of cost-effective local supply projects that prevent or reduce the demand for imported water and improve regional water supply reliability. The Programs reimburse member agencies for all or a portion of the difference between the actual per AF cost of producing local supplies, and the revenue generated by the participant through the sale of that AF of recycled water (not to exceed $250 and $200 per AF respectively).

In Fiscal Year 2015, local supplies (excluding savings achieved through water conservation) accounted for approximately 14% of the southern California region's water supply portfolio. Recent increases were achieved through the development of recycled water supplies and expanded groundwater use. In 2008, the LWSD program was expanded to include funding for local brackish and seawater desalination projects. However, there currently is no funding appropriated for new LWSD program projects. MWD and the CWA recalculate the LRP and LWSD contribution rate every year. As costs for imported water continues to rise, the incentives the City receives for its older projects will most likely diminish and potentially cease accruing, but in any case the programs expire in 2023. However, the LRP incentive continues to be an attractive option for future water supply projects such as the Pure Water Program.

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* MWD's LRP incentive amount was increased from $250 to $340 per AF produced in October 2014 for new projects.

In 2013 (published March 2014), the CWA updated its 2003 Regional Water Facilities Master Plan, which updated anticipated regional demands according to the 20x2020 conservation framework and acknowledged that the next increment of regional water supplies, after the completion of the regional seawater desalination project at Carlsbad, is anticipated to be from potable reuse projects sponsored by its member agencies - primarily the Pure Water Program. As such, the CWA's Master Plan identifies no new regional water supply projects until after 2025. However, a pilot seawater desalination project is authorized at the Pendleton Marine Base in the short term to study operational issues associated with subsurface intake of seawater.

See "INFORMATION CONCERNING THE METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA AND THE SAN DIEGO COUNTY WATER AUTHORITY."

**The Metropolitan Water District of Southern California**

***General***. The CWA is a member agency of MWD. MWD was created in 1928, under authority of the Metropolitan Water District Act (California Statutes 1927, Chapter 429, as reenacted in 1969 as Chapter 209, as amended) (the "MWD Act"). MWD's primary purpose is to provide wholesale imported water to its member 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, currently numbering 38 members, governs MWD. Each member agency has at least one representative on the MWD Board of Directors. Representation and voting rights are based upon the assessed valuation of property within each member agency. The CWA has four members on the MWD Board of Directors and its voting entitlement is 17.44% as of August 15, 2015. Of the total population in MWD's six-county service area, almost 18.5 million people, or 85%, lived within MWD's service area in 2014, based on official estimates from the California Department of Finance and on population distribution estimates from the Southern California Association of Governments ("SCAG") and SANDAG. Population projections prepared by SCAG in 2012 and SANDAG in 2010, as part of their planning process to update regional transportation and land use plans, show expected population growth of about 18% in MWD's service area between 2010 and 2035. These preliminary regional agency projections do not reflect a complete analysis of the 2010 Census population estimates and may be revised.

The water supply for MWD's service area is provided in part by MWD and in part by non-MWD sources available to members. Approximately 60% of the water supply for MWD's service area is imported water received by MWD from the CRA and the State Water Project and by the City of Los Angeles from the Los Angeles Aqueduct. While the City of Los Angeles is one of the largest water customers of MWD, it receives a substantial portion of its water from the Los Angeles Aqueduct and local groundwater supply. The balance of water within the region is produced locally, primarily from groundwater supplies and runoff.

MWD's member agencies are not required to purchase or use any of the water available from MWD. Some agencies depend on MWD to supply nearly all of their water needs, regardless of the weather. Other agencies, with local surface reservoirs or aqueducts that capture rain or snowfall, rely on MWD more in dry years than in years with heavy rainfall, while others, with ample groundwater supplies, purchase MWD water only to supplement local supplies and to recharge groundwater basins. The demand for supplemental supplies provided by MWD is dependent on water use at the retail consumer level and the amount of locally supplied and conserved water. Consumer demand and locally supplied water vary from year to year, resulting in variability in water sales. Future reliance on MWD supplies will be dependent, among other things, on local projects and the amount of water, if any, that may be derived from sources other than MWD. In recent years, supplies and demands have been affected by drought,

water use restrictions, economic conditions, weather conditions and environmental laws, regulations and judicial decisions

Historically, the CWA has been the largest purchaser of water from MWD. In the fiscal year ended June 30, 2015, the CWA's estimated water purchases from MWD represented approximately 20.9% of MWD's total sales. In addition, under an exchange agreement, MWD transported about 180,000 AF of the CWA's independently obtained Colorado River water to the CWA. See the information under the heading "San Diego County Water Authority" above for a discussion of the CWA's QSA supplies.

In the fiscal year ended June 30, 2015, MWD supplied approximately 1.72 million AF of water to its member agencies. MWD faces a number of challenges in providing a reliable and high quality water supply for Southern California. These include, among others: (1) population growth within the service area; (2) increased environmental regulations, which may impact treatment techniques and operations of facilities; (3) regulatory restrictions on the operation of the State Water Project; (4) variable weather conditions; (5) cost associated with maintaining its supplies; and (6) increasing water rates' impact on its water sales. Supply deficiencies can occur during periods of drought. While MWD plans and manages reserve supplies to account for normal occurrences of drought conditions, increased regulatory restrictions and prolonged droughts may impact MWD's ability to provide water to its member agencies. Implementation of the Water Supply Allocation Plan (the "Water Supply Allocation Plan" or the "WSAP") at a Level 3 Regional Shortage Level and the Governor's Order (as defined herein) are anticipated to reduce supplies delivered by MWD to MWD's member agencies in fiscal year 2015-16 to approximately 1.6 million AF.

It is MWD's declared policy to meet all its member agencies' wholesale water needs, including those of the CWA. In the most recent three water supply shortages in the early 1990's and 2000's, the MWD Board of Directors has adopted allocation plans using financial penalties to limit the amount of water MWD supplies to its member agencies. Operating under the 2008 WSAP, as amended in December 2014, MWD's allocation of water takes into consideration population growth, local supply investments, changes in local supply conditions, demand hardening from conservation, groundwater replenishment needs of some of its member agencies, and each member agency's dependence on MWD supplies. In the past seven years, MWD has implemented Level 2 and Level 3 of its WSAP and altered such levels based on changing water supply outlook, storage conditions, and water demands. On April 14, 2015, the MWD Board of Directors approved a water shortage allocation for fiscal year 2016; WSAP Level 3, or 15% reduction on MWD demand, which took effect on July 1, 2015. MWD has since rescinded the Level 3 WSAP for the 2016-17 water year, and in May 2017 approved a Level 2 – "Water Supply Alert" WSAP for such year. See "State Water Project" below.

See "INFORMATION CONCERNING THE METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA AND THE SAN DIEGO COUNTY WATER AUTHORITY."

***Colorado River.*** The Colorado River was MWD's original source of water after MWD's establishment in 1928. MWD has a legal entitlement to receive water from the Colorado River under a permanent service contract with the Secretary of the Interior, resulting from an agreement dated August 18, 1931, among Palo Verde Irrigation District, Imperial Irrigation District, Coachella Valley County Water District, MWD, the City of Los Angeles, the City of San Diego and the County of San Diego. These agreements establish respective water rights priorities among users. Water from the Colorado River and its tributaries is also available to other users in California, as well as users in the states of Arizona, Colorado, Nevada, New Mexico, Utah, and Wyoming (the "Colorado River Basin States"), resulting in both competition and the need for cooperation among these holders of Colorado River entitlements.

The CRA, 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. Up to 1.25 million AFY may be conveyed through the CRA to MWD's member agencies, subject to availability of Colorado River water for delivery as described below. Work on the CRA commenced in 1933 and water deliveries started in 1941. Additional facilities were completed by 1961 to meet additional requirements of MWD's member agencies. The CRA is 242 miles long, starting at Lake Havasu and terminating at Lake Mathews in Riverside County.

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 one-half of any surplus that may be available for use collectively in Arizona, California, and Nevada as declared on an annual basis by the United States Secretary of the Interior.

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

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

(1) Agreement dated August 18, 1931, among Palo Verde Irrigation District, Imperial Irrigation District, Coachella Valley County Water District, MWD, the City of Los Angeles, the City and the County of San Diego. These priorities were memorialized in the agencies' respective water delivery contracts with the Secretary of the Interior.

(2) The Coachella Valley Water District serves Coachella Valley.

(3) In 1946, the City, the CWA, MWD and the Secretary of the Interior entered into a contract that merged and added the City and the County of San Diego's rights to storage and delivery of Colorado River water to the rights of MWD.

Source: MWD.

In addition, under a 1944 treaty, Mexico has an allotment of 1.5 million AF of Colorado River water annually except in the event of extraordinary drought or serious accident to the delivery system in the United States, in which event the water allotted to Mexico would be curtailed. Mexico also can schedule delivery of an additional 200,000 AF of Colorado River water per year if water is available in excess of the requirements in the United States and the 1.5 million AF allotted to Mexico.

MWD holds the fourth priority right of 550,000 AFY and a fifth priority right of 662,000 AFY (after priority rights to 3,850,000 AF held by Palo Verde Irrigation District, Yuma Project in California, Imperial Irrigation District and the All-American Canal, and Palo Verde Irrigation District). MWD's fourth priority right is within California's basic annual apportionment of 4.4 million AF; however, the fifth priority right is outside of this entitlement and therefore is not considered a firm supply of water. Until 2003, MWD had been able to take full advantage of its fifth priority right as a result of the availability of surplus water and water apportioned to Arizona and Nevada that was not needed by those states. However, during the 1990's Arizona and Nevada increased their use of water from the Colorado River, and by 2002 no unused apportionment was available for California. In addition, severe drought in the Colorado River Basin reduced storage in system reservoirs, ending the availability of surplus deliveries to MWD. No Colorado River water is available to MWD under its fifth priority right.

Prior to 2003, MWD could divert over 1.25 million AF in any year. Average annual net deliveries for 2004 through 2014 were approximately 838,000 AF, with annual volumes dependent primarily on programs to augment supplies, including transfers of conserved water agriculture. For 2015, MWD planned Colorado River deliveries of 923,000 AF, relying on its basic Priority 4 supply, other supply programs, as well as 180,000 AF of the CWA's QSA supplies. MWD also anticipates up to 165,000 AF of transfers and exchanges from both the Colorado River and State Water Project systems.

MWD has taken steps to augment its share of Colorado River water through agreements with other agencies that have rights to use such water. Under a 1988 water conservation agreement (the "1988 Conservation Agreement") between MWD and the IID, MWD provided funding for IID to construct and operate a number of conservation projects that have conserved up to 109,460 AF of water per year that has been provided to MWD. In 2015, 107,820 AF of conserved water was made available by IID to MWD.

*Management of California's Colorado River Water Supply*. In response to Arizona and Nevada increasing use of their respective apportionments in the late 1990's and the uncertainty of continued surpluses on the Colorado River, the Colorado River Board of California ("CRB"), in consultation with MWD, IID, the Palo Verde Irrigation District ("PVID"), CVWD, the Los Angeles Department of Water and Power, and the CWA, embarked on the development of a plan for reducing California's use of Colorado River water to its basic annual apportionment of 4.4 million AF (the "California Plan"). In 1999, MWD, IID, CVWD and the State agreed to a set of Key Terms aimed at managing California's Colorado River supply. These Key Terms were incorporated into CRB's May 2000 California Plan that proposed to optimize the use of Colorado River supply through water conservation, transfers from higher priority agricultural users to the CWA's and MWD's respective service areas, and storage programs.

Many of the core elements of the California Plan are being implemented by the QSA. The QSA also allows MWD to enter into other cooperative Colorado River supply programs, modify existing conservation and cooperative water supply agreements consistent with the QSA, and set aside several disputes among California's Colorado River water agencies. See the information under the heading "San Diego County Water Authority" above for a discussion of the CWA's QSA supplies.

*MWD Colorado River Supply Programs*. MWD has taken steps to increase its access to Colorado River water through agreements with agencies that have higher priority rights to the water. Under the

1988 Conservation Agreement between MWD and IID, IID constructed conservation projects that are providing 105,000 AF of conserved water per year to MWD. Under the QSA, MWD agreed to forgo up to 20,000 AF of this water for CVWD's use. In doing so, MWD firmed up its 1988 IID transfer to be taken from IID's Priority 3 supply. In August 2004, MWD and PVID entered into a Land Management Crop Rotation and Water Supply Program. This program can produce up to 133,000 AF of water to MWD under certain conditions. MWD water conservation programs with the agricultural agencies were made possible through the quantification of water under the QSA and are dependent on the continuation of the QSA and the accounting of Colorado River water that it makes possible. In October 2004, MWD entered into a storage and interstate release agreement with Southern Nevada Water Authority ("Nevada"). Under this program, Nevada can request MWD to store unused Nevada apportionment in California. The stored water improves near-term water supply reliability for MWD, but obligates MWD to return water to Nevada in future years.

*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 the 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 also extended existing Interim Surplus Guidelines ("ISG") until 2026, which determine when surplus water is available for California, Arizona and Nevada. Availability of ISG surplus water depends 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, under Intentionally Created Surplus ("ICS") provisions. Under ICS provisions, MWD can implement water conservation programs to create a storage account in Lake Mead of up to 1,500,000 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. At the start of 2016, MWD had approximately 46,000 AF in its ICS accounts, comprised of water conserved by fallowing in the Palo Verde Valley and from the yield allocated to MWD from the Drop 2 Reservoir Project and the Yuma Desalter pilot program. Also under the terms of the 2007 agreement, as amended, IID is allowed to store up to 100,000 AF of conserved water within MWD's system with a cumulative limit of 200,000 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 CRA. A number of species that are on either "endangered" or "threatened" lists under the Federal ESA or the California ESA 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 of its Colorado River facilities and to minimize any uncertainty from additional listings of endangered species. The MSCP also covers operations of federal dams and power plants on the Colorado River.

*Seismic Considerations*. Portions of the CRA are located near earthquake faults, including the San Andreas Fault. The five pumping plants on the CRA have been buttressed to better withstand seismic events. Other components of the CRA are monitored for any necessary rehabilitation and repair. Supplies are dispersed throughout MWD's service area, and a six-month reserve supply of water normally held in local storage provides reasonable assurance of continuing water supplies during and following seismic events. MWD has developed an emergency plan that calls for specific levels of response appropriate to an

earthquake's magnitude and location. However, 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 CRA.

***State Water Project***. MWD's other major source of water is the SWP. The State-owned SWP is operated by the DWR. The SWP transports Feather River water stored in, and released from Oroville Dam and unregulated flows diverted directly from the San Francisco Bay/Sacramento-San Joaquin Delta Estuary ("Bay-Delta") south via the California Aqueduct to four delivery points to MWD near the northern and eastern boundaries of MWD's service area. The total length of the California Aqueduct is 444 miles. MWD rights to SWP water are set forth in its State Water Contract which currently provides for the delivery of up to 1,911,500 AFY. MWD also has a "call" on 100,000 AFY of water it transferred to CVWD and the Desert Water Agency, if needed, and is required to pay for the financial obligations associated with that water supply during the call period.

Upon expiration of the State Water Contract term (currently in 2035), MWD has the option to continue service under substantially the same terms and conditions. In June 2014, DWR and the SWP Contractors reached an Agreement in Principle ("AIP") to extend the contract to 2085 and to make certain changes related to financial management of the SWP in the future. The AIP will serve as the "proposed project" for purposes of environmental review under the California Environmental Quality Act ("CEQA"). DWR issued a Notice of Preparation of an Environmental Impact Report ("EIR") for the proposed project on September 14, 2014. Following CEQA review, a State Water Contract amendment will be prepared. Such amendment will be subject to review by the Legislature.

The SWP was originally intended to produce 4.2 million AF of water supply annually. The first SWP facilities were completed in the early 1970's; at that time, it was envisioned that additional facilities would be constructed as the demand for SWP water increased. Several factors, including public opposition and increased costs, combined to delay the construction of additional facilities. The quantity of SWP water supply available for delivery each year is determined by both hydrology and operational considerations. Water supplies received from the SWP by MWD from 2002 through 2014, including water from water transfers, groundwater banking and exchange programs, varied from a low of approximately 605,000 AF in calendar year 2009 to a high of approximately 1,800,000 AF in calendar year 2004.

The State Water Contract, under a 100% allocation, provides MWD 1,911,500 AF of water. The 100% allocation is referred to as the contracted amount. Late each year, DWR announces an initial allocation estimate for the upcoming year, but may revise the estimate throughout the year if warranted by developing precipitation and water supply conditions. For calendar year 2015, DWR's initial allocation estimate to SWP Contractors was announced on December 1, 2014, as 10% of contracted amounts. Due to December 2014 and February 2015 storm runoff and storage in the State's major reservoirs, this allocation was increased on January 15, 2015 to 15% of contracted amounts, and increased again on March 2, 2015 to 20%, or 382,000 AF. On December 1, 2015, DWR announced that the initial allocation estimate for 2016 is 10% of contracted amounts, or 191,150 AF. This allocation reflects a fourth consecutive year of drought, low storage levels in the State's major reservoirs, and federally mandated environmental restrictions which have been imposed upon water deliveries from the Bay Delta, including the biological opinions as discussed below. As in previous dry years, MWD is augmenting these deliveries using withdrawals from its storage programs along the SWP and through water transfer and exchange programs.

In 2015, MWD took delivery of approximately 549,000 AF of water supply through the California Aqueduct, including approximately 154,000 AF of water it had previously stored in its Central Valley groundwater accounts and about 36,000 AF in carryover storage. In 2014, MWD used

approximately 190,000 AF of flex storage which it is required to pay back within five years. In 2015, MWD repaid 36,000 AF of flex storage it used.

The preliminary SWP allocation for calendar year 2016 was 45% of contracted amounts, providing MWD with approximately 860,000 AF. Due to improved hydrology in the State, the DWR's latest allocation analysis released on April 21, 2016 increased the allocation to 60% of contracted amounts. In April 2015, due to lack of adequate imported supplies at that time, the MWD Board of Directors implemented Level 3 of its WSAP for fiscal year 2016, which was set to continue through June 2016, subject to consideration of the WSAP allocation level at its May 2016 meeting. Based on the improved hydrologic conditions and increased allocation to 60%, or approximately 1.15 million AF to MWD, the MWD Board of Directors rescinded the Level 3 WSAP for the 2016-17 water year, and approved a Level 2 – "Water Supply Alert" WSAP for such year.

*Bay-Delta Regulatory and Planning Activities*. The water supply and reliability challenges affecting the SWP are largely a result of longstanding environmental issues in the Bay-Delta estuary. 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. One hundred fifty years of human activity have contributed to the destruction of habitat, the decline of several estuarine and anadromous fish species, and the deterioration of water quality. These activities have historically included increasing water demands from urban and agricultural water uses, the dredging and filling of tidal marshes, the construction of levees, urban runoff, wastewater discharges, agricultural drainage, runoff from abandoned mines, and the introduction of non-native species.

The SWRCB is the agency responsible, together with its nine regional water quality control boards that exercise rulemaking and regulatory activities by groundwater basins, for setting water quality standards and administering water rights throughout California. SWRCB decisions can affect the availability of water to users of SWP water, including MWD. 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 ("WQCP"), which establishes the water quality standards and proposed flow regime of the estuary, and water rights decisions that assign responsibility for implementing the objectives of the WQCP to users throughout the system by adjusting their respective water rights. Since 2000, the SWRCB's Water Rights Decision 1641 ("D-1641") has governed the SWP's ability to export water from the Bay-Delta for delivery to SWP contractors. See also "State Water Project Operational Constraints" below. The SWRCB is reviewing San Joaquin River flows and southern Delta salinity as well as potential modifications to the 2006 Bay-Delta Plan and its implementation. On January 29 2014, DWR and the Bureau of Reclamation filed a petition requesting changes to D-1641 terms that govern outflows in the Bay-Delta. The SWRCB approved elements of the temporary urgency change petition which enable water to be conserved in reservoirs in case of continued drought, and other changes allow more flexible operations of gates based on evolving water quality conditions and fish migration information.

The CALFED Bay-Delta Program was a collaborative effort among State and federal agencies to develop a long-term solution to improve water supplies in California and the health of the Bay-Delta watershed. In August 2000, the federal government and the State issued a ROD and related documents approving the final programmatic environmental documentation for the CALFED Bay-Delta Program. Implementing the CALFED Bay-Delta Program during the first seven years resulted in 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 Bay-Delta Program and identify a strategy for managing the Bay-Delta as a sustainable resource, then-Governor Schwarzenegger in September 2006 established, by Executive Order, a Delta Vision process. The Delta

Vision process was tied 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 (the "Strategic Plan") on October 17, 2008, providing its recommendations for long-term sustainable management of the Bay-Delta. The Strategic Plan was reviewed by the Delta Vision Committee, chaired by the State Secretary for Natural Resources. The Implementation Report summarizing the Delta Vision Committee's recommendations was submitted to then-Governor Schwarzenegger on December 31, 2008. These recommendations include completing the Bay-Delta Conservation Plan ("BDCP") and associated environmental assessments to permit ecosystem revitalization and water conveyance 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 working with the State Legislature on a comprehensive water bond package to fund Bay-Delta infrastructure projects.

On November 4, 2009, the State Legislature passed a comprehensive package of water legislation that included five bills addressing California's statewide water situation, with particular emphasis on the Bay-Delta. The water legislation signed into law (the "2009 State Water Legislation") includes, among other things, a 20% water conservation mandate for most localities in the State by 2020, new regulations regarding voluntary monitoring of groundwater levels by localities, and an $11.14 billion State general obligation bond measure that would provide funding for projects and programs throughout the State and in the Bay-Delta. The bond measure was scheduled to be included on the November 2010 ballot, but the State Legislature postponed the bond election first, to 2012, and subsequently, to 2014. In August 2014, the California Legislature replaced the 2009 bond measure with a smaller water bond. California Proposition 1 ("Proposition 1"), the Water Bond, was approved by voters on November 4, 2014. The measure will enact the Water Quality, Supply, and Infrastructure Improvement Act of 2014. Among other things, it authorized $7.12 billion in general obligation bonds for State water supply infrastructure projects, and provided specific spending proposals, such as $520 million to improve water quality, $1.495 billion for multi-benefit ecosystem and watershed protection and restoration projects, and $2.7 billion for water storage projects, dams and reservoirs.

The 2009 State Water Legislation also directed that the Bay-Delta be managed with the dual goals of water supply reliability and ecosystem protection. It created two new governmental agencies – the Sacramento-San Joaquin Delta Conservancy and the Delta Stewardship Council. The Sacramento-San Joaquin Delta Conservancy will implement ecosystem restoration activities in the Bay. The Delta Stewardship Council, formed in February 2010, is CALFED's successor agency; it was directed to adopt and oversee implementation of a comprehensive management plan for the Bay-Delta (the "Delta Plan") by January 1, 2012. The Delta Plan was intended to lay the foundation for projects and programs that will meet the State's co-equal goals of improving statewide water supply reliability while providing a healthy ecosystem. The Delta Plan was adopted by the Delta Stewardship Council on May 16, 2013. Subsequently, its 14 regulatory policies were approved by the Office of Administrative Law. The Delta Plan became effective with legally-enforceable regulations on September 1, 2013.

The 2009 State Water Legislation also provides that the BDCP, when completed and successfully permitted as a habitat conservation plan, be incorporated into the Delta Plan. Originally, the BDCP was being developed as a 50-year habitat conservation plan with the goals of restoring the Sacramento-San Joaquin Delta ecosystem and securing California's water supplies. A full public draft BDCP and environmental impact reports were released in December 2013. Key elements of the public draft BDCP included the construction of a double-bore tunnel to move water under the Delta for 30 miles to the State and federal aqueducts at a combined capacity of up to 9,000 cubic feet per second when water is available in the Sacramento River. The operations would be phased in over several years and the conveyance design using gravity flow would maximize energy efficiency and minimize environmental impact. The

water ratepayers of the SWP, including MWD, and federal Central Valley Project ("CVP") contractors would fund the conveyance portion of the project. MWD's SWP-related costs are generally reflected in charges to MWD's member agencies, including the CWA. In late 2014, DWR announced significant refinements needed to the proposed BDCP and associated documents, including changes intended to reduce impacts to Delta communities and improve the long-term reliability and operation of the proposed tunnels. More recently, in April 2015, Governor Brown unveiled an even more scaled back BDCP, separating the restoration effort from the tunnel construction, reportedly to accelerate the restoration of the Delta ecosystem and fix the State's aging infrastructure. On July 9, 2015, DWR released a set of Partially Recirculated Draft environmental documents on the BDCP and the "California WaterFix" for public comment, which ended on October 30, 2015. The California WaterFix, considered the new preferred alternative, includes facilities similar to those under the BDCP, but will be developed pursuant to Federal ESA Section 7 and corresponding State permit rather than the HCP/NCCPA regulations as planned under the BDCP. In doing so, the California WaterFix will function under the same permit standards as how the SWP is currently being operated. Draft terms include incidental take authorization for an unspecified period and would include only limited amounts of habitat restoration. Preliminary cost estimates for this project alternative are approximately $17 billion. When a decision selecting the final project has been made, costs will be updated and allocated. MWD has stated that it anticipates that it could bear approximately 25% of the costs of the project. The final planning documents are expected to be completed in mid-2016.

*Endangered Species Act Considerations*. The listing of several fish species as threatened or endangered under the Federal ESA or the California ESA have adversely impacted SWP operations and limited the flexibility of SWP operations. Currently, five species (the winter-run and spring-run Chinook salmon, Delta smelt, North American green sturgeon and Central Valley steelhead) are listed under the ESAs. In addition, on June 25, 2009, the California Department of Fish and Game, now the California Department of Fish and Wildlife ("CDFW"), declared the longfin smelt a threatened species under the California ESA.

The Federal ESA requires that before any federal agency authorizes funds or carries out an action it must consult with the appropriate federal fishery agency to determine whether the action would jeopardize the continued existence of any threatened or endangered species, or adversely modify habitat critical to the species' needs. The result of the consultation is known as a "biological opinion." In the biological opinion the federal fishery agency determines whether the action would cause jeopardy to a threatened or endangered species or adverse modification to critical habitat and recommends reasonable and prudent alternatives or measures that would allow the action to proceed without causing jeopardy or adverse modification. The biological opinion also includes an "incidental take statement." The incidental take statement allows the action to go forward even though it will result in some level of "take," including harming or killing some members of the species, incidental to the agency action, provided that the agency action does not jeopardize the continued existence of any threatened or endangered species and complies with reasonable mitigation and minimization measures recommended by the federal fishery agency.

In 2004 and 2005, the United States Fish and Wildlife Service ("USFWS") and National Marine Fisheries Service ("NMFS") issued biological opinions and incidental take statements that govern operations of the SWP and the CVP with respect to the Delta smelt, the winter-run and spring-run Chinook salmon and the Central Valley steelhead.

In July 2006, the United States Bureau of Reclamation ("USBR") reinitiated consultation with the USFWS and NMFS with respect to the 2004 and 2005 biological opinions (with the addition of the North American green sturgeon, which was listed in April 2006) following the filing of legal challenges to those biological opinions and incidental take statements. Under the Federal ESA, critical habitat also must be

designated for each listed species. Critical habitat has been designated for each of the currently listed species, including the North American green sturgeon.

On May 25, 2007, U.S. District Judge Oliver Wanger invalidated the Delta smelt biological opinion that had guided the SWP and the CVP operations and ordered a new biological opinion be developed. In December 2008, USFWS issued a new Delta smelt biological opinion, largely mirroring Judge Wanger's injunction in 2007, which caused significant pumping restrictions to water exports by the SWP and CVP. MWD along with other agencies and interested parties filed separate lawsuits in federal district court challenging the biological opinion, which the federal court consolidated under the caption Delta Smelt Consolidated Cases. On December 14, 2010, Judge Wanger issued a decision on summary judgment finding that there were major scientific and legal flaws in the Delta smelt biological opinion and remanding the biological opinion to the USFWS for reconsideration. The court's decision invalidates some of the restrictions on the SWP operations contained in the Delta smelt biological opinion. On May 4, 2011, Judge Wanger issued a final amended judgment directing the USFWS to complete a new draft biological opinion by October 1, 2011 and to complete a final biological opinion with environmental documentation by December 1, 2013, which through later stipulations was changed to December 1, 2014. On December 14, 2011, a draft biological opinion was issued that deferred specification of a reasonable and prudent alternative and an incidental take statement pending completion of review under the National Environmental Policy Act ("NEPA"). The federal defendants and environmental interveners appealed the final judgment invalidating the 2008 Delta smelt biological opinion; while the SWP and CVP contractor plaintiffs cross-appealed from the final judgment. Those appeals and cross-appeals were argued on September 10, 2012. On March 13, 2014, a three judge panel of the Ninth Circuit Court of Appeals reversed in large measure Judge Wanger's district court decision relating to the 2008 Delta smelt biological opinion. The ruling validates the biological opinion and the Reasonable and Prudent Alternatives ("RPAs"). The RPAs include the pumping and export restrictions imposed to protect the Delta smelt. Implementation of pumping restrictions has resulted in the loss of about 1.5 million AF of State Project water to MWD since 2008. On October 6, 2014, federal and State water contractors filed a petition to review the Ninth Circuit's decision with the U.S. Supreme Court. Impacts resulting from this litigation and ruling cannot be determined at this time.

On June 4, 2009, the NMFS released its new biological opinion for salmonid species. The salmonid species biological opinion contains additional restrictions on SWP and CVP operations. Six lawsuits have been filed challenging the 2009 salmon biological opinion, which the court consolidated under the caption Consolidated Salmon Cases. On May 25, 2010, the court granted the plaintiffs' request for preliminary injunction in the Consolidated Salmon Cases, which restrained enforcement of two requirements that limit exported water during the spring months. Hearings on motions for summary judgment were held on December 16, 2010. On September 20, 2011, Judge Wanger granted a motion for summary judgment, finding that the salmon biological opinion was flawed and that some of the restrictions in the biological opinion were arbitrary and capricious. On December 12, 2011, U.S. District Judge Lawrence J. O'Neill, who was assigned to the case after Judge Wanger's retirement, issued a final judgment in the Consolidated Salmon Cases. The final judgment remands the 2009 biological opinion to the NMFS and directs that a new draft salmon biological opinion be issued. The due date for the draft salmon biological opinion was extended to October 1, 2015, and the due date for the final opinion was extended to February 1, 2017.

On November 13, 2009, the Center for Biological Diversity filed separate lawsuits challenging the failure by USFWS to respond to a petition to change the Delta smelt's federal status from threatened to endangered, and denial of its petition for federal listing for the longfin smelt. An agreement settling the longfin smelt litigation was approved on February 2, 2011. Under the agreement, the USFWS agreed to complete a rangewide status review of the longfin smelt and consider whether the Bay-Delta longfin smelt population, or any other longfin smelt population from California to Alaska, qualifies as a "distinct

population" that warrants federal protection. On April 2, 2012, the USFWS issued its finding that the Bay-Delta longfin smelt population warrants protection under the ESA but is precluded from listing as a threatened or endangered species by the need to address other higher priority listing actions. The finding includes the determination that the Bay-Delta longfin smelt will be added to the list of candidates for ESA protection, to be reviewed annually.

In addition to the Federal ESA litigation, other environmental groups sued DWR on October 4, 2006 in the Superior Court of the State of California 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*) requested that DWR be ordered 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 Superior Court issued its Statement of Decision finding that DWR was illegally "taking" listed fish through operation of the SWP export facilities. The Superior Court ordered DWR to "cease and desist from further operation" of those facilities within 60 days unless it obtained take authorization from the CDFW. DWR appealed the order on May 7, 2007. The Court of Appeal subsequently issued a decision finding that DWR was a "person" under the California ESA and subject to its take prohibitions. The State Water Contractors and Kern County Water Agency have filed suit in State court challenging the Consistency Determinations under the California ESA that have been issued for both Delta smelt and salmon. Those lawsuits challenging the Consistency Determinations have been stayed and await final ruling in federal court regarding the validity of the Delta smelt and salmon biological opinions.

*State Water Project Operational Constraints*. DWR has altered the operations of the SWP to accommodate species of fish listed under the ESAs. These changes in project operations have adversely affected SWP deliveries, with reductions estimated to be as much as one million AF in an average year, 0.3 million AF in a critically dry year and 1.3 million AF in an above-average water year. Operational constraints are likely to remain in place until a long-term solution to the problems in the Bay-Delta is identified and implemented. New litigation, listings of additional species or new regulatory requirements could further adversely affect future SWP operations by requiring additional export reductions, releases of additional water from storage or other operational changes impacting water supply availability. Neither the City nor the CWA can predict the ultimate outcome of any of the litigation or regulatory processes described above but each believes they could have a materially adverse impact on the availability and cost of SWP and MWD water supplies.

*SWP Capital Projects.* The majority of the capital costs associated with the development and maintenance of the SWP is financed using revenue bonds. These bonds have historically been sold with 30 year terms that extend to the year 2035, the year in which most of the SWP contracts expire. As the years progress, it is becoming more challenging to affordably finance capital expenditures for the SWP since bonds used to finance these expenditures are limited to terms that only extend to the year 2035. The current proposed extension of the SWP contracts will allow DWR to continue to sell bonds with 30 year terms, thereby ensuring the debt service on these bonds remains affordable to SWP Contractors and their water customers. Neither the City nor the CWA can predict the ultimate outcome of the finalized contract extension described above but it could have a materially adverse impact on the cost of SWP and MWD water supplies.

*Seismic Considerations*. Major portions of the California Aqueduct are located parallel to and near the San Andreas and other faults. All major faults are crossed either by canal at ground level or by pipeline at very shallow depths to ease repair in case of damage from movement along a fault. SWP facilities are designed to withstand earthquakes without major damage. Dams, for example, are designed to accommodate movement along their foundations and to resist earthquake forces on their embankments.

Earthquake loads have been taken into consideration in the design of project structures such as pumping and power plants. The location of check structures on the canal allows for hydraulic isolation of the fault-crossing repair. No assurance can be made that a significant seismic event would not cause damage to SWP structures and interrupt the water supply available from the SWP.

***Additional MWD Water Supplies***. MWD has a number of water transfer and storage and exchange programs with state, federal, public and private water districts and individuals in order to augment its imported water supplies. MWD has entered into groundwater basin storage agreements with the Arvin Edison Water Storage District and Semitropic Water Storage District, an agreement with San Bernardino Valley Municipal Water District to coordinate the use of facilities and SWP supplies, and groundwater banking and exchange transfer agreements with the Kern Delta Water District, the Mojave Water Agency, CVWD and the Desert Water Agency. MWD has additional agreements with other SWP Contractors and water agencies to augment MWD supply.

***MWD Storage***. In addition to making its imported water supplies available for annual consumptive uses, MWD also purchases and stores excess imported water in wet years for use in dry years. MWD reports that its storage capacity is 5.93 million AF, which includes reservoirs, conjunctive use and other groundwater storage programs within its service area, and groundwater and surface storage programs along the SWP and CRA. As a result of increased State Water Project supplies and reduced demands from 2010 to 2012, MWD rebuilt its storage after several years of withdrawals to approximately 3.375 million AF, including emergency storage. This was the highest end-of-year total water reserves in MWD's history. In 2013, MWD drew 407,000 AF from storage to meet demands, reducing overall storage to 2.968 million AF. MWD withdrew approximately 1.2 million AF from storage in 2014 and 2014 year-end overall storage was approximately 1.8 million AF. Approximately 127 thousand AF was withdrawn from storage reserves in the first six months of 2015, leaving 1.72 million AF in storage reserves as of July 1, 2015. MWD staff estimated that the overall storage reserve level as of December 31, 2015 would be about 1.5 million AF. The actual withdrawal from storage will vary depending on supply conditions and member agencies' response to MWD's call to reduce demand.

See "INFORMATION CONCERNING THE METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA AND THE SAN DIEGO COUNTY WATER AUTHORITY."

**Recent CWA and MWD Actions in Response to Drought Conditions**

To offset reductions in SWP supplies and mitigate impacts of the California drought, MWD has utilized supplies from the Colorado River and storage reserves, and is also encouraging responsible and efficient water use to lower demands. MWD is prepared to meet water demands in its service area through calendar year 2016 using a combination of SWP and CRA deliveries, storage reserves and supplemental water transfers and purchases. Through 2015, the CRA is anticipated to operate near capacity. Operations to distribute Colorado River supplies into areas normally served by SWP supplies began in 2014. These measures have offset the low 2015 SWP supply allocation. Approximately 120,000 AF was withdrawn from dry-year storage reserves in the first six months of 2015, leaving 1.72 million AF in storage reserves as of July 1, 2015. (An acre-foot is the amount of water that will cover one acre to a depth of one foot and equals approximately 326,000 gallons, which represents the needs of two average families in and around the home for one year.)

On April 1, 2015, Governor Brown issued an Executive Order ("Governor's Order") calling for a 25% reduction in consumer water use in response to the historically dry conditions throughout the State. As a wholesale water agency providing a supplemental water supply to its member agencies, MWD is not subject to the requirements of the Governor's Order, which applies to retail water agencies, however MWD's member agencies will need to reduce their water sales in order to comply with the Governor's

Order. MWD also relies upon its WSDM Plan to identify resource actions in times of shortage and its WSAP for equitable distribution of available water supplies in case of extreme shortages. On April 14, 2015, the MWD Board of Directors declared the implementation of the MWD's WSAP at a Level 3 Regional Shortage Level for the allocation year, effective July 1, 2015 through June 30, 2016. MWD has reported that implementation of the WSAP Level 3 and the Governor's Order are anticipated to reduce supplies delivered by MWD to MWD's member agencies in fiscal year 2015-16 to approximately 1.6 million AF. As described above, MWD has since rescinded the Level 3 WSAP for the 2016-17 water year, and in May 2017 approved a Level 2 – "Water Supply Alert" WSAP for such year.

The emergency regulation includes specific conservation standards that took effect June 1, 2015, and require urban water suppliers to reduce usage through February 2016, as compared to the amount used in 2013. The target reduction can vary between 4% and 36% statewide, and for member agencies in the CWA's service area, the range is between 12% to 36%. CWA member agencies are required to reduce their potable urban demands by their specific percentage reduction during the months of June 2015 through February 2016 compared to the same months in 2013. The CWA is not subject to the conservation mandate, as it does not apply to suppliers that are functioning solely in a wholesale capacity. An urban water supplier may subtract the amount of water supplied for commercial agricultural use from its water production total if certain criteria are met.

Legislation approved in November 2009 sets a statewide conservation target for urban per capita water use of 20% reductions by 2020 (with credits for existing conservation) at the retail level, providing an additional catalyst for conservation by member agencies and retail suppliers. MWD's water sales projections incorporate an estimate of conservation savings that will reduce retail demands. Current projections include an estimate of additional water use efficiency savings that would result from local agencies reducing their per capita water use in response to the 20% by 2020 conservation savings goals required by recent legislation as well as an estimate of additional conservation that would have to occur to reach MWD's current Integrated Resources Plan goal of reducing overall regional per capita water use by 20% by 2020.

Since Governor Brown's initial drought emergency proclamation in January 2014, MWD has worked proactively with its member agencies to conserve water supplies in its service area. In February 2014, MWD declared a Water Supply Alert, calling upon local cities and water agencies to immediately implement extraordinary conservation measures and institute local drought ordinances, and significantly expanded its water conservation and outreach programs and increased funding for conservation incentive programs.

The CWA has taken incremental steps and continues to take action to respond to the statewide drought. On February 13, 2014, the CWA Board of Directors implemented its Water Shortage and Drought Response Plan ("WSDRP"), declaring the Voluntary Supply Management stage, and approved notification to its member agencies of a Regional Drought Response Level 1, Drought Watch condition, under its Model Drought Response Ordinance. The CWA launched a drought response campaign in April 2014, to encourage conservation and greater use of regional conservation programs. Water savings are important to help preserve storage reserves in case dry conditions continue. Also on February 13, 2014, the CWA Board of Directors voted to support the expediting of local and regional supply development and to advocate for the development of more storage statewide. With dry conditions continuing, Governor Brown issued another Executive Order on April 24, 2014 to further strengthen the State's ability to effectively manage water. On July 15, 2014, the SWRCB adopted an emergency regulation for statewide urban water conservation. On July 24, 2014, the CWA Board of Directors declared implementation of the Supply Enhancement stage, under the WSDRP, and approved notification to the CWA member agencies of a Regional Drought Response Level 2, Drought Alert condition, under its Model Drought Response Ordinance, which includes mandatory water use restrictions.

Water agencies, including the CWA, have called for an approach to the emergency regulation that provides greater recognition for investments in drought resistant water supplies. This was cited in the SWRCB's Resolution No. 2015-0032, item 17, which also directed staff to work with stakeholders on a thoughtful process to devise options for extended and expanded emergency regulations should the drought continue into 2016.

WSAP Level 3 put in place a 15% reduction in regional deliveries and is in effect July 1, 2015 through June 30, 2016. MWD will provide the CWA an annual amount of water based on the allocation methodology contained in its WSAP. If the CWA exceeds its allocation by the end of the fiscal year 2016 allocation period, MWD will apply a penalty on water use in excess of the allocation limit.

In response to supply cutbacks from MWD in fiscal year 2016 and the SWRCB Emergency Regulation for statewide urban water conservation, the CWA Board, at its May 14, 2015 meeting:

1. Declared the Mandatory Supply Cutback Stage of the CWA's Water Shortage and Drought Response Plan, and approved member agency supply allocations for municipal and industrial ("M&I") and Transitional Special Agricultural Water Rate ("TSAWR") for fiscal year 2016.

2. Set penalties for local agencies that exceed their M&I and TSAWR supply allocations.

3. Restricted the irrigation of ornamental landscapes and turf with potable water to no more than two days a week across the region to help agencies meet their reduction targets.

A supply and demand analysis for fiscal year 2016, taking into account the CWA's estimated available supplies, shows that investments made in the San Diego region for supply reliability projects and programs were able to mitigate the 15% shortfall from MWD. The CWA's 20-year diversification strategy was successful in reducing water shortages from MWD due to drought. The estimated regional supply shortfall for fiscal year 2016 is only 1%. Based on the reduced demand levels achieved by the member agencies during fiscal year 2016 in response to the SWRCB regulations, the CWA could potentially store available supplies locally to help mitigate continued drought conditions within the region.

Locally, total precipitation in the San Diego region was brought closer to normal levels for water year 2015 due to record breaking rainfall that came with unseasonable storms in July 2015. Annual rainfall at Lindbergh Field was at 105% of normal for water year 2015 as of August 12, 2015. However, the lack of precipitation in the region over the past few years has resulted in below average local surface water storage. As of January 31, 2016, reservoir storage in the San Diego region was at 43% of capacity, or just over 319,000 AF. As of January 31, 2016, CWA storage accounted for 146,007 AF in 5 different reservoirs.

However, ratepayer investments over the last 20 years to diversify water supply resources, and the regional commitment to conservation have greatly improved supply reliability for the San Diego region. As a result, the San Diego region is better able to manage dry-year conditions than many other communities across California. For example, the CWA's Colorado River transfers under the QSA increased to 180,256 AF in fiscal year 2014, and the transfer schedule will ramp up to 200,000 AF by 2021. The Carlsbad Desalination Project began commercial production in December 2015, and has the potential to produce up to 56,000 AFY of new drought-proof water supplies. In addition, strong conservation efforts in the San Diego region have resulted in a 24% decrease in per capita total water use between 2007 to 2014 prior to the imposition of emergency conservation targets by the SWRCB.

On March 10, 2016, SWRCB staff certified the supply of potable water from the Carlsbad Desalination Plant (the Carlsbad Project herein) as drought-resilient, which allowed each of the CWA's member agencies to reduce its conservation standard by an amount up to 8%, but not beyond an 8% minimum conservation standard, with a retroactive application date of March 1, 2016.

On May 9, 2016, Governor Brown issued an Executive Order with additional conservation mandates and changes to water use restrictions. This order included permanent changes not included in the City's municipal code for water use restrictions, including restrictions for irrigating ornamental turf on public street medians and prohibiting home owner associations from restricting conservation activities. This order also proposed to lift the following restrictions currently included in the City's permanent water use restrictions: restrictions on eating and drinking establishments to serve water other than on request; requirement on hotels and motels to offer the choice to patrons to have towels and linens laundered daily; and limits on outdoor irrigation of ornamental turf with potable water no more than two days per week. The Governor's order also required the permanent continuation of monthly reporting on water use, conservation achieved, and enforcement. The SWRCB is anticipated to issue revised rules based on the Governor's mandate that would apply through January 2017. The SWRCB is scheduled to consider these revised rules on May 18, 2016 and may take action that could result in further reductions in the City's mandatory conservation standard. The SWRCB will factor into consideration the hydrologic conditions statewide at the end of April 2016, including the amount of snowpack and water in storage, and consider either lifting the Emergency Conservation Regulation altogether or allowing regional reductions in conservation mandates as local conditions merit. Given the improvements in water conditions statewide and the San Diego region's water supply diversification and storage accomplishments to date, the Department expects that the San Diego region will be allowed to reduce its conservation standard below 8% through January 2017 if the revised rules are approved by the SWRCB as currently proposed.

See "INFORMATION CONCERNING THE METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA AND THE SAN DIEGO COUNTY WATER AUTHORITY."

**Recent City Actions in Response to Drought Conditions**

On July 1, 2015, the City declared Level 2 Drought Alert conditions to comply with the State mandate that the City reduces its water usage by 16%. Adopting modification to its Emergency Water Regulations, the City implemented Level 2 restrictions which limit outdoor landscaping watering for a maximum of 2 days a week (on assigned days only), 5 minutes per day (if using a standard sprinkler system) and also include mandatory compliance with both permanent mandatory restrictions (*e.g.*, Water Waste Prohibitions) and all Level 1 Drought Watch water conservation practices. City staff has been enforcing these restrictions through the issuance of warning letters, notices of violations and citations that carry fines. A total of 7,586 complaints were received and processed from November 2014 to November 2015 while implementing Drought Response Level 2 restrictions and 262 citations with fines were issued in the same time frame. These regulation modifications, along with the concerted effort of the public to conserve water, have resulted in the City exceeding its 16% water use reduction mandate as of February 2016.

The Water Conservation Program was established by the City Council in 1985 and promotes permanent water savings. 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 sustainable landscapes, low-flush toilets and soon to include grant funded rebates for gray water systems and pressure regulating valves. The City continues to offer survey programs, drought response outreach

and enforcement, efficient landscaping and irrigation management programs, park and recreation partnerships, and public education and outreach.

The 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 Department continues to provide its proven water conservation programs as well as implement State mandated water use restrictions to help ease the impact of the current drought.

**City Planning and Resource Management**

**Strategic Plan and 2012 Long-Range Plan**. The City has developed and continues to develop strategic plans for the Water System. A principal planning document is the City's 2012 Long-Range Water Resources Plan ("2012 Long-Range Plan"). The 2012 Long Range Plan is the City's most recent update to its 1997 Strategic Plan for Water Supply (the "Strategic Plan"), which 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, and its 2002 Long-Range Water Resources Plan, which was an update of the Strategic Plan. The 2012 Long-Range Plan addresses population growth, water resource diversification, climate change and other issues affecting water reliability. The 2012 Long-Range Plan was completed in December 2013.

The plan was developed using an open, participatory planning process, with input from a dedicated 11-member stakeholder committee that represented a wide range of interests and backgrounds and who provided guidance and input on alternative strategies for meeting San Diego's water needs through 2035. The 2012 Long-Range Plan evaluates water supply and conservation options with consideration of multiple planning objectives. The 2012 Long-Range Plan uses the latest projections of water demands, imported water availability, and costs; and evaluates new supply opportunities. Due to heavy reliance on imported water, the plan examined the various risk elements associated with that supply. In addition to imported water concerns, the plan considered key issues regarding development of local water resources.

Due to the high-level, strategic nature of this plan, water supply and conservation options proposed in 2012 Long-Range Plan are considered conceptual in nature. Because no single water supply option can meet all of the goals of the 2012 Long-Range Plan, a range of options were considered to form eight portfolios and diversify the approach to meet the objective of the plan. The eight portfolios were evaluated against more than 20 performance metrics such as water shortages, hydrologic variability etc. The portfolios were ranked in terms of their cumulative performance. Based on these rankings, and their climate change adaptation benefits, three portfolios consistently ranked highest. One of the City's goals for the 2012 Long-Range Plan was to have a flexible strategy that outlined a course of action, but allowed for changes mid-stream, if necessary, to accommodate new information or new science. Hence an "Adaptive Management" strategy was developed, which balances the cost of option implementation with the risks of "no action" to chart how we plan for the future so water supply objectives are met. All three of the highest ranked portfolios included Potable Reuse as a common resource option, which is significant. Based on the 2012 Long-Range Plan findings, the following water supply strategies and additional actions were approved by the City Council for implementation to enhance the reliability of the City's water supply:

1. Water supply options to implement (until 2035)

- Additional Active Conservation – 20,900 AFY (18.7 mgd)
- Rainwater Harvesting – 420 AFY (0.38 mgd)
- Groundwater Supply – up to 4,000 AFY (3.57 mgd)
- Potable Reuse (3 phases) – 92,960 AFY (83 mgd)

2. Assess progress made on near-term implementation of options, and re-assess risk triggers concurrent with the City's Urban Water Management Plan schedule (2020, 2025, 2030, 2035, 2040).

3. Update the 2012 Long-Range Plan in 2020 (and every 10 years thereafter), in order to identify new trends, reliability of imported water, and additional resource options.

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

On June 28, 2011, the City Council adopted the 2010 Urban Water Management Plan ("2010 UWMP"). The City is required to submit the adopted UWMP to the DWR's in order to be eligible for water management grants or loans administered by DWR, the SWRCB or the Delta Stewardship Council [CWC Sec. 10631.5(a)].

The City's 2010 UWMP describes long-term resource planning responsibilities to ensure adequate water supplies are available to meet existing and future demands. In preparation of the 2010 UWMP, the Department coordinated with the CWA and the local water agencies and cities to which the City sells untreated, potable or recycled water. The 2010 UWMP provides assessments for current demands; supplies over a 20-year planning horizon; and details contingency plans and drought response actions for various drought scenarios. The UWMP serves as the foundation document for Water Supply Assessments and Water Supply Verifications (SB 610/2221).

The City is currently in the process of a five year update to the UWMP. In August of 2015 the City began work on the 2015 Urban Water Management Plan ("2015 UWMP"). In preparation of the 2015 UWMP, the Department is coordinating with the CWA for consistency of data and receiving regional supply options. The 2015 UWMP will assess current demands; supplies over a 20-year planning horizon; and details contingency plans and drought response actions for various drought scenarios. A draft of the 2015 UWMP ("Draft 2015 UWMP") was released in April 2016 for public review and comment, and is anticipated to be completed in July 2016.

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

The groundwater from these basins is predominantly brackish. Improved technologies for processing brackish groundwater and the severe drought taking place in the last five years have made

using groundwater more attractive when discussing a foreseeable affordable water supply source. These groundwater supply sources are a viable alternative and are very much a part of the City's planning and investigative efforts. Local water supply projects using groundwater at any and/or all of the available City-owned Basins will benefit city rate payers by alleviating any drought restrictions and allowing the City to locally control its water. The City is presently assessing the development potential of its groundwater basins.

In 2013, the City and SWA signed a settlement agreement which allows the City to receive up to 50% of any additional potable water produced at SWA's Richard A. Reynolds Desalination Facility (SWA Desal Facility). This will provide the City with up to 2,600 AFY of potable water anticipated in late 2017. As part of the settlement agreement, the City and SWA will be working together in the development of a groundwater management strategy to manage and control groundwater resources for long-term sustainability.

In 2014, Governor Brown signed into legislation the Sustainable Groundwater Management Act ("SGMA"), to the California Water Code. The new law grants certain local public agencies the ability to become a Groundwater Sustainability Agency ("GSA") for their groundwater basin or a portion thereof, with broad authority to develop and implement Groundwater Sustainability Plans ("GSPs"). The law significantly increases the monitoring and reporting requirements for almost all groundwater users, with non-compliance subject to action by the local GSA and/or the SWRCB. The City has started to actively participate in complying with the DWR required guidelines for compliance with SGMA for San Pasqual and San Diego River Valley basin.

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

Although all of the aforementioned water supply sources are important to the City's long range water supply goals, the City still relies and will for the foreseeable future, continue to rely heavily on the CWA as its main supply source.

***Recycled Water***. The City has made significant capital investments in the recycled water program. To date, approximately $460 million has been spent on two water reclamation plants (consisting of the North City Water Reclamation Plant (the "North City Plant") and the South Bay Water Reclamation Plant (the "South Bay Plant"), distribution systems and related facilities. Approximately 25% of those costs were covered by State and federal grants. Recycled water usage is seasonal and is primarily used for irrigation. Customers also use the water for dust suppression or soil compaction at construction sites, in cooling towers, ornamental fountains, and for office building toilet and urinal flushing (dual plumbing). The 1998 Regional Wastewater Disposal Agreement between the City and the Participating Agencies ("PAs") of the Metropolitan Sewerage System ("Metro System") specified that the revenues from the sale of recycled water from the North City Plant should first be used to pay the cost of the distribution system borne by the Water Utility, then the tertiary treatment costs borne by the Metro System; and the agreement was silent on the revenue from sales from the South Bay Plant. The Participating Agencies previously asserted that under the terms of the Regional Wastewater Disposal Agreement that they were entitled to a percentage of the revenue from the sale of recycled water produced by the South Bay Plant. The City and Participating Agencies have reached an agreement to share South Bay Plant net revenues, *i.e.*, revenues net of operating and capital expenses incurred by the Water Utility Fund for the recycled water system. In June 2015, the City paid the Participating Agencies approximately $3.7 million for recycled water that was sold between Fiscal Years 2002 through 2014. In future years, the Department will provide the Participating Agencies their percentage of the recycled water revenue from the South Bay Plant on an annual basis. The Department estimates that the Participating Agencies'

percentage of recycled water revenue will be approximately $550,000 in Fiscal Year 2016 and approximately $1.1 million annually in Fiscal Years 2017 through 2020.

***North City Plant.*** In Fiscal Year 2015, the plant operated at an average flow rate of approximately 16 mgd. The North City Plant is producing an average of 6 mgd of recycled water that is distributed to users through the Northern Water Distribution System. The North City Plant also is capable of providing treatment beyond the tertiary level through the demineralization of a portion of the effluent, to reduce total dissolved solids ("TDS") to meet recycled water customers' needs. The North City Plant limits its production of recycled water to meet demand. Excess treated effluent is returned to the sewer system for conveyance to the Point Loma Plant and ocean outfall. In Fiscal Year 2015, approximately 10 mgd was returned to the sewer system.

As of December 31, 2015, the North City Plant produced recycled water that served 669 retail and four wholesale meters. Three of the wholesale meters serve the Olivenhain Municipal Water District and the remaining wholesale meter serves the City of Poway. Revenues from the sale of recycled water are collected by the Department for deposit in the Water Utility Fund and used to pay for the cost of the recycled water distribution system and then operations and maintenance costs for the distribution system.

***South Bay Plant.*** The South Bay Plant commenced operations in 2002. The South Bay Plant is currently in the process of implementing a demineralization facility to reduce total dissolved solids ("TDS") for a portion of the recycled water to meet a contracted quality of 1,000 parts per million ("ppm") TDS. The Regional Water Board permit criteria for recycled water is 1,200 ppm TDS. The South Bay Plant has a permitted capacity of 15 mgd average daily flow. For Fiscal Year 2015 the plant operated at an average flow rate of approximately 8 mgd. The South Bay Plant produced an average of 3.05 mgd of recycled water that was distributed to one wholesale and six retail meters. The wholesale connection is to the OWD, and contracted at the retail rate, is pursuant to a take or pay recycled water service agreement for up to 6 mgd.

Recycled water rates were lowered from $1.34 to $0.80 per hundred cubic feet ("HCF") on July 1, 2001 for all customers, except for the City of Poway, because it has a separately negotiated contract rate. On November 17, 2015, the City Council, in accordance with Proposition 218, held a public hearing vote on potable and recycled water rates. The Council approved a five Fiscal Year rate case for Fiscal Years 2016 through 2020 (the "2016 Rate Case"), of which the recycled rates were approved to rise to $1.734/HCF beginning January 1, 2016, with the exception of the City of Poway's current contract rate of $1.67/HCF. The new city-wide rate will be in effect through Fiscal Year 2020, when it will be reevaluated via cost of service principles and could be adjusted again.

**Pure Water Program**

***General***. The Pure Water Program is the Department's program to provide a safe, secure, and sustainable local drinking water supply for San Diego. Advanced water purification technology will be used to produce potable water from recycled water. The City and its regional partners face significant issues with water supply and wastewater treatment. Typically, the Department has provided 85-90% of its customers' water needs from imported sources. The region's reliance on imported water causes the water supply to be vulnerable to impacts from shortages and susceptible to price increases beyond the control of the Department. As sources of local water supply are few, consideration has been given to both non-potable and potable reuse options of treated water. Water reuse is proven, safe, reliable, and is currently in use in other communities in the United States and around the world. The Pure Water Program is a significant water and wastewater capital improvement program that is expected, upon full implementation, to create 83 mgd by the end of calendar year 2035 of locally controlled water, and reduce flows to the Point Loma Plant which would reduce total suspended solids discharged, and recycle a

valuable and limited resource that is currently discharged to the ocean. See "WATER SYSTEM CAPITAL IMPROVEMENT PROGRAM – Description of Major Projects" and Table 10 under that heading. See, also "RISK FACTORS – Pure Water Program."

***Background of Pure Water***. In January 2004, the City Council authorized a comprehensive evaluation of all viable options to maximize the usage of recycled water. In March 2006, the City, working in partnership with an Independent Advisory Panel and a City Assembly on Water Reuse, published the "City of San Diego Water Reuse Study" (the "Water Reuse Study"). The Water Reuse Study included analysis and research on the health effects of reuse options and a public participation process. The Water Reuse Study's stakeholders identified reservoir augmentation as their preferred strategy. In October 2007, the City Council also recognized such strategy as their preferred alternative. In December 2007, the City Council voted to accept the Water Reuse Study and proceed with the Water Purification Demonstration Project (the "Demonstration Project") which evaluated the feasibility of turning recycled water produced at the North City Plant into drinkable water through the use of Advanced Water Purification ("AWP") technology. The AWP process uses multiple treatment barriers to remove contaminants from the water and prevent them from re-entering the water supply. The process begins with membrane filtration, followed by reverse osmosis, and ends with advanced oxidation. The result is water that meets all drinking water standards and is similar in quality to distilled water. The water is then sent to an environmental buffer, a reservoir, as the next step in the indirect potable reuse process. The water in the reservoir is treated at a drinking water treatment plant before it is distributed for drinking purposes. As part of the Demonstration Project, the Department tested and operated a one mgd demonstration-scale AWP facility from June 2011 to August 2012. The Demonstration Project was completed in March 2013, and in April 2013, the City Council unanimously voted to accept the Demonstration Project and continue to pursue potable reuse options for the City. The Department is currently evaluating reservoirs where the purified water can be stored.

***Current Treatment Waiver for Point Loma Plant***. Completion of the Pure Water Program as described in this Official Statement and upon the assumptions set forth herein is dependent, in part, upon the Department receiving assurance that the Pure Water Program will suffice to offset any requirement that the Point Loma Plant be modified to comply with Clean Water Act secondary treatment requirements. It is the City's current determination that the cost of implementing the Pure Water Program without a corresponding offsetting of any requirement that the Point Loma Plan be modified to comply with Clean Water Act secondary treatment requirements will be financially burdensome. Accordingly, the Department is pursuing both legislative and regulatory relief from such requirements.

In December 2007, the City submitted an application to the United States Environmental Protection Agency ("EPA") to request a renewal of the Modified Permit for the Point Loma Plant. The City's renewal application followed the same conventions as previous applications relative to the Clean Water Act requirements. The City received a Tentative Decision to approve the Modified Permit from the EPA in December 2008. In January 2009, the City Council approved a resolution authorizing the City to negotiate and execute an agreement with two local environmental groups regarding the Modified Permit. Pursuant to the agreement, the two environmental groups agreed not to challenge the Tentative Decision and the City was obligated to research options to increase the use of recycled wastewater and decrease discharges to the Pacific Ocean from the Point Loma Plant, After receiving public input through a joint public hearing process conducted with the EPA, the Regional Water Board unanimously approved the Modified Permit in June 2009. In August 2009, the California Coastal Commission denied a consistency certification for the Modified Permit, rejecting the recommendations for approval from the EPA and staff of the California Coastal Commission.

The EPA cannot grant the Modified Permit or waiver without approval from the California Coastal Commission. Pursuant to Federal Coastal Zone Management Act of 1972, the California Coastal

Commission must concur with the City's certification that the waiver would be consistent with the California Coastal Management Program ("CCMP") before the EPA issues the permit. The City's permit application is reviewed by the California Coastal Commission to ensure that the waiver is consistent with the CCMP. The policies of the CCMP are governed by the California Coastal Act and relate generally to public access, recreation, marine environment, land resources, and development. Stakeholders in this process include local environmental groups. The Department's outreach efforts to promote the implementation of the Pure Water Program to its regional partners includes these environmental groups and advocacy that the Pure Water Program will offset any requirement that the Point Loma Plant be modified to comply with current Clean Water Act secondary treatment requirements.

The California Coastal Commission approved the Modified Permit in March 2010 with the condition that the City return in two years to present the results of the Recycled Water Study (defined below). The Recycled Water Study was presented to the California Coastal Commission in October 2012. The Modified Permit became effective on August 1, 2010 and expired on July 31, 2015. The City submitted a renewal application in January 2015 and the existing Modified Permit has been administratively continued pending a decision by the regulatory agencies. Since its initial Modified Permit approval in 1995, the Point Loma Plant has been in consistent compliance with the requirements of the Clean Water Act for Modified Permits. Based on the City's past experience and its high level of compliance with the Clean Water Act, it expects to receive approval of a new Modified Permit by the end of the first quarter of 2017. The California Coastal Commission has encouraged the City to act to consider the expectations of local environmental groups and the City has taken action, and is committed to take such action as necessary, to meet such expectations towards certification by the California Coastal Commission.

As part of the process for EPA approval, and the City's 2015 National Pollutant Discharge Elimination System ("NPDES") permit renewal process, the City entered into a Cooperative Agreement (the "Cooperative Agreement") with two environmental groups providing for a "Recycled Water Study" to find ways to maximize water reuse and minimize the flow to the Point Loma Plant. In accordance with the Cooperative Agreement, both environmental groups provided support to the United States Environmental Protection Agency's ("EPA") decision to grant the Modified Permit. The Recycled Water Study was conducted and completed in July 2012. In addition to developing integrated water reuse alternatives for both non-potable and indirect potable reuse to augment the region's water supply, the Recycled Water Study identified locations for future advanced water purification facilities. The Recycled Water Study also identified two City owned and operated reservoirs as potential locations for reservoir augmentation. The City Council voted to accept the Recycled Water Study report in July 2012.

At the time of acceptance of the Demonstration Project, the City Council directed City staff to define in greater detail the City's potable reuse options, including direct potable reuse. This is an overlap between the City Council directive and the follow on work associated with the Recycled Water Study. The combined efforts of the Demonstration Project and the Recycled Water Study comprise the Pure Water Program.

Despite the history of approvals, a high level of compliance and the City's belief that it would receive on-going approval, Modified Permits are subject to a regulatory approval process every five years. As an alternative to this process, which would provide additional assurance that Point Loma would not need to be upgraded to comply with Clean Water Act secondary treatment requirements, the City has also been considering whether an amendment to the Clean Water Act could be approved. As of the date of this Official Statement, such legislative approach is being pursued, but the City does not expect an amendment to be feasible in the current Legislative cycle. Absent a Modified Permit, or amendment to the Clean Water Act, the Point Loma Plant would need to be modified to comply with the Clean Water Act secondary treatment requirements. As a result of the Recycled Water Study, the City engaged local

environmental groups to explore whether sufficient wastewater could be offloaded from the Point Loma Plant to make the effluent from the Point Loma Plant equivalent to what would be realized through secondary treatment. The offloaded wastewater would then go through advanced water treatment to create potable water. This approach of achieving "secondary equivalency" through potable reuse became known as the Pure Water Program.

In May 2014, the City Council adopted a resolution in support of the Pure Water Program. The City believes that implementation of the Pure Water Program will assist the City in receiving Modified Permits in the future. Wastewater flows and the total amount of solids handled by the Point Loma Plant will be reduced, thereby improving the discharge to the ocean over the discharge that has consistently qualified for past Modified Permits. To verify the validity of this strategy, the City has maintained an open dialogue with the EPA to insure that the facility planning for the Pure Water Program will provide an even greater degree of assurance for future Modified Permits. In September 2015, the EPA noted its approval of the three prior applications for modified secondary treatment standards and advised that as of such date it had identified no barriers to renewal of the permit and modified secondary treatment standards.

Future water and wastewater systems costs are components of the City's potable reuse considerations. If the City does not obtain a renewal of the Modified Permit (or any subsequent Modified Permit), the implementation of secondary treatment would be required at the Point Loma Plant. Based on Fiscal Year 2015 calculations, the cost to bring the Point Loma Plant into compliance with the secondary treatment requirements of the Clean Water Act would be approximately $2.1 billion (in current dollars) through Fiscal Year 2050, with approximately $1.8 billion occurring by Fiscal Year 2030. Further, the City estimates there also would be an increase in operating and maintenance costs of approximately $39 million per year, including additional energy and personnel costs, once the Point Loma Plant was fully operational at the secondary treatment level. Increased costs associated with bringing the Point Loma Plant to the secondary treatment level could potentially result in increased wastewater service charges. Such estimated costs do not incorporate the expected reduction of flows that would result from the implementation of the Pure Water Program. In the event the Modified Permit is not approved for renewal, the Department would reevaluate the projected costs of bringing the Point Loma Plant into compliance with the secondary treatment requirements given the reduced flows that are expected to result from the implementation of phase one of the Pure Water Program,

***Pure Water Program Facilities***. The Pure Water Program is a twenty-year program that will involve the planning, design, and construction of new advanced water treatment facilities, wastewater treatment facilities, pump stations, transmission lines and pipelines. The Pure Water Program also will include property and easement acquisition, discretionary permitting, financing, facility startup, testing, operation and maintenance of new facilities, significant public education and community engagement.

The total capital cost to build the Pure Water Program facilities and infrastructure is estimated to be approximately $3 billion (in 2016 dollars), of which approximately $1.2 billion will be a cost to the Water Utility Fund. The remaining costs of the Pure Water Program (approximately $1.8 billion) will be a cost to the Sewer Revenue Fund (including its customers and Participating Agencies, which are required to pay their respective share of Sewer's Metropolitan Sub-System operation and maintenance and capital improvement program costs, currently at approximately 33% of these total costs). The Department has determined that costs for the program will be allocated between the Water and Wastewater funds in the following way: All capital and operational costs related to facilities for the conveyance of wastewater and the treatment of the wastewater through secondary treatment would be borne by the Sewer Revenue Fund (including its customers and regional partners); all capital and operational costs related to treatment and conveyance of process water post the secondary phase will be borne by the Water Utility Fund.

The first phase of the Pure Water Program is anticipated to be operational by late calendar year 2021. The first phase is estimated to cost approximately $1 billion (in 2016 dollars), of which approximately $741 million allocated to the Water Utility Fund, with approximately $266 million would be a cost to the Sewer Revenue Fund (including its customers and Participating Agencies). A portion of these costs include an initial five-year, $30 million, as-needed contract with MWH Americas, Inc. ("MWH"). Working with Department staff, MWH will provide strategic planning, project delivery, program controls, pre-design of conveyance and treatment facilities, design oversight/management, pilot testing of proposed technologies, regulatory permitting, outreach and public education, quality management and risk mitigation services.

The program is expected to be funded with various funding sources available to the City. Preliminary CIP cost projections for the Water Utility Fund in this Official Statement through 2020 include Pure Water Program phase one expenditures totaling $116 million for Fiscal Years 2016 through 2019, then a ramp up in Fiscal Year 2020 to approximately $227 million, resulting in approximately $343 million in projected Pure Water Program expenditures through 2020. See "WATER SYSTEM CAPITAL IMPROVEMENT PROGRAM – Description of Major Projects" and Table 10 under that heading.

Additionally, Water Utility Fund Pure Water Program expenditures in Fiscal Year 2021 are preliminarily projected to be $414 million, followed by an estimated total spending of $42 million from 2022 to 2025. It is anticipated that CIP costs for phase two (expected through 2035) of the Pure Water Program will begin to be expended in Fiscal Year 2021 for design. The Water Utility Fund share of the Pure Water Program capital costs, approximately $1.2 billion, includes costs for both phases.

Water rates for Fiscal Year 2021 and beyond are not part of the 2016 Rate Case. Pure Water Program expenditures for the Water Utility Fund are rate dependent. The City anticipates that additional rate capacity is necessary after Fiscal Year 2020. The City expects to perform cost of service analysis to prepare a new rate case for recommended rate adjustments for the Water Utility Fund to address future capital program costs, operation and maintenance expenditures, and Pure Water Program capital expenditures.

Based on MWH projections, the first year total annual operating costs associated with the phase one of the Pure Water Program are projected to begin in Fiscal Year 2021, estimated at approximately $15 million, of which $9 million will be payable from the Water Utility Fund. Annual operating costs are estimated to ramp up to full operating costs for phase one of approximately $59 million in Fiscal Year 2023, of which $35 million will be payable from the Water Utility Fund. When the Pure Water Program is fully implemented in 2035, the total annual operating costs associated with the Pure Water Program facilities at full capacity are estimated to be approximately $137 million (in 2016 dollars), of which approximately $86 million will be payable from the Water Utility Fund. See "WATER SYSTEM CAPITAL IMPROVEMENT PROGRAM."

Pure Water Program costs as described in this Official Statement are based upon the Department's current estimates. See "RISK FACTORS –Pure Water Program."

The key Pure Water Program facilities can be categorized as treatment, storage, and conveyance. Treatment facilities include the existing North City Plant and South Bay Plant, as well as a proposed Central Area facility. Pump station and pipeline facilities are included for conveying different types of flows to and from the treatment facilities for: diverting wastewater flows to advanced water purification facilities; conveying purified water from treatment facilities to a reservoir; and transporting solid wastes from treatment processes to solids handling facilities.

All projects will be planned and coordinated with existing operations, and in full compliance with applicable federal, State, and local regulations. Pursuant to the Cooperative Agreement, the City has committed to produce at least 15 mgd of potable reuse by the end of calendar year 2023, a cumulative total of 30 mgd of potable reuse by the end of calendar year 2027, and a cumulative total of at least 83 mgd of potable reuse by the end of calendar year 2035. Cumulative totals of potable reuse include projects that may be implemented by the Participating Agencies. The City is currently evaluating the option of delivering up to 30 mgd of purified water for phase one of the program by the end of calendar year 2021.

The City continues to review and evaluate all components of the Pure Water Program, including the methods to be employed to purify water and the locations of the purification facilities.

***North City Component***. The North City Area component of the Pure Water Program includes possible expansion of the North City Plant, construction of a new Advanced Purification Facility, pipelines, and support facilities such as pump stations. The purified water will be piped to a reservoir where it will blend with raw water in the reservoir. Plans for the North City Plant are to maximize the current plant capacity or expand the plant capacity to treat 52 mgd, which would yield 30 mgd of purified water and 12 mgd of non-potable recycled water. The new advanced treatment facility would be located on the vacant City-owned lot across the street to the north of the existing North City Plant. A new pump station, sewer force main, and a brine pipeline would be required to support the treatment facility at an expanded capacity. Pump stations and a new pipeline would be constructed between the advanced purification facility and the reservoir. A total of 15 mgd to 30 mgd reduction in Point Loma Plant flow is possible with this North City component.

***South Bay Component***. The South Bay component of the Pure Water Program will include the expansion of the South Bay Plant, installation of additional pump stations and pipelines to convey additional wastewater to the plant, and construction of an Advanced Water Purification Facility and a conveyance system to deliver purified water to a reservoir. The South Bay component will be expanded to treat 44 mgd of wastewater and producing 15 mgd of purified water and 9 mgd of non-potable recycled water. The South Bay component will minimize flows discharged to the South Bay Outfall.

***Central Area Component***. The Central Area component of the Pure Water Program would be the largest proposed facility. The Central Area facilities will carry all of the flows that are conveyed to the Point Loma Plant. The Central Area facilities would produce 53 mgd of purified water. Pipelines would be built that connect the purified water from Central Area facilities to a reservoir. Additionally, another pipeline would be needed between the Central Area facilities and the Point Loma Plant to convey solids from the Central Area facilities to the Point Loma Plant for use in energy production. A total of 53 mgd reduction in Point Loma Plant flow is possible with this Central Area component. Cumulative totals of potable reuse include projects that may be implemented by the Participating Agencies.

**Future City Water Demand**

Table 9A below sets forth water demand projections as currently projected in the City's 2010 Urban Water Management Plan ("2010 UWMP"). Although the City continues to promote water conservation, the demand for water within the City's service area was projected to increase. These projections were based on certain assumptions, which can change as evidenced by the Draft 2015 UWMP.

**TABLE 9A**
**PROJECTED WATER DEMAND**
**AS OF THE 2010 URBAN WATER MANAGEMENT PLAN**
**Fiscal Years 2020 through 2035**
**(AFY)**

| 2020 | 2025 | 2030 | 2035 |
|---|---|---|---|
| 260,211 | 276,375 | 288,481 | 298,860 |

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

The City's Draft 2015 UWMP, which is currently in the public review and comment process, is anticipated to be completed in July 2016. Table 9B below sets forth the total water demand forecast as currently projected in the Draft 2015 UWMP. As compared to projections included in the 2010 UWMP, the projected overall water demand decreased significantly due to the City's conservation efforts, public education, drought response and mandatory water use restrictions. These projections are based on many assumptions that include population growth, weather patterns and economic development, which are subject to change. There can be no assurance that the local demand for the services provided by the Water System will be maintained at levels described below or elsewhere in this Official Statement. See "RISK FACTORS – Water System Demand."

**TABLE 9B**
**WATER DEMAND FORECAST**
**IN THE DRAFT 2015 URBAN WATER MANAGEMENT PLAN**
**Fiscal Years 2020 through 2040**
**(AFY)**

| 2020 | 2025 | 2030 | 2035 | 2040 |
|---|---|---|---|---|
| 200,489 | 242,038 | 264,840 | 273,748 | 273,408 |

Source: Draft 2015 Urban Water Management Plan, Public Utilities Department, City of San Diego.

## WATER SYSTEM REGULATORY REQUIREMENTS

### General

Public water supply systems in the State such as the Water System are primarily regulated by the DDW and, in some limited instances, by the EPA, and the SWRCB, together with its nine regional water quality control boards that exercise rulemaking and regulatory activities by groundwater basins. Drinking water delivered to retail customers must comply with statutory and regulatory water quality standards designed to protect public health and safety.

As part of routine operations and maintenance activities, the Department transfers treated water between storage facilities and discharges water to the environment. These transfers and discharges are regulated under the Federal Clean Water Act through general and facility-specific NPDES permits issued by the SWRCB. Such permits contain numerical effluent limitations, monitoring, reporting, and notification requirements for water discharges from the facilities and pipelines of the Water System. The

City is operating and maintaining the water treatment and transmission facilities in compliance with the NPDES permit requirements.

**Federal Requirements**

The City's Water System operations are subject to the provisions of the Federal Safe Drinking Water Act (as amended, the "Safe Drinking Water Act"), which sets forth requirements relating to the protection of drinking water and its sources, including rivers, lakes, reservoirs, springs, and ground water wells, against both naturally-occurring and man-made contaminants that may be found in drinking water. The Safe Drinking Water Act is administered by the EPA, with direct oversight by the DDW and includes, among other things, primary standards for 104 chemical, microbiological, radiological, and physical contaminants in drinking water and requirements for the preparation of consumer confidence reports, water system operator certifications, water distributions system monitoring, treatment plant monitoring and drinking water source assessments. As part of these requirements, the City performs required sampling at scheduled intervals under EPA's Lead and Copper Rule to ensure the City's potable water meets all lead and copper standards. San Diego's regional source water quality, treatment processes and the distribution system's infrastructure age and materials, are appreciably different from other geographical localities in the country which have encountered issues with meeting lead and copper regulatory standards. All analyses continue to show that the City meets all federal and State regulations.

The Safe Drinking Water Act also requires that every five years the EPA establish a list of contaminants that are known or anticipated to occur in public water systems and may require future regulation under the Safe Drinking Water Act. From this contaminant candidate list, the EPA identifies contaminants that are priorities for additional research and data gathering, which information is then used to determine whether or not a regulation is appropriate. This process is repeated for each list every five years. The EPA completed its latest review in 2009 and no additional primary standards were added to the regulations. The EPA is currently evaluating the risks from several additional compounds and organisms including: microbial contaminants; the byproducts of drinking water disinfection; fire retardants; radon; water systems that do not currently disinfect their water but get it from a potentially vulnerable ground water source; and issues related to water treatment and distribution system operational practices impacting distribution system water storage tanks' water quality. The City currently complies with all applicable standards and regulations of the Safe Drinking Water Act.

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

**State Regulations**

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

**Proposed Regulations**

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

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

**Compliance Order by the California Department of Public Health/DDW**

The California Department of Public Health (now DDW and hereafter referred to as DDW) 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, the DDW notified the City that certain deficiencies in the Water System were found during a routine sanitary survey of the Water System conducted by the DDW 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 the DDW (initially California Department of Public Health) 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 DDW 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 "DDW Compliance Order"), to include additional items that were not in the 1997 Compliance Order. The DDW Compliance Order requires the completion of eight pump stations, 10 reservoirs/standpipes, nine treatment-related projects, four pipelines and the awarding of 10 miles of distribution (small diameter) cast iron water main replacement per Fiscal Year. The DDW Compliance Order will remain in effect until the projects and pipeline replacement requirements are completed.

The Department has made substantial progress in completing the projects set forth in the DDW Compliance Order. As of 2012, all of the required projects have been completed. The awarding of 10 miles of distribution cast iron water main replacement is ongoing and the Department expects to complete the replacement of all remaining cast iron water mains by 2018, which will fulfill the final requirement of the DDW Compliance Order. The Department is currently meeting the ongoing requirements thereof, including the obligation to provide the DDW with quarterly progress reports and hold periodic status meetings.

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 DDW Compliance Order

project costs for Fiscal Years 2016 through 2020 total approximately $62.7 million. The Department anticipates financing such costs with existing net assets, present and future revenues, and financing proceeds secured by System Revenues provided, however, there can be no assurance that any or all of such financing sources will be available or secured.

**Permits and Licenses**

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

**Dam Licensing and Safety Issues**

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

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

## WATER SYSTEM CAPITAL IMPROVEMENT PROGRAM

**The Capital Improvement Program**

The Water System CIP is established to address current and future system needs in a cost effective manner. The program's principal drivers are: update and improvement of infrastructure to reduce pipeline breaks and emergency repairs; improving process technology; expansion of the Water System to accommodate growth; compliance with the Federal Safe Drinking Water Act and the DDW Compliance Order; and implementation of the Pure Water Program. In November 2015, the City Council adopted rate increases for Fiscal Years 2016 through 2020 to pay for the increased cost of purchased water, revenue recovery due to the drought and the State mandated water use cuts, recovery of required debt service coverage levels, the initial phase of the Pure Water Program, and update and improvement of existing infrastructure. The infrastructure improvements consist of water treatment plants, pipelines,

reservoirs and pump stations, projects related to anticipated growth within the City's service area, and projects required by or related to applicable State and federal regulations and orders.

**Description of Major Projects**

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

The CIP projects can be classified into one of nine categories as they relate to the Water System. The following is a brief description of the Water System CIP by categories.

The current cost estimate of CIP projects for the period from Fiscal Years 2016 through 2020, with inflation, is approximately $872.9 million, and the cost estimates are subject to change. The budget for each project and program is established and approved by the City Council and adjustments to such budget requires approval of the City Council.

***Pipelines.*** The CIP includes the replacement of distribution water pipelines located throughout the City. The Department plans the awarding of contracts for the replacement of 30 to 35 miles per fiscal year, which includes cast iron pipes mandated by the DDW Compliance Order and high priority asbestos cement pipes based on their high risk of failure and degraded condition.

***Transmission Pipelines.*** The CIP provides for the replacement of 16-inch and larger diameter water pipelines at various locations throughout the City, which are in a deteriorated condition or have reached the end of their service life. The Department is also assessing its transmission pipelines and is scheduling the replacement of these pipelines based on the condition of existing facilities, system needs and available funds.

***Water Storage Facilities.*** The CIP includes projects that will replace water outlet structures at Lower Otay and Morena reservoirs to comply with the DSOD seismic requirements as well as the construction of two new clearwells to increase the water storage capacity at the Miramar Water Treatment Plant.

***Pure Water Program.*** The CIP includes the construction of several treatment plants and conveyance facilities to provide up to an estimated 83 mgd of purified water. This program will be implemented in multiple phases. An initial water purification facility that will produce up to 30 mgd is planned to be in operation by 2021.

***Pump Stations.*** The CIP includes projects that will upgrade, rehabilitate and construct pump stations throughout the Water System to improve service reliability and to accommodate current and future water demands.

***Groundwater.*** The CIP provides for investigation work related to legal, technical, regulatory, and water quality issues; and for the planning, design, and construction of groundwater facilities to increase the local water supply. The groundwater feasibility projects being explored by the City are in San Pasqual, Mission Valley, San Diego Formation and the Santee-El Monte.

***Recycled Water.*** The CIP projects provide for the upgrade and expansion of the recycled water system as well as making improvements needed to comply with the latest regulatory requirements of the SWRCB, together with San Diego's regional water quality control board.

***Water Treatment Plants.*** The CIP provides for upgrades and improvement of the treatment facilities at Alvarado, Miramar, and Otay Water Treatment Plants (WTP) and the installation of the sodium hypochlorite facility at the Otay WTP.

***Miscellaneous***. Other CIP projects include the Chollas building, water security projects at reservoirs and dams, solar projects at Bayview reservoir and MOC Complex facilities, the Advanced Metering Infrastructure ("AMI") project – the Department's project to replace all existing meters with automated "Smart Meters" and its associated infrastructure, as well as the Department's Infrastructure Asset Management program are contained within this category.

The following table shows categories of projects with the estimated cost of expenditures contained in the CIP for the period of Fiscal Years 2016 through 2020. Final CIP project costs will be refined as the CIP progresses. The budget for each project and program is established and approved by the City Council and adjustments to such budget requires approval of the City Council.

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**TABLE 10**
**SUMMARY OF PROJECTED CIP PROJECTS[(1)(2)(3)]**
**Fiscal Years 2016 through 2020**
**($ Amounts in Thousands)**

| Description | Estimated 2016 | Projected 2017[(4)] | Projected 2018 | Projected 2019 | Projected 2020 | Projected Total[(7)] |
|---|---|---|---|---|---|---|
| Pipelines | $29,543 | $ 39,505 | $ 38,389 | $ 35,992 | $ 36,159 | $179,588 |
| Transmission Pipelines | 17,075 | 23,986 | 34,785 | 34,524 | 36,036 | 146,407 |
| Storage Facilities[(5)] | 4,518 | 23,657 | 25,108 | 25,343 | 28,839 | 107,466 |
| Pure Water Program | 11,836 | 60,069 | 29,676 | 14,696 | 226,832 | 343,109 |
| Pump Stations | 7,261 | 6,007 | 13,503 | 4,679 | 3,999 | 35,450 |
| Groundwater Projects | 88 | 114 | 1,506 | 7,657 | 1,951 | 11,316 |
| Recycled Water | 1,080 | 849 | -- | -- | -- | 1,928 |
| Water Treatment Plants | 1,981 | 45 | -- | 86 | 474 | 2,587 |
| Miscellaneous Projects[(6)] | 7,105 | 23,042 | 14,320 | 193 | 354 | 45,013 |
| **Total[(7)]** | **$80,487** | **$177,275** | **$157,288** | **$123,170** | **$334,643** | **$872,863** |

(1) Projections as of April 2016.
(2) Amounts reflect the aggregate costs of all CIP projects required to satisfy the DDW Compliance Order as well as projects related thereto or necessary for the operation thereof. It is the Department's expectation that the final awarding of cast iron distribution line replacement will be completed by Fiscal Year 2018, thus fulfilling the requirements of the compliance order. For Fiscal Years 2016 through 2020, approximately 7% of the capital program is mandated by the DDW.
(3) The projected amounts in Fiscal Years 2017 and onward reflect an annual inflation rate of 2.27% due to anticipated increases in construction costs over time and the expected execution of the CIP.
(4) The Fiscal Year 2017 Proposed Budget, released on April 14, 2016, is the basis for projections.
(5) Storage Facilities include treated and untreated water reservoirs.
(6) Miscellaneous Projects include water security projects, solar projects, and the AMI Program.
(7) Figures may not add to total due to independent rounding.
Source: Public Utilities Department, City of San Diego.

The Pure Water Program is the Department's program to provide a safe, secure, and sustainable local drinking water supply for San Diego. Advanced water purification technology will be used to produce potable water from recycled water. See "WATER SUPPLY – Pure Water Program" for additional information on the Pure Water Program. As projected above, the expenditures for the Pure Water Program attributable to the Water Utility Fund represent the single largest component – $343 million, or 39% of the overall CIP for Fiscal Years 2016 through 2020. These expenditures are for the first phase of the program and are for the expansion of existing facilities and the construction of new infrastructure for the North City component. Approximately 32% of these expenditures represent planning and design, while construction comprises 64%, and the 4% balance is for land acquisition. Preliminary Pure Water Program expenditures total $116 million for Fiscal Years 2016 through 2019, then ramp up in Fiscal Year 2020 to approximately $227 million, resulting in approximately $343 million in projected Pure Water Program expenditures through 2020. See Table 10 above, "WATER SUPPLY – Pure Water Program" and "RISK FACTORS – Pure Water Program."

## Capital Improvement Financing Plan

The Water System CIP includes the costs described in Table 10 above. Table 11 below sets forth the projected sources of funds for the Water System CIP for Fiscal Years 2016 through 2020.

As shown in Table 11, the City anticipates incurring approximately $401 million of additional Obligations in Fiscal Years 2016 through 2020, payments with respect to which will be senior to, or on parity with, the City's obligation to make 2016 Subordinated Installment Payments, subject to satisfaction of the conditions specified in the Master Installment Purchase Agreement, the proceeds of which will be

provided to the City under the Installment Purchase Agreement to pay the costs of certain projects in the Water System CIP. This figure includes the $80 million in net proceeds from the 2016A Bonds.

The City anticipates in Fiscal Years 2016 through 2020 to finance the costs of certain projects in the Water System CIP in the approximate amount of $321 million through SRF loans. This includes approximately $17.5 million from existing loans which proceeds are expected to be received within Fiscal Years 2016 and 2017. Subject to final approval and execution of financing agreements with the SWRCB in Fiscal Years 2017 and 2018, the Department expects to receive SRF loan proceeds in the approximate amount of $303.3 million. These proceeds from additional SRF loans will provide funding in Fiscal Years 2017 through 2020. Such SRF loans are expected to be senior in right of payment to the City's obligation to make 2016 Subordinated Installment Payments.

Additionally, the Department anticipates securing federal and State grants for a portion of the costs of the Pure Water Program, which also are recognized in the City's Financial Rate Model.

The Department has distinguished between repair and replacement and expansion CIP costs to properly apply revenue sources. New customers will benefit from capacity created by expansion projects. These projects will be funded, in part by capacity charges. Capacity charge revenues are projected to be $15 million for Fiscal Year 2016 and $12 million per year thereafter through Fiscal Year 2020.

Any remaining costs of the CIP will be paid on a pay-as-you-go-basis, which are supported by currently approved water rates. See "WATER SYSTEM FINANCIAL OPERATIONS – Financial Projections and Modeling Assumptions." These projected costs include an annual inflation rate of 2.27% due to anticipated increases in construction costs over time and the expected execution of the CIP.

**TABLE 11**
**SOURCES OF FUNDS FOR CAPITAL EXPENDITURES OF THE WATER SYSTEM CAPITAL IMPROVEMENT PROGRAM**
**Fiscal Years 2016 through 2020**
**($ Amounts in Thousands)**
**(Unaudited)**

| | 2016 | 2017 | 2018 | 2019 | 2020 | Total |
|---|---|---|---|---|---|---|
| **Source of Funds:** | | | | | | |
| Financing Proceeds | $46,251 | $ 70,247 | $ 62,940 | $ 62,113 | $159,538 | $401,089 |
| SRF loans[1] | 9,242 | 87,875 | 68,701 | 32,896 | 122,061 | 320,774 |
| **Subtotal of Debt Funded CIP** | $55,493 | $158,122 | $131,641 | $ 95,009 | $281,599 | $721,864 |
| Federal and State Grants[2] | $ 2,000 | $ 3,364 | $ 2,055 | $ 2,467 | $ 30,595 | $ 40,481 |
| Capacity Fees | 15,000 | 12,000 | 12,000 | 12,000 | 12,000 | 63,000 |
| Cash Funding | 7,994 | 3,789 | 11,592 | 13,694 | 10,449 | 47,518 |
| **Subtotal of Cash Funded CIP** | $24,994 | $ 19,153 | $ 25,647 | $ 28,161 | $ 53,044 | $150,999 |
| **Total Source of Funds** | $80,487 | $177,275 | $157,288 | $123,170 | $334,643 | $872,863 |

(1) Includes proceeds from existing SRF loans (approximately $17.5 million), and additional proceeds through Fiscal Year 2020 (approximately $303.3 million) for SRF loans for which the City expects to have executed financing agreements in Fiscal Years 2017 and 2018.

(2) Fiscal Year 2016 grant proceeds are either received or have been secured via agreement. Grant proceeds in subsequent years are expected to be obtained for Pure Water Program projects. The increase in Fiscal Year 2020 reflects anticipated Proposition 1 funding for a portion of the Pure Water Program construction phase costs.

Source: Public Utilities Department, City of San Diego.

**Environmental Compliance**

The projects contained in the Water System CIP are generally subject to CEQA. 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. This review process may require the preparation of an Environmental Impact Report ("EIR"), Mitigated Negative Declaration ("MND"), Negative Declaration (described below) or Notice of Exemption ("NOE") depending on the significance of project impacts on the environment. An EIR reflects not only an independent technical analysis of the project's potential impacts, but also may include comments from other agencies with some form of jurisdiction over the project and comments from interested members of the public. Contents of an EIR include a detailed statement of the project's potentially significant environmental effects; any such effects which cannot be avoided if the project is implemented; mitigation measures proposed to eliminate or minimize such effects; alternatives to the proposed project; and any significant irreversible environmental changes which would result from the project. If the City, as the lead 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. An MND is appropriate for projects that could potentially result in a significant environmental impact, but revisions or standard mitigation measures are incorporated into the project that clearly mitigate the impact. Statutory exemptions are activities that are exempt from CEQA. Water System CIP projects can also be exempted if they fit a specific "category" of activities identified by the State Legislature. Once an agency approves or determines to carry out a project, either following an EIR process or after adopting a Negative Declaration or an MND, it must file a Notice of Determination ("NOD"). If the NOD is filed within five days, any action or proceeding challenging the agency's determination must be brought within 30 days following the filing of such notice. If the NOD is filed after the five-day period, the statute of limitations for any challenges is 180 days.

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

The Water System CIP involves replacement, upgrading and increasing capacity of existing facilities. There are no current or anticipated environmental considerations that would adversely affect the completion of the Water System CIP within the contemplated budget or current timeline.

**Project Management for the Water System Capital Improvement Program**

The Department and the City Public Works Department ("Public Works") are responsible for the implementation of the Water System CIP. The Department is responsible for identifying the projects that are included in the Water System CIP. Development of such projects involves, among other things, master planning studies, assessing conditions, hydraulic modeling and forecasting, evaluating regulatory and health and safety requirements, prioritizing projects, scheduling preparing planning reports, and allocating the budget. Subsequently, the Department transfers to Public Works the proposed projects scope of work, a planning report or 10% design, as appropriate, and the proposed schedule and budget. Public Works is responsible for the design, construction and start-up of the majority of all Water System CIP projects. However, as described below, Public Works will not be responsible for the design, construction and start-up of the Pure Water Program.

Each Fiscal Year, the Department and Public Works enter into a Service Level Agreement (each, an "SLA") which outlines the responsibilities of each department as it relates to the planning, design and

construction of water improvements with respect to water mains, water pump stations and treatment plants. Pursuant to the SLA, Public Works provides engineering services, including project management, design, environmental, permitting, land acquisition, scheduling, budget and construction management. Public Works implements the Water System CIP from design to completion, including capitalization of the final asset and management of warranty issues, as directed by the Department. The Department provides overall direction and policy for planning, financing and operations and maintenance of the Water System. Further, the Department funds the positions and non-personnel expenses, which are necessary for the service provider of a particular project to fulfill its responsibilities.

Due to the size and scope of the Pure Water Program, the Department has secured a five-year, not to exceed $30 million, as-needed, engineering technical services contract with MWH. MWH will provide engineering support, planning, design, and assist the Department with permitting and regulatory review, cost estimating, financial studies, rate design, economic impact, procurement strategies, public education and stakeholder outreach for the Pure Water Program. The Department will be responsible for the delivery of the Pure Water Program, including project management and construction.

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

### Contract Disputes

From time to time, the City is engaged in disputes with the contractors and subcontractors working on the CIP and most disputes are settled through mediation. As of December 31, 2015 there are no liability claims outstanding.

## WATER SYSTEM FINANCIAL OPERATIONS

### Establishment of Water Service Charges

The primary revenue sources of the Water Utility Fund are generated from water sales to single family residential customers and other customer classes, capacity fees, interest earnings from the investments of available funds and rental income. City utility bills include water and sewer charges and storm drain fees. Only water charges are revenues to the Water Utility Fund. The water component is comprised of two parts, a fixed monthly service charge and a commodity charge that is for the volume of water used. Bills are distributed on a bi-monthly basis for most customers and a monthly basis for high consumption residential, commercial and industrial, and irrigation customers.

Periodically, the City will enlist the services of an outside consulting firm to perform a full cost of service ("COS") analysis, typically producing a rate case for two to five years. The City conducted a

COS process in 2013 with the intention of producing a five year rate case. It became evident that because the City was facing several significant issues regarding water and sewer services in the 2016 to 2020 time frame, *e.g.*, the unknown costs related to the Pure Water Program and the impacts of costs for water purchased from the CWA, due to their commitment to purchase a minimum of 48,000 AFY of desalinated seawater; the rate case was shortened to two years: 2014 and 2015 as Phase I, which produced the rate case for Fiscal Years 2014 and 2015 (the "2014 Rate Case"). Subsequent to consideration of the recommendations set forth in the 2014 Rate Case, in November 2013, the City Council adopted rate increases of up to 7.25% and 7.5% respectively, for 2014 and 2015 (7.25% rate increase implemented in 2014 and 7.1% rate increase implemented in 2015), in compliance with the requirements of Proposition 218. See "WATER SYSTEM FINANCIAL OPERATIONS – Financial Projections and Modeling Assumptions."

The 2015 COS study (Phase II) produced the 2016 Rate Case, which covered Fiscal Years 2016 through 2020, was approved by the City Council in November 2015 following the Proposition 218 process. Following Phase I increases, the City Council adopted additional rate increases of 9.8% on January 1, 2016, 6.4% on July 1, 2016, 6.4% on July 1, 2017, 5.0% on July 1, 2018 and 7.0% on July 1, 2019.

The 2015 COS study was based on comprehensive forecasted annual operation and maintenance expenditures and additional capital costs including the Pure Water Program costs for the Fiscal Years 2016 through 2020. The 2016 Rate Case started with the Department's budgeted Fiscal Year 2016 expenditures as its base year. Future years were adjusted for changes since the budget was developed and for anticipated changes in operations and the effect of inflation. See "WATER SYSTEM FINANCIAL OPERATIONS – Operation and Maintenance Expenditures." Phase II of the COS also incorporated purchased water costs from CWA that includes desalination costs. With the Department's approved rate increases occurring July 1st of each year, the rate increase that will be implemented each fiscal year will incorporate the approved CWA rate increase that will be effective in January during each fiscal year. The CWA rate increase impacts to the City are projected to be 4.5% in Fiscal Year 2017, 2.5% in Fiscal Years 2018 and 2019, and 3.0% in 2020, which are based on current estimates. In the event that each annual CWA rate increase impact to the City is different than the projected amounts described above, the City expects to pass through only the actual CWA pass-through cost impact to the ratepayer, up to a maximum of 7.0% for each of the Fiscal Years 2017 through 2019 and up to 3% in Fiscal Year 2020.

On April 12, 2016, MWD's Board of Directors adopted a biennial budget for fiscal years 2016-17 and 2017-18 of $1.65 billion and $1.70 billion respectively or $3.35 billion collectively. MWD's Board of Directors also adopted biennial rates and charges for calendar years 2017 and 2018 representing an average 4% increase in MWD's wholesale water rates. In setting the rates and charges, MWD's Board of Directors rejected an option to establish a fixed treatment charge to partially recover treatment costs, for which revenues are currently only recovered through a volumetric rate. These MWD rates and charges will become effective January 1, 2017 and 2018. The impact on CWA rates will be reflected in its rate proposal to be released in late May 2016 and as adopted by CWA's Board of Directors in June 2016. As part of its rates adoption process, MWD's Board of Directors called for the formation of a board working group to explore more fixed revenue streams to cover at least a portion of fixed treated water costs.

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# TABLE 12
# FIVE-YEAR WATER SERVICE CHARGE HISTORY FOR SINGLE FAMILY RESIDENTIAL, MULTI-FAMILY, NON-RESIDENTIAL, IRRIGATION, AND TEMPORARY CONSTRUCTION
## Fiscal Years 2012 through 2016

| | | Fiscal Year 2012 | Fiscal Year 2013 | Fiscal Year 2014 (effective 1/1/2014) | Fiscal Year 2015 (effective 1/1/2015) | Fiscal Year 2016 (effective 1/1/2016) |
|---|---|---|---|---|---|---|
| **CWA pass-through costs:** | | 0% | 0% | 7.25% | 6.6% | 4.5% |
| **Increase in Water System costs:** | | 0% | 0% | 0% | 0.5% | 5.3%[1] |
| **Total Increase amount:** | | **0%** | **0%** | **7.25%** | **7.1%** | **9.8%** |
| | | 7/1/2012 | 7/1/2013 | 1/1/2014 | 1/1/2015 | 1/1/2016 |
| **BASE FEES[2]** | | | | | | |
| Meter Size: | 5/8 inch | $ 19.33 | $ 19.33 | $ 18.89 | $ 20.31 | $ 22.26 |
| | 3/4 inch | 19.33 | 19.33 | 18.89 | 20.31 | 22.26 |
| | 1 inch | 28.46 | 28.46 | 25.59 | 27.51 | 29.50 |
| | 1 1/2 inch | 49.34 | 49.34 | 40.89 | 43.96 | 46.04 |
| | 2 inch | 75.44 | 75.44 | 60.03 | 64.53 | 66.72 |
| | 3 inch | 136.74 | 136.74 | 104.98 | 112.86 | 115.32 |
| | 4 inch | 224.15 | 224.15 | 169.07 | 181.75 | 184.59 |
| | 6 inch | 440.73 | 440.73 | 327.86 | 352.44 | 356.23 |
| | 8 inch | 701.64 | 701.64 | 519.16 | 558.10 | 563.03 |
| | 10 inch | 1,006.94 | 1,006.94 | 742.99 | 798.72 | 804.98 |
| | 12 inch | 1,875.82 | 1,875.82 | 1,380.05 | 1,483.55 | 1,493.60 |
| | 16 inch | 3,267.86 | 3,267.86 | 2,400.67 | 2,580.72 | 2,596.85 |
| **COMMODITY CHARGE[3]** | | | | | | |
| **Customer Type:** | | | | | | |
| Single Family Residential | | | | | | |
| Tier 1 | 0-7 HCF | $ 3.612 | $ 3.612 | | | |
| Tier 2 | 8-14 HCF | 3.917 | 3.917 | | | |
| Tier 3 | 15+ HCF | 4.398 | 4.398 | | | |
| Tier 1 | 0-4 HCF | | | $ 3.639 | $ 3.896 | $ 4.240 |
| Tier 2 | 5-12 HCF | | | 4.076 | 4.364 | 4.754 |
| Tier 3 | 13-18 HCF | | | 5.823 | 6.234 | 6.791 |
| Tier 4 | 19+ HCF | | | 8.188 | 8.766 | 9.550 |
| Typical Single Family Monthly Bill Based on 12 HCF/month | | $ 64.20 | $ 64.20 | $ 66.09 | $ 70.81 | $ 77.25 |
| Multi-Family | per HCF[4] | $ 3.917 | $ 3.917 | $ 4.343 | $ 4.650 | $ 5.125 |
| Non-Residential[5] | per HCF[4] | 3.757 | 3.757 | 4.175 | 4.470 | 5.020 |
| Irrigation | per HCF[4] | 4.014 | 4.014 | 4.621 | 4.947 | 5.666 |
| Temporary Construction | per HCF[4] | 4.014 | 4.014 | 4.621 | 4.947 | 6.023 |

(1) Increases in Water System costs due to CIP, implementation of Pure Water Program, and drought.

(2) The base fee is dependent on the meter size.

(3) HCF (Hundred Cubic Feet) = 748 gallons.

(4) One rate applies for all usage amounts.

(5) Previously Commercial/Industrial. One rate for all usage accounts.

Source: Public Utilities Department, City of San Diego.

***Water Service Charges***. The Water System's water service charge for all retail user classes includes a fixed monthly service charge (also referred to as a base fee) and a commodity charge that is for the volume of water used. The base fee is determined by the size of a customer's meter, and is charged to the customer regardless of whether the customer uses water. The base fee is based upon the assumption that the Department incurs certain costs in order to be in a position to serve the commodity to the water customer upon demand. Those costs are incurred by the Department regardless of whether the customer uses the commodity or not. They include such costs as the general administrative costs of the Department for billing, payment processing, and account management related to the Water System. The size of the customer's connection provides an approximation of the amount of water the customer conceivably could have delivered to his or her property. While the service charge is charged to each water meter and varies with meter size, the commodity charge is applied to a customer's water usage.

The commodity charge is a set rate charge based upon each HCF of water consumed. The City has a tiered commodity charge structure for SFR customers that is broken down by water usage within each rate block. The remaining retail customers (Multi-Family, Non-Residential, Temporary Construction and Irrigation) are billed under the same uniform commodity charge for their respective customer classification. See Table 12 above for a schedule of commodity charge(s) applicable to each customer class and the base fees for the various water meter sizes in the Water System through Fiscal Year 2016, which were adopted by the City Council.

***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 2015. The City will be undertaking a cost of service study in calendar year 2016 to determine the amount of the new capacity charge, if necessary. The water available for use for a typical SFR is equated to one EDU and equals 500 gallons per day. Non-residential customers are charged based upon calculated usage or an inventory of plumbing components that are assigned a number of "fixture units," which are converted to EDU's using a conversion factor that equates 20 fixture units to one EDU. The minimum capacity assigned to any user is one EDU.

Capacity charges are not treated as operating income for financial reporting purposes but are considered System Revenues and are deposited in the Water Utility Fund. Pursuant to State law, capacity charges can be applied only for the purpose of paying costs associated with capital expansion, bonds, contracts, or other indebtedness of the Water System related to expansion. Because capacity charges are primarily collected on new construction within the City, revenues obtained from such charges vary based upon construction activity. The current capacity charge is $3,047 per EDU, and has been unchanged for the past several years.

The following table sets forth the historical capacity charge revenues from Fiscal Years 2011 through 2015. Aggregate capacity charge revenues may not equal the amount derived by multiplying the water capacity rate by the number of units because of individual customer account characteristics. Since capacity charge revenue is dependent on development activity within the City, capacity charge revenues are impacted by increases and decreases in residential and non-residential construction.

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**TABLE 13**
**WATER UTILITY FUND**
**HISTORICAL CAPACITY CHARGE REVENUES**
**Fiscal Years 2011 through 2015[1]**

| Fiscal Year | New Equivalent Dwelling Units | Capacity Charge Revenues[2] |
|---|---|---|
| 2011 | 2,474 | $ 7,516,512 |
| 2012 | 2,221 | 8,003,332 |
| 2013 | 4,223 | 11,704,419 |
| 2014 | 4,803 | 14,623,833 |
| 2015 | 5,152 | 15,760,349 |

(1) Fiscal Year 2011 – 2015 Included with Capital Contributions on Statement of Revenues, Expenses and Changes in Net Assets in the Comprehensive Annual Financial Report of the indicated Fiscal Year.
(2) Amounts include potable and recycled capacity charge revenues.
Source: Office of the Comptroller and Public Utilities Department, City of San Diego.

## Collection of Water Service Charges

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

Pursuant to the approved policies and procedures, 100% of the water used is billed, including water usage that occurred up to three years prior to the date of billing. These policies provide the Department authority to grant one 14-day payment time extension on any invoice to help customers weather short-term financial challenges and time extensions for payment under limited conditions, (*e.g.*, public health and safety, legal negotiations, or to avoid a negative impact to other ratepayers overall. Such policies and procedures also provide the Department the authority to grant a payment plan in only two circumstances: a customer receiving a bill greater than 200% of the usage on their normal bill and a customer being back-billed for services received but previously unbilled. In both cases, the customer is allowed only one payment plan at a time. Further, the approved policies provide that a security deposit, for those customers requiring one, will be equal to two average billing periods and a fee of $25 will be imposed for each payment returned unpaid.

## Accounts Receivable

Typically, the Department seeks to collect unpaid bills by: (a) issuing a payment reminder notice 25 days after a bill is issued; (b) issuing a shut-off notice 38 days after a bill is issued; and (c) shutting off the customer's water service 48-54 days after a bill is issued. This procedure results in almost all past due bills being paid. If necessary, the Department establishes a payment plan for customers who are unable to pay a past due amount. Open accounts with an unpaid amount due of $60 or greater are referred to the City Treasurer for collection activities 75 days after the bill is issued. Once referred for collections, unpaid amounts due on subsequent bills issued on the account are referred 16 days after the bill is issued until all referred amounts are paid. An allowance is taken each Fiscal Year for accounts receivable that are not expected to be paid. During Fiscal Years 2011 through 2015, accounts receivable amounts outstanding for more than 120 days ranged from approximately $1.9 million to approximately $4.6 million. Water service charges to City utility customers are collected on the municipal utility bill, which

also includes sewer service charges, storm drain fees and other related fees. Only water charges are revenues to the Water Utility Fund. Bills are distributed on a bi-monthly basis for most customers and a monthly basis for high consumption residential, commercial, industrial and irrigation customers.

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

**TABLE 14**
**WATER CUSTOMER ACCOUNTS RECEIVABLE**
**AND SHUT-OFFS BY FISCAL YEAR**
**Fiscal Years 2011 through 2015**
**($ Amounts in Thousands)**
**(Unaudited, except as otherwise noted)**

| | 2011 | 2012 | 2013 | 2014 | 2015 |
|---|---|---|---|---|---|
| Water Sales Revenue[1] | $358,747 | $391,614 | $400,448 | $434,285 | $439,744 |
| Accounts Receivable[2] | $ 58,072 | $ 61,403 | $ 67,143 | $ 76,610 | $ 68,630 |
| Accounts Receivable Over 120 Days[2] | $ 1,861 | $ 4,403 | $ 3,534 | $ 4,484 | $ $4,593 |
| % of Total Water Sales Revenues[3] | 0.52% | 1.12% | 0.88% | 1.03% | 1.04% |
| Number of Shut-Offs[4] | 23,271 | 23,156 | 19,815 | 20,079 | 19,833 |

(1) Audited.
(2) Amounts are as of June 30 and represent the receivable portion of billed customer accounts as of the end of each Fiscal Year.
(3) Percentage of Accounts Receivable over 120 days as compared to Total Water Sales Revenues.
(4) Shut-Offs for non-payment may include multiple shut-offs associated with the same account throughout the Fiscal Year.

Sources: The City's Comprehensive Annual Financial Reports for the indicated Fiscal Years 2011 through 2015 with respect to "Water Sales Revenue." Public Utilities Department, for all other line items.

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## Revenues

The Water Utility Fund's principal source of revenues is Water Service charges to City residents and non-residential enterprises as shown below. The following table sets forth the historical sources of water sales revenues of the Water Utility Fund for Fiscal Years 2011 through 2015, followed by the Water Utility Fund's Statements of Revenues, Expenses, and Changes in Fund Net Assets for Fiscal Years 2011 through 2015, and a debt service coverage table for Fiscal Years 2011 through 2015.

**TABLE 15**
**HISTORICAL SOURCES OF WATER SALES REVENUES**
**Fiscal Years 2011 through 2015**
**($ Amounts in Thousands)**
**(Unaudited, except as otherwise noted)**

| Sources | 2011 | 2012 | 2013 | 2014 | 2015 |
|---|---|---|---|---|---|
| **Retail** | | | | | |
| Single Family Residential | $155,675 | $156,995 | $162,352 | $176,886 | $176,841 |
| Multi-Family Residential | 73,902 | 80,749 | 80,225 | 83,425 | 86,096 |
| Non-Residential | 76,315 | 87,111 | 86,547 | 95,284 | 102,237 |
| Irrigation | 37,100 | 46,864 | 51,269 | 55,975 | 50,924 |
| Reclaimed | 4,130 | 5,467 | 5,460 | 5,660 | 5,352 |
| **Wholesale to Other Retailers** | | | | | |
| Treated[(1)] | 9,747 | 12,184 | 12,028 | 14,711 | 15,375 |
| Untreated | 489 | 332 | 541 | 32 | 126 |
| Reclaimed | 1,389 | 1,912 | 2,026 | 2,312 | 2,793 |
| **Total[(2)]** | **$358,747** | **$391,614** | **$400,448** | **$434,285** | **$439,744** |

(1) Primarily reflects wholesale revenues from Cal-American Water Company.
(2) Audited.
Source: The City's Comprehensive Annual Financial Reports for Fiscal Years 2011 through 2015 for Total; and Office of the Comptroller, City of San Diego for all other line items.

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## TABLE 16
## STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN FUND NET ASSETS
## FOR THE WATER UTILITY FUND
### Fiscal Years 2011 through 2015 Audited
### ($ Amounts in Thousands)

| | 2011 | 2012 | 2013 | 2014 | 2015 |
|---|---|---|---|---|---|
| **OPERATING REVENUES[1]** | | | | | |
| Sales of Water | $ 358,747 | $ 391,614 | $ 400,448 | $ 434,285 | $ 439,744 |
| Charges for Services | 3,789 | 7,822 | 5,743 | 4,533 | 6,432 |
| Revenue from Use of Property | 5,540 | 6,184 | 5,864 | 7,007 | 6,693 |
| Usage Fees | 33 | 34 | 35 | -- | -- |
| Other | 3,406 | 2,465 | 2,418 | 1,740 | 2,353 |
| **TOTAL OPERATING REVENUES** | $ 371,515 | $ 408,119 | $ 414,508 | $ 447,565 | $ 455,222 |
| **OPERATING EXPENSES[2]** | | | | | |
| Maintenance and Operations | $ 72,027 | $ 78,108 | $ 79,188 | $ 91,357 | $ 79,732 |
| Cost of Purchased Water Used | 143,155 | 167,104 | 205,704 | 207,721 | 237,274 |
| Taxes[3] | 1,755 | 1,826 | 1,797 | 1,963 | 2,117 |
| Administration | 65,926 | 53,619 | 47,553 | 54,498 | 58,599 |
| Depreciation | 43,054 | 46,030 | 48,334 | 48,957 | 51,935 |
| **TOTAL OPERATING EXPENSES** | $ 325,917 | $ 346,687 | $ 382,576 | $ 404,496 | $ 429,657 |
| **OPERATING INCOME (LOSS)** | $ 45,598 | $ 61,432 | $ 31,932 | $ 43,069 | $ 25,565 |
| **NONOPERATING REVENUES (EXPENSES)** | | | | | |
| Earnings on Investments[4] | $ 4,468 | $ 4,244 | $ 1,231 | $ 3,185 | $ 2,714 |
| Federal Grant Assistance | 203 | 442 | 1,095 | 109 | -- |
| Other Agency Grant Assistance | 7,028 | 372 | 261 | 575 | 627 |
| Gain (Loss) on Sale/Retirement of Capital Assets | (1,164) | 1,270 | (106) | (1,630) | (2,431) |
| Debt Service Interest Expense | (34,490) | (36,496) | (37,280) | (37,100) | (35,771) |
| Other | 3,552 | 365 | 570 | 3,839 | 2,432 |
| **TOTAL NON OPERATING REVENUES (EXPENSES)** | $ (20,403) | $ (29,803) | $ (34,229) | $ (31,022) | $ (32,429) |
| **INCOME (LOSS) BEFORE CONTRIBUTIONS AND TRANSFERS** | $ 25,195 | $ 31,629 | $ (2,297) | $ 12,047 | $ (6,864) |
| Capital Contributions | $ 18,011 | $ 56,640[5] | $ 64,893 | $ 37,250 | $ 358,451[6] |
| Transfers from Other Funds | 113 | 79 | 51 | 44 | 58 |
| Transfers from Governmental Funds | 142 | -- | 1,234 | 3,608 | -- |
| Transfers to Other Funds | -- | (496) | (579) | (356) | (3,651) |
| Transfer to Governmental Funds | (222) | (6,312) | (8,168) | (7,094) | (16) |
| Extraordinary Gain (Loss) | -- | 686[7] | (686)[8] | -- | -- |
| **CHANGE IN NET ASSETS** | $ 43,239 | $ 82,226 | $ 54,448 | $ 45,499 | $ 347,978 |
| Net Assets at Beginning of Year | $1,472,397 | $1,515,636 | $1,597,862 | $1,638,417[9] | $1,572,384[10] |
| **NET ASSETS AT END OF YEAR** | $1,515,636 | $1,597,862 | $1,652,310 | $1,683,916 | $1,920,362 |

(1) Operating Revenues represent charges to customers for sales and services.
(2) Operating Expenses include cost of sales and services, administrative expenses, and depreciation on capital assets.
(3) Includes annual property taxes and quarterly payments of taxes in-lieu to the CWA.
(4) Earnings on investments include interest earned on the bond construction funds for Fiscal Years 2011 through 2013.
(5) Includes $40.7 million in grant revenue in Fiscal Year 2012.
(6) Pursuant to the Emergency Storage Project Agreement between the CWA and the City, the CWA built various facilities and infrastructure in order to raise the height of the San Vicente Dam and increase the reservoir's capacity. During Fiscal Year 2015, the CWA conveyed the facilities and infrastructure related to the expansion, valued at over $330.4 million, to the City, which was the primary cause of the increase in Capital Contribution.
(7) Extraordinary Gain resulting from the dissolution of the Redevelopment Agency.
(8) Extraordinary Loss resulting from prior year loan receivable from the Redevelopment Agency that will not be repaid.
(9) Beginning balance restated due to the net effects of the implementation of GASB 65 (as defined herein) and reclassification of worker's compensation.
(10) Beginning balance restated due to the net effects of the implementation of GASB 68 and 71 (as defined herein).

Source: The City's Comprehensive Annual Financial Reports for Fiscal Years 2011 through 2015.

## TABLE 17
## CALCULATION OF HISTORIC DEBT SERVICE COVERAGE
### Fiscal Years 2011 through 2015
### ($ Amounts in Thousands)
### (Unaudited)

| | | | | | | Senior Obligations | | | | All Obligations[1] | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Fiscal Year | Total System Revenues[2] | Total Maintenance & Operation Costs (Excludes Depreciation)[3] | Net System Revenue | Less: Interest Earnings on Reserve Fund[4] | Adjusted Net System Revenues | Total Senior Debt Service | Less: Senior Interest Earnings[4] | Adjusted Debt Service | Adjusted Debt Service Coverage | Total Debt Service | Aggregate Debt Service Coverage |
| 2011 | $397,755 | $285,059 | $112,696 | $(1,436) | $111,260 | $34,115 | $(1,436) | $32,679 | 3.40 | $62,784 | 1.79 |
| 2012 | 431,188[5] | 307,465 | 123,723 | (1,919) | 121,804 | 37,518 | (1,919) | 35,599 | 3.42 | 66,191 | 1.87 |
| 2013 | 444,751[6] | 342,989 | 101,762 | (363) | 101,399 | 39,707 | (363) | 39,344 | 2.58 | 64,210 | 1.58 |
| 2014 | 473,908 | 362,989 | 110,919 | (1,017) | 109,902 | 39,921 | (1,017) | 38,904 | 2.82 | 66,691 | 1.66 |
| 2015[7] | 468,274 | 381,389 | 86,885 | (897) | 85,988 | 40,063 | (897) | 39,166 | 2.20 | 66,835 | 1.30 |

(1) All Obligations include Outstanding Senior Obligations and the Outstanding Subordinated Obligations

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

(3) Amounts under Total Expenses reflect the Maintenance and Operation Costs of the Water System for such Fiscal Year in accordance with the Installment Purchase Agreement and generally includes maintenance and operations, administration, cost of water purchases, transfers to other funds, pension benefits, and retiree health costs.

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

(5) Includes receipt of grant revenue ($40.7 million) and transfers to Rate Stabilization Fund ($29.8 million).

(6) Includes transfers from Rate Stabilization Fund ($11.8 million).

(7) Unadjusted Aggregate Debt Service Coverage is 1.41. $7.6 million was transferred to the Rate Stabilization Fund. Total System Revenues and affected coverage ratios are net of this transfer.

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

Source: Statistical Section (Unaudited) of the City's Comprehensive Annual Financial Reports for Fiscal Years 2011 through 2015.

**Management's Discussion and Analysis**

The following discussion relates to certain items set forth in Table 16. Some of the following information in connection with the financial condition and results of operations of the Water Utility Fund for Fiscal Year 2015, is unaudited and should be read in conjunction with certain of the information contained in the City's CAFR for Fiscal Year 2015, and specifically the portion of the basic financial statements relating to the operation of the Water Utility Fund, which is available through EMMA, and incorporated by reference in this Official Statement. See "FINANCIAL STATEMENTS" herein.

***Operating Revenues***. Total operating revenues for Fiscal Year 2015 were $455.2 million, which represented an increase of $7.7 million from the previous Fiscal Year. This was primarily due to an increase in water sales revenue, which was the result of a 7.1% water rate increase that became effective in January 2015, and charges for services.

***Operating Expenses***. Total operating expenses for Fiscal Year 2015 were $429.7 million, an increase of $25.2 million from Fiscal Year 2014. This was primarily the result of an increase in the cost to purchase water.

Operation and maintenance expenditures were 18.5% of operating expenses and totaled $79.7 million for Fiscal Year 2015. This was a decrease of $11.6 million or 12.7% less than the corresponding amount for Fiscal Year 2014. This was primarily the result of the City's implementation of GASB 68 and 71 (as defined below). These implementations resulted in the Water Utility Fund reporting its Fiscal Year 2015 pension contributions as a deferred outflow of resources instead of as an expense.

***Non-operating Revenues***. Non-operating revenues for Fiscal Year 2015 decreased by $1.9 million from non-operating revenues received in Fiscal Year 2014. This was primarily due to a decrease in investment earnings and a one-time litigation award that was received in Fiscal Year 2014.

***Non-operating Expenses***. Non-operating expenses decreased by $0.5 million to $38.2 million during Fiscal Year 2015. This was due to a $1.3 million decrease in debt service interest expense offset by a $0.8 million increase in the loss on sale/retirement of capital assets.

***Contributions and Transfers***. Capital contributions increased in Fiscal Year 2015 from Fiscal Year 2014 by $321.2 million. Pursuant to the Emergency Storage Project Agreement between the CWA and the City, the CWA built various facilities and infrastructure in order to raise the height of the San Vicente Dam and increase the reservoir's capacity. During Fiscal Year 2015, the CWA conveyed the facilities and infrastructure related to such expansion, valued at approximately $330.4 million, to the City, which was the primary cause of the increase in capital contributions. Transfers out decreased in Fiscal Year 2015 by $3.8 million. This was the result of an effort to classify certain IT related expenses as Operating Expenses to more accurately reflect the nature of the services.

**Water Utility Fund Reserves**

The City has established accounts within the Water Utility Fund for four reserve funds: the Emergency Operating Reserve ("Operating Reserve"), the Secondary Purchase Reserve, the Rate Stabilization Fund Reserve ("Rate Stabilization Fund"), and the Emergency Capital Reserve ("Capital Reserve"). The Department operates these reserve funds in accordance with the City's reserve policy (the "City Reserve Policy"). The City's goals with respect to the City Reserve Policy are to provide adequate cash balances to ensure that the City meets its cash flow obligations, maximizes earnings on investments, minimizes borrowing costs and maintains the highest credit on its bonds and financial obligations. In the event amounts contained in a particular reserve are below the anticipated reserve level as stated in the

City Reserve Policy, the Mayor is to propose a plan as part of the budget for the subsequent Fiscal Year to replenish such reserve in a reasonable timeframe. As of June 30, 2015, the Water Utility Fund had total reserves of approximately $96.4 million.

The Operating Reserve is intended to be used in the event of a catastrophe that prevents the Water System from operating in its normal course of business. The reserve level is defined as the number of days of operation it could support in the event of a major disruption to the Water System. It is calculated based on the annual operating budget for the Fiscal Year, less the budgeted operating contingency and the budget for water purchases and debt service (including SRF loan repayments). The Operating Reserve target is equivalent to 70 days of operations. This reserve level target of 70 days recognizes that the Water System has a large diversified customer base, a steady and reliable demand for services, and other reserves available for specific needs. Use of the Operating Reserve is restricted to emergency situations, and City Council approval is required to appropriate these reserves. Any request to utilize the Operating Reserve will include a plan and timeline for replenishment, which may be in conjunction with the City Council authorization of a future cost of service study and rate adjustment. As of June 30, 2015, there was approximately $31.7 million in the Operating Reserve.

The Secondary Purchase Reserve was established to purchase additional water supply in case of a major drought or unforeseen emergency that diminishes the City's normal supply. The size of the reserve is equal to 6% of the annual water purchase budget (including commodity charge and fixed costs). City Council action is required in order to appropriate these reserves. As of June 30, 2015, there was approximately $13.6 million in the Secondary Purchase Reserve.

The Rate Stabilization Fund was established and is maintained pursuant to the Master Installment Purchase Agreement. Transfers in and out of this fund serve as a revolving mechanism to mitigate potential fluctuations in the rates for the Water System operations, and maintain stable debt service coverage ratios for the Outstanding Obligations. The permitted uses of the Rate Stabilization Fund are limited to the Maintenance and Operation Costs of the Water System. The City Reserve Policy establishes a baseline target for the Rate Stabilization Fund in an amount equal to 5% of the prior Fiscal Year Water System total operating revenues. The funding level in the Rate Stabilization Fund can go up or down depending on year to year changes in the Water System's operating revenues and expenditures. The Rate Stabilization Fund will be treated as a coverage stabilization tool enabling transfers into and out of the fund, as seen necessary by the Chief Financial Officer, upon recommendation of the Department. Transfers may be made into the Rate Stabilization Fund, increasing the balance above the 5% baseline, if there are excess Net System Revenues in any given Fiscal Year. In contrast, if Net System Revenues decrease in any given Fiscal Year, amounts can be withdrawn from the Rate Stabilization Fund to cover current Fiscal Year Maintenance and Operation Costs of the Water System. If amounts on deposit in the Rate Stabilization Fund decrease below the baseline amount of 5% of the prior Fiscal Year Water System total operating revenue, it will be replenished to the target level from any surplus Net System Revenue in the next Fiscal Year or in conjunction with the City Council authorization of a future cost of service study and rate adjustments. The reserve target for Fiscal Year 2016 is approximately $22.8 million. The current balance in the reserve is $46.1 million. Due to the negative effects on revenue of extraordinary conservation, in part as a result of the Governor's mandate via the SWRCB to do so, the Department is projected to transfer $32.0 million to its Water Operating fund in Fiscal Year 2016 to maintain legally required debt service coverage levels and to mitigate the rate increase impacts on ratepayers. The transfer will be carried out per the City Reserve Policy. This will leave $14.1 million in the reserve, or approximately $8.7 million below the City Reserve Policy level. The Department has a plan to replenish the reserve to policy levels over the next several years as part of its City Council approved 2016 Rate Case.

The Capital Reserve is intended to be used for emergency capital needs. The reserve is budgeted annually at $5.0 million in the Water System CIP budget. If the reserve is used to fund unforeseen emergency conditions resulting in the need to immediately repair or replace existing assets, approval from the Chief Financial Officer or the Chief Operating Officer is required. As of June 30, 2015, there was $5.0 million in the Capital Reserve.

**TABLE 18**
**RESERVES AND TOTAL CASH AND CASH EQUIVALENTS**
**IN WATER UTILITY FUND**
**Fiscal Years 2011 through 2015 (Actuals) and 2016 (Projected)[1]**
**($ Amounts in Thousands)**

| | 2011 | 2012 | 2013 | 2014 | 2015 | Projected Year-End 2016[1] |
|---|---|---|---|---|---|---|
| **Reserve Funds[2]** | | | | | | |
| Operating Reserve | $ 29,923 | $ 29,557 | $ 29,493 | $ 30,662 | $ 31,696 | $ 40,108 |
| Secondary Purchase Reserve | 11,263 | 12,504 | 12,315 | 12,544 | 13,582 | 13,582 |
| Rate Stabilization Fund | 20,500 | 50,300 | 38,500 | 38,500 | 46,117 | 14,117 |
| Capital Reserve | 5,000 | 5,000 | 5,000 | 5,000 | 5,000 | 5,000 |
| Dedicated Reserve for Efficiencies and Savings[3] | 13,973 | 21,393 | 29,902 | -- | -- | -- |
| **Total Reserve Funds** | $ 80,659 | $118,754 | $115,210 | $ 86,706 | $ 96,395 | $ 72,807 |
| **Total Cash and Cash Equivalents in Water Utility Fund[4]** | $221,831 | $367,528 | $338,683 | $299,396 | $250,477 | $210,305 |
| **Days of Cash on Hand[5]** | 277 | 436 | 362 | 299 | 234 | 179 |

(1) Fiscal Year 2016 year-end projection based on actual results as of March 2016.
(2) Established in accordance with City Reserve Policy.
(3) The Dedicated Reserve for Efficiencies and Savings was discontinued per the 2014 update to the City Reserve Policy and the remaining balance was applied to capital costs of the Water System.
(4) Fiscal Years 2011 through 2015 audited. Includes Cash and Investments (which includes the Reserve totals above), Restricted Cash and Investments, less Investments Not Meeting the Definition of Cash Equivalents.
(5) Days of cash on hand is calculated by: Cash and Investments/(Operating Expenses less Depreciation / 365 days).
Source for Cash and Cash Equivalents: The City's Comprehensive Annual Financial Reports for Fiscal Years 2011 through 2015.
Source for Reserves and Fiscal Year 2016 year-end projection: Public Utilities Department and Office of the Comptroller, City of San Diego.

The Fiscal Year 2016 year-end Total Cash and Cash Equivalents in the Water Utility Fund is projected to be $210.3 million, and the days of cash on hand is projected to be approximately 179 days. The Fiscal Year 2016 year-end Total Cash and Cash Equivalents is anticipated to decline from the Fiscal Year 2015 level due to the downward pressure on revenues resulting from drought and increased cost of imported water compared to prior Fiscal Years. It is projected that future years' Total Cash and Cash Equivalents will increase from Fiscal Year 2016 levels with the approved rate increases through FY 2020, in addition to steady pay-go levels and CIP funding reliance on bond funds and loans.

For information on the possible limitation on the City's ability to set rates and charges at levels that would permit the City to make deposits into the Rate Stabilization Fund or the Secondary Purchase Fund as a consequence of Proposition 218, see "WATER SYSTEM FINANCIAL OPERATIONS." See

also Table 19 under the caption "Financial Projections and Modeling Assumptions" below for currently anticipated withdrawals from and deposits into the Rate Stabilization Fund.

**Financial Projections and Modeling Assumptions**

Table 19 below sets forth the financial forecast for Fiscal Years 2016 through 2020.

The figures incorporate the rate increases of 9.8% on January 1, 2016, 6.4% on July 1, 2016, 6.4% on July 1, 2017, 5.0% on July 1, 2018 and 7.0% on July 1, 2019 as adopted by City Council in November 2015. The rate increases of the 2016 Rate Case approved by Council contain the City's best estimate of the impacts of the CWA's projected rate increases on its rates for calendar years 2017 through 2019. The CWA rate increase impacts to the City are projected to be 2.5% in 2017 and 2018, and 3.0% in 2019. The City has historically increased water rates over time to adjust to increases in the cost of water purchased from the CWA, which increases are generally based on the costs for the infrastructure, operation and maintenance of the CWA's water supply system and the cost the CWA pays to purchase water from MWD. See "WATER SYSTEM FINANCIAL OPERATIONS – Establishment of Water Service Charges."

Fiscal Year 2016 Year-End Estimate of Net System Revenues and coverage ratios reflect year end estimates based on actual results through March 2016. The City realized a cumulative 16.63% water use conservation starting June 1, 2015 through April 2016 in response to the ongoing drought and mandated water restrictions for residential and commercial customers. As such, a water conservation level of 16% is assumed to be maintained through the end of the Fiscal Year. The operating revenues reflect this decrease in volumetric water sales, combined with a rate increase of 9.8% that went into effect in January 2016. Maintenance and operation costs are projected to increase by approximately 6.3% over Fiscal Year 2015 (Department expenditures increasing by $47.4 million and Water Purchases decreasing by $23.3 million).

The projections include the assumption of a continued 16% conservation level for water use. See "WATER SUPPLY – Recent CWA and MWD Actions in Response to Drought Conditions." The City, in review with the CWA and other member agency projections, still believes that there will be water conservation at a higher level than the 8% mandate. Actual increases in water use as compared to the 16% conservation level assumed in Table 19 would improve the financial projections included in Table 19. These projections do not include any offsetting savings of water purchases due to the new supply of local potable water from the Pure Water Program, anticipated to provide offsets starting approximately in Fiscal Year 2022.

The forecast for Fiscal Years 2017 through 2020 incorporates certain assumptions adopted by the Department, including assumed inflation and interest rates. The System Revenues for Fiscal Years 2017 through 2020 reflect (a) an increase in volumetric water deliveries attributable to a population growth factor of approximately 0.8% per Fiscal Year; (b) an account growth rate of 0.67% per Fiscal Year; (c) an increase of approximately $3.0 million per Fiscal Year in recycled water revenues due to Council approved rate increases; (d) maintenance and operation costs for Fiscal Years 2017 through 2020 reflect the Mayor's Five-Year Financial Outlook for Fiscal Years 2017 through 2021 with increases at a 3.3% rate per Fiscal Year for energy and utilities, and at a 3.5% rate per Fiscal Year for contracts and supplies; (e) Water Utility Fund personnel expenditure increases related to the approved San Diego Municipal Employees' Association bargaining agreement and the proposed American Federation of State, County, and Municipal Employees Local 127 tentative agreement; and (f) Debt Service for Fiscal Year 2017 and future years include the anticipated issuance of additional revenue bonds secured by installment payments pursuant to the Master Installment Purchase Agreement, including net proceeds of the 2016A Bonds and a

combination of future bond offerings and SRF loans. See also "WATER SYSTEM FINANCIAL OBLIGATIONS – Anticipated Additional Obligations."

The assumed interest rates estimated for projected earnings on fund balance range between 0.7% and 2.3% in Fiscal Years 2016 - 2020.

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## TABLE 19
## PROJECTED NET SYSTEM REVENUES AND DEBT SERVICE COVERAGE
## Fiscal Years 2016 through 2020
## ($ Amounts in Thousands)
## (Unaudited)

| DESCRIPTION | Fiscal Year 2016 Year-End Estimate[1] | Fiscal Year 2017 Projected[2] | Fiscal Year 2018 Projected | Fiscal Year 2019 Projected | Fiscal Year 2020 Projected |
|---|---|---|---|---|---|
| **System Revenues** | | | | | |
| Operating Revenues[3] | $430,357 | $500,869 | $534,826 | $564,236 | $606,181 |
| Interest Income on Operating Funds | 3,226 | 3,500 | 5,667 | 6,408 | 8,068 |
| Interest Earnings on Debt Service Reserve Funds | 1,119 | 1,358 | 1,382 | 1,396 | 1,692 |
| Other Non-Operating Revenues | 2,100 | 2,100 | 2,100 | 2,100 | 2,100 |
| Capacity Charge Revenue[4] | 15,000 | 12,000 | 12,000 | 12,000 | 12,000 |
| Grant Proceeds | 2,000 | 3,364 | 2,055 | 2,467 | 30,595 |
| Transfers (to)/from Rate Stabilization Fund[5] | 32,000 | -- | (5,397) | (5,397) | (5,397) |
| Transfers (to)/from Metro Wastewater Fund[6] | -- | (3,445) | (3,445) | -- | -- |
| Transfers (to)/from Secondary Purchase Reserve | -- | (482) | (634) | (1,118) | (694) |
| Total System Revenues | $485,802 | $519,264 | $548,554 | $582,092 | $654,545 |
| **Maintenance and Operation Costs** | | | | | |
| Water Purchases[7] | $213,945 | $234,393 | $244,967 | $263,598 | $275,163 |
| Water System Expenses[8] | 183,800 | 191,583 | 197,943 | 199,676 | 210,995 |
| Pure Water Program Expenses[9] | 7,675 | 7,005 | 5,890 | 5,590 | 3,384 |
| Total Maintenance and Operation Costs | $405,420 | $432,981 | $448,800 | $468,864 | $489,542 |
| **Net System Revenues** | $ 80,382 | $ 86,283 | $ 99,754 | $113,228 | $165,003 |
| **Senior Debt Service Coverage** | | | | | |
| Adjusted Net System Revenues[10] | $ 79,397 | $ 85,286 | $ 98,732 | $112,193 | $163,727 |
| Adjusted Senior Debt Service[11][12] | 40,008 | 52,937 | 57,823 | 64,288 | 68,562 |
| Senior Debt Service Coverage[11] | 1.98 | 1.61 | 1.71 | 1.75 | 2.39 |
| **Aggregate Debt Service Coverage** | | | | | |
| Net System Revenues | $ 80,382 | $ 86,283 | $ 99,754 | $113,228 | $165,003 |
| Senior Debt Service[12] | 40,993 | 53,935 | 58,844 | 65,324 | 69,838 |
| Subordinate Debt Service[12] | 26,396 | 16,460 | 16,457 | 16,462 | 16,455 |
| Aggregate Debt Service Coverage[12] | 1.19 | 1.23 | 1.32 | 1.38 | 1.91 |

(1) Fiscal Year 2016 Year-End Estimate based on actual results as of March 2016.

(2) The Fiscal Year 2017 Proposed Budget, released on April 14, 2016, is the basis for projections. The Fiscal Year 2017 projection has additional items incorporated pursuant to the Master Installment Purchase Agreement coverage calculations which are not budgeted.

(3) Includes City Council approved rate increases. See "WATER SYSTEM FINANCIAL OPERATIONS – Establishment of Water Service Charges."

(4) Capacity Charge revenue is based on projected population growth and building permits. The decrease in Fiscal Year 2017 reflects a return to moderate building activity following growth that occurred in Fiscal Years 2014, 2015 and 2016.

(5) Timing and amounts of withdrawals and deposits are estimates. Projected deposits are anticipated to replenish the Rate Stabilization Fund to the City Reserve Policy required target level.

(6) Transfer to Metro Wastewater Fund for recycled water sales from the South Bay Plant. See "WATER SUPPLY – City Planning and Resource Management – Recycled Water."

(7) Water purchase projections incorporate CWA's projected rate increases. See Establishment of Water Service Charges herein.

(8) Includes costs of maintenance and operations, administration, pension benefits and retiree health costs, and the projected cost impacts from the recently negotiated labor agreements with employee bargaining organizations. See "Labor Relations" below. This does not include Pure Water Program costs, which are reflected below.

(9) Includes Pure Water Program pre-design, design, and outreach related costs.

(10) Adjusted Net System Revenues is Net System Revenues less earnings from investments in the Common Senior Debt Service Reserve Fund.

(11) Adjusted Senior Debt Service is the Senior Debt Service less earnings from investments in the Common Senior Debt Service Reserve Fund.

(12) Reflects scheduled debt service on outstanding obligations, projected debt service on additional senior lien bonds the City assumes to issue, and additional senior lien SRF loans the City expects to receive from the SWRCB. Projections do not reflect anticipated debt service savings resulting from the refunding through the 2016B Bonds, which savings are expected to result in changes to senior and aggregate debt service coverage levels.

Source: Public Utilities Department, City of San Diego.

The Water Utility Fund 2016 Rate Case supports the Fiscal Years 2016-2020 capital program and operational expenditures. The ongoing CIP and operational expenditures are rate dependent, including, particularly, Pure Water Program expenditures for the Water Utility Fund share in Fiscal Year 2021, which are preliminarily projected to be $414 million, followed by estimated total expenditures of $42 million in Fiscal Year 2022 through 2025. The City anticipates that additional rate capacity is necessary after Fiscal Year 2020. The City expects to perform cost of service analysis to prepare a new rate case for recommended rate adjustments for the Water Utility Fund for Fiscal Year 2021 and later Fiscal Years.

The achievement of certain results or other expectations contained in Table 19 involve known and unknown risks, uncertainties, and other factors that may cause actual results, performance, or achievements reflected in Table 19 to be materially different from any future results, performance, or achievements expressed or implied in such Table 19. Although, in the opinion of the Department, such projections are reasonable, there can be no assurance that any or all of such projections will be realized or predictive of future results. See also "INTRODUCTION – Forward-Looking Statements."

**Outstanding Indebtedness**

As shown in the table below, as of April 30, 2016, the aggregate principal amount of Outstanding Senior Obligations was $618,620,692 (including Senior Bonds, which all or a portion will be refunded with proceeds of the 2016B Bonds and $53,565,692 aggregate principal amount of Senior SRF Loans, payable in each case from Net System Revenues on parity with the Net System Revenues securing the Senior Obligations), and the aggregate principal amount of Outstanding Subordinated Obligations was $147,533,770 (including the 2012A Subordinated Bonds and $11,563,770 aggregate principal amount Subordinate SRF Loan (which Subordinate SRF Loan will be refunded with proceeds of the 2016B Bonds) payable from Net System Revenues on parity with the Net System Revenues securing the Subordinated Obligations including the 2016 Bonds). See a description of the City's Water Utility Fund long-term debt as of June 30, 2015, as presented in Note 6 to the City's CAFR for Fiscal Year 2015, which is available through EMMA, and is incorporated by reference in this Official Statement. See "FINANCIAL STATEMENTS" herein.

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**TABLE 20**
**OUTSTANDING DEBT**
**As of April 30, 2016**

| Series | Final Maturity | Outstanding Principal Amount |
|---|---|---|
| Senior Obligations: | | |
| 2009A Bonds [1] | August 1, 2038 | $148,055,000 |
| 2009B Bonds [1] | August 1, 2039 | 293,925,000 |
| 2010A Bonds [1] | August 1, 2028 | 123,075,000 |
| Total Senior Bonds [1] | | $565,055,000 |
| Senior SRF Loans: | | |
| Miramar Water Treatment Plant | July 1, 2031 | $ 16,262,969 |
| Alvarado Water Treatment Plant | July 1, 2031 | 9,758,739 |
| Otay Water Treatment Plant | July 1, 2032 | 15,078,286 |
| Harbor Drive Pipeline Replacement | July 1, 2033 | 9,508,887 |
| Lindbergh Field Pipeline Replacement | July 1, 2033 | 2,956,811 |
| Total Senior SRF Loans | | $ 53,565,692 |
| **Total Senior Obligations** [1] | | **$618,620,692** |
| **Subordinated Obligations:** | | |
| 2012A Subordinated Bonds | August 1, 2032 | $135,970,000 |
| Earl Thomas Reservoir SRF Loan [2] | July 1, 2025 | 11,563,770 |
| **Total Subordinated Obligations** | | **$147,533,770** |
| **Total Senior and Subordinated Outstanding Obligations**[1][2][3] | | **$766,154,462** |

(1) The City is refunding all or portions of the outstanding 2009A Bonds, 2009B Bonds, and 2010A Bonds. Amounts shown are prior to the refunding and defeasance of the Refunded Bonds. See "PLAN OF FINANCE – The Refunding Plan."

(2) The Subordinate SRF Loan is being current refunded by the 2016B Bonds. Amounts shown do not reflect such refunding. See "PLAN OF FINANCE – The Refunding Plan."

(3) Does not include the Department's payment obligations under the Equipment Lease, which is not secured by a pledge of or lien on Net System Revenues and therefore are neither a Senior Obligation nor a Subordinated Obligation.

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

The City has no general obligation bonds outstanding (for water purposes or otherwise) and has no immediate plans to issue such indebtedness. Pursuant to Section 90 of the City Charter, general obligation bonded indebtedness for the development, conservation, and furnishing of water shall not exceed 15% of the last preceding assessed valuation of all real and personal property of the City subject to direct taxation. See "WATER SYSTEM CAPITAL IMPROVEMENT PROGRAM – Financing Plans for the CIP."

**Anticipated Additional Obligations**

Pursuant to the Master Installment Purchase Agreement, the City may incur additional obligations, payments with respect to which will be senior to, or on parity with, the City's obligation to make 2016 Subordinated Installment Payments, subject to satisfaction of the conditions specified in the Master Installment Purchase Agreement. Table 11 sets forth the projected sources and uses of funds for the Water System CIP for Fiscal Years 2016 through 2020.

The City anticipates issuing additional debt in Fiscal Years 2017 through 2020 to finance the costs of certain projects in the CIP in the approximate amount of $624.5 million through a combination of SRF loans, revenue bonds, and commercial paper. The expected receipt of the additional SRF loan

proceeds and bond funds are included in the City's Financial Rate Model. Proceeds from the additional SRF loans will provide funding in Fiscal Years 2017 through 2020, with interest only repayment projected to begin in Fiscal Year 2017 until construction completion of the projects, which vary from Fiscal Year 2016 to Fiscal Year 2023. As specified by the State, any additional SRF loans will be considered senior liens, payable on parity with the Net System Revenues securing the Senior Obligations. The lien status of future obligations payable from System Revenues is yet to be determined.

See "SECURITY AND SOURCES OF PAYMENT FOR THE 2016 BONDS – Issuance of Additional Obligations Under the Master Installment Purchase Agreement" and "WATER SYSTEM CAPITAL IMPROVEMENT PROGRAM – Financing Plans for the CIP."

**Labor Relations**

*Unless otherwise indicated, the information under this heading "Labor Relations" is a discussion of labor relations for all employees of the City.*

***General.*** The table below shows the City's several recognized employee bargaining organizations which represent City employees. Certain classified and unclassified City employees are unrepresented.

**The City's Employee Organizations**

| Organization[1] | Represented Employees[3] |
|---|---|
| San Diego Municipal Employees' Association ("MEA") | 5,056 |
| American Federation of State, County, and Municipal Employees, Local 127 ("AFSCME Local 127") | 2,087 |
| San Diego Police Officers Association ("POA") | 2,032 |
| San Diego City Firefighters, International Association of Firefighters, Local 145 ("IAFF Local 145") | 939 |
| California Teamsters Local 911 ("Teamsters Local 911") | 168 |
| Deputy City Attorneys Association ("DCAA")[2] | 150 |

(1) Represents classified employees, except where otherwise noted.
(2) Represents unclassified deputy city attorneys.
(3) As of the City's Fiscal Year 2017 Proposed Budget.
Source: Fiscal Year 2017 Proposed Budget, Financial Management, City of San Diego

As provided in the Fiscal Year 2017 Proposed Budget, there are approximately 782 regular full time employees of the Department (Water Branch), of which approximately 422 are represented by the MEA, and approximately 303 are represented by AFSCME Local 127. The remaining employees are unrepresented.

***Collective Bargaining Agreements***. In 2013, the City entered into a collective bargaining agreement with each of its recognized employee organizations, for a five-year term, from July 1, 2013 through June 30, 2018. Each agreement includes terms consistent with Proposition B, an initiative approved by City voters in June 2012 to reform the City's retirement system. Under Proposition B, and specifically Charter section 70.2, the City must comply with certain procedural requirements, from July 20, 2012, the effective date of Proposition B through June 30, 2018, if it intends to negotiate increases to

pensionable pay. The City Council must obtain an actuarial analysis from its retirement system actuary that discloses the impact of any proposed pay increases and must approve any negotiated increases by a two-thirds vote of the City Council. The City and each recognized employee organization agreed that they would not negotiate any general salary increases, which are pensionable, during the five-year period covered by Charter section 70.2. However, individual employees may still receive merit increases or promotions within the parameters of the Fiscal Year 2011 salary schedules. In exchange for the agreement to limit pensionable pay of employees during this five-year period, the City agreed to increases in non-pensionable pay. Each of the collective bargaining agreements includes non-pensionable pay increases in Fiscal Year 2016, with reopeners in Fiscal Years 2017 and 2018 to meet and confer solely regarding increases to non-pensionable compensation. Flexible benefit credits are non-pensionable. Each collective bargaining agreement remains in effect through June 30, 2018; however, the City and POA have negotiated a successor collective bargaining agreement which was approved by the City Council to amend the agreement for a term from July 1, 2015 through June 30, 2020. In addition, the City and MEA negotiated a successor collective bargaining agreement, which was approved by City Council on December 8, 2015 and will go into effect for a new term from July 1, 2016 through June 30, 2020. Likewise, on or about April 22, 2016, the City reached tentative agreements on successor collective bargaining agreements with AFSCME Local 127, DCAA and Teamsters Local 911, which if ratified by the membership of their respective recognized employee organizations and approved by City Council in June 2016, they will go into effect for a new term from July 1, 2016 through June 30, 2020 (except DCAA will be from July 1, 2016 through June 30, 2019).

*MEA*: In 2015, the City and MEA mutually agreed to reopen negotiations to meet and confer on terms for Fiscal Years 2017 through 2020. The City and MEA have negotiated a successor collective bargaining agreement for a new term from July 1, 2016 through June 30, 2020. MEA-represented employees will receive a 3.3% increase in pensionable compensation in Fiscal Year 2019 and a 3.3% increase in pensionable compensation in Fiscal Year 2020. In addition, effective in Fiscal Year 2019 there will be special salary adjustments ranging from 5% to 7% for certain classifications experiencing recruitment and retention issues. The agreement also contains non-pensionable compensation increases in Fiscal Years 2017 through 2020.

*AFSCME Local 127*: In 2016, the City and AFSCME Local 127 mutually agreed to reopen negotiations to meet and confer on terms for Fiscal Years 2017 through 2020. The City and AFSCME Local 127 have reached a 4 year tentative agreement as of April 22, 2016. If the tentative agreement is ratified by the membership of the recognized employee organization and approved by Council, then the new term of the successor collective bargaining agreement will be from July 1, 2016 through June 30, 2020. AFSME Local 127-represented employees will receive a 3.3% general salary increase in pensionable compensation in Fiscal Years 2019 and 2020. In addition, effective in Fiscal Year 2019 there will be special salary adjustments ranging from 5% to 10% for certain classifications experiencing recruitment and retention issues. The tentative agreement also contains non-pensionable compensation increases in Fiscal Years 2017 through 2020.

*POA*: In 2014, the City and POA mutually agreed to reopen negotiations to meet and confer on terms for Fiscal Years 2016 through 2020. The City and POA have agreed to amend the collective bargaining agreement for a new term from July 1, 2015 through June 30, 2020. POA-represented employees will receive a 3.3% general salary increase in pensionable compensation in Fiscal Years 2019 and 2020. The agreement also contains non-pensionable compensation increases in Fiscal Years 2016 through 2020. The non-pensionable compensation includes increases to flexible benefit credits for all POA-represented employees with additional credits for employees with eight or more years of service. Employees with eight or more years of service will also receive increases to annual uniform and equipment allowances, as will new recruits. Employees will also receive up to 40 hours of discretionary leave for full-time employees with proportionally reduced hours for part-time employees.

*IAFF Local 145*: IAFF Local 145-represented employees received increased annual flexible benefit credits in Fiscal Year 2016. The City and IAFF Local 145 are currently in negotiations solely for the purpose to meet and confer upon non-pensionable compensation increases in Fiscal Year 2017. In addition, IAFF Local 145 will have the option to reopen negotiations solely for the purpose to meet and confer upon non-pensionable compensation increases in Fiscal Year 2018.

*Teamsters Local 911*: In 2016, the City and Teamsters Local 911 mutually agreed to reopen negotiations to meet and confer on terms for Fiscal Years 2017 through 2020. The City and Teamsters Local 911 have reached a 4 year tentative agreement as of April 22, 2016. If the tentative agreement is ratified by the membership of the recognized employee organization and approved by Council, then the new term of the successor collective bargaining agreement will be from July 1, 2016 through June 30, 2020. Teamsters Local 911-represented employees will receive a 3.3% general salary increase in pensionable compensation in Fiscal Years 2019 and 2020. In addition, beginning in Fiscal Year 2019 the specialty pays will be provided for participation on specialty teams or special assignments. The tentative agreement also contains non-pensionable compensation increases in Fiscal Years 2017 through 2020.

*DCAA*: In 2016, the City and DCAA mutually agreed to reopen negotiations to meet and confer on terms for Fiscal Years 2017 through 2019. The City and DCAA have reached a 3 year tentative agreement as of April 21, 2016. If the tentative agreement is ratified by the membership of the recognized employee organization and approved by Council, then the new term of the successor collective bargaining agreement will be from July 1, 2016 through June 30, 2019. DCAA-represented employees will receive a 3.3% general salary increase in pensionable compensation in Fiscal Year 2019. In addition, effective in Fiscal Year 2019 there will be special salary adjustments ranging from 2% to 3% for Deputy II, IV and V due to recruitment and retention issues. The tentative agreement also contains non-pensionable compensation increases in Fiscal Years 2017 through 2019.

**Insurance and Liability Claims**

The City is self-insured for workers' compensation and long-term disability and for public liability claims exposure up to $3 million per occurrence. For liability between $3 million and $50 million, the Department is covered by the City, which purchases insurance in collaboration with the CSAC-EIA, a statewide joint powers authority risk pool, in layers for its public liability exposure.

***Property and Flood Insurance***. The City participates in the joint purchase of property insurance and flood insurance through the CSAC-EIA pool (policy term March 31, 2016 through March 31, 2017), which includes flood and earthquake coverage for scheduled locations, including bond financed locations of the Water System. The City is not required to provide flood insurance for other City property, and in its discretion, may elect to modify the designation of covered properties in the future.

This joint purchase of the City's "all risk" property insurance, insuring approximately $4.6 billion of City property, provides coverage for loss to City property under the primary policy up to approximately $25 million per occurrence, with a $25,000 deductible. Additional excess limits are available as part of the City's insurance property program through CSAC-EIA where coverage "towers" with designated coverage limits are provided. Coverage towers are groups of properties, which are diversified based on ownership (risk-pool members) and geographical location. The City participates in four coverage towers with dedicated coverage limits of $300 million for "All Risk" and Flood. Additional rooftop limits of $300 million for "All Risk" and $250 million for Flood may be accessible. There is no sharing of limits among the City and member counties of the CSAC-EIA pool, unless the City and member counties are mutually subject to losses due to the same occurrence. Limits and coverage may be adjusted periodically in response to requirements of bond financed projects, acquisitions, and in

response to changes in the insurance marketplace. The City can give no assurance that any future losses will be covered or that its insurance provider will be able to cover any such losses.

***Earthquake Insurance***. CSAC-EIA's insurance property program structure of dedicated tower limits applies also to Earthquake coverage. The City participates in four coverage towers. Earthquake coverage is provided for designated buildings/structures in the amount of $100 million under primary policies per tower, and additional excess rooftop limits of $415 million may be accessed. The earthquake coverage is subject to a 2% of total insured values deductible per unit per occurrence, subject to a minimum of $100,000, and a maximum of $100 million effective through March 31, 2017. The City's earthquake coverage is purchased jointly and limits are 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 earthquake. Depending on the availability and affordability of 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. Depending on availability and affordability of earthquake insurance, the City may elect not to purchase such coverage in the future.

See Note 14 "– RISK MANAGEMENT" contained in the City's CAFR for Fiscal Year 2015, which is available through EMMA, are incorporated by reference in this Official Statement, for additional information on the City's insurance coverages. See "FINANCIAL STATEMENTS" herein.

For a discussion of insurance for the Water System, see "WATER SYSTEM SERVICE AREA AND FACILITIES – Insurance for the Water System" in the front part of this Official Statement.

The following table sets forth the liabilities claims budget and expenditures for liability claims of the Water System for Fiscal Years 2011 through 2015.

**TABLE 21**
**WATER UTILITY FUND LIABILITY CLAIMS BUDGET AND EXPENDITURES**
**Fiscal Years 2011 through 2015**
**(Unaudited)**

| Fiscal Year | Budget | Expenditures[1] |
|---|---|---|
| 2011 | $1,402,805 | $2,587,932 |
| 2012 | 1,295,600 | 1,844,669 |
| 2013 | 1,295,600 | 1,971,461 |
| 2014 | 1,295,600 | 4,386,039 |
| 2015 | 1,295,600 | 4,554,115 |

(1) Over-budget expenditures are paid from the Water Utility Fund balance available for appropriations.
Source: Public Utilities Department and Risk Management Department, City of San Diego

## Investment of Funds

***General***. Amounts in the funds and accounts of the Water Utility Fund are invested by the City Treasurer in the City Treasurer's Pooled Investment Fund (the "City Pool") described below. 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 participants either voluntary or involuntary in the City Pool. The investment objectives of the City Pool are preservation of capital, liquidity and return.

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

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

***Authorized Investments***. Investments in the City Pool are governed by State law and further restricted by the City Treasurer's Investment Policy. The Investment Policy is prepared with safety of principal being the foremost objective. Permitted investments include, but not limited to, U.S. Treasury securities, U.S. Agency securities, U.S. Agency mortgage backed securities, corporate medium term notes, money market instruments, non-negotiable Federal Deposit Insurance Corporation-insured certificates of deposit and the Local Agency Investment Fund (California State Pool). Reverse repurchase agreements ("reverse repos") and securities lending arrangements 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, the Liquidity and Core portfolios. In its management of the "Liquidity" portfolio, comprising approximately 35% of total funds, the City invests in a variety of debt securities with maturities typically ranging from one day to one year; performance is measured against the Bank of America Merrill Lynch three-to-six month Treasury Bill Index. The remaining 65% of funds are managed in a separate "Core" portfolio that consists of a variety of debt securities ranging from one day to five years; performance is measured against the Bank of America Merrill Lynch one- to three-year U.S. Treasury Index. The 35% Liquidity/65% Core portfolio split serves as a guideline. The actual split may vary due to market conditions or other factors. Safety of principal and liquidity are paramount considerations in the management of both portfolios.

***Pool Liquidity and Other Characteristics***. The City Pool (including both the "Liquidity" and the "Core" portfolios) is highly liquid. Based on unaudited month-end data as of March 31, 2016, approximately 7% of the City Pool's investments mature within 62 days, 10% within 92 days, 30% within 184 days, 40% within 1 year, 75% within 2 years, 97% within 3 years, and 100% within 5 years (on a cumulative basis). As of March 31, 2016, the City Pool had a weighted average maturity of 1.35 years (492 days) and its weighted average yield was 0.82%. 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 0.31 years and the Core portfolio had a duration of 1.68 years as of March 31, 2016. 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 0.31% for every 1% increase in market interest rates while the Core portfolio should decrease in market value by 1.68% 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.

The following table sets forth the investments in the City Pool as of March 31, 2016.

**TABLE 22**
**CITY OF SAN DIEGO POOLED INVESTMENT FUND**
**at March 31, 2016**
**($ Amounts in Thousands)**
**(unaudited)**

| Investment Instrument | Book Value | Fair Value | Percent of Total[1] |
|---|---|---|---|
| U.S. Treasury Notes | $ 849,451 | $ 852,524 | 38.50% |
| Agency Discount Notes | 289,161 | 289,566 | 13.11 |
| Agency Notes & Bonds | 444,839 | 445,732 | 20.16 |
| Supranationals[2] | 84,809 | 85,198 | 3.84 |
| Commercial Paper | 49,805 | 49,939 | 2.26 |
| Corporate Notes & Bonds | 154,637 | 155,628 | 7.01 |
| Local Agency Investment Fund | 60,004 | 60,004 | 2.72 |
| Negotiable Certificates of Deposit | 200,001 | 200,105 | 9.07 |
| Asset Backed Securities | 73,529 | 73,566 | 3.33 |
| **TOTAL INVESTMENTS[3]** | **$2,206,236** | **$2,212,262** | **100.00%** |

(1) Based on book value.
(2) Supranationals are entities formed by two or more central governments through international treaties. Examples are the International Bank for Reconstruction and Development and the Inter-American Development Bank.
(3) Approximately 8% of the City Pool is allocable to the Water Utility Fund.
Source: Office of the City Treasurer and Office of the Comptroller (for footnote 3), City of San Diego.

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

**San Diego City Employees' Retirement System**

*Unless otherwise indicated, the information under this heading "San Diego City Employees' Retirement System" is a discussion of the San Diego City Employees' Retirement System as it relates to all employees of the City.*

***General.*** The City faces significant financial challenges in addressing an unfunded pension liability to the San Diego City Employees' Retirement System ("SDCERS"), which, as of June 30, 2015, was approximately $2.00 billion. However, as explained below under the caption, "City and Water Utility Fund Pension Contributions," the Water Utility Fund's proportionate share of the City's actuarially determined contribution to SDCERS is approximately 5.4% (equal to approximately $13.8 million, assuming a City pension payment of $254.9 million) for Fiscal Year 2016.

SDCERS is a public employee retirement system established in Fiscal Year 1927 by the City. SDCERS administers independent, qualified, single employer governmental defined benefit plans and trusts for the City, the San Diego Unified Port District (the "Port") and the San Diego County Regional

Airport Authority (the "Airport"). The assets of the three separate plans and trusts are pooled in the SDCERS Group Trust for investment purposes. These plans are administered by the SDCERS Board to provide retirement, disability, death and survivor benefits for its members. Amendments to the City's benefit provisions require City Council approval and amendments to retirement benefits require a majority vote by those SDCERS members who are also eligible City employees or retirees. Benefit increases also require a majority vote of the public. All approved benefit changes are codified in the City's Municipal Code. The plans cover all eligible employees of the City, the Port, and the Airport. All City employees initially hired before July 20, 2012 working half-time or greater, all sworn police officers of the City irrespective of hire date, and full-time employees of the Port and the Airport are eligible for membership and are required to join SDCERS.

Due to the implementation of Proposition B, discussed below, as of July 20, 2012, SDCERS is closed to new City employees, except for the Police plan, which will remain open. SDCERS is considered part of the City's financial reporting entity and is included in the City's Comprehensive Annual Financial Report as a pension trust fund. See Note 11, "PENSION PLANS" in the City's CAFR for Fiscal Year 2015, which is available through EMMA, and is incorporated by reference in this Official Statement. See "FINANCIAL STATEMENTS" herein. SDCERS also prepares its own Comprehensive Annual Financial Report, the most recent of which is for Fiscal Year 2015.

The amounts and percentages set forth under this caption relating to SDCERS, including, for example, actuarial accrued liabilities and funded ratios, are based upon numerous demographic and economic assumptions, including investment return rates, inflation rates, salary increase rates, cost of living adjustments, postemployment mortality, active member mortality, and rates of retirement. Prospective purchasers of the 2016 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 2016 Bonds are cautioned that such sources and the underlying assumptions speak as of their respective dates, and are subject to change. Prospective purchasers of the 2016 Bonds should also be aware that some of the information presented under this caption contains forward-looking statements and the actual results of the pension system may differ materially from the information presented herein.

The information disclosed herein relates solely to the City's participation in SDCERS and not to the participation of the Airport or the Port. City employment classes participating in the City's defined benefit plan are elected officers, general employees and safety employees (including police, fire and lifeguard members). These classes are represented by various unions depending on the type and nature of work performed, except for elected officials, unclassified and unrepresented employees.

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**TABLE 23**
**CITY OF SAN DIEGO PLAN MEMBERSHIP**
**as of June 30, 2015**

| | General | Safety | Total by Classification |
|---|---|---|---|
| Active Members | 4,870 | 2,180 | 7,050 |
| Inactive Members | 2,329 | 569 | 2,898 |
| Retirees | 4,861 | 3,111 | 7,972 |
| DROP Participants[(1)] | 696 | 435 | 1,131 |
| Total Members | 12,756 | 6,295 | 19,051 |

(1) Participants in the Deferred Retirement Option Plan ("DROP") no longer accrue service credits and do not make contributions to SDCERS. They continue to work for the City and contribute 3.05% of their salary, with an employer match, into a personal DROP account. Their service retirement benefit is also deposited into their DROP account and they must retire within five years of entering DROP. Employees hired after June 30, 2005 are ineligible for DROP.

Source: SDCERS Comprehensive Annual Financial Report for Fiscal Year 2015.

The City is required to make contributions to the pension system as determined by the SDCERS Board. Pension contributions are authorized and appropriated annually in accordance with the adoption of the City's annual budget. The City's Actuarially Determined Contribution ("ADC")[1] is calculated by the SDCERS' actuary, Cheiron, Inc. ("Cheiron") and approved by the SDCERS Board. Cheiron conducts an actuarial analysis for SDCERS annually, the most recent of which is the June 30, 2015 Annual Actuarial Valuation of SDCERS, dated February 26, 2016 (the "2015 Actuarial Valuation"). The 2015 Actuarial Valuation serves as the basis for the City's pension contribution for Fiscal Year 2017. The City's actual annual pension contribution may differ from the ADC based on a number of factors discussed below, but the pension contribution is not expected to be less than the ADC in any Fiscal Year.

***Actuarial Assumptions and Methods.***

***Funding Method.*** Cheiron calculates the City's contribution using the Entry Age Normal ("EAN") actuarial funding method. Under EAN, there are two components to the total contribution: the normal cost and an amortization payment on any unfunded actuarially accrued liability ("UAAL"). Beginning in Fiscal Year 2016, a third component was added representing a portion of SDCERS expected administrative expenses, as discussed below. The normal cost (associated with active employees only) is the present value of the benefits that SDCERS expects to become payable in the future attributable to the current year's employment. Normal cost is computed as the level annual percentage of pay required to fund the retirement benefits between each member's date of hire and assumed retirement. The difference between the EAN actuarial liability and the actuarial value of assets is the UAAL.

***Amortization Periods and Methodology.*** The UAAL as of June 30, 2015 for the Police portion of SDCERS is amortized over several different closed periods as follows: changes in the UAAL due to changes in methods and assumptions are amortized over 30 years, changes in the UAAL due to benefit changes are amortized over five years, the outstanding balance of the Fiscal Year 2007 UAAL is

[1] Actuarially Determined Contribution ("ADC") has replaced the Annual Required Contribution ("ARC") as the funding policy for SDCERS. This change, in accordance with GASB 67, was approved by the SDCERS Board in November 2013. This action formalized a funding policy that is based on the existing practices formerly used to develop the ARC, which are described above under the caption "Funding Method."

amortized over a closed 20 year period (such that, as of Fiscal Year 2016, 12 years of amortization remain), and subsequent yearly experience gains and losses are amortized over 15 years. As a result of Proposition B and in compliance with then-current Governmental Accounting Standards Board ("GASB") standards, the non-Police portion of UAAL is amortized over 15 years. Finally, if necessary, there is an additional UAAL cost component to ensure that there is no negative amortization in any year. Also as a result of Proposition B, the non-Police portion of the UAAL is amortized using the level dollar method while the Police portion is amortized using the level percentage of payroll method. Level dollar amortization generally results in decreasing inflation-adjusted payments over time whereas level percentage of payroll amortization generally results in level inflation-adjusted payments over time.

In January 2015, the SDCERS Board voted to account for expected administrative expenses explicitly as a cost component in the ADC. Expected administrative expenses are $12.8 million in Fiscal Year 2017 and increase by 2.5% annually. The expected administrative expense cost is phased into the ADC over three years such that two-thirds of the cost, $8.8 million, was added to the ADC for Fiscal Year 2017, and beginning in Fiscal Year 2018 100% of expected administrative expenses will be added to the ADC.

***Actuarial Assumptions.*** The following are the principal actuarial assumptions used by Cheiron in preparing the 2015 Actuarial Valuation. The actuarial assumptions reflect recommendations approved by the SDCERS Board in November 2015. As noted below, the SDCERS Board also approved certain changes to be used for the SDCERS Actuarial Valuation of SDCERS as of June 30, 2016 (the "2016 Actuarial Valuation").

1. Investment Return Rate: 7.125% per year, net of investment expenses. The investment return rate is scheduled to decrease to 7% for the 2016 Actuarial Valuation.

2. Inflation Rate: 3.175% per year, compounded annually. The inflation rate is scheduled to decrease to 3.05% for the 2016 Actuarial Valuation.

3. Administrative Expense Assumption: Administrative expenses are assumed to be $12.8 million for Fiscal Year 2017, increasing by 2.5% annually. Of this amount, two-thirds, or $8.8 million, has been included in the Fiscal Year 2017 ADC. For Fiscal Year 2018 and for all fiscal years following, 100% of the expected administrative expenses will be added to the ADC.

4. Interest Credited to Member Contributions: 7.125% compounded annually.

5. Projected Salary Increases Due to Inflation: 0% in Fiscal Years 2015-2018, 3.175% thereafter.

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

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

***Actuarial Value of Assets (Asset Smoothing Method).*** SDCERS uses an actuarial value of assets to calculate the City's pension contribution each year and uses an asset smoothing method to dampen the volatility in asset values that could occur because of fluctuations in market conditions. Use of an asset

smoothing method is consistent with the long-term nature of the actuarial valuation process. The actuarial value of assets each year is equal to 100% of the expected actuarial value of assets[2] plus 25% of the difference between the current market value of assets and the expected actuarial value of assets. The market value of assets represents, as of the valuation date, the value of the assets as if they were liquidated on that date. This means that changes in the market value of assets are factored into the actuarial value of assets roughly over a four year period. The actuarial value of assets will also be adjusted, if necessary, to ensure that the actuarial value of assets will never be less than 80% of the market value of assets, nor greater than 120% of the market value of assets. The consequence of the smoothing methodology is that the actuarial value of assets increased by 6.4%, while the market value of assets increased by 1.5% from June 30, 2014 to June 30, 2015. As of June 30, 2015, the market value of plan assets was approximately $6.388 billion, and the actuarial value was approximately $6.204 billion.

***Implementation of GASB Statements Nos. 67 and 68.*** In Fiscal Year 2014, GASB Statement No. 67 ("GASB 67"), which applies to pension plans, replaced GASB Statement No. 25, and in Fiscal Year 2015, GASB Statement Nos. 68 and 71 ("GASB 68 and 71"), which applies to plan sponsors, replaced the current GASB Statement No. 27 ("GASB 27"). GASB 67 is intended to enhance note disclosures and schedules of required supplementary information that will be presented by pension plans in their audited financial statements. GASB 67 was implemented by SDCERS in Fiscal Year 2014. The 2015 Actuarial Valuation reflects the funding policy adopted by SDCERS to calculate the ADC. This funding policy requires the ADC to be calculated in the same manner previously used to calculate the City's annual required contribution ("ARC").

The City implemented GASB 68 and 71 in Fiscal Year 2015. This resulted in significant financial accounting and reporting changes to the City's financial statements. The most significant change stems from the requirement that the City record, in its Statement of Net Position, the Net Pension Liability ("NPL") related to defined benefit retirement plans offered to City employees. The NPL represents the difference between the Total Pension Liability and the fair value of pension assets. The City elected to use Fiscal Year 2014 as its measurement date, which means that the NPL reported in the City's CAFR for Fiscal Year 2015, which is available through EMMA, is based on the fair value of pension assets as of June 30, 2014 and the Total Pension Liability as of the valuation date, June 30, 2013, updated to June 30, 2014. GASB 68 and 71 also require that certain pension related inflows and outflows be deferred and recognized in subsequent periods. The GASB 67/68 Report as of June 30, 2014, which was prepared by Cheiron, reported an NPL of $1.535 billion, of which $96.9 million was allocated to the Water Utility Fund. The NPL as of June 30, 2014 is included in the City's CAFR for Fiscal Year 2015. The GASB 67/68 Report as of June 30, 2015, which was also prepared by Cheiron, reported an NPL of $1.714 billion, of which approximately $110.6 million is anticipated to be allocated to the Water Utility Fund. The NPL as of June 30, 2015 will be included in the City's Comprehensive Annual Financial Report for the Fiscal Year ending June 30, 2016. See Table 25 for the Water System's share of the ADC from Fiscal Years 2012 through 2016.

The measurement of the NPL for Fiscal Years 2015 and 2016 assumes a long-term expected rate of return of plan investments of 7.25% (the "Discount Rate"). A change in the assumed Discount Rate would have a significant effect on the measurement of the NPL. For Fiscal Year 2016, a 1% decrease in the assumed Discount Rate to 6.25% would increase the NPL by $899 million, or 52%; and a 1% increase in the assumed Discount Rate to 8.25% would decrease the NPL by $747 million, or 44%. The investment return rate was assumed to be 7.125% for the 2015 Actuarial Valuation and is scheduled to

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

decrease to 7% for the 2016 Actuarial Valuation, both which rates are lower than the 7.25% Discount Rate used to calculate the NPL for Fiscal Year 2016. Any increase or decrease to the City's NPL would have a corresponding increase or decrease to the amount allocated to the Water Utility Fund.

***Funding Status.*** According to the 2015 Actuarial Valuation, at June 30, 2015, the City had a UAAL of $2.001 billion and a funded ratio, based on the actuarial value of assets, of 75.6%. The UAAL decreased by $28.4 million over the UAAL set forth in the June 30, 2014 Actuarial Valuation of SDCERS, dated February 26, 2015 ("2014 Actuarial Valuation"), which was $2.030 billion, and the funded ratio increased by 1.4%. The UAAL in the 2015 Actuarial Valuation was expected to decline by $198.3 million compared to the UAAL in the 2014 Actuarial Valuation. The smaller than expected decrease was primarily a result of the net impact of reducing the investment rate of return and wage inflation rate assumptions ($95.8 million) and the return on the market value of assets being less than expected ($51.4 million). There was also an actuarial loss of $25.7 million with the largest source being mortality (members living longer than expected).

The following table sets forth the City's portion of SDCERS historical funding progress for Fiscal Years 2006 through 2015. Additionally, see Note 11, "PENSION PLANS" in the City's CAFR for Fiscal Year 2015, which is available through EMMA, and are incorporated by reference in this Official Statement. See "FINANCIAL STATEMENTS" herein.

**TABLE 24**
**CITY OF SAN DIEGO**
**SCHEDULE OF FUNDING PROGRESS**
**Fiscal Years 2006 through 2015**
**($ Amounts in Thousands)**
**(Unaudited)**

| Valuation Date (June 30) | Actuarial Value of Assets (A) | Market Value of Assets (B) | AAL (C) | Funded Ratio (Actuarial) | Funded Ratio (Market) | UAAL (Actuarial) (C) – (A) | AAL Less Market Value of Assets (C) – (B) | Covered Payroll[1] | UAAL to Covered Payroll |
|---|---|---|---|---|---|---|---|---|---|
| 2006[2] | $3,981,932 | $3,981,932 | $4,982,699 | 79.9% | 79.9% | $1,000,767 | $1,000,767 | $534,103 | 187.4% |
| 2007[3] | 4,413,411 | 4,641,341 | 5,597,653 | 78.8 | 82.9 | 1,184,242 | 956,312 | 512,440 | 231.1 |
| 2008[4] | 4,660,346 | 4,408,719 | 5,963,549 | 78.1 | 73.9 | 1,303,203 | 1,554,830 | 535,774 | 243.2 |
| 2009 | 4,175,229 | 3,479,357 | 6,281,636 | 66.5 | 55.4 | 2,106,408 | 2,802,279 | 536,591 | 392.6 |
| 2010 | 4,382,047 | 3,900,537 | 6,527,224 | 67.1 | 59.8 | 2,145,177 | 2,626,687 | 530,238 | 404.6 |
| 2011[4] | 4,739,399 | 4,848,054 | 6,917,175 | 68.5 | 70.1 | 2,177,776 | 2,069,121 | 514,265 | 423.5 |
| 2012 | 4,982,442 | 4,799,827 | 7,261,731 | 68.6 | 66.1 | 2,279,289 | 2,461,904 | 511,091 | 446.0 |
| 2013[5] | 5,317,778 | 5,395,158 | 7,555,527 | 70.4 | 71.4 | 2,237,749 | 2,160,369 | 499,463 | 448.0 |
| 2014 | 5,828,594 | 6,292,855 | 7,858,703 | 74.2 | 80.1 | 2,030,110 | 1,565,848 | 480,536 | 422.5 |
| 2015[6] | 6,204,244 | 6,387,829 | 8,205,953 | 75.6 | 77.8 | 2,001,709 | 1,818,124 | 480,662 | 416.4 |

(1) Covered payroll includes all elements of compensation paid to active City employees (who are in the SDCERS defined benefit plan) on which contributions to the pension plan are based.

(2) Reflects revised actuarial methodologies.

(3) Reflects revised actuarial assumptions, including the return to EAN actuarial funding method.

(4) Reflects revised actuarial methodologies and assumptions.

(5) Reflects revised actuarial assumptions.

(6) Reflects revised actuarial methodologies and assumptions. Current year methodologies and assumptions are discussed above. Methodologies and assumptions were not changed from 2013 to 2014.

Source: SDCERS Comprehensive Annual Financial Report for Fiscal Year 2015 for Actuarial Value of Assets, AAL, Funded Ratio (Actuarial), UAAL (Actuarial), Covered Payroll and UAAL to Covered Payroll (2006-2014); Cheiron Actuarial Valuations for Market Value of Assets (2006-2015), Funded Ratio (Market) and AAL Less Market Value of Assets (2011-2015) and Actuarial Value of Assets, AAL, Funded Ratio (Actuarial), UAAL (Actuarial) and Covered Payroll (2015); Office of the Comptroller, City of San Diego for Funded Ratio (Market) (2006-2010), AAL Less Market Value of Assets (2006-2010), and UAAL to Covered Payroll (2015).

***Preservation of Benefits Plan.*** The Preservation of Benefits ("POB") Plan is a qualified governmental excess benefit arrangement ("QEBA") under Internal Revenue Code ("IRC") section 415(m). The POB Plan allows for the payment of promised benefits that exceed IRC section 415(b) limits and therefore cannot be paid from SDCERS assets. The POB Plan is unfunded within the meaning of federal tax law and the City may not prefund the POB Plan to cover future liabilities. Because the POB Plan is not administered by a trust, GASB 27 remains applicable for accounting and disclosure purposes. Pursuant to GASB 27, Cheiron prepares an annual actuarial valuation ("POB Valuation") for the POB Plan. This valuation is separate from the actuarial valuation for the pension plan, and the POB ADC included in the POB Valuation is not used to calculate the City's POB contribution. Contributions to the POB Plan are funded annually on a pay-go basis by the City and the payments are calculated by Cheiron based on the amount of pension benefits earned in excess of the IRC Section 415(b) limit in any particular fiscal year. See Table 25 entitled "CITY OF SAN DIEGO AND WATER UTILITY FUND PENSION CONTRIBUTION" below. The actuarial liability for the POB Plan as of June 30, 2015, the most recent year for which the City has data, was $9.5 million, and this entire amount is unfunded.

***City and Water System Pension Contributions.*** The City's Pension Plan ADC for Fiscal Year 2016 is $254.9 million. The Water Utility Fund's proportional share of the ADC for Fiscal Year 2016 was $13.8 million. The 2015 Actuarial Valuation shows the City's Pension Plan ADC for Fiscal Year 2017 increasing to $261.1 million. Based on the Fiscal Year 2017 Proposed Budget, the ADC allocable to the Water Utility Fund is projected to be approximately $14.7 million.

The City's pension plan payment is typically made on July 1 of each Fiscal Year, including Fiscal Year 2016. POB Plan contributions are made on a monthly basis as payments are owed to beneficiaries.

The following sets forth the City's ADC and pension payments for Fiscal Years 2012 through 2016 (budgeted), as well as the amounts related specifically to the Water System. Prior to Fiscal Year 2014, in addition to the City contributions set forth in the table below, the City made certain pension contributions on behalf of certain employee groups. The City no longer pays any portion of employee pension contributions.

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**TABLE 25**
**CITY OF SAN DIEGO AND WATER UTILITY FUND**
**PENSION CONTRIBUTION**
**Fiscal Years 2012 through 2016**
**($ Amounts in Thousands)**
**(Unaudited)**

| Fiscal Year | Pension Plan ARC/ADC | POB Plan ARC | Total Plan ADC/ARC | Pension Plan Contribution | POB Plan Contribution | Total Pension Contribution[1] | Water System Contribution | Water System Contribution (% of O&M) |
|---|---|---|---|---|---|---|---|---|
| 2012 | $231,200 | $1,269 | $232,469 | $231,200 | $1,626 | $232,828 | $13,600 | 3.9% |
| 2013 | 231,100 | 1,314 | 232,414 | 231,100 | 1,572 | 232,672 | 13,619 | 3.6 |
| 2014 | 275,400 | 708 | 276,108 | 275,400 | 1,403 | 276,803 | 15,265 | 3.8 |
| 2015 | 263,600 | 876 | 264,476 | 263,600 | 1,399 | 264,999 | 16,907 | 3.9 |
| 2016[2] | 254,900 | 842 | 255,742 | 254,902 | 1,500 | 256,402 | 13,827 | 3.2 |

(1) Comprised of the pension plan contribution and the POB Plan contribution; may not sum due to rounding.

(2) Except for Pension Plan ARC/ADC all other amounts are budgeted.

Source: SDCERS Comprehensive Annual Financial Reports; Cheiron Actuarial Valuations for Pension Plan ARC/ADC; SDCERS for POB Plan ARC; Office of the Comptroller, City of San Diego for Total Plan ARC/ADC, Pension Plan Contribution, POB Plan Contribution, Total Pension Contribution, Water System Contribution (2012-2015); Financial Management, City of San Diego for Water System Contribution (2016).

***Prospective Funding Status.*** As part of its actuarial valuations for SDCERS, Cheiron prepares projected financial trends to show the City's expected cost progression. The following table uses the actuarial assumptions and methodologies discussed above, including the revised assumptions approved by the SDCERS Board on November 13, 2015 that were used for the 2015 Actuarial Valuation. The table also assumes the validity of Proposition B, which is discussed below. It is important to note that the table uses investment returns as assumed, 7.125% in Fiscal Year 2016 and 7% annually thereafter. These exact returns will not occur given the historical variability in annual investment returns. The City expects investment returns will vary, and may vary significantly from year to year, which will potentially result in greater volatility and higher (or lower) ADC payments than presented in the table.

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**TABLE 26**
**CITY OF SAN DIEGO**
**ACTUARIAL FUNDING PROJECTIONS**
**Fiscal Years 2016 through 2025**
**(earnings as assumed)**
**(Unaudited)**

| Fiscal Year | Assumed Investment Return Rate | Actuarially Determined Contribution ($ millions) | UAAL ($ billion) |
|---|---|---|---|
| 2016 | 7.125% | $254.9 | $2.03 |
| 2017 | 7.000 | 261.1 | 2.00 |
| 2018 | 7.000 | 267.9 | 1.99 |
| 2019 | 7.000 | 265.5 | 1.87 |
| 2020 | 7.000 | 263.8 | 1.74 |
| 2021 | 7.000 | 262.9 | 1.60 |
| 2022 | 7.000 | 262.5 | 1.47 |
| 2023 | 7.000 | 262.5 | 1.33 |
| 2024 | 7.000 | 263.0 | 1.18 |
| 2025 | 7.000 | 263.3 | 1.03 |

Source: Cheiron presentation to SDCERS Board, January 8, 2016.

***Supplemental COLA.*** On August 5, 2013, the City Council amended the San Diego Municipal Code to provide a method for funding for a supplemental cost-of-living benefit (the "Supplemental COLA") previously given to a closed group of retirees who retired on or before June 30, 1982. The Supplemental COLA was established in 2000 to increase retirement benefits up to a determined amount according to a formula in the Municipal Code. Pursuant to the Municipal Code, the funding for this benefit is an annual appropriation by the City, however, the City is not required to pay the benefit. The City is invoiced by SDCERS at the beginning of each fiscal year for the full cost of the benefit during that fiscal year. In Fiscal Year 2015, the cost of the benefit citywide was $2,060,000 and the Water Utility Fund share of this cost was $143,788. In Fiscal Year 2016, the cost of the benefit citywide was $2,076,000 and the Water Utility Fund share of this cost was approximately $148,526. SDCERS has estimated that, for Fiscal Year 2017, the cost of the benefit citywide will be approximately $2.1 million and the Water Utility Fund share of this cost will be approximately $148,097. SDCERS maintains Supplemental COLA funding separate from SDCERS assets and no system assets can be used to pay the benefit.

***Proposition B.*** Proposition B was approved by voters on June 5, 2012 and implemented by the City in Fiscal Year 2013. Generally, the measure amends the City Charter to provide all new City employees hired on or after July 20, 2012, except sworn police officers, with a 401(a) defined contribution plan instead of a defined benefit plan. The initiative contains other provisions intended to limit pension costs for existing employees by directing the City to seek, through labor negotiations, to limit City employees' compensation used to calculate pension benefits. Effective in Fiscal Year 2014, the City reached agreements with each employee organization that will freeze pensionable pay and cost of living increases for Fiscal Years 2014 through 2018. The labor agreements may be reopened at the option of employee organizations in Fiscal Years 2017 and 2018 for specified purposes not including pensionable pay increases. Each employee organization has exercised this option. See "– Labor Relations" above.

Proposition B is the subject of ongoing litigation before the California Public Employment Relations Board ("PERB"). The labor agreements discussed above are not being challenged as a part of this litigation and are not expected to be affected regardless of the outcome. On February 11, 2013, a PERB administrative law judge ("ALJ") issued a proposed decision finding that the City violated State labor laws by failing to meet and confer with City labor organizations prior to placing Proposition B on the ballot. The City filed exceptions to the proposed decision. On December 29, 2015, PERB issued Decision No. 2464 M (the "PERB Decision"), which affirmed and adopted the ALJ's proposed decision with minor modifications. On January 12, 2016, the City Council directed the City Attorney's Office to appeal the PERB Decision to the California Court of Appeal, Fourth Appellate District. On January 25, 2016, the City filed an appeal with the Court of Appeal. The litigation could potentially repeal or unwind the implementation of some or all of the requirements of Proposition B. Based on the analysis conducted by the SDCERS actuary of the employees hired after the effective date of Proposition B (July 20, 2012 to December 31, 2015), the liability for the employer's UAAL is estimated at $20.2 million as of the December 31, 2015 valuation date, subject to increase with the passage of time and the addition of affected employees. If the City did not contribute the $20.2 million to the pension system to reinstate the employees for this period, and SDCERS amortized the liability over 15 years with level dollar payments, the annual increase to the ADC would be approximately $8 million. (The Water Utility Fund's proportionate share of the City's actuarially determined contribution is approximately 5.4%). However, all actual outcomes are dependent on the negotiations with the employee organizations and actual financial impacts are unknown. Notwithstanding the PERB Decision and on-going litigation, the 2015 Actuarial Valuation assumes the validity of Proposition B, the City has fully implemented its requirements and the City intends to comply with those requirements under the terms specified in the initiative unless ordered otherwise by a court of law.

**Other Retirement Plans**

In addition to the defined benefit plan administered by SDCERS, the City offers various defined contribution plans to its employees that include employer contributions. In Fiscal Year 2015, the City contributed approximately $24.5 million as an employer match for the plans discussed below.

***Supplemental Pension Savings Plan.*** Pursuant to the City's withdrawal from the federal Social Security system, effective January 8, 1982, the City established its Supplemental Pension Savings Plan ("SPSP"). SPSP is a 401(a) plan. SPSP was previously available to General members, lifeguards and elected officers. SPSP was closed to new General members as of July 1, 2009, lifeguards as of January 1, 2011 and elected officers as of July 20, 2012.

SPSP requires both the City and the employee to contribute an amount equal to 3% of the employee's salary each pay period. Employees hired before July 1, 1986 may voluntarily contribute up to an additional 4.5% of salary and participants hired on or after July 1, 1986 may voluntarily contribute up to an additional 3.05% of salary. City contributions for employees vest at 20% per year and are fully vested after 5 years of employment. Employee mandatory and voluntary contributions have been made on a post-tax basis. Employee mandatory contributions on or after January 1, 2016 are made pre-tax. The voluntary contributions will remain post-tax. The City match has always been and will remain to be made as a pre-tax contribution.

***SPSP -H Plan.*** Pursuant to the City's withdrawal from the federal Social Security system, the City established the Supplemental Pension Savings Plan -H ("SPSP-H Plan") for hourly (no standard hour) employees. These employees contribute a mandatory 3.75%. All bargaining groups except MEA and Teamsters Local 911 have a City match equal to the employee contribution (3.75%). MEA and Teamsters Local 911 for Fiscal Year 2015 had an employer contribution of 4.25% and 6.0% for Fiscal Year 2016. All contributions are always 100% vested. Employee mandatory contributions on or before

December 31, 2015 are made post-tax. Employee mandatory contributions made on or after January 1, 2016 are made pre-tax and the City match remains pre-tax.

Pursuant to Proposition B, newly hired standard hourly employees hired on or after July 20, 2012, except sworn police officers, are not eligible to participate in SDCERS and are provided with a 401(a) plan that is administered along with the SPSP-H Plan but with different contribution rates and employer match. Non-public safety employees and elected officers contribute an amount equal to 9.2% of salary and firefighters, lifeguards, and police recruits contribute 11% of salary on a mandatory basis. The City matches all such contributions and contributions are fully vested immediately upon employment. Police recruits participate in SDCERS when they become sworn. All contributions are always 100% vested. Employee mandatory contributions on or before December 31, 2015 are made post-tax. Employee mandatory contributions on or after January 1, 2016 are made pre-tax and the City match remains pre-tax.

***2009 401(a) Plan***. The City established a separate 401(a) plan for General employees hired between July 1, 2009 and July 19, 2012. These employees are not eligible for SPSP-H but are SDCERS members. Employees contribute an amount equal to 1% of salary on a mandatory basis with a matching City contribution. Both employee and City match are made on a pre-tax basis. Voluntary contributions, made on a post-tax basis, are permitted up to IRS limits but there is no City match for voluntary contributions. All contributions are always 100% vested. The City also provides a variety of other tax advantaged retirement plans that are funded exclusively through employee contributions and do not require an employer match.

**Postemployment Healthcare Benefits**

*Unless otherwise indicated, the information under this heading "Postemployment Healthcare Benefits" is a discussion of the postemployment benefits provided to all employees of the City.*

***General.*** The only postemployment benefits provided by the City are retiree healthcare benefits, also known as other postemployment benefits ("OPEB"), to certain health-eligible retirees and employees through a variety of defined benefit and defined contribution plans. Plan determination is based on several factors including hire date, termination date and individual employee election. Effective April 1, 2012, pursuant to the memoranda of understanding described below ("PEHB MOU"), OPEB benefits were modified and a significant group of participants opted out of the defined benefit plan and into a defined contribution plan. Accordingly, those participants have been removed from the GASB Statement No. 45 ("GASB 45") valuation information below because they no longer represent a GASB 45 liability. The City's defined benefit OPEB plan ("DB OPEB Plan") includes 6,103 retirees, and 1,334 active employees as of June 30, 2015. All other health-eligible employees, former employees and retirees are now participating in the defined contribution retiree healthcare plan ("DC Plan"). The City closed the DB OPEB Plan to employees hired on or after July 1, 2005.

The City initiated actuarial funding of its DB OPEB Plan in 2008 and has entered into an agreement with the California Public Employees Retirement System ("CalPERS") as a participating employer in the California Employers' Retiree Benefit Trust ("CERBT") to pre-fund future DB OPEB Plan expenses. As of June 30, 2015, the City's assets invested in CERBT totaled $121.1 million.

See Note 12, "OTHER POSTEMPLOYMENT BENEFITS" in the City's CAFR for Fiscal Year 2015 for information regarding the City's OPEB plans. The City's CAFR for Fiscal Year 2015 which is available through EMMA, which information is incorporated by reference in this Official Statement and shall be deemed to be a part hereof. Investors should read the entire Official Statement including such financial statements in order to obtain information essential to the making of an informed investment decision. See "FINANCIAL STATEMENTS" herein.

***Actuarial Assumptions and Methods.*** The City commissions an actuarial valuation of its DB OPEB Plan liability annually for the purpose of determining the City's annual cost in accordance with GASB 45. The valuation as of June 30, 2015 ("2015 OPEB Valuation"), dated December 1, 2015, was performed by Buck Consultants ("Buck"). The following are the major actuarial assumptions and methods employed by Buck in performing the 2015 OPEB Valuation:

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

2. Amortization Rate: Level Dollar.

3. Remaining Amortization Period: 22 years in Fiscal Year 2015 (commencing with 23 years in Fiscal Year 2014), closed.

4. Actuarial Asset Valuation Method: Market Value.

5. Discount Rate: 6.73%.

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

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

8. Health Care Cost Trend: 7.5% for Fiscal Year 2015, grading down 0.5% each year to an ultimate rate of 4.5% in Fiscal Year 2021.

9. Mortality Rates: RP 2000 Combined Healthy Mortality Tables for future and current retirees. Base rates for disabled retirees are consistent with experience study of SDCERS members.

The OPEB Valuation is also required to use the actuarial assumptions adopted by the SDCERS Board with respect to assumptions such as termination, disability and retirement rates because the health-eligible employee and retiree population is very similar to the City's SDCERS membership.

***Funding Status.*** According to the 2015 OPEB Valuation, at June 30, 2015, the City had a DB OPEB Plan UAAL of $537.3 million and a funded ratio of 18.4%. The DB OPEB Plan UAAL increased by approximately $57.8 million over the OPEB UAAL in the 2014 valuation of the DB OPEB Plan, which was $479.5 million, and the funded ratio decreased from 21.1%.

The City began prefunding the DB OPEB Plan in 2008. The following table shows the DB OPEB Plan funding progress for Fiscal Years 2008 through 2015:

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**TABLE 27**
**CITY OF SAN DIEGO**
**SCHEDULE OF FUNDING PROGRESS (DB OPEB PLAN)**
**Fiscal Years 2008 through 2015**
**($ Amounts in Thousands Except for Percentages)**
**(Unaudited)**

| Fiscal Year | Actuarial Value of Assets | Actuarial Accrued Liability | Unfunded Actuarial Liability | Funded Ratio | Covered Payroll[1] | UAAL as % of Covered Payroll |
|---|---|---|---|---|---|---|
| 2008 | $ 29,637 | $1,235,707 | $1,206,070 | 2.40% | $556,857 | 216.6% |
| 2009 | 41,497 | 1,359,377 | 1,317,880 | 3.05 | 549,012 | 240.0 |
| 2010 | 72,720 | 1,200,910 | 1,128,190 | 6.06 | 472,561 | 238.7 |
| 2011 | 116,608 | 1,248,151 | 1,131,543 | 9.34 | 455,537 | 248.4 |
| 2012 | 104,304 | 553,432 | 449,128 | 18.85 | 124,675 | 360.2 |
| 2013 | 113,404 | 557,551 | 444,147 | 20.34 | 112,782 | 393.8 |
| 2014 | 128,238 | 607,712 | 479,474 | 21.10 | 98,742 | 485.6 |
| 2015 | 121,115 | 658,408 | 537,293 | 18.40 | 87,252 | 615.8 |

(1) Represents DB OPEB Plan participation only.
Source: The City's Comprehensive Annual Financial Reports, Office of the Comptroller, City of San Diego.

***Citywide and Water Utility Fund OPEB Contributions.*** In Fiscal Year 2012, the City entered into the 15-year PEHB MOU through Fiscal Year 2027, which significantly reduced its OPEB liabilities and created the DC Plan for certain health-eligible employees and former employees. Pursuant to the PEHB MOU, the City's total retiree healthcare annual contribution is $57.8 million for Fiscal Year 2015 ("MOU Contribution"), distributed among the City's pay-go contribution to the DB OPEB Plan ("DB OPEB Paygo") and its contribution to the DC Plan. The City's MOU Contribution will increase by up to 2.5% annually thereafter. The PEHB MOU also requires that certain employees contribute towards the DB OPEB Plan to fund a portion of the DB OPEB Paygo ("Employee Contributions"). The terms of PEHB MOU may be renegotiated with a two-thirds vote of the City Council. As of the date of this Official Statement, there are no discussions ongoing to renegotiate the PEHB MOU.

The City's annual payment for the DB OPEB Plan and the DC Plan are made on a pay-go basis. The City funds these payments through its MOU Contribution, Employee Contributions and withdrawals from the CERBT ("Healthcare Obligations"). In Fiscal Year 2015, the Healthcare Obligations totaled $65.3 million and were funded by a $57.8 million MOU Contribution, a $1.0 million Employee Contributions and a withdrawal of $6.5 million from the CERBT. For Fiscal Year 2016, the total City retiree healthcare contribution is budgeted at $59.2 million with a Water Utility Fund proportionate share of $4.2 million (1% of the Fiscal Year 2016 budgeted maintenance and operation costs of the Water System). For Fiscal Year 2017, the total City retiree healthcare contribution is budgeted at $60.7 million with a Water Utility Fund proportionate share of $4.2 million (1% of the Fiscal Year 2017 budgeted maintenance and operation costs of the Water System).

The following table sets forth the City's DB OPEB ARC and the City's contributions for Fiscal Years 2012 through 2016, as well as the amounts related specifically to the Water Utility Fund.

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**TABLE 28**
**CITY OF SAN DIEGO AND WATER UTILITY FUND**
**RETIREE HEALTH CONTRIBUTION**
**Fiscal Years 2012 through 2016**
**($ Amounts in Thousands)**
**(Unaudited)**

| Fiscal Year | DB OPEB ARC | City DB OPEB Contribution[1] | City DC Plan Contribution | Total City Retiree Health Contribution | Water Fund Retiree Health Contribution | Water Fund Contribution (% of O&M) |
|---|---|---|---|---|---|---|
| 2012 | $49,061 | $23,857 | $34,424 | $58,281 | $4,609 | 1.3% |
| 2013 | 35,348 | 38,103 | 19,679 | 57,782 | 4,348 | 1.1 |
| 2014 | 38,097 | 32,143 | 25,639 | 57,782 | 3,979 | 0.9 |
| 2015 | 41,740 | 31,515 | 26,267 | 57,782 | 4,667 | 1.1 |
| 2016[2] | 46,976 | N/A | N/A | 59,234 | 4,196 | 1.0 |

(1) Includes administrative costs for DB OPEB Plan.
(2) The DB OPEB and DC Plan contributions will be available at the end of the fiscal year.
Source: Risk Management, Financial Management, Office of the Comptroller, City of San Diego.

***Implementation of GASB Statement No. 75.*** In June 2015, GASB issued Statement No. 75, Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions ("GASB 75"), which applies to state and local government employers who provide other postemployment benefits to employees. GASB 75 requires the liability of employers to be measured as the portion of the present value of projected benefit payments to be provided to current active and inactive employees that is attributed to those employees' past periods of service (total OPEB liability), less the amount of the OPEB plan's fiduciary net position. GASB 75 requires the recognition of the total OPEB liability in the Statement of Net Position. GASB 75 must be implemented by Fiscal Year 2018.

**Retiree Medical Trust**

In addition to the retiree healthcare plan discussed above, the City created a Retiree Medical Trust for certain City employees hired on or after July 1, 2009. The Retiree Medical Trust contributions are separate from and in addition to the contribution required by the PEHB MOU and the City's obligation is limited to an employer match of 0.25% of the salary of eligible employees. Total Retiree Medical Trust City contribution for Fiscal Year 2015 was $205,755 (the Water Utility Fund portion of the contribution was $14,193), and the budgeted contributions for Fiscal Year 2016 is $303,515 (the Water Utility Fund budgeted portion of the contribution was $20,848) and for Fiscal Year 2017 is $354,821 (the Water Utility Fund budgeted portion of the contribution is $22,045).

## RISK FACTORS

***Investment in the 2016 Bonds involves risks that may not be appropriate for certain investors. The following is a discussion of certain risk factors that should be considered, in addition to other matters set forth herein, in evaluating the 2016 Bonds for investment. The information set forth below does not purport to be an exhaustive listing of the risks and other considerations that may be relevant to an investment in the 2016 Bonds. In addition, the order in which the following information is presented is not intended to reflect the relative importance of any such risks.***

**Limited Obligations**

The obligation of the City to pay the 2016 Subordinated Installment Payments securing the 2016 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 payable on a basis that is subordinate to the right of payment by the City of its Outstanding Senior Obligations under the Installment Purchase Agreement. The obligation of the City to make the 2016 Subordinated Installment Payments does not constitute an obligation of the City to levy or pledge any form of taxation or for which the City has levied or pledged any form of taxation. The City is obligated under the 2016 Supplement to make the 2016 Subordinated Installment Payments solely from Net System Revenues payable Net System Revenues on a basis that is subordinate to the right of payment by the City of its Outstanding Senior Obligations under the Installment Purchase Agreement.

No assurance can be made that Net System Revenues, estimated or otherwise, will be realized by the City in amounts sufficient to pay the 2016 Subordinated Installment Payments. Among other matters, drought, general and local economic conditions, and changes in law and government regulations (including initiatives and moratoriums on growth) could adversely affect the amount of Net System Revenues realized by the City. In addition, the realization of future Net System Revenues is subject to, among other things, the capabilities of management of the City, the ability of the City to provide water to its customers, and the ability of the City to meet its covenant to fix, prescribe, and collect rates and charges for the Water Service in amounts sufficient to timely pay the 2016 Subordinated Installment Payments, which could in turn adversely impact the Authority's ability to make payments of the principal of or interest on the 2016 Bonds. The City has covenanted in the Master Installment Purchase Agreement to fix, prescribe, and collect rates and charges for the Water Service which will be at least sufficient to yield the greater of (i) Net System Revenues (as defined herein) sufficient to pay during each Fiscal Year all Obligations payable in such Fiscal Year, or (ii) Adjusted Net System Revenues during each Fiscal Year equal to 120% of the Adjusted Debt Service for such Fiscal Year. Adjusted Debt Service does **not** include debt service on Subordinated Obligations, such as the 2016 Subordinated Installment Payments. See "WATER SYSTEM FINANCIAL OPERATIONS – Establishment of Water Service Charges."

The 2016 Bonds are limited obligations of the Authority payable solely from and secured solely by the Subordinated Revenues pledged therefor and amounts on deposit in the Subordinated Bonds Payment Fund established under the Indenture. Funds for the payment of the principal of and the interest on the 2016 Bonds are derived solely from the 2016 Subordinated Installment Payments. The Authority has no other source of revenues from which to pay debt service on the 2016 Bonds. The Authority has no taxing power.

**Subordinate Obligations**

The 2016 Bonds are limited obligations of the Authority payable solely from and secured by the 2016 Subordinated Installment Payments to be received by the Authority and from the amounts on deposit in certain funds held under the Indenture. The 2016 Subordinated Installment Payments are payable from Net System Revenues on a basis that is subordinate to the right of payment by the City of its Outstanding Senior Obligations under the Installment Purchase Agreement. In the event of a default under the Indenture, the owners of the Senior Obligations have, in certain circumstances, the right to accelerate the entire principal amount of the Senior Obligations. See "Acceleration; Limitations on Remedies" below. In such circumstances, owners of the 2016 Bonds may not receive scheduled payments of principal of and interest on the 2016 Bonds until all holders of Senior Obligations have been paid in full. Further, as concerns the Rate Covenant under the Indenture, Adjusted Debt Service does not include debt service on Subordinated Obligations such as the 2016 Subordinated Installment Payments.

See "SECURITY AND SOURCES OF PAYMENT FOR THE 2016 BONDS" and "APPENDIX A – SUMMARY OF PRINCIPAL LEGAL DOCUMENTS."

**Water System Expenses, Collections, and Future Rates**

The operation and maintenance expenditures related to the Water System are expected to increase in the next five years. See "WATER SYSTEM FINANCIAL OPERATIONS – Financial Projections and Modeling Assumptions." However, there can be no assurance that the City's projected future Maintenance and Operation Costs of the Water System will actually be as projected by the Department and described in this Official Statement. In addition, demands on the Water System are expected to increase due to population growth and regulatory requirements in the future. As described herein, the City is in the process of implementing the Long-Range Water Resources Plan and the attendant CIP to provide a framework for meeting future water requirements. Increases in expenses could require a significant increase in rates or charges in order to pay for CIP projects, including those anticipated under the City's Long-Range Water Resources Plan, the Pure Water Program, and to pay the debt service on account of any Obligation senior to or on a parity with the Subordinated Installment Payments including, without limitation, the 2016 Subordinated Installment Payments securing the 2016 Bonds. Also, any such rate increases could increase the likelihood of nonpayment by purchasers of water from the City and could also decrease demand from such purchasers and may impact the City's ability to make the 2016 Subordinated Installment Payments, which could in turn adversely impact the Authority's ability to make payments of the principal of and interest on the 2016 Bonds as and when due.

Rates for Fiscal Year 2021 and beyond are not part of the 2016 Rate Case. Related CIP expenditures are rate dependent, including, particularly, Pure Water Program expenditures for the Water Utility Fund share in Fiscal Year 2021. The City anticipates that additional rate capacity is necessary after Fiscal Year 2020. The City expects to perform cost of service analysis to prepare a new rate case for recommended rate adjustments for the Water Utility Fund for Fiscal Year 2021 and later Fiscal Years.

**Water System Demand**

There can be no assurance that the local demand for the services provided by the Water System will be maintained at levels described in this Official Statement. Because of changes in demographics within the boundaries of the City, it is possible for the demand for water services to decline over the term of the 2016 Bonds. A significant decline in demand might create a situation in which the City could not increase rates sufficiently to offset the decrease in subscribers or usage. This would reduce the City's ability to make the 2016 Subordinated Installment Payments, which could in turn adversely impact the Authority's ability to make payments of the principal of and interest on the 2016 Bonds as and when due.

**Rate-Setting Process Under Proposition 218**

Proposition 218, which added Articles XIIIC and XIIID to the State Constitution, affects the City's ability to impose future rate increases and no assurance can be given that future rate increases will not encounter majority protest opposition or be challenged by initiative action authorized under Proposition 218. In the event that future proposed rate increases cannot be imposed as a result of majority protest or initiative, the City might thereafter be unable to generate Net System Revenues in the amounts required by the 2016 Supplement to pay the 2016 Subordinated Installment Payments, which could in turn adversely impact the Authority's ability to make payments of the principal of and interest on the 2016 Bonds. See "CONSTITUTIONAL LIMITATIONS ON TAXES AND WATER RATES AND CHARGES – Article XIIIC" and "– Article XIIID" and "LITIGATION – Ratepayers Proposition 26 and 218 Litigation and Claims."

Notwithstanding the foregoing, the City has covenanted to fix, prescribe, and collect rates and charges for Water Service at a level at least sufficient to meet its debt requirements for Senior Bonds, as set forth under "SECURITY AND SOURCES OF PAYMENT FOR THE 2016 BONDS – Rate Covenant," and to use its best efforts to effect Water Service rate increases in compliance with Proposition 218. The current water rates approved by the City Council have been imposed in compliance with Proposition 218. See "CONSTITUTIONAL LIMITATIONS ON TAXES AND WATER RATES AND CHARGES – Article XIIIC" and "– Article XIIID."

**Pure Water Program**

Among current Water System CIP projects, the Pure Water Program is the most significant in cost and scope. Project costs for the Pure Water Program described in this Official Statement are based upon preliminary estimates by the Department, as are projected schedules for the completion of project components, plans and designs, construction costs, and funding sources. The amount of capital contributions, including the allocation of contribution between the Water Utility Fund and the Sewer Revenue Fund as described in this Official Statement are also based upon preliminary estimates by the Department assuming system capacities and respective costs of service. Accordingly, actual results are subject to adjustment and may vary, and costs may be higher or lower than such estimates. This is true including for the estimates of the cost of the contracts for services and tasks needed to complete the first and second phase of the Pure Water Program. In addition, completion of the Pure Water Program includes certain assumptions (which the Department considers to be reasonable), and Department goals, including as recommended in the 2015 IROC Report, that the Department (a) pursue all options in order to get regulatory certainty that the Pure Water San Diego Program will suffice to offset the requirement to move up to secondary treatment; (b) continue outreach efforts to promote the Pure Water Program to all communities within the San Diego region. In the event the costs of the first phase of the Pure Water Program exceed the Department's original estimates, delays or unforeseen obstacles are faced, additional capital contributions may be necessary in order to pay for the total costs of the first phase of the Pure Water Program. The exact amount of any such additional capital contributions will depend upon (a) the actual costs of the first phase of the Pure Water Program incurred to date where costs and funding are different than anticipated, (b) any unanticipated additional costs of the first phase of the Pure Water Program needed to complete the first phase of the Pure Water Program, (c) approval of a rate case to address future capital program costs in Fiscal Years 2021 and later Fiscal Years, and (d) whether any bonds, loans or grants will differ from projected to finance costs of the first phase of the Pure Water Program. Such variables also apply to the timing, costs and funding of phase two (expected through 2035) of the Pure Water Program, which is projected to begin to be expended in Fiscal Year 2021, however, such estimates are currently more subject to change than those with respect to phase one because of the extended time frame. The Water Utility Fund share of the Pure Water Program capital costs, approximately $1.2 billion, includes costs for both phases. The Sewer Revenue Fund share of the Pure Water Program capital costs, approximately $1.8 billion, includes costs for both phases. If the Sewer Revenue Fund (including its customers and participating agencies) does not contribute to any phase or component of the Pure Water Program, the Water Utility Fund could bear the total project costs. See "WATER SUPPLY – Pure Water Program" and "WATER SYSTEM CAPITAL IMPROVEMENT PROGRAM" for additional information on the Pure Water Program. As with each component of the Water System CIP, the achievement of projected results, completion, and other expectations involves known and unknown risks, uncertainties, and other factors that may hinder the Department's ability to meet the CIP schedule set forth herein. See "WATER SYSTEM CAPITAL IMPROVEMENT PROGRAM – Description of Major Projects" and Table 10 under that heading.

**Statutory and Regulatory Compliance**

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

The City's failure to comply with applicable laws and regulations could result in significant fines and penalties. Such claims are payable from assets of the Water System or from other legally available sources. In addition to claims by private parties, changes in the scope and standards for public agency water systems such as that operated by the Department may also lead to administrative orders issued by federal or State regulators. Future compliance with such orders can also impose substantial additional costs on the Water Utility Fund. No assurance can be given that the cost of compliance with such laws, regulations, and orders would not adversely affect the ability of the Water System to generate Net System Revenues sufficient to pay the debt service on account of any Obligation senior to or on a parity with the 2016 Subordinated Installment Payments including, without limitation, the 2016 Subordinated Installment Payments, which could in turn adversely impact the Authority's ability to make payments of the principal of and interest on the 2016 Bonds. See "WATER SYSTEM REGULATORY REQUIREMENTS – Compliance Order by the California Department of Public Health."

The City has covenanted in the Master Installment Purchase Agreement to fix, prescribe, and collect rates and charges for the Water Service which will be at least sufficient to yield the greater of (i) Net System Revenues (as defined herein) sufficient to pay during each Fiscal Year all Obligations payable in such Fiscal Year, or (ii) Adjusted Net System Revenues during each Fiscal Year equal to 120% of the Adjusted Debt Service for such Fiscal Year. Adjusted Debt Service does not include debt service on Subordinated Obligations, such as the 2016 Subordinated Installment Payments. See "WATER SYSTEM FINANCIAL OPERATIONS – Establishment of Water Service Charges." 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 2016 Subordinated Installment Payments.

**Risks Relating to the Water Supply**

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

***Drought Risks***. The ability of the Water System to operate effectively can be affected by the water supply available to the City, which is situated in an arid and semi-desert environment. If the water supply decreases significantly, whether by operation of mandatory supply restrictions, prohibitively high water costs or otherwise, Water System sales will diminish and Net System Revenues available to pay the 2016 Subordinated Installment Payments may be adversely affected. Suppliers of water to the City, including the CWA and MWD, have planned and managed reserve supplies to account for normal occurrences of drought conditions. See "WATER SUPPLY."

***Earthquakes, Wildfires, and Other Natural Disasters***. Although the City has not experienced any significant damage from seismic activities, the geographic area in which the City is located is subject to unpredictable seismic activity. Southern California is characterized by a number of geotechnical conditions that represent potential safety hazards, including expansive soils and areas of potential liquefaction and landslide. The San Andreas, Rose Canyon, Elsinore, and San Jacinto fault zones are all capable of producing earthquakes in the San Diego area and beyond. Water conveyance and distribution facilities maintained by DWR, MWD and the CWA are all subject to the risk of earthquakes and other natural disasters which could interrupt deliveries to the Water System. Earthquakes or other natural disasters could interrupt operation of the Water System or that of its suppliers and thereby interrupt the ability of the City to realize Net System Revenues sufficient to pay the 2016 Subordinated Installment Payments securing the payment of principal of and interest on the 2016 Bonds. In anticipation of such potential disasters, the City designs and constructs all facilities of the Water System to the seismic codes in effect at the time of design of the project. The Water System has not experienced any significant losses of facilities or services as a result of earthquakes.

Water conveyance facilities generally consist of pipelines and connections, flow control facilities, and pumping stations, which are not typically vulnerable to damage by wildfires. The above ground facilities within the Water System are designed to be tolerant to damage by wildfires through the use of fire resistant material where possible, such as concrete and masonry blocks. In addition, the Department works closely with the City's fire department to ensure that proper vegetative clearances are maintained in and around the properties and facilities of the Water System. The Department watches for wildfires that may threaten the facilities of the Water System and operations and maintenance crews are dispatched to ensure that all above-ground facilities remain safe and operational. Further, during fires, the Department works closely with the City's fire department and law enforcement officers to monitor and protect facilities of the Water System to ensure continuous operation.

As described under the caption "WATER SYSTEM SERVICE AREA AND FACILITIES – Existing Water System Facilities – Raw Water Reservoirs," the City is also cooperating with the 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 the CWA, a portion of which is purchased by the Department, extend for hundreds of miles and cross several major fault lines en route to the County. A severe earthquake, drought or other significant disaster could cut off the County's imported water supply for up to six months.

Although the City has implemented disaster preparedness plans and made improvements to Water System facilities in connection with such natural disasters, there can be no assurance that these or any additional measures will be adequate in the event that a natural disaster occurs, nor that costs of preparedness measures will be as currently anticipated. Further, damage to components of the Water System could cause a material increase in costs for repairs or a corresponding material adverse impact on Net System Revenues. **The City is not obligated under the Master Installment Purchase Agreement to procure and maintain, or cause to be procured and maintained, earthquake insurance on the Water System.**

***Environmental Considerations***. Several fish species and other wildlife species either directly or indirectly have the potential to affect SWP and Colorado River operations as well as CWA and MWD supplies and facilities. See "WATER SUPPLY."

***Security of the Water System***. Military conflicts and terrorist activities may adversely impact the operations and finances of the Water System. The Department continually plans and prepares for emergency situations and immediately responds to ensure the quality and service of water is maintained.

The Department prepares for emergencies such as earthquake, fire, power failure, or possible water contamination in a variety of ways, including: extensively monitoring the entire water treatment and distribution system on a routine basis throughout the year, in part by taking thousands of water samples; routinely training staff on critical security and safety; conducting disaster drills to improve coordination efforts throughout the region; collaborating with the DDW, law enforcement and fire-rescue agencies in order to improve multiple agency response to water emergencies; implementing a water quality notification plan to keep customers informed in emergency situations; and implementing additional security measures at all water treatment plants, reservoirs, and other local and remote water facilities. However, there can be no assurance that any existing or additional safety and security measures will prove adequate in the event that terrorist activities are directed against the Water System or that costs of security measures will not be greater than presently anticipated. Further, damage to certain components of the Water System could require the City to increase expenditures for repairs to the Water System significantly enough to adversely impact the City's ability to make the 2016 Subordinated Installment Payments, which could in turn adversely impact the Authority's ability to make payments of the principal of and interest on the 2016 Bonds. The Water System CIP has made use of and will continue to pursue additional use of Homeland Security grants to enhance security of various facilities throughout the Water System. In addition, the City has established the Operating Reserve, which is currently funded at a minimum 70 days of operating costs which may be used under certain circumstances for repairs to the Water System. See "WATER SYSTEM FINANCIAL OPERATIONS – Rate Stabilization Fund; Other Funds and Accounts."

Suppliers of water to the City have also taken actions to increase the security of water from the CRA and the SWP. MWD conducts ground and air patrols of the CRA and monitoring and testing at all treatment plants and along the CRA. Similarly, DWR has in place security measures to protect critical facilities of the SWP, including both ground and air patrols of the SWP. Although MWD has constructed redundant systems and other safeguards to ensure its ability to continually deliver water to its customers, and DWR has made similar efforts, a terrorist attack or other security breach against water facilities could materially impair MWD's ability to deliver water to its member agencies, including the CWA, from which the Department purchases a substantial portion of its water supplies, through the CRA 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 2016 Subordinated Installment Payments, which could in turn adversely impact the Authority's ability to make payments of the principal of and interest on the 2016 Bonds.

The safety of the facilities of the Water System is maintained via a combination of regular inspections by City employees, electronic monitoring, and analysis of unusual incident reports. All critical above-ground facilities operated and maintained by the City are controlled access facilities with fencing, gates, closed circuit television systems and security officers at certain points. Critical facilities additionally include monitored closed circuit television systems. Security services are provided at facilities, and this service was recently renewed through a contract award in January 2015 for five years, which will continue the consistent and reliable security guard services at Water System Facilities. Smaller, above ground and subterranean pumping stations operated and maintained by the City are locked with padlock or internal locking mechanisms, and most are monitored via access/intrusion alarms. Security improvements are evaluated on an ongoing basis. The electronic operations and controls have been evaluated and exposure reduced through a series of technology systems enhancements and integration.

***Utility Costs***. Power outages may cause difficulties in receiving an adequate water supply and thus increase the cost of water. No assurance can be given that any future significant reduction or loss of power would not materially adversely affect the operations of the Water System. Also, the Department cannot guarantee that prices for electricity or gas will not increase, which could adversely affect the

Water System's financial condition, although the rate increases previously approved by the City for Fiscal Years 2016 through 2020 allow for 3.3% inflation in gas and electric costs. The Department also cannot guarantee that additional increases in water rates charged by the CWA, the City's wholesale provider, or other charges imposed by the CWA or MWD will not be proposed. Costs for electric power required for operating the pumping systems of the CWA, and MWD for CRA and the State Water Project, are a substantial part of their respective expenses. Such increases in water rates and such other charges as well as increases in electricity and gas costs are eligible to be "passed through" to the City's water customers as increased water rates in accordance with the City's Municipal Code. Such "pass-through" rate increases are subject to Proposition 218 notice requirements. See "CONSTITUTIONAL LIMITATIONS ON TAXES AND WATER RATES AND CHARGES – Article XIIIC" and "– Article XIIID."

**Acceleration; Limitations on Remedies**

The Indenture provides that, upon and during the continuance of an Event of Default thereunder, the Trustee may, subject to certain conditions, declare the principal of all Senior Bonds then Outstanding and the interest accrued thereon to be due and payable immediately. So long as any Senior Bonds remain outstanding under the Indenture, no Owners of Subordinated Bonds shall have the right to declare an Event of Default, to declare any Subordinated Bonds immediately due and payable or to direct the Trustee or waive any Event of Default. The foregoing notwithstanding, the remedy of acceleration is subject to the limitations on legal remedies against public entities in the State, including a limitation on enforcement obligations against funds needed to serve the public welfare and interest. Also, any remedies available to the Owners of the 2016 Bonds upon the occurrence of an Event of Default under the Indenture are in many respects dependent upon judicial actions, which are often subject to discretion and delay and could prove both expensive and time consuming to obtain.

Further, enforceability of the rights and remedies of the Owners of the 2016 Bonds, and the obligations incurred by the City, may become subject to the federal bankruptcy code and applicable bankruptcy, insolvency, receivership, reorganization, moratorium, or similar laws relating to or affecting the enforcement of creditor's rights generally, now or hereafter in effect, equity principles that may limit the specific enforcement under State law of certain remedies, the exercise by the United States of America of the powers delegated to it by the Constitution, the reasonable and necessary exercise, in certain exceptional situations, of the police powers inherent in the sovereignty of the State and its governmental bodies in the interest of serving a significant and legitimate public purpose, and the limitations on remedies against counties in the State. Bankruptcy proceedings, or the exercise of powers by the federal or State government, if initiated, could subject the Owners of the 2016 Bonds to judicial discretion and interpretation of their rights in bankruptcy or otherwise and consequently may entail risks of delay, limitation, or modification of their rights. The opinions to be delivered by Bond Counsel, concurrently with the issuance of the 2016 Bonds, that the 2016 Bonds constitute valid and binding limited obligations of the City and the Indenture constitutes a valid and binding obligation of the City will be subject to such limitations and the various other legal opinions to be delivered concurrently with the issuance of the 2016 Bonds will be similarly qualified. See "APPENDIX B – FORM OF BOND COUNSEL OPINION."

If the City fails to comply with its covenants under the 2016 Supplement to pay the 2016 Subordinated Installment Payments, there can be no assurance of the availability of remedies adequate to protect the interests of the holders of Senior Bonds and, accordingly, the Subordinated Bonds.

**Dam Safety**

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

**Future Legislation**

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

**Potential Impact of Climatic Change**

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

- Sea level rise and an increase in saltwater intrusion,
- Changes in the timing, intensity, and variability of precipitation, and an increased amount of precipitation falling as rain instead of as snow,
- Reductions in the average annual snowpack due to a rise in the snowline and a shallower snowpack in the low- and medium-elevation zones, and a shift in snowmelt runoff to earlier in the year,
- Long-term changes in watershed vegetation and increased incidence of wildfires that could affect water quality,
- Increased water temperatures with accompanying adverse effects on some fisheries,
- Increases in evaporation and concomitant increased irrigation need, and
- Changes in urban and agricultural water demand.

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

The Climate Change-Related Impacts in the San Diego Region by 2050 Report, released by California Climate Change Center in August 2009, suggested that due to global climate changes, the mean sea level ("MSL") in the year 2050 will rise by 1.5 feet. A review of historical tide data from the National Oceanic and Atmospheric Administration (NOAA) determined that the average high tide rise for the San Diego Region was 6.55 feet. The projected elevation of the 2050 high tide will be the current high

tide elevation (6.55 feet) plus the projected rise in sea level by the year 2050 (1.5 feet), which makes the projected San Diego Region 2050 high tide elevation 8.05 feet above MSL. The City performed an analysis based on these referenced information determining what would be the potential impacts to the City's water and wastewater facilities. Based on the analysis, no water pump stations or treatment plants will be affected by this potential sea level change since these facilities are all situated at higher grounds. The City maintains and operates more than 3,300 miles of water lines; less than 22 miles of these water pipes may be impacted by the projected rise in sea level. The impacts on affected water pipes will be limited by the fact that the Water System is under high inner pressure.

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

**Uncertainties of Projections, Forecasts and Assumptions**

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

**Absence of Market for the 2016 Bonds**

There can be no guarantee that there will ever be a secondary market for purchase or sale of the 2016 Bonds or, if a secondary market exists, that the 2016 Bonds can be sold for any particular price. Occasionally, because of general market conditions or because of adverse history or economic prospects connected with a particular issue, secondary marketing practices in connection with a particular issue are suspended or terminated. Additionally, prices of issues for which a market is being made will depend upon then prevailing circumstances. Such prices could be substantially different from the original purchase price.

**Loss of Tax Exemption on 2016 Bonds**

As discussed under the caption "TAX MATTERS," interest on the 2016 Bonds could become included in gross income for purposes of federal income taxation, retroactive to the date the 2016 Bonds were issued, as a result of future acts or omissions of the City or the Authority in violation of their respective covenants in the Indenture and the Installment Purchase Agreement.

**Economic, Political, Social, and Environmental Conditions**

Prospective investors are encouraged to evaluate current and prospective economic, political, social, and environmental conditions as part of an informed investment decision. Changes in economic,

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

## CONSTITUTIONAL LIMITATIONS ON TAXES AND WATER RATES AND CHARGES

### Article XIIIA

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

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

Under California law, any fee that exceeds the reasonable cost of providing the service for which the fee is charged is a "special tax," which under Article XIIIA must be authorized by a two-thirds vote of the electorate. Under Article XIIID, fees and charges for water, sewer, and refuse collection services are subject to majority protest, but are not subject to the two-third vote requirement of Article XIIIA. The reasonable cost of providing water services has been determined by the State Controller to include depreciation and allowance for the cost of capital improvements. In addition, the California courts have determined to date that fees such as capacity fees will not be special taxes if they approximate the reasonable cost of constructing the water or wastewater capital improvements contemplated by the local agency imposing the fee. See "WATER SYSTEM FINANCIAL OPERATIONS – Revenues."

### Article XIIIB

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

To the extent that assessments, fees, and charges collected by the City are used to pay the costs of maintaining and operating the Water System and payments due on the Senior Bonds and the Subordinated Bonds (assuming the issuance of the 2016 Bonds), and including the funding of the Reserve Fund established for the Senior Bonds to the applicable Reserve Fund Requirement and the Common Subordinated Bonds Reserve Fund with respect to the 2012A Bonds to the Common Subordinated Bonds

Reserve Requirement, and the funding of the debt service reserve fund established for each SRF loan to its required level, the City believes as of the date hereof that such moneys should not be subject to the annual appropriations limit of Article XIIIB.

**Article XIIIC**

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

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

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

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

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

The Supreme Court further stated in the *Bighorn Decision* that it was not holding that the initiative power is free of all limitations and was not determining whether the initiative power is subject to the statutory provision requiring that water and wastewater service charges be set at a level that will pay debt service on bonded debt and operating expenses. Such initiative power could be subject to the limitations imposed on the impairment of contracts under the contract clause of the United States Constitution. Additionally, SB 919 provides that the initiative power provided for in Proposition 218

"shall not be construed to mean that any owner or beneficial owner of a municipal security, purchased before or after November 5, 1996 (the date of adoption of Proposition 218), assumes the risk of, or in any way consents to, any action by initiative measure that constitutes an impairment of contractual rights" protected by the United States Constitution. No assurance can be given that the voters of the City will not, in the future, approve initiatives that repeal, reduce or prohibit the future imposition or increase of assessments, fees or charges, including the City's Water Service fees and charges, which are the source of Net System Revenues to make Subordinated Installment Payments, including the 2016 Subordinated Installment Payments and, in turn, payments of the principal of and interest on the 2016 Bonds, and other Outstanding Subordinated Obligations.

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

**Article XIIID**

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

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

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

Article XIIID establishes procedural requirements for the imposition of assessments, which are defined as any charge upon real property for a special benefit conferred upon the real property. Standby charges are classified as assessments. Procedural requirements for assessments under Article XIIID include conducting a public hearing and mailed protest procedure, with notice to the record owner of each parcel subject to the assessment. The assessment may not be imposed if a majority of the ballots returned oppose the assessment, with each ballot weighted according to the proportional financial obligation of the affected parcel. To provide guidance to City staff regarding the conduct of Proposition 218 "property-related fee" protest proceedings, the City Council adopted Resolution R-2007-655 in January 2007 establishing additional procedures for submitting protests against proposed increases to water rates, including the provision of notice of a proposed change in water fees to all owners of record on each identified parcel and all water customers of the City as reflected in the billing records of the City at the time the notice is given, and additional procedures for the tabulation of protests against proposed increases to water rates, including guidelines for determining when a valid protest has been submitted.

The City and the City Attorney believe that as of the date of this Official Statement that current water fees and charges that are subject to Proposition 218 materially comply with the provisions thereof. Should it become necessary to increase the water fees and charges above current levels, the City would be required to comply with the requirements of Article XIIID in connection with such proposed increase. Until recently, the City had not had a substantive legal challenges to water rate increases implemented by the City pursuant to Proposition 218 or otherwise. A complaint alleging charges in excess of costs of service, among other things, was filed against the City and other local agencies in December 2015. See "LITIGATION – Ratepayers' Proposition 26 and 218 Litigation and Claims." As of the date of this Official Statement and under existing standards as of such date, the City and the City Attorney believe that rates and charges may be established at levels that are expected to permit deposits to a Rate Stabilization Fund or maintenance of uncommitted cash reserves. See "WATER SYSTEM FINANCIAL OPERATIONS – Financial Projections and Modeling Assumptions." The City and the City Attorney believe that current water capacity fees are not subject to Proposition 218.

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

**Proposition 26**

Proposition 26, a State ballot initiative aimed at restricting regulatory fees and charges, was approved by the California voters on November 2, 2010. Proposition 26 broadens the definition of "tax" in Article XIIIC of the California Constitution to include levies, charges and exactions imposed by local governments, except for charges imposed for benefits or privileges or for services or products granted to the payor (and not provided to those not charged) that do not exceed their reasonable cost; regulatory fees that do not exceed the cost of regulation; fees for the use of local governmental property; fines and penalties imposed for violations of law; real property development fees; and assessments and property-related fees imposed under Article XIIID of the California Constitution. California local taxes are subject to approval by two-thirds of the voters voting on the ballot measure for authorization. Proposition 26 applies to charges imposed or increased by local governments after the date of its approval. The City believes that Proposition 26 does not apply to its water rates and charges because such fees and charges are within various exceptions to Proposition 26. Until recently, the City had not had a substantive legal challenges to water rate increases implemented by the City pursuant to Proposition 26 or otherwise. A claim was filed by the Otay Water District against the City in January 2016. See "LITIGATION – Ratepayers Proposition 26 and 218 Litigation and Claims."

**Initiative, Referendum and Charter Amendments**

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

## TAX MATTERS

In the opinion of Orrick, Herrington & Sutcliffe LLP, Bond Counsel to the Authority ("Bond Counsel"), based upon an analysis of existing laws, regulations, rulings and court decisions, and assuming, among other matters, the accuracy of certain representations and compliance with certain covenants, interest on the 2016 Bonds is excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986 (the "Code"), and is exempt from State of California personal income taxes. Bond Counsel is of the further opinion that interest on the 2016 Bonds is not a specific preference item for purposes of the federal individual or corporate alternative minimum taxes, although Bond Counsel observes that such interest is included in adjusted current earnings when calculating corporate alternative minimum taxable income. A complete copy of the proposed form of opinion of Bond Counsel is set forth in APPENDIX B attached hereto.

To the extent the issue price of any maturity of the 2016 Bonds is less than the amount to be paid at maturity of such 2016 Bonds (excluding amounts stated to be interest and payable at least annually over the term of such 2016 Bonds), the difference constitutes "original issue discount," the accrual of which, to the extent properly allocable to each Beneficial Owner thereof, is treated as interest on the 2016 Bonds which is excluded from gross income for federal income tax purposes and State of California personal income taxes. For this purpose, the issue price of a particular maturity of the 2016 Bonds is the first price at which a substantial amount of such maturity of the 2016 Bonds is sold to the public (excluding bond houses, brokers, or similar persons or organizations acting in the capacity of underwriters, placement agents or wholesalers). The original issue discount with respect to any maturity of the 2016 Bonds accrues daily over the term to maturity of such 2016 Bonds on the basis of a constant interest rate compounded semiannually (with straight-line interpolations between compounding dates). The accruing original issue discount is added to the adjusted basis of such 2016 Bonds to determine taxable gain or loss upon disposition (including sale, redemption, or payment on maturity) of such 2016 Bonds. Beneficial Owners of the 2016 Bonds should consult their own tax advisors with respect to the tax consequences of ownership of 2016 Bonds with original issue discount, including the treatment of Beneficial Owners who do not purchase such 2016 Bonds in the original offering to the public at the first price at which a substantial amount of such 2016 Bonds is sold to the public.

2016 Bonds purchased, whether at original issuance or otherwise, for an amount higher than their principal amount payable at maturity (or, in some cases, at their earlier call date) ("Premium 2016 Bonds") will be treated as having amortizable bond premium. No deduction is allowable for the amortizable bond premium in the case of bonds, like the Premium 2016 Bonds, the interest on which is

excluded from gross income for federal income tax purposes. However, the amount of tax-exempt interest received, and a Beneficial Owner's basis in a Premium 2016 Bond, will be reduced by the amount of amortizable bond premium properly allocable to such Beneficial Owner. Beneficial Owners of Premium 2016 Bonds should consult their own tax advisors with respect to the proper treatment of amortizable bond premium in their particular circumstances.

The Code imposes various restrictions, conditions and requirements relating to the exclusion from gross income for federal income tax purposes of interest on obligations such as the 2016 Bonds. The Authority and the City have made certain representations and covenanted to comply with certain restrictions, conditions and requirements designed to ensure that interest on the 2016 Bonds will not be included in federal gross income. Inaccuracy of these representations or failure to comply with these covenants may result in interest on the 2016 Bonds being included in gross income for federal income tax purposes, possibly from the date of original issuance of the 2016 Bonds. The opinion of Bond Counsel assumes the accuracy of these representations and compliance with these covenants. Bond Counsel has not undertaken to determine (or to inform any person) whether any actions taken (or not taken), or events occurring (or not occurring), or any other matters coming to Bond Counsel's attention after the date of issuance of the 2016 Bonds may adversely affect the value of, or the tax status of interest on, the 2016 Bonds. Accordingly, the opinion of Bond Counsel is not intended to, and may not, be relied upon in connection with any such actions, events or matters.

Although Bond Counsel is of the opinion that interest on the 2016 Bonds is excluded from gross income for federal income tax purposes and is exempt from State of California personal income taxes, the ownership or disposition of, or the accrual or receipt of amounts treated as interest on, the 2016 Bonds may otherwise affect a Beneficial Owner's federal, state or local tax liability. The nature and extent of these other tax consequences depends upon the particular tax status of the Beneficial Owner or the Beneficial Owner's other items of income or deduction. Bond Counsel expresses no opinion regarding any such other tax consequences.

Current and future legislative proposals, if enacted into law, clarification of the Code or court decisions may cause interest on the 2016 Bonds to be subject, directly or indirectly, in whole or in part, to federal income taxation or to be subject to or exempted from state income taxation, or otherwise prevent Beneficial Owners from realizing the full current benefit of the tax status of such interest. For example, the Obama Administration's budget proposals in recent years have proposed legislation that would limit the exclusion from gross income of interest on the 2016 Bonds to some extent for high-income individuals. The introduction or enactment of any such legislative proposals or clarification of the Code or court decisions may also affect, perhaps significantly, the market price for, or marketability of, the 2016 Bonds. Prospective purchasers of the 2016 Bonds should consult their own tax advisors regarding the potential impact of any pending or proposed federal or state tax legislation, regulations or litigation, as to which Bond Counsel is expected to express no opinion.

The opinion of Bond Counsel is based on current legal authority, covers certain matters not directly addressed by such authorities, and represents Bond Counsel's judgment as to the proper treatment of the 2016 Bonds for federal income tax purposes. It is not binding on the Internal Revenue Service ("IRS") or the courts. Furthermore, Bond Counsel cannot give and has not given any opinion or assurance about the future activities of the Authority, or about the effect of future changes in the Code, the applicable regulations, the interpretation thereof or the enforcement thereof by the IRS. The Authority and the City have in the Indenture and the Installment Purchase Agreement covenanted, however, to comply with the requirements of the Code.

Bond Counsel's engagement with respect to the 2016 Bonds ends with the issuance of the 2016 Bonds, and, unless separately engaged, Bond Counsel is not obligated to defend the Authority or the

Beneficial Owners regarding the tax-exempt status of the 2016 Bonds in the event of an audit examination by the IRS. Under current procedures, parties other than the Authority and its appointed counsel, including the Beneficial Owners, would have little, if any, right to participate in the audit examination process. Moreover, because achieving judicial review in connection with an audit examination of tax-exempt bonds is difficult, obtaining an independent review of IRS positions with which the Authority legitimately disagrees, may not be practicable. Any action of the IRS, including but not limited to selection of the 2016 Bonds for audit, or the course or result of such audit, or an audit of bonds presenting similar tax issues may affect the market price for, or the marketability of, the 2016 Bonds, and may cause the Authority or the Beneficial Owners to incur significant expense.

## CONTINUING DISCLOSURE

Pursuant to the Continuing Disclosure Certificate of the City (the "Disclosure Certificate"), the City has agreed to provide, or cause to be provided, to the Municipal Securities Rulemaking Board in the manner prescribed by the SEC certain annual financial information and operating data and notice of certain Notice Events (as described in the Continuing Disclosure Certificate). The form of the Disclosure Certificate is attached hereto as "APPENDIX C – FORM OF CONTINUING DISCLOSURE CERTIFICATE. The annual report to be filed by the City is to be filed not later than April 10 after the end of the City's Fiscal Year (which currently ends June 30), commencing with the report for the fiscal year ending June 30, 2016, and is to include audited financial statements of the City. The City's covenants in the Continuing Disclosure Certificate have been made in order to assist the Underwriters in complying with Rule 15c2-12(b)(5) adopted by the SEC under the Securities Exchange Act of 1934 (the "Rule"). A failure by the City to comply with any of the covenants therein is not an event of default under the Indenture or the Installment Purchase Agreement.

The City has established an issuer's page on the MSRB's Electronic Municipal Market Access System ("EMMA") with respect to the Water Utility Bonds. The City's home page can be accessed at the following Internet address:

http://emma.msrb.org/IssuerHomePage/Issuer?id=0DE785B24DBD675DE053151E0A0AE7C0&type=M

Neither the home page nor any information on the home page is made a part of this Official Statement, nor is it incorporated by reference herein and should not be relied upon in making an investment decision with respect to the 2016 Bonds.

***City.*** The City is party to a number of continuing disclosure undertakings with respect to securities secured by the City's General Fund, the Sewer Revenue Fund, and the Water Utility Fund pursuant to the Rule. During the last five years, there was one instance where the City failed to comply in all material respects with certain of its previous undertakings related to its annual reports. The annual reports for Fiscal Year 2010 were filed late due to the unavailability of the City's audited financial statements. The delay in releasing the audited financial statements for Fiscal Year 2010 was principally due to the implementation of a new accounting reporting system for the City. The City timely filed notices of failure to timely provide the annual reports and audited financial statements for Fiscal Year 2010. The City subsequently filed its audited financial statements for Fiscal Year 2010 in October 2011, and filed its annual reports for Fiscal Year 2010 in November 2011, approximately seven months after its annual reporting deadlines under its continuing disclosure undertakings. The City timely filed its audited financial statements and annual reports for Fiscal Years 2011 through 2015 in compliance with its continuing disclosure undertakings.

***Former RDA and Successor Agency.*** The City also manages continuing disclosure undertakings of the City's Former RDA and the Successor Agency to the Former RDA. The audited financial statements and annual reports for Fiscal Year 2011 were filed one day late for certain of the Former

RDA's continuing disclosure obligations due to 2012 being a leap year. Additionally, over the last five years, the Former RDA failed to file notice of certain changes in underlying bond ratings on a timely basis. Notices of the current ratings were subsequently filed.

***Community Facilities Districts.*** The City manages the continuing disclosure undertakings of four community facilities districts formed by the City. During the last five years, there was one instance in which the community facilities district failed to comply in all material respects with certain of their previous undertakings related to their annual reports. Each of such entities filed on time that portion of its annual report(s) regarding the specified operating data. However, the report(s) filed for Fiscal Year 2010 for each of these entities was incomplete due to the unavailability of the City's audited financial statements, as described above. Notices of failure to timely provide the audited financial statements for Fiscal Year 2010 were timely filed. The community facilities districts subsequently filed the audited financial statements of the City for Fiscal Year 2010 with EMMA in October 2011 after their release by the City, which was approximately seven months after the deadline under the applicable continuing disclosure undertakings. The community facilities district timely filed annual operating data and the City's audited financial statements for Fiscal Years 2011 through 2015 in compliance with their continuing disclosure undertakings.

***Assessment Districts.*** Over the past five years, the City was also party to the continuing disclosure undertakings with respect to three assessment or reassessment districts formed by the City. During this time, there was one instance in which the City failed to comply in all material respects with certain of their previous undertakings related to its annual reports. The City filed on time the portion of its annual reports regarding the specified operating data. However, the reports filed for Fiscal Year 2010 were incomplete due to the unavailability of the City's audited financial statements, as described above. Notices of failure to timely provide the audited financial statements for Fiscal Year 2010 were timely filed. The City subsequently filed the audited financial statements of the City for Fiscal Year 2010 with EMMA in October 2011 after their release by the City, which was approximately seven months after the deadline under the applicable continuing disclosure undertakings. The City timely filed annual operating data and the City's audited financial statements for Fiscal Years 2011 through 2015 in compliance with their continuing disclosure undertakings.

## LITIGATION

As of the date of this Official Statement, there is no litigation pending against the City, the Corporation or the Authority or, to the knowledge of its respective executive officers, threatened, seeking to restrain or enjoin the issuance, sale, execution, or delivery of the 2016 Bonds or in any way contesting or affecting the validity of the 2016 Bonds or the authorizations or any proceedings of the City, the Corporation or the Authority taken with respect to the issuance or sale thereof, or the pledge or application of any moneys or security provided for the payment of the 2016 Bonds or the use of the proceeds of the 2016 Bonds. A claim and a complaint alleging charges in excess of costs of service, among other things, were filed against the City as described below under the caption "Ratepayers' Proposition 26 and 218 Litigation and Claims."

There are no pending lawsuits that, in the opinion of the City Attorney, challenge the validity of the 2016 Bonds, the corporate existence of the City, the Corporation or the Authority, or the title of the executive officers thereof to their respective offices. In connection with this review, attention has been given to not only litigation pending against the City, but also litigation pending against the Department. The Office of the City Attorney has prepared the following summary, as of the date of this Official Statement, of certain claims and lawsuits for which the estimated loss to the City as of such date exceeds $1 million ("Material Litigation") pending against the Water Utility Fund for construction claims and certain other alleged liabilities arising during the ordinary course of operations of the Water System:

***San Diego County Water Authority v. The Metropolitan Water District of Southern California.*** The City has typically depended on the CWA for approximately 85 - 90% of the City's water supply. In turn, the CWA relies on MWD for most of its water supply through both the purchase of water from MWD and the wheeling of water through MWD facilities that is transferred from the IID and the All-American & Coachella Canal lining project. The CWA filed *San Diego County Water Authority v. Metropolitan Water District of Southern California, et al*. on June 11, 2010 challenging MWD's 2011 and 2012 rates. Because the case was still pending and MWD continued to adopt new rates based on same cost of service methodology, the CWA filed additional lawsuits against MWD in 2012 and 2014 challenging MWD's 2013 and 2014 rates, and 2015 and 2016 rates, respectively. The core legal issues and facts in these two cases are similar. Each lawsuit asserts that MWD's rates assign water supply costs to transportation in violation of State law and the State constitution. All three cases allege that MWD has breached its contract by setting its water rates to discriminate against the CWA by artificially inflating the price charged for wheeling (transporting) water independently obtained by the CWA through MWD's pipes by an improper allocation of certain supply related costs, including the majority of SWP costs and MWD's costs for conservation and local resource projects to the wheeling rate it charges the CWA.

The CWA's lawsuits also challenge MWD's termination and withholding of further funding agreements with the CWA for local water supply development projects and conservation programs as a result of its rate challenge; MWD's local supply development and conservation subsidies are funded through its Water Stewardship Rate. MWD collects tens of million dollars annually from the CWA through the Water Stewardship Rate.

In another cause of action, the CWA asserts that MWD incorrectly excluded the transportation revenues it collects from the CWA in its calculation of the CWA's preferential right to MWD water supplies, further discriminating against the CWA.

The 2010 and 2012 lawsuits were tried in the San Francisco Superior Court. The cases are being heard in two phases, with all claims against MWD's rates heard in the first phase, followed by the breach of contract and preferential rights claims in the second phase. By stipulation of the parties, the 2014 case has been stayed in San Francisco Superior Court pending the outcome of the 2010 and 2012 cases.

On April 24, 2014, San Francisco Superior Court Judge Curtis E.A. Karnow issued phase one decision ruled that in setting rates for 2011, 2012, 2013 and 2014, MWD violated cost of service requirements of California law, including the wheeling statute, common law and, for the 2013 and 2014 rates, the California Constitution (Proposition 26, now Article XIIIC) by assigning water supply costs to transportation. The court invalidated the System Access Rate, System Power Rate, Water Stewardship Rate, and MWD's wheeling rate for 2011, 2012, 2013, and 2014. The court also held that the CWA had not met its prima facie burden of establishing that MWD's failure to account for standby costs of dry-year peaking renders MWD's Transportation Rates unconstitutional and unlawful. On August 28, 2015, Judge Karnow issued a final ruling for phase two. The ruling awards $188.3 million plus interest to the CWA for illegal water rates MWD charged from 2011 through 2014. Judge Karnow also ruled that MWD under-calculated the CWA's right to MWD water supplies.

On November 18, 2015, the court issued its Final Judgment and a Peremptory Writ of Mandate for both phases of the 2010 and 2012 lawsuits, awarding CWA damages in the amount of $188.3 million above, plus prejudgment interest, for a total judgment of $234.9 million. On November 19, 2015, MWD filed a Notice of Appeal in each case. The Judgment and the Writ will be stayed while the appeal is pending. Post-judgment interest will accrue on the damages and prejudgment interest awards at the rate of 7%. The CWA is unable to assess at this time the likelihood of success of this litigation, any possible appeal or any future claims.

The stakes in the litigation are estimated at between $1.3 billion and $2.1 billion over a 45-year period. As part of the 2003 contract that the CWA alleges MWD breached, MWD is required to place all disputed payments made by the CWA into an escrow account, which MWD cannot spend during the pendency of the litigation. If the CWA wins the case, MWD will be required to return those funds to the CWA. As of October 31, 2015, the escrow account held $220.6 million. The City is not a party to the lawsuit, is not exposed to any monetary liability and is not funding this litigation.

***Ratepayers' Proposition 26 and 218 Litigation and Claims***. In December 2015, the City received a copy of an amended complaint alleging that the City, the OWD, the CWA, and MWD all charge fees for water service that violate Article XIIID of the California Constitution (Proposition 218). *Coziahr v. Otay Water District*, Case No. 37-2015-00023413-CU-MC-CTL. The complaint seeks class action status, the class consisting of all customers of MWD who received water service since July 1, 1997. The complaint generally alleges that all of the defendants charge fees for water service that exceed the actual cost to provide the service to each parcel in violation of Proposition 218. With regard to the City, the complaint alleges that (1) the cost differences in tiers for single family residential customers is arbitrary, and (2) the difference in rates charged to multi-family residential customers, commercial customers, and temporary construction/irrigation customers is also arbitrary. The complaint further alleges that the City's water rates violate Proposition 218 because the City purchases water from the CWA and MWD at rates arbitrarily set by those agencies.

This lawsuit is in its infancy, and the City has yet to respond to the complaint. The potential liability to the City is unknown because the complaint does not allege what amount the City's water rates should be or make a specific monetary demand of the City. The City believes its water rates are based on cost of service principles and compliant with Proposition 218.

On February 19, 2016, Claimant Otay Water District, 2554 Sweetwater Springs Blvd, Spring Valley, CA 91978 filed a claim with the City. No lawsuit has been filed. Otay is represented by Daniel R. Shinoff, Esq., Artiano Shinoff and Holtz, APC 2488 Historic Decatur Road, San Diego, CA 92106. The claim alleges that the Otay Water District purchases recycled water from the City of San Diego, and that the City adopted a rate for recycled water that is not in compliance with the California Constitution as amended by Proposition 26 and 218. Consequently, they allege the rate set by the City for the recycled water it sells to Otay Water District is illegal. Otay alleges damages in excess of $25,000. It is assumed Otay will seek a refund of amounts paid, which could exceed the reporting threshold of $1,000,000, in addition to declaratory and injunctive relief.

The City has been consistent in applying Propositions 26 and 218 to all its rate increases. The City believes its water rates are based on cost of service principles and compliant with Propositions 26 and 218 and there to be a low risk of exposure at this time.

## CERTAIN LEGAL MATTERS

The validity of the 2016 Bonds and certain other legal matters are subject to the approving opinion of Orrick, Herrington & Sutcliffe LLP, Bond Counsel to the Authority. A complete copy of the proposed form of Bond Counsel opinion is contained in APPENDIX B hereto. Bond Counsel undertakes no responsibility for the accuracy, completeness or fairness of this Official Statement. Orrick, Herrington & Sutcliffe LLP, as Disclosure Counsel, will provide certain other legal services for the Authority. Certain legal matters will be passed upon for the Authority and the City by Jan I. Goldsmith, City Attorney, and for the Underwriters by their counsel, Stradling Yocca Carlson & Rauth, a Professional Corporation, Newport Beach, California.

## INVESTMENT ADVISOR

If the City purchases open market securities to be held in the Escrow Fund, Raymond James & Associates, Inc. ("Raymond James") will act as registered investment advisor to the City in its capacity as bidding agent in conducting a competitive bid procurement process for such securities. Raymond James will receive compensation for bidding agent services contingent on the sale and delivery of the 2016B Bonds.

## VERIFICATION

Causey Demgen & Moore P.C. will deliver its report verifying the accuracy of the mathematical computation concerning the adequacy of the maturing principal amounts of and interest earned on the investments, if any, together with other available moneys, to be placed in the Escrow Fund to pay when due, pursuant to a call for redemption, the principal of and interest on the Refunded Bonds.

## RATINGS

Fitch Ratings ("Fitch") and Moody's Investors Service, Inc. ("Moody's") have assigned their ratings of "AA-" and "Aa3," respectively, to the 2016 Bonds, each with a stable outlook. Such ratings reflect only the views of such organizations and any desired explanation of the significance of such ratings should be obtained from the rating agency furnishing the same, at the following addresses: Fitch Ratings, One State Street Plaza, New York, New York 10004 and Moody's Investors Service, Inc., 7 World Trade Center, 250 Greenwich Street, New York, New York 10007. Generally, a rating agency bases its rating on the information and materials furnished to it and on investigations, studies and assumptions of its own.

There is no assurance such ratings will continue for any given period of time or that such ratings will not be revised downward or withdrawn entirely by the rating agencies, if in the judgment of such rating agencies, circumstances so warrant. Any such downward revision or withdrawal of such ratings may have an adverse effect on the market price of the 2016 Bonds. Neither the City nor the Authority undertakes any obligation to oppose any downward revision, suspension or withdrawal.

## UNDERWRITING

The 2016 Bonds are being purchased by the Underwriters named on the cover page of this Official Statement (collectively, the "Underwriters"). J.P. Morgan Securities LLC is serving as the representative of the Underwriters. The Underwriters have agreed, subject to certain conditions, to purchase the 2016A Bonds at a purchase price of $_____ (equal to the original principal amount thereof, plus a net original issue premium of $_____, less an underwriters' discount of $_____) and to purchase the 2016B Bonds at a purchase price of $_____ (equal to the original principal amount thereof, plus a net original issue premium of $_____, less an underwriters' discount of $_____). The Underwriters are committed to purchase all of the 2016 Bonds if any are purchased. The following paragraphs under this section have been provided by the Underwriters, respectively.

J.P. Morgan Securities LLC ("JPMS"), has entered into negotiated dealer agreements (each, a "Dealer Agreement") with each of Charles Schwab & Co., Inc. ("CS&Co.") and LPL Financial LLC ("LPL") for the retail distribution of certain securities offerings at the original issue prices. Pursuant to each Dealer Agreement (if applicable to this transaction), each of CS&Co. and LPL may purchase 2016 Bonds from JPMS at the original issue price less a negotiated portion of the selling concession applicable to any 2016 Bonds that such firm sells.

Morgan Stanley, parent company of Morgan Stanley & Co. LLC, has entered into a retail distribution arrangement with its affiliate Morgan Stanley Smith Barney LLC. As part of the distribution arrangement, Morgan Stanley & Co. LLC may distribute municipal securities to retail investors through the financial advisor network of Morgan Stanley Smith Barney LLC. As part of this arrangement, Morgan Stanley & Co. LLC may compensate Morgan Stanley Smith Barney LLC for its selling efforts with respect to the 2016 Bonds.

Siebert Brandford Shank & Co., L.L.C. has entered into an agreement with Muriel Siebert & Co. for the retail distribution of certain securities offerings at the original issue prices. Pursuant to this distribution agreement, if applicable to the 2016 Bonds, Muriel Siebert & Co. will purchase 2016 Bonds at the original issue price less the selling concession with respect to any 2016 Bonds that Muriel Siebert & Co. sells. Siebert Brandford Shank & Co., L.L.C. will share a portion of its underwriting compensation with Muriel Siebert & Co.

The Underwriters may offer and sell the 2016 Bonds to certain dealers and others at prices lower the public offering price stated on the inside cover page hereof. The offering prices may be changed from time to time by the Underwriters.

## MUNICIPAL ADVISOR

Public Financial Management, Inc., has acted as Municipal Advisor to the City in conjunction with the issuance of the 2016 Bonds. The Municipal Advisor has assisted the City in preparation of this Official Statement and advised in other matters related to the planning, structuring, pricing, issuance and delivery of the 2016 Bonds. The Municipal Advisor will receive compensation contingent upon the sale and delivery of the 2016 Bonds.

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

## INFORMATION CONCERNING THE METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA AND THE SAN DIEGO COUNTY WATER AUTHORITY

The CWA and MWD each periodically files their respective official statements and disclosure reports with the MSRB in connection with their respective publicly offered bonds. Such official statements and disclosure reports contain, among other things, information on the CWA, CWA's water supply and CWA's rates and charges and MWD, MWD's water supply and MWD's rates and charges. Such official statements and disclosure reports are available from the MSRB but are not incorporated by reference herein and none of the CWA, MWD or the Underwriters assume any responsibility for the completeness or accuracy thereof. Neither the CWA nor MWD is obligated in any manner for the payment of principal of or interest on the 2016 Bonds and neither has provided or will provide any certifications regarding this Official Statement, nor has the CWA or MWD made any undertaking for the benefit of the owners and beneficial owners of the 2016 Bonds to file any information with the MSRB.

## FINANCIAL STATEMENTS

The City prepares financial statements annually in conformity with generally accepted accounting principles for governmental entities, which are audited by an independent certified public accountant. The City's most recent financial statements, for the Fiscal Year ended June 30, 2015, were audited by Macias Gini & O'Connell LLP (the "Independent Auditor"), independent certified public accountants, as

stated in their report. The City's basic financial statements contained in the City's CAFRs include the financial statements of the Water Utility Fund.

The City's CAFR for Fiscal Year 2015, which includes the City's audited basic financial statements as of and for the fiscal year ended June 30, 2015, is available through EMMA at http://emma.msrb.org/EP909456-EP705156-EP1107099.pdf, the contents of which is incorporated by reference in this Official Statement and shall be deemed to be a part hereof. Investors are encouraged to read the entire Official Statement including such financial statements in order to obtain information essential to the making of an informed investment decision.

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

## MISCELLANEOUS

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

There are appended to this Official Statement a summary of certain provisions of the principal and legal documents, the proposed form of opinion of Bond Counsel, and a general description of the City and a description of the Book-Entry Only System. The Appendices are integral parts of this Official Statement and must be read together with all other parts of this Official Statement.

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This Official Statement is not to be construed as a contract or agreement between the Authority or the City and the purchasers or holders of any of the 2016 Bonds. Any statements made in this Official Statement involving matters of opinion, whether or not expressly so stated, are intended merely as an opinion and not as representations of fact. The information and expressions of opinion herein are subject to change without notice and neither the delivery of this Official Statement nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the financial condition, results of operations, or any other affairs of the City, the Authority, or the Corporation since the date hereof.

PUBLIC FACILITIES FINANCING
AUTHORITY OF THE CITY OF SAN DIEGO

By:_____
Chair, Board of Commissioners

THE CITY OF SAN DIEGO

By:_____
Chief Financial Officer

# APPENDIX A

## SUMMARY OF PRINCIPAL LEGAL DOCUMENTS

*This Appendix A contains only a brief summary of certain of the terms of the Installment Purchase Agreement, the Indenture, and the Assignment Agreement relating to the 2016 Bonds and a full review should be made of the entire Official Statement, including the cover page and the Appendices. References to, and summaries of, provisions of the documents referred to herein do not purport to be complete and such references are qualified in their entirety by reference to the complete provisions. All statements contained in this Appendix A are qualified in their entirety by reference to the entire Official Statement and the complete provisions of the documents referenced.*

## DEFINITIONS

**Additional Bonds**

The term "Additional Bonds" means, collectively, Additional Senior Bonds and Additional Subordinate Bonds.

**Additional Senior Bonds**

The term "Additional Senior Bonds" means those Bonds authorized and issued under the Indenture on a parity with the 2009A Bonds, the 2009B Bonds and the 2010A Bonds, in accordance with the Indenture as summarized herein under the caption "INDENTURE – Additional Bonds – Proceedings for Execution and Delivery of Additional Bonds."

**Additional Subordinated Bonds**

The term "Additional Subordinated Bonds" means those Bonds authorized and issued under the Indenture on a parity with the 2012A Bonds and 2016 Bonds, in accordance with the Indenture as summarized herein under the caption "INDENTURE – Additional Bonds – Proceedings for Execution and Delivery of Additional Bonds."

**Acquisition Fund**

The term "Acquisition Fund" means the fund by that name established under the Indenture.

**Beneficial Owners**

The term "Beneficial Owners" means those individuals, partnerships, corporations or other entities for whom the Participants have caused the Depository to hold Book-Entry Bonds.

**Board**

The term "Board" means the Board of Commissioners of the Authority.

**Bond or Bonds**

The term "Bond" or "Bonds" means any of the bonds issued under the Indenture by the Authority, including any Additional Bonds.

**Bond Counsel**

The term "Bond Counsel" means a firm of attorneys that are nationally recognized as experts in the laws governing and relating to municipal finance.

**Book-Entry Bonds**

The term "Book-Entry Bonds" means Bonds executed and delivered under the book-entry system described in the Indenture.

**Business Day**

The term "Business Day" means a day of the year other than a Saturday or Sunday or a day on which banking institutions located in California are required or authorized to remain closed, or on which the New York Stock Exchange is closed. If the date for making any payment or the last date for performance of any act or the exercising of any right, as provided in the Indenture, shall not be a Business Day, such payment may be made or act performed or right exercised on the next succeeding Business Day, with the same force and effect as if done on the nominal date provided in the Indenture, and, unless otherwise specifically provided in the Indenture, no interest shall accrue for the period from and after such nominal date.

**Certificate of the City**

The term "Certificate of the City" means an instrument in writing signed by the Chief Financial Officer, the Chief Operating Officer, or any of their respective designees.

**Charter**

The term "Charter" means the Charter of the City as it now exists or may be amended, and any new or successor Charter.

**Closing Date**

The term "Closing Date" means any date upon which a Series of Bonds is purchased.

**Code**

The term "Code" means the Internal Revenue Code of 1986, as amended and the regulations thereunder, and any successor laws or regulations.

**Common Subordinated Bonds Reserve Fund**

The term "Common Subordinated Bonds Reserve Fund" means the fund by that name established under the Indenture.

**Common Subordinated Reserve Fund Bonds**

The term "Common Subordinated Reserve Fund Bonds" means Subordinated Bonds secured by the Common Subordinated Bonds Reserve Fund.

**Common Subordinated Reserve Fund Bonds Maximum Annual Debt Service**

The term "Common Subordinated Reserve Fund Bond Maximum Annual Debt Service" means, the maximum amount of principal and interest becoming due on the Common Subordinated Reserve Fund Bonds in the then-current or any future Fiscal Year, calculated by the Authority or by an Independent Certified Public Accountant in accordance with this subsection and provided to the Trustee. For purposes of calculating Common Subordinated Reserve Fund Bonds Maximum Annual Debt Service, the following assumptions shall be used to calculate the principal and interest becoming due in any Fiscal year:

(i) in determining the principal amount due in each Fiscal year, payments shall (except to the extent a different subsection of this definition applies for purposes of determining principal maturities or amortization) be assumed to be made in accordance with any amortization schedule established for such debt, including the amount of any Common Subordinated Reserve Fund Bonds which are or have the characteristics of commercial paper and which are not intended at the time of issuance to be retired from the sale of a corresponding amount of Common Subordinated Reserve Fund Bonds, and including any scheduled mandatory redemption or prepayment of Common Subordinated Reserve Fund Bonds on the basis of accreted value due upon such redemption or prepayment, and for such purposes, the redemption payment or prepayment shall be deemed a principal payment; provided, however, that with respect to Common Subordinated Reserve Fund Bonds which are or have the characteristics of commercial paper and which are intended at the time of issuance to be retired from the sale of a corresponding amount of other Obligations, which other Obligations would not constitute Balloon Indebtedness, each maturity thereof shall be treated as if it were to be amortized in substantially equal installments of principal and interest over a term of 30 years, commencing in the year of such stated maturity; in determining the interest due in each Fiscal Year, interest payable at a fixed rate shall (except to the extent subsection (A)(ii) or (iii) of this definition applies) be assumed to be made at such fixed rate and on the required payment dates;

(ii) if all or any portion or portions of an Outstanding Series of Common Subordinated Reserve Fund Bonds constitute Balloon Indebtedness or if all or any portion or portions of a Series of Common Subordinated Reserve Fund Bonds or such payments then proposed to be issued would constitute Balloon Indebtedness, then, for purposes of determining Common Subordinated Reserve Fund Bonds Maximum Annual Debt Service, each maturity which constitutes Balloon Indebtedness shall be treated as if it were to be amortized in substantially equal annual installments of principal and interest over a term of 30 years, commencing in the year the stated maturity of such Balloon Indebtedness occurs, the interest rate used for such computation shall be determined as provided in subsection (iv) or (v) below, as appropriate, and all payments of principal and interest becoming due prior to the year of the stated maturity of the Balloon Indebtedness shall be treated as described in subsection (i) above;

(iii) if any Outstanding Series of Common Subordinated Reserve Fund Bonds constitutes Tender Indebtedness or if Common Subordinated Reserve Fund Bonds proposed to be issued would constitute Tender Indebtedness, then for purposes of determining Common Subordinated Reserve Fund Bonds Maximum Annual Debt Service, Tender Indebtedness shall be treated as if the principal amount of such Common Subordinated Reserve Fund Bonds were to be amortized in accordance with the amortization schedule set forth in the Supplemental Indenture for such Tender Indebtedness or in the standby purchase or liquidity facility established with respect to such Tender Indebtedness, or if no such amortization schedule is set forth therein, then such Tender Indebtedness shall be deemed to be amortized in substantially equal annual installments of principal and interest over a term of 30 years commencing in the year in which such Series is first subject to tender, the interest rate used for such computation shall be determined as provided in subsection (iv) or (v) below, as appropriate;

(iv) if any Outstanding Series of Common Subordinated Reserve Fund Bonds constitutes Variable Rate Indebtedness, the interest rate on such Obligations shall be assumed to be 110% of the daily average interest rate on such Common Subordinated Reserve Fund Bonds during the 12 months ending with the month preceding the date of calculation, or such shorter period that such Common Subordinated Reserve Fund Bonds shall have been Outstanding;

(v) if Common Subordinated Reserve Fund Bonds proposed to be issued will be Variable Rate Indebtedness, then such Common Subordinated Reserve Fund Bonds shall be assumed to bear interest at 80% of the average Revenue Bond Index during the calendar quarter preceding the calendar quarter in which the calculation is made, or if that index is no longer published, another similar index selected by the City, or if the City fails to select a replacement index, an interest rate equal to 80% of the yield for outstanding United States Treasury bonds having an equivalent maturity, or if there are no such Treasury bonds having such maturities, 100% of the lowest prevailing prime rate of any of the five largest commercial banks in the United States ranked by assets; and

(vi) if moneys or Permitted Investments have been deposited by the City into a separate fund or account or are otherwise held by the City or by a fiduciary to be used to pay principal of and/or interest on specified Common Subordinated Reserve Fund Bonds, then the principal and/or interest to be paid from such moneys, Permitted Investments or from the earnings thereon shall be disregarded and not included in calculating Maximum Annual Debt Service.

**Common Subordinated Bonds Reserve Requirement**

The term "Common Subordinated Bonds Reserve Requirement" means, as of any date of computation by the Authority, an amount equal to the least of (i) ten percent (10%) of the proceeds (within the meaning of Section 148 of the Code) of the Common Subordinated Bond Reserve Fund Bonds; (ii) 125% of average annual debt service on the Outstanding Common Subordinated Reserve Fund Bonds; or (iii) Common Subordinated Reserve Fund Bonds Maximum Annual Debt Service; provided, however, that, if, upon issuance of a Series of Subordinated Bonds secured by the Common Subordinated Reserve Fund, such amount would require moneys to be credited to the Common Subordinated Reserve Fund from the proceeds of such Series of Subordinated Bonds in an amount in excess of the maximum amount permitted under the Code, the Common Subordinated Bonds Reserve Requirement shall mean an amount equal to the sum of the Common Subordinated Bonds Reserve Requirement immediately preceding issuance of such Subordinated Bonds and the maximum amount permitted under the Code to be deposited therein from the proceeds of such Subordinated Bonds, as certified by the Authority; and provided further, that, for purposes of calculating average annual debt service on the Outstanding Common Subordinated Reserve Fund Bonds, the "average annual debt service" of a Series of Subordinated Bonds secured by the Common Subordinated Reserve Fund shall not be greater than the average annual debt service of such Series on the date of issuance of such Series. Upon early redemption of any Subordinated Bonds secured by the Common Subordinated Bonds Reserve Fund, the Authority, at the request of the City, may request the Trustee to recalculate and reduce the Common Subordinated Bonds Reserve Requirement, whereupon any excess in the Common Subordinated Bonds Reserve Fund over and above the Common Subordinated Bonds Reserve Requirement shall be transferred to the Subordinated Bonds Payment Fund.

***Note:*** With respect to the four definitions above, no debt service reserve fund will be created or funded to secure the 2016 Bonds. Debt service reserve funds were created in connection with the issuance of the 2009A Bonds, 2009B Bonds, 2010A Bonds and 2012A Subordinated Bonds and under the funding agreements for the SRF loans. Amounts on deposit in, or to be on deposit in, such debt service reserve funds are not available to secure the 2016 Bonds. See "SECURITY AND SOURCES OF

PAYMENT FOR THE 2016 BONDS – No Debt Service Reserve Fund for 2016 Bonds" in this Official Statement.

**Components**

The term "Components" means components of the Project for which the City makes Installment Payments or Subordinated Installment Payments pursuant to any Supplement.

**Comptroller**

The term "Comptroller" means the Comptroller of the City.

**Corporate Trust Office of the Trustee**

The term "Corporate Trust Office of the Trustee" means the corporate trust office of the Trustee at the address set forth in the Indenture or such other or additional offices as may be specified to the Authority by the Trustee in writing.

**Costs of Issuance**

The term "Costs of Issuance" means all items of expense directly or indirectly payable by or reimbursable to the City, the Corporation, or the Authority relating to the issuance, sale, and delivery of any Bonds under the Indenture, including, but not limited to, costs of preparation and reproduction of documents; fees and expenses of the Feasibility Consultant; fees and expenses of the Authority (including its counsel); expenses of the City, Authority, and Corporation staff; fees of the City's Financial Advisor; initial fees, expenses, and charges of the Trustee (including its counsel); Rating Agency fees; Underwriters' discount; legal fees and charges of Bond Counsel; Disclosure Counsel; Underwriters' counsel, and the City Attorney; and any other cost, charge, or fee in connection with the issuance and delivery of the Bonds.

**Costs of Issuance Account**

The term "Costs of Issuance Account" means the fund by that name established under the Indenture with respect to the 2016 Bonds.

**Depository**

The term "Depository" means the securities depository acting as Depository pursuant to the Indenture.

**DTC**

The term "DTC" means The Depository Trust Company, New York, New York, and its successors.

**Event of Default**

The term "Event of Default" shall have that meaning set forth in the Indenture or the Installment Purchase Agreement, as applicable.

**Federal Securities**

The term "Federal Securities" means the following securities:

1. United States Treasury Bills, bonds, and notes for which the full faith and credit of the United States are pledged for payment of principal and interest;

2. Direct senior obligations issued by the following agencies of the United States Government: the Federal Farm Credit Bank System, the Federal Home Loan Bank System, the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, and the Tennessee Valley Authority;

3. Mortgage Backed Securities (except stripped mortgage securities) issued by the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, and the Government National Mortgage Association; and

4. United States Treasury Obligations, State and Local Government Series.

**First Supplemental Indenture**

The term "First Supplemental Indenture" means the First Supplemental Indenture, dated as of June 1, 2009, by and between the Authority and the Trustee.

**Fiscal Year**

The term "Fiscal Year" means the fiscal year of the Authority, which, as of the date of the Indenture, is the period from July 1 to and including the following June 30.

**Fitch**

The term "Fitch" means Fitch Ratings and its successors and, if such company shall for any reason no longer perform the functions of a securities rating agency, "Fitch" shall be deemed to refer to any nationally recognized securities rating agency designated by the Authority and the City.

**Fourth Supplemental Indenture**

The term "Fourth Supplemental Indenture" means the Fourth Supplemental Indenture, dated as of June 1, 2016, by and between the Authority and the Trustee.

**Indenture**

The term "Indenture" means the Original Indenture, as supplemented and amended by the First Supplemental Indenture, the Second Supplemental Indenture, the Third Supplemental Indenture and the Fourth Supplemental Indenture.

**Information Services**

The Term "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, with respect to the 2016 Bonds, August 1, 2016, and each February 1 and August 1 thereafter until the Bonds are paid or redeemed in full.

**Installment Payments**

The term "Installment Payments" means Installment Payments that are Parity Obligations (as defined in the Installment Purchase Agreement), scheduled to be paid by the City under and pursuant to any Supplement that has been assigned to the Trustee (as assignee of the Authority) to secure any Bonds.

**Installment Purchase Agreement**

The term "Installment Purchase Agreement" means the Master Installment Purchase Agreement, dated as of August 1, 1998, as supplemented and amended by a 1998 Supplement to Master Installment Purchase Agreement, dated as of August 1, 1998, a 2002 Supplement to Master Installment Purchase Agreement, dated as of October 1, 2002, an Amended and Restated Master Installment Purchase Agreement, dated as of January 1, 2009, a 2009A Supplement to Amended and Restated Master Installment Purchase Agreement, dated as of January 1, 2009, a 2009B Supplement to Amended and Restated Master Installment Purchase Agreement, dated as of June 1, 2009, a 2010A Supplement to Amended and Restated Master Installment Purchase Agreement, dated as of June 1, 2010, the 2012A Supplement, and the 2016 Supplement, each by and between the City and the Corporation, as such Installment Purchase Agreement may from time to time be further amended or supplemented by all Supplements executed pursuant to the provisions thereof.

**Interest Portion**

The term "Interest Portion" means the interest portion of 2016 Subordinated Installment Payments specified in the 2016 Supplement.

**Letter of Representations**

The term "Letter of Representations" means the letter of the Authority delivered to and accepted by the Depository on or prior to the delivery of any Book-Entry Bonds setting forth the basis on which the Depository serves as depository for such Book-Entry Bonds, as originally executed or as it may be supplemented or revised or replaced by a letter to a substitute Depository.

**Moody's**

The term "Moody's" means Moody's Investors Service, a corporation organized under the laws of the State of Delaware, and its successors, and if such corporation shall for any reason no longer perform the functions of a securities rating agency, "Moody's" shall be deemed to refer to any other nationally recognized securities rating agency designated by the Authority and the City.

**Nominee**

The term "Nominee" means the nominee of the Depository, which may be the Depository, as determined from time to time pursuant to the Indenture.

**Original Indenture**

The term "Original Indenture" means the Indenture, dated as of January 1, 2009, by and between the Authority and the Trustee.

**Outstanding**

The term "Outstanding," means, when used as of any particular time with reference to Bonds, means (subject to the provisions of the Indenture) all Bonds theretofore or thereupon executed by the Authority and authenticated and delivered by the Trustee pursuant to the terms of the Indenture, except:

1. Bonds theretofore cancelled by the Trustee or surrendered to the Trustee for cancellation;

2. Bonds paid or deemed to have been paid within the meaning of the Indenture;

3. Bonds beneficially owned by the City or the Authority; and

4. Bonds in lieu of or in substitution for which other Bonds shall have been executed by the Authority and authenticated and delivered pursuant to the terms of the Indenture.

**Owner**

The term "Owner" means any person who shall be the registered owner of any Outstanding Bond as shown on the registration books required to be maintained by the Trustee pursuant to the Indenture.

**Parity Installment Payments**

The term "Parity Installment Payments" means Installment Payments that are Parity Obligations scheduled to be paid by the City under and pursuant to any Supplement that has been assigned to the Trustee (as assignee of the Authority) to secure such Parity Obligations.

**Participants**

The term "Participants" means those broker-dealers, banks, and other financial institutions from time to time for which the Depository holds Book-Entry Bonds as securities depository.

**Payment Fund**

The term "Payment Fund" means the fund by that name established under the Indenture.

**Permitted Investments**

The term "Permitted Investments" means any of the following which, at the time of investment, are legal investments under the laws of the State for the moneys proposed to be invested therein:

(1) Federal Securities;

(2) The following listed obligations of government-sponsored agencies which are not backed by the full faith and credit of the United States of America:

(A) Federal Home Loan Mortgage Corporation (FHLMC) senior debt obligations and Participation certificates (excluded are stripped mortgage securities which are purchased at prices exceeding their principal amounts);

(B) Farm Credit System (formerly Federal Land Banks, Federal Intermediate Credit Banks and Banks for Cooperatives) consolidated system-wide bonds and notes;

(C) Federal Home Loan Banks (FHL Banks) consolidated debt obligations;

(D) Federal National Mortgage Association (FNMA) senior debt obligations and mortgage-backed securities (excluded are stripped mortgage securities which are purchased at prices exceeding their principal amounts);

(E) The senior debt obligations of Resolution Funding Corporation (RFCO), Financing Corporation (FICO) and Tennessee Valley Authority (TVA);

(3) 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, that are rated, at the time of purchase, in the highest Rating Category by two Rating Agencies;

(4) United States dollar denominated senior unsecured unsubordinated obligations issued or unconditionally guaranteed by the International Bank for Reconstruction and Development, International Finance Corporation, or Inter-American Development Bank. Investments under this subdivision shall be rated "AA" or better by a Rating Agency;

(5) Bonds, notes, debentures or other evidences of indebtedness issued or guaranteed by any corporation which are rated, at the time of purchase, "A1/P1/F1" by two Rating Agencies or, if the term of such indebtedness is longer than one year, rated in the highest Rating Category by two Rating Agencies;

(6) Taxable commercial paper or tax-exempt commercial paper with a maturity of not more than 270 days, which are rated, at the time of purchase, "A1/P1/F1" by two Rating Agencies;

(7) 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 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, at the time of purchase, in the highest short term rating by two Rating Agencies;

(8) 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, at the time of purchase, by two Rating Agencies in the highest short-term Rating Category, and which bankers acceptances mature not later than 365 days from the date of purchase;

(9) Any repurchase agreement: (A) with (i) 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 having short-term debt which is rated, at the time of the purchase, by two Rating Agencies in one of the three highest short-term Rating Categories; or (ii) any government bond dealer reporting to, trading with, and recognized as a primary dealer by, the Federal Reserve Bank of New York; and (B) which agreement is secured by any one or more of the securities and obligations described in clause (1) or (2) of this definition and having maturities equal to or less than 5 years from the date of delivery, which shall have a market value (valued at least monthly) not less than 102% of the principal amount of such investment and shall be placed with the Trustee 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 the Trustee that the aggregate market value of all such obligations securing each such repurchase agreement (as valued at least monthly) 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;

(10) 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), (3) and (9) of this definition and any money market fund, the entire investments of which are limited to investments described in clauses (1), (2), (3) and (9) of this definition and which money market fund is rated, at the time or purchase, by at least one Rating Agency in the highest Rating Category;

(11) Any guaranteed investment contract, including forward delivery agreements ("FDAs") and forward purchase agreements ("FPAs"), with a financial institution or insurance company which has (or which is unconditionally guaranteed by a legal entity which has), at the date of execution thereof, an outstanding issue of unsecured, uninsured and unguaranteed debt obligations or a claims-paying ability which is rated, at the time of purchase, by two Rating Agencies in one of two highest long-term Rating Categories. Only Permitted Investments described in clause (1) and (2) of this definition 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;

(12) Certificates, notes, warrants, bonds or other evidence of indebtedness of the State or of any political subdivision or public agency thereof which are rated, at the time of purchase, by two Rating Agencies in the highest short-term Rating Category or within one of the three highest long-term Rating Categories, but 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;

(13) For amounts less than $250,000, 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;

(14) Investments in Constant Net Asset Value taxable money market funds or portfolios restricted to obligations with an average maturity of one year or less and which funds or portfolios are: (A) rated, at the time of purchase, by two Rating Agencies in one of the two highest Rating Categories; or (B) have or are portfolios guaranteed as to payment of principal and interest by the full faith and credit of the United States of America;

(15) Investments in the City Treasurer's pooled investment fund;

(16) Shares of beneficial interest in diversified management companies investing exclusively in securities and obligations described in clauses (1) through (13) of this definition and which companies

are: (A) rated, at the time of purchase, by two Rating Agencies in the highest Rating Category; or (B) 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);

(17) 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; and

(18) Any other investment, with confirmation (or other action, satisfactory to the City) from each rating agency that has a current rating on the Bonds at the time of initial purchase thereof, that its rating on the Bonds will not be lowered or withdrawn as a result of such investment.

**Person**

The term "Person" mean any legal entity or natural person, as the context may require.

**Pre-Refunded Municipals**

The term "Pre-Refunded Municipals" means any bonds or other obligations of any state of the United States of America or of any agency, instrumentality, or local governmental unit of any such state which are not callable at the option of the obligor prior to maturity or as to which irrevocable instructions have been given by the obligor to call on the date specified in the notice.

**Principal Account**

The term "Principal Account" means the account of that name established under the Indenture.

**Principal Payment Date**

The term "Principal Payment Date" means, (i) with respect to the 2009A Bonds, each August 1, commencing August 1, 2009, through and including August 1, 2038, (ii) with respect to the 2009B Bonds, each August 1, commencing August 1, 2010, through and including August 1, 2039, (iii) with respect to the 2010A Bonds, each August 1, commencing August 1, 2022, through and including August 1, 2028, (iv) with respect to the 2012A Bonds, each August 1, commencing August 1, 2012, through and including August 1, 2032 and (v) with respect to the 2016 Bonds, each August 1, commencing August 1, 2016, through and including August 1, 20__.

**Principal Portion**

The term "Principal Portion" means the principal portion of 2016 Subordinated Installment Payments specified in the 2016 Supplement.

**Project**

The term "Project" means the acquisition, construction, installation, and improvements to the Water System described in Exhibit A to the Installment Purchase Agreement and as modified with respect to Components in conformance with the Installment Purchase Agreement.

**Project Costs**

The term "Project Costs" means the costs of the Project disbursed from time to time by the Comptroller from the Acquisition Fund pursuant to the Indenture.

**Purchase Price**

The term "Purchase Price" means the principal amount plus interest thereon owed by the City under the terms of the Installment Purchase Agreement as provided in the Indenture thereof and as specified in a Supplement.

**Rating Agency**

The term "Rating Agency" means Fitch, Moody's, or S&P.

**Rebate Fund**

The term "Rebate Fund" means the fund by that name created under the Indenture and any other accounts thereunder.

**Record Date**

The term "Record Date" means the fifteenth day of the calendar month immediately preceding an Interest Payment Date, whether or not such day is a Business Day.

**Redemption Account**

The term "Redemption Account" means the account by that name established under the Indenture.

**Requisition**

The term "Requisition" means a requisition form, by which the City shall withdraw moneys from the Acquisition Fund or the Costs of Issuance Account.

**Reserve Fund**

The term "Reserve Fund" means the fund by that name established under the Indenture, in which the Reserve Requirement shall be held and invested.

**Reserve Requirement**

The term "Reserve Requirement" means, as of any date of calculation, the least of (10%) of the proceeds (within the meaning of section 148 of the Code) of the Bonds; (ii) 125% of average annual debt service on the then-Outstanding Bonds; or (iii) the Maximum Annual Debt Service for that and any subsequent year. Upon early redemption of any of the Bonds, the Authority, at the request of the City, may request the Trustee to recalculate and reduce any Reserve Requirement, whereupon any excess in the Reserve Fund over and above such Reserve Requirement shall be transferred to the Payment Fund.

***Note:*** With respect to the two definitions above, no debt service reserve fund will be created or funded to secure the 2016 Bonds. Debt service reserve funds were created in connection with the issuance of the 2009A Bonds, 2009B Bonds, 2010A Bonds and 2012A Subordinated Bonds and under the

funding agreements for the SRF loans. Amounts on deposit in, or to be on deposit in, such debt service reserve funds are not available to secure the 2016 Bonds. See "SECURITY AND SOURCES OF PAYMENT FOR THE 2016 BONDS – No Debt Service Reserve Fund for 2016 Bonds" in this Official Statement.

**Revenues**

The term "Revenues" means all Installment Payments received by or due to be paid to the Corporation, and the interest, and the interest or profits from the investment of money in any account or fund (other than the Subordinated Bonds Payment Fund, the Subordinated Bonds Reserve Fund and the Rebate Fund) pursuant to the Indenture.

**S&P**

The term "S&P" means Standard & Poor's Ratings Group, a division of The McGraw-Hill Companies, Inc., a corporation organized and existing under the laws of the State of New York, and its successors, and if such corporation shall for any reason no longer perform the functions of a securities rating agency, "S&P" shall be deemed to refer to any other nationally recognized securities rating agency designated by the Authority and the City.

**Second Supplement**

The term "Second Supplement" means the Second Supplemental Indenture, dated as of June 1, 2010, by and the Authority and the Trustee.

**Securities Depository**

The term "Securities Depository" means The Depository Trust Company, 55 Water Street, 50th Floor, New York, N.Y. 10041-0099 Attn. Call Notification Department, Fax (212) 855-7232, or, in accordance with then-current guidelines of the Securities and Exchange Commission, such other securities depositories, or no such depositories, as the Authority may indicate in a Written Request of the Authority delivered to the Trustee.

**Senior Bonds**

The term "Senior Bonds" means the 2009A Bonds, the 2009B Bonds, the 2010A Bonds and any other Bonds secured by pledge of Revenues on a parity with such Bonds.

**Separate Subordinated Bonds Reserve Fund**

The term "Separate Subordinated Bonds Reserve Fund" means a reserve fund, if any, created pursuant to a Supplemental Indenture for a Series of Subordinated Bonds that is not part of the Common Subordinated Bonds Reserve Fund.

**Separate Subordinated Bonds Reserve Requirement**

The term "Separate Subordinated Bonds Reserve Requirement" means the requirement set forth in the Supplemental Indenture establishing a Separate Subordinated Bonds Reserve Fund.

***Note:*** With respect to the two definitions above, no debt service reserve fund will be created or funded to secure the 2016 Bonds. Debt service reserve funds were created in connection with the issuance of the 2009A Bonds, 2009B Bonds, 2010A Bonds and 2012A Subordinated Bonds and under the

funding agreements for the SRF loans. Amounts on deposit in, or to be on deposit in, such debt service reserve funds are not available to secure the 2016 Bonds. See "SECURITY AND SOURCES OF PAYMENT FOR THE 2016 BONDS – No Debt Service Reserve Fund for 2016 Bonds" in this Official Statement.

**State**

The term "State" means the State of California.

**Subordinated Bonds**

The term "Subordinated Bonds" means the 2012A Bonds and 2016 Bonds and any other Bonds secured by a pledge of Subordinated Revenues on a parity with such Bonds.

**Subordinated Bonds Interest Account**

The term "Subordinated Bonds Interest Account" means the account by that name established under the Indenture.

**Subordinated Bonds Payment Fund**

The term "Subordinated Bonds Payment Fund" means the fund by that name established under the Indenture.

**Subordinated Bonds Principal Account**

The term "Subordinated Bonds Principal Account" means the account by that name established under the Indenture.

**Subordinated Bonds Redemption Account**

The term "Subordinated Bonds Redemption Account" means the account by that name established under the Indenture.

**Subordinated Bonds Reserve Fund**

The term "Subordinated Bonds Reserve Fund" means the fund by that name established under the Indenture. No debt service reserve fund will be created or funded to secure the 2016 Bonds. Debt service reserve funds were created in connection with the issuance of the 2009A Bonds, 2009B Bonds, 2010A Bonds and 2012A Subordinated Bonds and under the funding agreements for the SRF loans. Amounts on deposit in, or to be on deposit in, such debt service reserve funds are not available to secure the 2016 Bonds. See "SECURITY AND SOURCES OF PAYMENT FOR THE 2016 BONDS – No Debt Service Reserve Fund for 2016 Bonds" in this Official Statement.

**Subordinated Installment Payments**

The term "Subordinated Installment Payments" means Installment Payments that are Subordinated Obligations (as defined in the Installment Purchase Agreement) scheduled to be paid by the City under and pursuant to any Supplement that has been assigned to the Trustee (as assignee of the Authority) to secure any Subordinated Bonds or Notes.

**Subordinated Revenues**

The term "Subordinated Revenues" means all Subordinated Installment Payments received by or due to the Corporation pursuant to the Installment Purchase Agreement and the interest or profits from the investment of money in the Subordinated Bonds Payment Fund and the Subordinated Bonds Reserve Fund.

**Supplement**

The term "Supplement" means a supplement to the Installment Purchase Agreement providing for the payment of specific Installment Payments as the Purchase Price for Components of the Project, executed and delivered by the City and the Corporation.

**Supplemental Indenture**

The term "Supplemental Indenture" means any indenture supplemental to or amendatory of the Indenture duly executed and delivered by the Authority and the Trustee as authorized under the Indenture.

**Surety Bond**

The term "Surety Bond" means a reserve bond, insurance policy, letter of credit, or other similar instrument rated "Aa3" or "AA-" or better by at least two Rating Agencies at the time of purchase or issuance and providing, by its terms, a stated amount as a credit towards or in satisfaction of all or part of the Reserve Requirement, which Surety Bond shall be held by the Trustee in trust pursuant to the Indenture. A Surety Bond shall constitute and qualify as a "Reserve Fund Credit Facility," as such term is defined in the Installment Purchase Agreement.

**2016 Bonds**

The term "2016 Bonds" means the 2016A Bonds and the 2016B Bonds.

**2016A Bonds**

The term "2016A Bonds" means the Authority's Subordinated Water Revenue Bonds, Refunding Series 2016A (Payable Solely from Subordinated Installment Payments Secured by Net System Revenues of the Water Utility Fund), issued under the Indenture.

**2016B Bonds**

The term "2016B Bonds" means the Authority's Subordinated Water Revenue Bonds, Refunding Series 2016B (Payable Solely from Subordinated Installment Payments Secured by Net System Revenues of the Water Utility Fund), issued under the Indenture.

**2016 Closing Date**

The term "2016 Closing Date" means June __, 2016, the date of initial delivery of the 2016 Bonds.

**2016 Components**

The term "2016 Components" shall have the meaning given such term in the 2016 Supplement.

**2016 Installment Payment Date**

The term "2016 Installment Payment Date" means the 15th day of the calendar month immediately preceding each Interest Payment Date for the 2016 Bonds.

**2016 New Money Components**

The term "2016 New Money Components" means the components of the Project for which the City makes Installment payments under the 2016 Supplement, as set forth in Exhibit A to the 2016 Supplement.

**2016 Refunded Obligations**

The term "2016 Refunded Obligations" means the [2009A Bonds, the 2009B Bonds, the 2010A Bonds and the Subordinate SRF Loan].

**2016 Subordinated Installment Payments**

The term "2016 Subordinated Installment Payments" means those Installment Payments scheduled to be paid by the City under the 2016 Supplement.

**2016 Supplement**

The term "2016 Supplement" means the 2016 Supplement to Amended and Restated Master Installment Purchase Agreement, dated as of June 1, 2016, by and between the City and the Corporation.

**Tax Certificate**

The term "Tax Certificate" means the Tax Exemption Certificate delivered with respect to Tax-Exempt Bonds on their Closing Date.

**Tax-Exempt Bonds**

The term "Tax-Exempt Bonds" means those Bonds that, by their terms, bear interest that is excluded from gross income for federal income tax purposes, pursuant to the Code.

**Third Supplemental Indenture**

The term "Third Supplemental Indenture" means the Third Supplemental Indenture, dated as of March 1, 2012, by and between the Authority and the Trustee.

**Treasurer**

The term "Treasurer" means the Office of the City Treasurer of the City of San Diego.

**Trustee**

The term "Trustee" means U.S. Bank National Association, a national banking association existing under and by virtue of the laws of the United States, or any other bank or trust company that may at any time be substituted in its place as provided in the Indenture.

**Underwriters**

The term "Underwriters" means, with respect to the 2016 Bonds, collectively, J.P. Morgan Securities LLC, Morgan Stanley & Co. LLC, Siebert Brandford Shank & Co., L.L.C., Ramirez & Co, and The Williams Capital Group, L.P.

**Water System**

The term "Water System" means any and all facilities, properties, improvements, and works at any time owned, controlled, or operated by the City as part of the public utility system of the City for water purposes, for the development, obtaining, conservation, production, storage, treatment, transmission, furnishing, and distribution of water and its other commodities or byproducts for public and private use (whether located within or outside the City), and any related or incidental operations designated by the City as part of the Water System, including reclaimed and re-purified water.

**Written Request of the Authority**

The term "Written Request of the Authority" means instrument in writing signed by the Chair, the Vice Chair, or the Secretary of the Authority, or by any other officer or Commissioner of the Board duly authorized by the Authority for that purpose.

**Written Request of the City**

The term "Written Request of the City" means an instrument in writing signed by the Chief Operating Officer, the Chief Financial Officer or any of their respective designees, or by any other official of the applicable administrative departments of the City duly authorized by the City for that purpose.

**2009A Bonds**

The term "2009A Bonds" means the Public Facilities Financing Authority of the City of San Diego Water Revenue Bonds, Series 2009A (Payable Solely From Installment Payments Secured by Net System Revenues of the Water Utility Fund) issued in the aggregate principal amount of $157,190,000.

**2009B Bonds**

The term "2009B Bonds" means the Public Facilities Financing Authority of the City of San Diego Water Revenue Bonds, Series 2009B (Payable Solely From Installment Payments Secured by Net System Revenues of the Water Utility Fund) issued in the aggregate principal amount of $328,060,000.

**2010A Bonds**

The term "2010A Bonds" means the Public Facilities Financing Authority of the City of San Diego Water Revenue Bonds, Refunding Series 2010A (Payable Solely from Installment Payments Secured by Net System Revenues of the Water Utility Fund), issued under the Indenture in the original aggregate principal amount of $123,075,000.

**2012A Bonds**

The term "2012A Bonds" means the Authority's Subordinated Water Revenue Bonds, Refunding Series 2012A (Payable Solely from Subordinated Installment Payments Secured by Net System Revenues of the Water Utility Fund), issued under the Indenture in the original aggregate principal amount of $188,610,000.

**2012A Installment Payment Date**

The term "2012A Installment Payment Date" means the 15th day of the calendar month immediately preceding each Interest Payment Date for the 2012A Bonds.

**2012A Subordinated Installment Payments**

The term "2012A Subordinated Installment Payments" means those Installment Payments scheduled to be paid by the City under the 2012A Supplement.

**2012A Supplement**

The term "2012A Supplement" means the 2012A Supplement to Amended and Restated Master Installment Purchase Agreement, dated as of March 1, 2012, by and between the City and the Corporation.

**2016 Installment Payment Date**

The term "2016 Installment Payment Date" means the 15th day of the calendar month immediately preceding each Interest Payment Date for the 2016 Bonds.

**2016 Subordinated Installment Payments**

The term "2016 Subordinated Installment Payments" means those Installment Payments scheduled to be paid by the City under the 2016 Supplement.

**2016 Supplement**

The term "2016 Supplement" means the 2016 Supplement to Amended and Restated Master Installment Purchase Agreement, dated as of June 1, 2016, by and between the City and the Corporation.

## INDENTURE

The Indenture sets forth certain terms of the 2016 Bonds, the nature and extent of the security for the 2016 Bonds, the rights of the Owners of the 2016 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 2016 BONDS" and "SECURITY AND SOURCES OF PAYMENT FOR THE 2016 BONDS." Capitalized terms used in connection with the Indenture but not defined below have the meanings ascribed thereto in the body of this Official Statement.

**Establishment of Funds; Deposit and Application**

***Establishment of Funds and Accounts.***

(a) Pursuant to the Original Indenture, the Trustee has established the Payment Fund, including the Interest Account, the Principal Account, and the Redemption Account for the Senior Bonds and the Subordinated Bond Payment Fund, including the Subordinated Bonds Interest Account, the Subordinated Bonds Principal Account, and the Subordinated Bonds Redemption Account for the Subordinated Bonds.

(b) Pursuant to the Fourth Supplement, the Trustee shall establish the Costs of Issuance Account for the 2016 Bonds.

(c) Pursuant to the Fourth Supplement, the Trustee shall establish the Acquisition Fund.

(d) Pursuant to the Fourth Supplement, the Trustee shall establish the SRF Refunding Fund.

(d) Pursuant to the Original Indenture, the Trustee has established the Reserve Fund for the Senior Bonds, and, pursuant to the Third Supplement, the Subordinated Bonds Reserve Fund and the Common Subordinated Bonds Reserve Fund, in order to facilitate compliance by the City with the Tax Certificate and the Installment Purchase Agreement.

No debt service reserve fund will be created or funded to secure the 2016 Bonds. Debt service reserve funds were created in connection with the issuance of the 2009A Bonds, 2009B Bonds, 2010A Bonds and 2012A Subordinated Bonds and under the funding agreements for the SRF loans. Amounts on deposit in, or to be on deposit in, such debt service reserve funds are not available to secure the 2016 Bonds. See "SECURITY AND SOURCES OF PAYMENT FOR THE 2016 BONDS – No Debt Service Reserve Fund for 2016 Bonds" in this Official Statement.

***Use of Moneys in Acquisition Fund for the 2016A Bonds***. The Trustee shall disburse moneys from the Acquisition Fund for the 2016A Bonds to pay Project Costs with respect to the 2016A Bonds or, at the election of the City as set forth in a Requisition or Written Request of the City, transfer such moneys therefrom to the Interest Account to pay interest on the 2016A Bonds when and as the same shall become due and payable. Such disbursements shall be made from time to time upon receipt of Requisitions of the City on behalf of the Authority in accordance with the terms of the Fourth Supplement. If, after payment of all Requisitions of the City on behalf of the Authority and delivery to the Trustee of a Certificate of Completion, there shall remain any balance of money in the Acquisition Fund, all money so remaining shall be transferred to the Subordinated Bonds Interest Account within the Subordinated Bonds Payment Fund, to be applied as a credit towards the next interest payment on the 2016 Bonds.

***Use of Moneys in Costs of Issuance Account for the 2016 Bonds***. The Trustee shall disburse moneys from the Costs of Issuance Account for the 2016 Bonds to pay Costs of Issuance with respect to the 2016 Bonds. Such disbursements shall be made from time to time upon receipt of Requisitions of the City on behalf of the Authority in accordance with the terms of the Fourth Supplement. On the day that is the 181st day following the 2016 Closing Date, the Trustee shall transfer any then-remaining but uncommitted amount on deposit in the Costs of Issuance Account for the 2016 Bonds to the Subordinated Bonds Interest Account within the Subordinated Bonds Payment Fund, to be applied as a credit towards the next interest payment on the 2016 Bonds.

***Subordinated Bonds Payment Fund***. The Trustee shall establish and maintain a special trust fund to be designated the "City of San Diego Water System Improvement Project Subordinated Bonds Payment Fund" (the "Subordinated Bonds Payment Fund"). Within the Subordinated Bonds Payment Fund, the Trustee shall establish and maintain a Subordinated Bonds Interest Account (the "Subordinated Bonds Interest Account"), a Subordinated Bonds Principal Account (the "Subordinated Bonds Principal Account"), and a Subordinated Bonds Redemption Account (the "Subordinated Bonds Redemption Account").

***Subordinated Bonds Reserve Fund***. The Trustee shall establish and maintain a special trust fund to be designated the "City of San Diego Water System Improvement Project Subordinated Bonds Reserve Fund" (the "Subordinated Bonds Reserve Fund"). Within the Subordinated Bonds Reserve Fund, the

Trustee shall establish and maintain a Common Subordinated Bonds Reserve Fund (the "Common Subordinated Bonds Reserve Fund") and shall establish and maintain any Separate Subordinated Bonds Reserve Fund required by a Supplemental Indenture to be established and maintained. The 2012A Bonds are secured by the Common Subordinated Bonds Reserve Fund.

No debt service reserve fund will be created or funded to secure the 2016 Bonds. Debt service reserve funds were created in connection with the issuance of the 2009A Bonds, 2009B Bonds, 2010A Bonds and 2012A Subordinated Bonds and under the funding agreements for the SRF loans. Amounts on deposit in, or to be on deposit in, such debt service reserve funds are not available to secure the 2016 Bonds. See "SECURITY AND SOURCES OF PAYMENT FOR THE 2016 BONDS – No Debt Service Reserve Fund for 2016 Bonds" in this Official Statement.

(a) The Subordinated Bonds Reserve Fund and, within the Subordinated Bonds Reserve Fund, the Common Subordinated Bonds Reserve Fund and each separate Subordinated Bonds Reserve Fund are each a separate fund held in trust by the Trustee. An amount equal to the Common Subordinated Bond Reserve Requirement shall be maintained in or credited to the Common Subordinated Bonds Reserve Fund and amounts equal to each Separate Subordinated Bonds Reserve Requirement shall be maintained in or credited to such Separate Subordinated Bonds Reserve Fund at all times, subject to the provisions of subsection (e) of this section, and any deficiency therein shall be replenished from the first available Subordinated Revenues pursuant to paragraph (e) below.

(b) Moneys in or available from the Subordinated Bonds Reserve Fund shall be used solely for the purpose of paying the principal of and interest on the Subordinated Bonds, including the redemption price of the Subordinated Bonds coming due and payable by operation of mandatory sinking fund redemption, in the event that the moneys in the Subordinated Bonds Payment Fund are insufficient therefor. If and during such time as a Surety Bond is in effect for a Series of Subordinated Bonds secured by a Separate Subordinated Reserve Fund, not less than two Business Days prior to each Interest Payment Date, the Trustee shall ascertain the necessity for a draw upon the Surety Bond and, if the draw is necessary, shall provide notice thereof to the provider of the Surety Bond in accordance with the terms of the Surety Bond at least two Business Days prior to each Interest Payment Date. In the event that the amount on deposit in the Subordinated Bonds Payment Fund on any date is insufficient to enable the Trustee to pay in full the aggregate amount of principal of and interest on such Series of Subordinated Bonds secured by a Separate Subordinated Reserve Fund coming due and payable by operation of mandatory sinking fund redemption, the Trustee shall withdraw the amount of such insufficiency from the applicable Separate Subordinated Bonds Reserve Fund of make a draw upon the applicable Surety Bond in the amount of such insufficiency and transfer such amount to the Subordinated Bonds Payment Fund. Amounts on deposit in the Subordinated Bonds Reserve Fund shall not be applied to the payment of Senior Bonds.

(c) In the event that the amount on deposit in the Common Subordinated Bonds Reserve Fund or a Separate Subordinated Bonds Reserve Fund exceeds the Common Subordinated Bonds Reserve Requirement or applicable Separate Subordinated Bonds Reserve Fund Requirement on the fifteenth (15th) calendar day of the month preceding any Interest Payment Date, the amount of such excess shall be withdrawn therefrom by the Trustee and transferred to (a) the Rebate Fund, to the extent required under the Indenture, or (b) the Subordinated Bonds Payment Fund. In any case where a fund in a Separate Subordinated Bonds Reserve Fund is funded with a combination of cash and a Surety Bond, any such withdrawal of excess shall be effected through a withdrawal of cash not a reduction in the amount of the Surety Bond. The remaining balance in any fund in the Subordinated Bonds Reserve Fund may be applied at the direction of the Authority, to the payment of the final maturing principal payments of Subordinated Bonds secured by such fund.

(d) The Authority may replace all or a portion of a Separate Subordinated Bonds Reserve Fund Requirement, originally funded with cash, with one or more Surety Bonds. Upon deposit of any Surety Bond with the Trustee, the Trustee shall transfer to the Acquisition Fund from amounts in the related Separate Subordinated Bonds Reserve Fund an amount equal to the principal of the Surety Bond, which principal shall comprise the Separate Subordinated Bonds Reserve Fund, as applicable, under the Indenture, or make other transfers in accordance with a Written Direction of the City.

In any case where a fund in a Separate Subordinated Bonds Reserve Fund is funded with a combination of cash and a Surety Bond, the Trustee shall deplete all cash balances before drawing on the related Surety Bond. With regard to replenishment, any available moneys provided by the City shall be used first to reinstate the related Surety Bond and second, to replenish the cash in the related Separate Subordinated Bonds Reserve Fund in accordance with subsection (e) of this section. In the event the Surety Bond is drawn upon, the City shall make payment of interest on amounts advanced under the Surety Bond after making any payments pursuant to the Indenture as summarized herein under the caption "INDENTURE – Revenues – Maintenance of Accounts for Use of Money in the Subordinated Bonds Payment Fund."

In the event the Surety Bond is scheduled to lapse or expire, the Trustee shall draw upon such Surety Bond prior to its lapsing or expiring in the full amount of such Surety Bond, make deposits from available Subordinated Revenues to the Separate Subordinated Bonds Reserve Fund, as applicable, to increase the amount on deposit therein to the Separate Subordinated Bonds Reserve Fund Requirement, as applicable or substitute such Surety Bond with a Surety Bond that satisfies the requirements of this section.

The Authority acknowledges that the rating on any Surety Bond obtained or provided under the Indenture may change after the date such Surety Bond is purchased or issued. Within twelve (12) months after the date that the Authority obtains actual knowledge that any Surety Bond is no longer rated at least "Aa3" or "AA-" by any Rating Agency, the Authority shall either (i) deposit into the related Separate Subordinated Bonds Reserve Fund, as applicable, money in an amount equal to the stated or principal amount of such Surety Bond or (ii) obtain a substitute Surety Bond that satisfies the provisions of the Indenture.

(e) In the event that the amount on deposit in the Common Subordinated Bonds Reserve Fund or Separate Subordinated Bonds Reserve Fund at any time falls below the Common Subordinated Bonds Reserve Requirement or Separate Subordinated Bonds Reserve Fund Requirement, as applicable, or in the event of a draw on the Surety Bond deposited therein, the Trustee shall promptly notify the City and the Authority of such fact and the Trustee shall promptly (A)(i) withdraw the amount of such insufficiency from available Subordinated Revenues on deposit in the Subordinated Bonds Payment Fund, and (ii) transfer such amount to the Common Subordinated Bonds Reserve Fund or applicable Separate Subordinated Bonds Reserve Fund or (B) withdraw an amount necessary to repay such drawing on the Surety Bond and related expenses. Repayment of draws, expenses and accrued interest (collectively, "Policy Costs") shall commence in the first month following each draw, and each such monthly payment shall be in an amount at least equal to 1/12 of the aggregate of Policy Costs related to such draw.

(f) Notwithstanding any other provision in the Indenture, amounts in deposit in the Common Subordinated Bonds Reserve Fund shall secure and shall be used solely for the purpose of paying the principal of and interest on Common Subordinated Reserve Fund Bonds and amounts on deposit in a Separate Subordinated Bonds Reserve Fund shall secure and shall be used solely for the purpose of paying the principal of and interest on Subordinated Bonds specified in the Supplemental Indenture as secured by such Separate Subordinated Bonds Reserve Fund.

***Senior Bonds Reserve Fund.***

***Senior Bonds Reserve Fund.*** (a) Within the Reserve Fund, the Trustee shall establish and maintain a Common Senior Bonds Reserve Fund (the "Common Senior Bonds Reserve Fund") and shall establish and maintain any Separate Senior Bonds Reserve Fund required by a Supplemental Indenture to be established and maintained. The Reserve Fund and, within the Reserve Fund, the Common Senior Bonds Reserve Fund and each separate Senior Bonds Reserve Fund are each a separate fund held in trust by the Trustee. An amount equal to the Common Senior Bond Reserve Requirement shall be maintained in or credited to the Common Senior Bonds Reserve Fund and amounts equal to each Separate Senior Bonds Reserve Requirement shall be maintained in or credited to such Separate Senior Bonds Reserve Fund at all times, subject to the provisions of subsection (e) below, and any deficiency therein shall be replenished from the first available Senior Revenues pursuant to (e) below.

(b) Moneys in or available from the Reserve Fund shall be used solely for the purpose of paying the principal of and interest on the Senior Bonds, including the redemption price of the Senior Bonds coming due and payable by operation of mandatory sinking fund redemption, in the event that the moneys in the Senior Bonds Payment Fund are insufficient therefor. If and during such time as a Surety Bond is in effect for a Series of Senior Bonds secured by a Separate Senior Reserve Fund, not less than two Business Days prior to each Interest Payment Date, the Trustee shall ascertain the necessity for a draw upon the Surety Bond and, if the draw is necessary, shall provide notice thereof to the provider of the Surety Bond in accordance with the terms of the Surety Bond at least two Business Days prior to each Interest Payment Date. In the event that the amount on deposit in the Senior Bonds Payment Fund on any date is insufficient to enable the Trustee to pay in full the aggregate amount of principal of and interest on such Series of Senior Bonds secured by a Separate Senior Reserve Fund coming due and payable by operation of mandatory sinking fund redemption, the Trustee shall withdraw the amount of such insufficiency from the applicable Separate Senior Bonds Reserve Fund of make a draw upon the applicable Surety Bond in the amount of such insufficiency and transfer such amount to the Senior Bonds Payment Fund. Amounts on deposit in the Reserve Fund shall not be applied to the payment of Subordinated Bonds.

(c) In the event that the amount on deposit in the Common Senior Bonds Reserve Fund or a Separate Senior Bonds Reserve Fund exceeds the Common Senior Bonds Reserve Requirement or applicable Separate Senior Bonds Reserve Fund Requirement on the fifteenth (15th) calendar day of the month preceding any Interest Payment Date, the amount of such excess shall be withdrawn therefrom by the Trustee and transferred to (a) the Rebate Fund, to the extent required under the Indenture, or (b) the Senior Bonds Payment Fund. In any case where a fund in a Separate Senior Bonds Reserve Fund is funded with a combination of cash and a Surety Bond, any such withdrawal of excess shall be effected through a withdrawal of cash not a reduction in the amount of the Surety Bond. The remaining balance in any fund in the Senior Bonds Reserve Fund may be applied at the direction of the Authority, to the payment of the final maturing principal payments of Senior Bonds secured by such fund.

(d) The Authority may replace all or a portion of a Separate Senior Bonds Reserve Fund Requirement, originally funded with cash, with one or more Surety Bonds. Upon deposit of any Surety Bond with the Trustee, the Trustee shall transfer to the Acquisition Fund from amounts in the related Separate Senior Bonds Reserve Fund an amount equal to the principal of the Surety Bond, which principal shall comprise the Separate Senior Bonds Reserve Fund, as applicable, under the Indenture, or make other transfers in accordance with a Written Direction of the City.

In any case where a fund in a Separate Senior Bonds Reserve Fund is funded with a combination of cash and a Surety Bond, the Trustee shall deplete all cash balances before drawing on the related Surety Bond. With regard to replenishment, any available moneys provided by the City shall be used first

to reinstate the related Surety Bond and second, to replenish the cash in the related Separate Senior Bonds Reserve Fund in accordance with subsection (e) of this section. In the event the Surety Bond is drawn upon, the City shall make payment of interest on amounts advanced under the Surety Bond after making any payments pursuant to the Indenture.

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 Senior Revenues to the Separate Senior Bonds Reserve Fund, as applicable, to increase the amount on deposit therein to the Separate Senior Bonds Reserve Fund Requirement, as applicable or substitute such Surety Bond with a Surety Bond that satisfies the requirements of this section.

(e) In the event that the amount on deposit in the Common Senior Bonds Reserve Fund or Separate Senior Bonds Reserve Fund at any time falls below the Common Senior Bonds Reserve Requirement or Separate Senior Bonds Reserve Fund Requirement, as applicable, or in the event of a draw on the Surety Bond deposited therein, the Trustee shall promptly notify the City and the Authority of such fact and the Trustee shall promptly (A)(i) withdraw the amount of such insufficiency from available Senior Revenues on deposit in the Senior Bonds Payment Fund, and (ii) transfer such amount to the Common Senior Bonds Reserve Fund or applicable Separate Senior Bonds Reserve Fund or (B) withdraw an amount necessary to repay such drawing on the Surety Bond and related expenses. Repayment of draws, expenses and accrued interest (collectively, "Policy Costs") shall commence in the first month following each draw, and each such monthly payment shall be in an amount at least equal to 1/12 of the aggregate of Policy Costs related to such draw.

(f) Amounts in deposit in the Common Senior Bonds Reserve Fund shall secure and shall be used solely for the purpose of paying the principal of and interest on Common Senior Reserve Fund Bonds and amounts on deposit in a Separate Senior Bonds Reserve Fund shall secure and shall be used solely for the purpose of paying the principal of and interest on Senior Bonds specified in the Supplemental Indenture as secured by such Separate Senior Bonds Reserve Fund.

(g) In any case where any Common Senior Reserve Fund or Separate Senior Bonds Reserve Fund is funded in whole or in part with a Surety Bond, the Authority acknowledges that the rating on such Surety Bond may change after the date such Surety Bond is purchased or issued. In no event shall the City or the Authority by required to replace such Surety Bond initially delivered under the Indenture with a similar instrument or with cash.

***Note***: No debt service reserve fund will be created or funded to secure the 2016 Bonds. Debt service reserve funds were created in connection with the issuance of the 2009A Bonds, 2009B Bonds, 2010A Bonds and 2012A Subordinated Bonds and under the funding agreements for the SRF loans. Amounts on deposit in, or to be on deposit in, such debt service reserve funds are not available to secure the 2016 Bonds. See "SECURITY AND SOURCES OF PAYMENT FOR THE 2016 BONDS – No Debt Service Reserve Fund for 2016 Bonds" in this Official Statement.

**Revenues**

***Pledge of Subordinated Revenues.***

(a) All Subordinated Revenues and amounts on deposit in the Subordinated Bonds Payment Fund and the Subordinated Bonds Reserve Fund (if deemed applicable to a Series of Subordinated Bonds) are, as provided in the Indenture, irrevocably pledged to the payment of the interest on and principal of the Subordinated Bonds but only as provided in the Indenture, and the Subordinated Revenues shall not be used for any other purpose while any of the Subordinated Bonds remain Outstanding; provided, that

out of the Subordinated Revenues there may be allocated such sums for such purposes as are expressly permitted by the Indenture as summarized herein under the caption "INDENTURE – Revenues – Maintenance of Accounts for Use of Money in the Subordinated Bonds Payment Fund."

No debt service reserve fund will be created or funded to secure the 2016 Bonds. Debt service reserve funds were created in connection with the issuance of the 2009A Bonds, 2009B Bonds, 2010A Bonds and 2012A Subordinated Bonds and under the funding agreements for the SRF loans. Amounts on deposit in, or to be on deposit in, such debt service reserve funds are not available to secure the 2016 Bonds. See "SECURITY AND SOURCES OF PAYMENT FOR THE 2016 BONDS – No Debt Service Reserve Fund for 2016 Bonds" in this Official Statement.

(b) The Trustee shall be entitled to and shall receive all of the Subordinated Installment Payments pledged to secure any Subordinated Bond, and any such Subordinated Installment Payments collected or received by the Authority shall be deemed to be held, and to have been collected or received, by the Authority as agent of the Trustee and shall forthwith be paid by the Authority to the Trustee.

***Receipt and Deposit of Revenues in the Subordinated Bonds Payment Fund***. To carry out and effectuate the pledge contained in the Indenture, the Authority agrees and covenants that all Subordinated Revenues when and as received shall be received in trust under the Indenture for the benefit of the Owners and shall be deposited when and as received in the Subordinated Bonds Payment Fund. All Subordinated Revenues shall be accounted for through and held in trust in the Subordinated Bonds Payment Fund, and the Authority shall have no beneficial right or interest in any of the Subordinated Revenues except only as provided in the Indenture. All Subordinated Revenues, whether received by the Authority in trust or deposited with the Trustee as provided in the Indenture, shall nevertheless be allocated, applied and disbursed solely to the purposes and uses set forth in the Indenture, and shall be accounted for separately and apart from all other accounts, funds, money or other assets of the Authority.

***Maintenance of Accounts for Use of Money in the Subordinated Bonds Payment Fund.***

(a) In accordance with the Indenture, all money in the Subordinated Bonds Payment Fund shall be deposited by the Trustee in the following respective special accounts within the Subordinated Bonds Payment Fund (each of which the Trustee has covenanted and agreed to maintain under the Indenture) in the following order of priority:

(i) Subordinated Bonds Interest Account,

(ii) Subordinated Bonds Principal Account, and

(iii) Subordinated Bonds Redemption Account.

All money in each of such Accounts shall be held in trust by the Trustee and shall be applied, used and withdrawn only for the purposes as summarized hereinafter in this section and under the Indenture.

(b) On or before each Interest Payment Date, the Trustee shall transfer from the Subordinated Bonds Payment Fund and deposit in the Subordinated Bonds Interest Account that amount of money that, together with any money contained in the Subordinated Bonds Interest Account, equals the aggregate amount of interest becoming due and payable on all Outstanding Subordinated Bonds on such Interest Payment Date. No deposit need be made in the Subordinated Bonds Interest Account if the amount contained in the Subordinated Bonds Interest Account equals at least the aggregate amount of interest becoming due and payable on all Outstanding Subordinated Bonds on such Interest Payment Date. All

money in the Subordinated Bonds Interest Account shall be used and withdrawn by the Trustee solely for the purpose of paying the interest on the Subordinated Bonds as it shall become due and payable (including accrued interest on any Subordinated Bonds redeemed prior to maturity).

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

(d) In addition to the above accounts, the Trustee shall establish and maintain within the Subordinated Bonds Payment Fund a special account designated the "Subordinated Bonds Redemption Account." All money in the Subordinated Bonds Redemption Account shall be held in trust by the Trustee and shall be applied, used, and withdrawn to redeem Subordinated Bonds for the purposes authorized in this subsection (d). Any moneys that, pursuant to the terms for prepayment of Installment Payments pursuant to the Installment Purchase Agreement and the related provisions of any Supplements, are to be used to redeem Subordinated Bonds shall be deposited by the Trustee in the Redemption Account. The Trustee shall, on the scheduled redemption date, withdraw from the Subordinated Bonds Redemption Account and pay the Owners entitled thereto an amount equal to the redemption price of the Subordinated Bonds to be redeemed on such date.

(e) Any delinquent Subordinated Installment Payments pledged to the Subordinated Bonds shall be applied first to the Subordinated Bonds Interest Account for the immediate payment of interest payments past due and the to the Subordinated Bonds Principal Account for immediate payment of principal payments past due on any Subordinated Bond. Any remaining money representing delinquent Subordinated Installment Payments pledged to Subordinated Bonds shall be deposited in the Subordinated Bonds Payment Fund to be applied in the manner provided therein.

***Pledge of Revenues.***

(a) All Revenues and amounts on deposit in the funds and accounts established under the Indenture (other than amounts on deposit in the Subordinated Bonds Payment Fund, the Subordinated Bonds Reserve Fund and the Rebate Fund created pursuant to the Indenture, and the Reserve Fund if not deemed applicable to a Series of Bonds) are, as provided in the Indenture, irrevocably pledged to the payment of the interest on and principal of the Senior Bonds as provided in the Indenture, and the Revenues shall not be used for any other purpose while any of the Senior Bonds remain Outstanding; provided, that out of the Revenues there may be allocated such sums for such purposes as are expressly permitted by the Indenture.

(b) To secure the pledge of the Revenues contained in this subheading, the Authority transfers, conveys and assigns to the Trustee, for the benefit of the Owners, all of the Authority's rights under the 2016 Supplement and, in connection with any Additional Bonds issued under the Indenture, the Authority's rights under the Supplement(s) executed by the City and the Corporation to secure payment of principal of and interest on such Additional Bonds, including the right to receive Installment Payments from the City, the right to receive any proceeds of insurance maintained thereunder or any condemnation award rendered with respect to the 2016 Components and the right to exercise any remedies provided

therein in the event of a default by the City thereunder. The Trustee accepts said assignment for the benefit of the Owners subject to the provisions of the Indenture.

(c) The Trustee shall be entitled to and shall receive all of the 2016 Subordinated Installment Payments and, in connection with any Additional Bonds issued under the Indenture, the Installment Payments made by the City pursuant to the Supplement(s) executed by the City and the Corporation to secure payment of principal of and interest on such Additional Bonds, and any 2016 Subordinated Installment Payments and additional Installment Payments collected or received by the Authority shall be deemed to be held, and to have been collected or received, by the Authority as agent of the Trustee and shall forthwith be paid by the Authority to the Trustee.

***Receipt and Deposit of Revenues in the Payment Fund***. To carry out and effectuate the pledge contained in the Indenture, the Authority agrees and covenants that all Revenues when and as received shall be received in trust under the Indenture for the benefit of the Owners and shall be deposited when and as received in the Payment Fund. All Revenues shall be accounted for through and held in trust in the Payment Fund, and the Authority shall have no beneficial right or interest in any of the Revenues except only as provided in the Indenture. All Revenues, whether received by the Authority in trust or deposited with the Trustee as provided in the Indenture, shall nevertheless be allocated, applied and disbursed solely to the purposes and uses set forth in the Indenture, and shall be accounted for separately and apart from all other accounts, funds, money, or other assets of the Authority.

***Maintenance of Accounts for Use of Money in the Payment Fund.***

(a) All money in the Payment Fund shall be deposited by the Trustee in the following respective special accounts within the Payment Fund in the following order of priority:

(i) Interest Account,

(ii) Principal Account, and

(iii) Redemption Account.

All money in each of such Accounts shall be held in trust by the Trustee and shall be applied, used and withdrawn only for the purposes authorized in the Indenture.

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

(c) On or before each Principal Payment Date, the Trustee shall transfer from the Payment Fund and deposit in the Principal Account that amount of money that, together with any money contained in the Principal Account, equals the aggregate principal becoming due and payable on all Outstanding Senior Bonds. No deposit need be made in the Principal Account if the amount contained therein is at least equal to the aggregate amount of principal become due and payable on Outstanding Senior Bonds.

All money in the Principal Account shall be used and withdrawn by the Trustee solely for the purpose of paying the principal of the Senior Bonds as it shall become due and payable.

(d) In addition to the above accounts, the Trustee shall establish and maintain within the Payment Fund a special account designated the "Redemption Account." All money in the Redemption Account shall be held in trust by the Trustee and shall be applied, used, and withdrawn either to redeem the Senior Bonds or for the purposes authorized in this subsection (d). Any moneys that, terms for prepayment of Installment Payments pursuant to the Installment Purchase Agreement and the related provisions of any Supplements, are to be used to redeem Senior Bonds shall be deposited by the Trustee in the Redemption Account. The Trustee shall, on the scheduled redemption date, withdraw from the Redemption Account and pay the Owners entitled thereto an amount equal to the redemption price of the Senior Bonds to be redeemed on such date.

(e) Any delinquent Installment Payments pledged to the Senior Bonds shall be applied first to the Interest Account for the immediate payment of interest payments past due and the to the Principal Account for immediate payment of principal payments past due on any Senior Bond. Any remaining money representing delinquent Installment Payments pledged to Senior Bonds shall be deposited in the Payment Fund to be applied in the manner provided therein.

***Investment of Moneys in Funds and Accounts***. 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 (10) of the definition of Permitted Investments. The obligations in which moneys in the said funds and accounts are invested shall mature prior to the date on which such moneys are estimated to be required to be paid out under the Indenture. For purposes of determining the amount of deposit in any fund or account held under the Indenture, 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 the first (1st) calendar day of the month preceding the Interest Payment dates, and at such times as the Authority shall deem appropriate, value the investments in the funds and accounts under the Indenture on the basis of the lesser of market value or the cost thereof based on accepted industry standards from accepted industry providers. Except as otherwise provided in this section, Permitted Investments representing an investment of moneys attributable to any fund or account under the Indenture and all investment profits or losses thereon shall be deemed at all times to be a part of said fund or account.

**Additional Bonds**

***Execution and Delivery of Additional Bonds***. In addition to the 2009A Bonds, the 2009B Bonds and the 2010A Bonds, the Trustee shall, upon Written Request of the Authority, by a supplement to the Indenture, establish one or more other series of Bonds secured by the pledge made under the Indenture equally and ratably with any Senior Bonds previously issued and delivered (if such Bonds are to be Senior Bonds) or equally and ratably with any Subordinated Bonds (if such Bonds are to be Subordinated Bonds), in such principal amount as shall be determined by the Authority, but only upon compliance with the provisions of the Indenture, the requirements of the Installment Purchase Agreement applicable to the incurrence of Parity Obligations (if such Bonds are to be Senior Bonds) or Subordinated Obligations (if such Bonds are Subordinated Bonds) and any additional requirements set forth in the applicable Supplemental Indenture, which are, as provided in the Indenture, made conditions precedent to the execution and delivery of Additional Bonds:

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

(b) The Supplemental Indenture providing for the execution and delivery of such Additional Bonds shall specify the purposes for which such Additional Bonds are then proposed to be delivered, which shall be one or more of the following: (i) to provide moneys needed to provide for Project Costs by depositing into the Acquisition Fund the proceeds of such Additional Bonds to be so applied; (ii) to provide for the payment or redemption of Bonds then Outstanding under the Indenture, by depositing with the Trustee moneys and/or investments required for such purpose under the defeasance provisions set forth in the Indenture; or (iii) to provide moneys needed to refund or refinance all or part of any other current or future obligations of the City with respect to the funding of the Water System. Such Supplemental Indenture may, but shall not be required to, provide for the payment of expenses incidental to such purposes, including the Costs of Issuance of such Additional Bonds, capitalized interest with respect thereto for any period authorized under the Code (in the case of Tax-Exempt Bonds) and, in the case of any Additional Bonds intended to provide for the payment or redemption of existing Bonds, or other Obligations of the City, expenses incident to calling, redeeming, paying or otherwise discharging the Obligations to be paid with the proceeds of the Additional Bonds;

(c) The Supplemental Indenture providing for the execution and delivery of such Additional Bonds shall state whether such Additional Bonds shall be Senior Bonds or Subordinated Bonds.

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

(e) If such Additional Bonds are Senior Bonds, the Authority shall deliver or cause to be delivered to the Trustee, from the proceeds of such Additional Bonds or from any other lawfully available source of moneys, an amount (or a Surety Bond in an amount) sufficient to increase the balance in the Reserve Fund to the Reserve Fund Requirement;

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

(g) If such Additional Bonds are Subordinated Bonds to be secured by a Separate Subordinated Bonds Reserve Fund, the Authority shall deliver or cause to be delivered by the Trustee, from the proceeds of such Additional Bonds or from any other lawfully available source of moneys, an amount (or a Surety Bond in an amount) sufficient to increase the balance in such Separate Subordinated Bonds Reserve Fund to the Separate Subordinated Bonds Reserve Fund for such Series of Subordinated Bonds

(h) The Additional Bonds shall be payable as to principal on August 1 and as to interest on February 1 and August 1 of each year during their term, except that the first interest payment due with respect thereto may be for a period of not longer than twelve (12) months;

(i) Fixed serial maturities or mandatory sinking account payments, or any combination thereof, shall be established in amounts sufficient to provide for the retirement of all of the Additional Bonds of such Series on or before their respective maturity dates;

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

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

Nothing in the Indenture shall limit in any way the power and authority of the Authority to incur other obligations payable from other lawful sources.

**Covenants of Authority**

***Punctual Payment and Performance***. The Authority shall punctually pay the interest and the principal to become due on every Bond issued under the Indenture in strict conformity with the terms of the Indenture and of the Bonds, and shall faithfully observe and perform all the agreements and covenants contained therein.

***Rebate Fund.***

(a) The Trustee shall maintain such accounts within the Rebate Fund as it is instructed by the Authority as shall be necessary in order to comply with the applicable Tax Certificate (which is incorporated in the Indenture by reference). The Trustee shall deposit moneys in the Rebate Fund made available by the Authority and/or the City pursuant to a Written Request of the City. All money at any time deposited in the Rebate Fund shall be governed by the Indenture and the Tax Certificate and shall be held by the Trustee in trust, to the extent required to satisfy the amount required to be rebated to the United States under the Code, and none of the City, the Corporation, Authority, the Trustee, or the Owners shall have any rights in or claims to such money. The Trustee shall make information regarding the investments under the Indenture available to the City, shall invest the Rebate Fund in Permitted Investments pursuant to a Written Request of the City that is in conformity with the restrictions set forth in the Tax Certificate and shall deposit income from such Permitted Investments immediately upon receipt thereof into the Rebate Fund. The Trustee agrees to comply with all Written Requests of the City given in accordance with the Tax Certificate.

(b) The City and the Authority shall make or cause to be made the rebate computations respecting all Outstanding Bonds in accordance with the Tax Certificate, as required by the Code, and shall provide to the Trustee written evidence that the computation of the rebate requirement has been made along with a letter from an independent certified public accountant or arbitrage consultant verifying the accuracy of such calculations. Upon a Written Request of the City, the Trustee shall make deposits into the Rebate Fund from deposits by the City so that the balance of the amount on deposit shall be equal to the rebate requirement. The Trustee shall have no obligation to rebate any amounts required to be rebated pursuant to the Indenture, other than from moneys held in the Rebate Fund or from other moneys provided to it by the City on behalf of itself or the Authority.

(c) Not later than sixty (60) days after the end of the fifth Bond Year as defined in the Tax Certificate and every five (5) years thereafter, the Trustee, upon receipt of a Written Request of the City, shall pay to the United States part or all of the amounts in the Rebate Fund, as so directed. Each payment shall be accompanied by a statement summarizing the determination of the amount to be paid to the United States, as provided by the City. In addition, if the City so directs, then the Trustee shall deposit moneys into or transfer moneys out of the Rebate Fund from or into such accounts or funds as directed by the Written Request of the City. Any amounts remaining in the Rebate Fund following the final payment of the rebate requirement shall be paid to the City. Money, including investment earnings, shall not be transferred from the Rebate Fund except as provided in the Indenture.

(d) Notwithstanding any other provision the Indenture, the obligation to remit the rebate requirement to the United States and to comply with all other requirements of the Indenture and the Tax Certificate shall survive the defeasance or payment in full of the Tax-Exempt Bonds.

(e) The Authority shall not use or permit any proceeds of the Tax-Exempt Bonds or any funds of the Authority, directly or indirectly, to acquire any securities or obligations, and shall not take or permit to be taken any other action or actions, that would cause any Tax-Exempt Bonds to be an "arbitrage bond" within the meaning of the Code or "federally guaranteed" within the meaning of Section 149(b) of the Code and any applicable regulations promulgated from time to time thereunder and under Section 103(c) of the Code. The Authority shall observe and not violate the requirements of Section 148 of the Code and any such applicable regulations. The Authority shall comply with all requirements of Sections 148 and 149(b) of the Code to the extent applicable to the Tax-Exempt Bonds.

(f) The Authority specifically covenants to comply with the provisions and procedures of the Tax Certificate.

(g) The Authority shall not use or permit the use of any proceeds of the Bonds or any funds of the Authority, directly or indirectly, in any manner, and shall not take or omit to take any action that would cause any Tax-Exempt Bonds to be treated as an obligation not described in Section 103(a) of the Code.

(h) Notwithstanding any provisions of the Indenture, if the Authority and the City shall provide to the Trustee an opinion of Bond Counsel to the effect that any specified action required under the Indenture is no longer required or that some further or different action is required to maintain the exclusion from gross income for federal income tax purposes of interest with respect to the Tax-Exempt Bonds, the Trustee, the Authority and the City may conclusively rely on such opinion in complying with the requirements of the Indenture and the covenants under the Indenture shall be deemed to be modified to that extent.

***Accounting Records and Reports***. The Authority shall keep or cause to be kept proper books of record and accounts in which complete and correct entries shall be made of all transactions relating to the receipts, disbursements, allocation and application of the Revenues and the Subordinated Revenues, and such books shall be available for inspection by the Trustee, at reasonable hours and under reasonable conditions. Not more than 270 days after the close of each Fiscal Year, the Authority shall furnish or cause to be furnished to the Trustee financial statements that include the Water Utility Fund for the preceding Fiscal Year, prepared in accordance with generally accepted accounting principles, together with a report of an Independent Certified Public Accountant thereon. For purposes of this section, "financial statement" shall mean audited financial statements, if available, or unaudited financial statements, if audited financial statements are not available and unaudited financial statements are available. The Authority shall also keep or cause to be kept such other information as is required under the Tax Certificate.

***The City's Budgets***. The Authority shall supply to the Trustee, as soon as practicable after the beginning of each Fiscal Year following the effectiveness of the applicable City ordinance but in no event later than six months from the date of effectiveness of such ordinance, a Certificate of the City certifying that the City has made adequate provision in its annual budget for such Fiscal Year for the payment of all Parity Installment Payments, Subordinated Installment Payments, and all other Obligations due under the Installment Purchase Agreement in such Fiscal Year. If the amounts so budgeted are not adequate for the payment of all Parity Installment Payments, Subordinated Installment Payments, and all other Obligations due under the Installment Purchase Agreement in such Fiscal Year, the Authority shall take such action as may be necessary and within its power to request such annual budget to be amended, corrected, or augmented by the City so as to include therein the amounts required to be paid by the City from Net System Revenues in such Fiscal Year, and shall notify the Trustee of the proceedings then taken or proposed to be by the Authority.

***Continuing Disclosure***. The City has undertaken all responsibility for compliance with continuing disclosure requirements, and accordingly the Authority shall have no liability to the Owners of the Bonds or any other person with respect to Securities and Exchange Commission Rule 15c2-12, and the City shall comply with and carry out all of the provisions of each continuing disclosure certificate, each dated the date of the execution and delivery of each Series of Bonds. See the caption in this Official Statement "CONTINUING DISCLOSURE." Notwithstanding any other provision of the Indenture, failure of the City to comply with a Continuing Disclosure Certificate shall not be considered an Event of Default under the Indenture or under the Installment Purchase Agreement; provided, that the Trustee may and, at the request of any participating underwriter or the Owners of at least twenty-five percent (25%) in aggregate principal amount of the Outstanding Bonds of any series, shall, or any Owner or Beneficial Owner of any of the Bonds may, take such actions as may be necessary and appropriate, including seeking mandate or specific performance by court order, to cause the City to comply with its obligations under the related Continuing Disclosure Certificate.

**Amendment of Indenture**

***Amendment of Indenture.***

(a) The Indenture and-the rights and obligations of the Authority and of the all Owners of the Bonds may be amended at any time by a Supplemental Indenture, which shall become binding when the written consents of the Owners of 51% in aggregate principal amount of the Senior Bonds then Outstanding and the written consents of the Owner of 51% in aggregate principal amount of the Subordinated Bonds then Outstanding, exclusive of Bonds disqualified as provided in the Indenture, are filed with the Trustee. No such amendment shall (i) permit the creation by the Authority of any pledge of the Revenues or Subordinated Revenues as provided in the Indenture superior to or on a parity with the pledge created under the Indenture for the benefit of any Bond without the written consent of the Owner thereof; (ii) modify any rights or obligations of the Trustee without its prior written assent thereto; or (iii) modify provisions respecting the time or amount of payments on any Bond, without the written consent of the Owner thereof.

(b) The Indenture and the rights and obligations of the Authority and of the Owners may also be amended at any time by a Supplemental Indenture, which shall become binding without the consent of any Owners of Bonds for any one or more of the following purposes:

(i) to make such provisions for the purpose of curing any ambiguity or of correcting, curing or supplementing any defective provision contained in the Indenture in regard to questions arising under the Indenture that the Authority may deem desirable or necessary and not inconsistent with the Indenture and that shall not adversely affect the interests of the Owners; or

(ii) to make any other change or addition thereto that shall not materially adversely affect the interests of the Owners, or to surrender any right or power reserved in the Indenture to or conferred in the Indenture on the Authority; provided, however, that the Owners shall be given prompt notice of any such amendment and shall receive a copy of the final executed Supplemental Indenture making such changes.

***Disqualified Bonds***. Bonds owned or held by or for the account of the Authority or the City shall not be deemed Outstanding for the purpose of any consent or other action or any calculation of Outstanding Bonds provided in the Indenture, and shall not be entitled to consent to or take any other action provided therein.

***Endorsement or Replacement of Bonds After Amendment***. After the effective date of any action taken as described above, the Authority may determine that the Bonds may bear a notation by endorsement in form approved by the Authority as to such action, and in that case upon demand of the Owner of any Outstanding Bond and presentation of its Bond for such purpose at the Corporate Trust Office of the Trustee, a suitable notation as to such action shall be made on such Bond. If the Authority shall determine that a Bond shall bear such a notation by endorsement pursuant to the Indenture, a new Bond so modified shall be prepared and executed, and upon demand of the Owner of any Outstanding Bond, such new Bond shall be exchanged at the Corporate Trust Office of the Trustee without cost to such Owner upon surrender of such Bond.

***Amendment by Mutual Consent***. The provisions of the Indenture shall not prevent any Owner from accepting any amendment as to the particular Bonds owned by him, provided that due notation thereof is made on such Bonds.

**Events of Default and Remedies of Holders**

***Events of Default and Acceleration of Maturities.***

(a) The following events shall constitute events of default under the Indenture:

(i) failure in the due and punctual payment of the interest on the Bonds when and as the same shall become due and payable;

(ii) failure in the due and punctual payment of the principal of the Bonds when and as the same shall become due and payable, whether at maturity as therein expressed or by proceedings for redemption;

(iii) failure by the Authority in the performance of any of the other agreements or covenants required in the Indenture to be performed by the Authority, as set forth in the Indenture, and such default shall have continued for a period of 30 days after the Authority and the City shall have been given notice in writing of such default by the Trustee or to the Authority, the City and the Trustee by Owners of 25% or more of the aggregate principal amount of the Bonds then Outstanding; or

(iv) if any event of default shall have occurred and be continuing under the Installment Purchase Agreement; or

(v) if the Authority shall file a petition or answer seeking arrangement or reorganization under the federal bankruptcy laws or any other applicable law of the United States of America or any state therein, or if under the provisions of any other law for the relief or aid of debtors any court of competent jurisdiction shall assume custody or control of the Authority or of the whole or any substantial part of its property.

(b) If one or more Events of Default shall occur, then and in each and every such case during the continuance of such Event of Default, the Trustee may by notice in writing to the Authority and the City, declare the principal of all Bonds then Outstanding and the interest accrued thereon to be due and payable immediately. Upon any such declaration, the same shall become due and payable, anything contained in the Indenture or in the Bonds to the contrary notwithstanding. These provisions are subject to the condition that if at any time after the entire principal amount of the unpaid Bonds and the accrued interest thereon shall have been so declared due and payable and before any judgment or decree for the payment of the moneys due shall have been obtained or entered, there shall be deposited with the Trustee

a sum sufficient to pay the unpaid principal amount of the Bonds due prior to such declaration and the accrued interest thereon, with interest on such overdue installments at the rate or rates applicable thereto in accordance with their terms, and the reasonable fees and expenses of the Trustee, and any and all other defaults known to the Trustee (other than in the payment the entire principal amount of the unpaid Bonds and the accrued interest thereon due and payable solely by reason of such declaration) shall have been made good or cured to the satisfaction of the Trustee or provision deemed by the Trustee to be adequate shall have been made therefor, then and in every such case the Trustee, by written notice to the City and the Authority, may rescind and annul such declaration and its consequences; but no such rescission and annulment shall extend to or shall affect any subsequent default or shall impair or exhaust any right or power consequent thereon.

***Proceedings by Trustee***. Upon the occurrence and continuance of any Event of Default, the Trustee in its discretion may, and at the written request of Owners of 51% or more in aggregate principal amount of Bonds Outstanding shall (but only to the extent indemnified to its satisfaction from fees and expenses, including attorneys fees), do the following:

(a) by mandamus, or other suit, action, or proceeding at law or in equity, enforce all rights of the Owners and require the Authority to enforce all rights of the Owners of the Bonds, including the right to require the Authority to receive and collect Revenues and to enforce its rights under the Installment Purchase Agreement and to require the Authority to carry out any other covenant or agreement with Owners of Bonds and to perform its duties under the Indenture;

(b) bring suit upon the Bonds;

(c) by action or suit in equity enjoin any acts or things that may be unlawful or in violation of the rights of the Owners; and

(d) as a matter of right, have receivers appointed for the Revenues and the issues, earnings, income, products and profits thereof, pending such proceedings, with such powers as the court making such appointment shall confer.

***Limitation on Rights and Remedies of Holders of Subordinated Bonds***. So long as any Senior Bonds remain outstanding, no Owners of Subordinated Bonds shall have the right to declare an Event of Default, to declare any Bonds immediately due and payable, to direct the Trustee with respect to any Event of Default or to waive any Event of Default and, for such purposes, any reference to the Owners of a percentage of the principal amount of "Bonds then Outstanding" shall be deemed to refer to the Owners of such percentage of Senior Bonds then Outstanding.

***Effect of Discontinuance or Abandonment***. In case any proceeding taken by the Trustee on account of any default or Event of Default shall have been discontinued or abandoned for any reason, or shall have been determined adversely to the Trustee, then and in every such case, the Authority, the Trustee, and the Owners shall be restored to their former positions and rights under the Indenture, respectively, and all rights, remedies and powers of the Trustee shall continue as though no such proceeding had been taken.

***Rights of Owners.***

(a) Anything in the Indenture to the contrary notwithstanding and subject to the limitations and restrictions as to the rights of the Owners in the Indenture, upon the occurrence and continuance of any Event of Default or the Owners of 51% or more in aggregate principal amount of the Bonds then Outstanding shall have the right upon providing the Trustee security and indemnity reasonably

satisfactory to it against the costs, expenses, and liabilities to be incurred therein or thereby, by an instrument in writing executed and delivered to the Trustee, to direct the method and place of conducting all remedial proceedings to be taken by the Trustee under the Indenture.

(b) The Trustee may refuse to follow any direction that conflicts with law or the Indenture or that the Trustee determines is prejudicial to rights of other Owners or would subject the Trustee to personal liability.

***Restrictions on Owners' Actions.***

(a) In addition to the other restrictions on the rights of Owners to request action upon the occurrence of an Event of Default and to enforce remedies set forth in the Indenture, no Owner of any of the Bonds shall have any right to institute any suit, action, or proceeding in equity or at law for the enforcement of any trust under the Indenture, or any other remedy under the Indenture or on said Bonds, unless:

(i) such Owner previously shall have given to the Trustee written notice of an Event of Default as provided in the Indenture; and

(ii) the Owners of 51% or more in aggregate principal amount of the Bonds then Outstanding shall have made written request of the Trustee to institute any such suit, action, proceeding, or other remedy, after the right to exercise such powers or rights of action, as the case may be, shall have accrued, and shall have afforded the Trustee a reasonable opportunity either to proceed to exercise the powers granted in the Indenture, or to institute such action, suit or proceeding in its or their name; and

(iii) there shall have been offered to the Trustee security and indemnity satisfactory to it against the costs, expenses, and liabilities to be incurred therein or thereby; and

(iv) the Trustee shall not have complied with such request within a reasonable time.

(b) Such notification, request and offer of indemnity are declared in every such case, at the option of the Trustee, to be conditions precedent to the execution of the trusts of the Indenture or for any other remedy under the Indenture. It is understood and intended, subject to the Indenture, that no one or more Owners of the Bonds shall have any right in any manner whatever by his or their action to affect, disturb or prejudice the security of the Indenture, or to enforce any right under the Indenture or under the Bonds, except in the manner therein provided, and that all proceedings at law or in equity shall be instituted, and maintained in the manner therein provided, and for the equal benefit of all Owners of Outstanding Bonds.

***Power of Trustee to Enforce***. All rights of action under the Indenture or under any of the Bonds secured by the Indenture that are enforceable by the Trustee may be enforced by it without the possession of any of the Bonds, or the production thereof at the trial or other proceedings relative thereto. Any such suit, action, or proceedings instituted by the Trustee shall be brought in its own name, as Trustee, for the equal and ratable benefit of the Owners of the Bonds, subject to the provisions of the Indenture.

***Remedies Not Exclusive***. No remedy in the Indenture conferred upon or reserved to the Trustee or to the Owners of the Bonds is intended to be exclusive of any other remedy or remedies, and each and every such remedy shall be cumulative, and shall be in addition to every other remedy given under the Indenture or now or hereafter existing at law or in equity or by statute.

***Waiver of Events of Default; Effect of Waiver.***

(a) The Trustee shall waive any Event of Default under the Indenture and its consequences and rescind any declaration of acceleration, upon the written request of the Owners of 67% or more of the Outstanding Bonds. If any Event of Default shall have been waived as provided in the Indenture, the Trustee shall promptly give written notice of such waiver to the Authority and shall give notice thereof by first class mail, postage prepaid to all Owners of Outstanding Bonds if such Owners had previously been given notices of such Event of Default. No such waiver, rescission and annulment shall extend to or affect any subsequent Event of Default, or impair any right or remedy consequent thereon.

(b) No delay or omission of the Trustee or any Owner of the Bonds to exercise any right or power accruing upon any default or Event of Default shall impair any such right or power or shall be construed to be a waiver of any such default or Event of Default or an acquiescence therein. Every power and remedy given by the Indenture to the Trustee or the Owners of the Bonds, respectively, may be exercised from time to time and as often as may be deemed expedient.

***Application of Moneys.***

(a) Any moneys received by the Trustee pursuant to the Indenture, together with any moneys that upon the occurrence of an Event of Default are held by the Trustee in any of the funds and accounts under the Indenture (other than the Rebate Fund and other than moneys held for Bonds not presented for payment) shall, after payment of all fees and expenses of the Trustee, and the fees and expenses of its counsel, be applied as follows:

(i) Unless the principal of all of the Outstanding Bonds shall be due and payable:

First – To the payment of the Owners of all installments of interest then due on the Bonds, in the order of the maturity of the installments of such interest and, if the amount available shall not be sufficient to pay in full any particular installment, then to the payment ratably, according to the amounts due on such installment, to the Owners, without any discrimination or privilege;

Second - To the payment of the Owners of the unpaid principal of any of the Bonds that shall have become due (other than Bonds matured or called for redemption for the payment of which moneys are held pursuant to the provisions of the Indenture), in the order of their due dates and, if the amount available shall not be sufficient to pay in full the principal of and premium, if any, on such Bonds due on any particular date, then to the payment ratably, according to the amount due on such date, to the Owners without any discrimination; and

Third – To be held for the payment to the Owners as the same shall become due of the principal of and interest on the Bonds, that may thereafter become due either at maturity or upon call for redemption prior to maturity and, if the amount available shall not be sufficient to pay in full such principal and premium, if any, due on any particular date, together with interest then due and owing thereon, payment shall be made in accordance with the Indenture.

(ii) If the principal of all of the Outstanding Bonds shall be due and payable, to the payment of the principal and interest then due and unpaid upon the Outstanding Bonds without preference or priority of any of principal, or interest over the others or of any installment of interest, or of any Outstanding Bond over any other Outstanding Bond, ratably, according to the

amounts due respectively for principal and interest, to the Owners without any discrimination or preference except as to any difference in the respective amounts of interest specified in the Outstanding Bonds.

(b) Whenever moneys are to be applied pursuant to the provisions of the Indenture, such moneys shall be applied at such times, and from time to time, as the Trustee shall determine, having due regard to the amount of such moneys available for application and the likelihood of additional moneys becoming available for such application in the future. The Trustee shall give, by mailing by first-class mail as it may deem appropriate, such notice of the deposit with it of any such moneys.

**Defeasance**

If the Authority shall pay or cause to be paid to the Owners of all Outstanding Bonds the interest thereon and the principal thereof and the premiums, if any, thereon at the times and in the manner stipulated therein, then the Owners of such Bonds shall cease to be entitled to the pledge of the Revenues as provided in the Indenture, and all agreements, covenants and other obligations of the Authority to the Owners of such Bonds shall cease, terminate and become void and be discharged and satisfied. In such event, the Trustee shall execute and deliver to the Authority all such instruments as may be necessary or desirable to evidence such discharge and satisfaction, and the Trustee shall pay over or deliver to the Authority all money or securities or other property held by it pursuant to the Indenture that are not required for the payment of the interest on and principal of and redemption premiums, if any, on such Bonds.

Subject to the provisions of the above paragraph, when any of the Bonds shall have been paid and if, at the time of such payment, the Authority shall have kept, performed and observed all the covenants and promises in such Bonds and in the Indenture required or contemplated to be kept, performed and observed by the Authority or on its part on or prior to that time, then the Indenture shall be considered to have been discharged in respect of such Bonds and such Bonds shall cease to be entitled to the lien of the Indenture and such lien and all agreements, covenants, and other obligations of the Authority therein shall cease, terminate, and become void and be discharged and satisfied as to such Bonds.

Notwithstanding the satisfaction and discharge of the Indenture or the discharge of the Indenture in respect of any Bonds, those provisions of the Indenture relating to the maturity of the Bonds, interest payments and dates thereof, exchange and transfer of Bonds, replacement of mutilated, destroyed, lost, or stolen Bonds, the safekeeping and cancellation of Bonds, nonpresentment of Bonds, and the duties of the Trustee in connection with all of the foregoing, remain in effect and shall be binding upon the Trustee and the Owners of the Bonds and the Trustee shall continue to be obligated to hold in trust any moneys or investments then held by the Trustee for the payment of the principal of, redemption premium, if any, and interest on the Bonds, to pay to the Owners of Bonds the funds so held by the Trustee as and when such payment becomes due. Notwithstanding the satisfaction and discharge of the Indenture or the discharge thereof in respect of any Bonds, those provisions of the Indenture relating to the compensation of the Trustee shall remain in effect and shall be binding upon the Trustee and the Authority.

Any Outstanding Bonds shall prior to the maturity date or redemption date thereof be deemed to have been paid for purposes of the Indenture if: (i) in case any of such Bonds are to be redeemed on any date prior to their maturity date, the Authority shall have given to the Trustee in form satisfactory to it irrevocable instructions to mail, on a date in accordance with the provisions of the Indenture, notice of redemption of such Bonds on said redemption date, said notice to be given in accordance with the Indenture; (ii) there shall have been deposited with the Trustee either (A) money in an amount that shall be sufficient; or (B) Federal Securities of which are not subject to redemption prior to maturity except by the holder thereof (including any such Permitted Investments issued or held in book-entry form on the

books of the Department of the Treasury of the United States of America) and/or Pre-Refunded Municipals, the interest on and principal of which when due, and without any reinvestment thereof, will provide money that, together with the money, if any, deposited with the Trustee at the same time, shall, as verified by an independent certified public accountant or other independent financial consultant acceptable to the Trustee, be sufficient, to pay when due the interest to become due on such Bonds on and prior to the maturity date or redemption date thereof, as the case may be, and the principal of and interest on such Bonds; and; (iii) in the event such Bonds are not by their terms subject to redemption within the next succeeding 60 days, the Authority shall have given the Trustee in form satisfactory to it irrevocable instructions to mail as soon as practicable, a notice to the Owners of such Bonds and to the Securities Depositories and the Information Services that the deposit required by clause (ii) above has been made with the Trustee and that such Bonds are deemed to have been paid in accordance with the Indenture and stating the maturity date or redemption date upon which money is to be available for the payment of the principal of and interest on such Bonds.

**Governing Law**

The Indenture will be governed by the laws of the State of California applicable to contracts made and performed in the State.

## INSTALLMENT PURCHASE AGREEMENT

The Installment Purchase Agreement sets forth certain terms and conditions of the purchase of the Project by the City. The term "Installment Purchase Agreement" means the Master Installment Purchase Agreement, dated as of August 1, 1998, as supplemented and amended by a 1998 Supplement to Master Installment Purchase Agreement, dated as of August 1, 1998, a 2002 Supplement to Master Installment Purchase Agreement, dated as of October 1, 2002, an Amended and Restated Master Installment Purchase Agreement, dated as of January 1, 2009, a 2009A Supplement to Amended and Restated Master Installment Purchase Agreement, dated as of January 1, 2009, a 2009B Supplement to Amended and Restated Master Installment Purchase Agreement, dated as of June 1, 2009, a 2010A Supplement to Amended and Restated Master Installment Purchase Agreement, dated as of January 1, 2009 and the 2012A Supplement, and the 2016 Supplement, each by and between the City and the Corporation, as such Installment Purchase Agreement may from time to time be further amended or supplemented by all Supplements executed pursuant to the provisions thereof. Certain definitions under and provisions of the Installment Purchase Agreement are given and summarized below. Other provisions are summarized in the Official Statement under the caption "SECURITY AND SOURCES OF PAYMENT FOR THE 2016 BONDS."

***Selected Definitions.***

**Accountant's Report**

The term "Accountant's Report" means a report signed by an Independent Certified Public Accountant.

**Adjusted Debt Service**

The term "Adjusted Debt Service" means, for any Fiscal Year, Debt Service on Parity Obligations for such Fiscal Year, minus an amount equal to earnings from investments in any Reserve Fund securing Parity Obligations for such Fiscal Year.

**Adjusted Net System Revenues**

The term "Adjusted Net System Revenues" means, for any Fiscal Year, the Net System Revenues for such Fiscal Year, minus an amount equal to earnings from investments in any Reserve Fund securing Parity Obligations for such Fiscal Year.

**Authorizing Ordinance**

The term "Authorizing Ordinance" means the ordinance pursuant to which the Installment Purchase Agreement was authorized and any additional ordinance or official authorizing act of the council of the City approving execution and delivery of any Supplement to the Installment Purchase Agreement or any Issuing Instrument.

**Balloon Indebtedness**

The term "Balloon Indebtedness" means, with respect to any Series of Obligations twenty-five percent (25%) or more of the principal of which matures on the same date or within a 12-month period (with sinking fund payments on Term Obligations deemed to be payments of matured principal), that portion of such Series of Obligations which matures on such date or within such 12-month period; provided, however, that to constitute Balloon Indebtedness the amount of indebtedness maturing on a single date or over a 12-month period must equal or exceed 150% of the amount of such Series of Obligations which matures during any preceding 12-month period. For purposes of this definition, the principal amount maturing on any date shall be reduced by the amount of such indebtedness which is required, by the documents governing such indebtedness, to be amortized by prepayment or redemption prior to its stated maturity date.

**Capacity Charge**

The term "Capacity Charge" means a charge imposed upon a person, firm, corporation or other entity incident to the granting of a permit for a new water connection or due to an increase in water usage by the addition of any type of dwelling, commercial or industrial unit, which charge is based upon an increase in water consumption as measured by equivalent dwelling units, and the proceeds of which are used to construct, improve and expand the Water System to accommodate the additional business of such added dwellings or commercial or industrial units.

**Consultant**

The term "Consultant" means the consultant, consulting firm, engineer, architect, engineering firm, architectural firm, accountant, or accounting firm retained by the City to perform acts or carry out the duties provided for such consultant in the Installment Purchase Agreement. Such consultant, consulting firm, engineer, architect, engineering firm, or architectural firm shall be nationally recognized within its profession for work of the character required. Such accountants or accounting firm shall be independent certified public accountants licensed to practice in the State.

**Credit Provider**

The term "Credit Provider" means any municipal bond insurance company, bank, or other financial institution or organization which is performing in all material respects its obligations under any Credit Support Instrument for some or all of the Parity Obligations.

**Credit Provider Reimbursement Obligations**

The term "Credit Provider Reimbursement Obligations" means obligations of the City to repay from Net System Revenues, amounts advanced by a Credit Provider as credit support or liquidity for Parity Obligations, which obligations shall constitute Parity Obligations or Subordinated Obligations, as designated by the City.

**Credit Support Instrument**

The term "Credit Support Instrument" means a policy of insurance, a letter of credit, a standby purchase agreement, revolving credit agreement or other credit arrangement pursuant to which a Credit Provider provides credit support or liquidity with respect to the payment of interest, principal, or the purchase price of any Parity Obligations.

**Debt Service**

With regard to the issuance of Parity Obligations, the term "Debt Service" means, for any Fiscal Year, the sum of (a) the interest payable during such Fiscal Year on all Outstanding Parity Obligations, assuming that all Outstanding Serial Parity Obligations are retired as scheduled and that all Outstanding Term Parity Obligations are redeemed or paid from sinking fund payments as scheduled (except to the extent that such interest is to be paid from the proceeds of sale of any Parity Obligations), (b) that portion of the principal amount of all Outstanding Serial Parity Obligations maturing on the next succeeding principal payment date which falls in such Fiscal Year (excluding Serial Obligations which at the time of issuance are intended to be paid from the sale of a corresponding amount of Parity Obligations), (c) that portion of the principal amount of all Outstanding Term Parity Obligations required to be redeemed or paid on any redemption date which falls in such Fiscal Year (together with the redemption premiums, if any, thereon); provided that, (1) as to any Balloon Indebtedness, Tender Indebtedness, and Variable Rate Indebtedness, interest thereon shall be calculated as provided in the definition of Maximum Annual Debt Service and principal shall be deemed due at the nominal maturity dates thereof; (2) the amount on deposit in a debt service reserve fund on any date of calculation of Debt Service shall be deducted from the amount of principal due at the final maturity of the Parity Obligations for which such debt service reserve fund was established and in each preceding year until such amount is exhausted; and (3) the amount of payments on account of Parity Obligations which are redeemed, retired, or repaid on the basis of the accreted value due on the scheduled redemption, retirement, or repayment date shall be deemed principal payments, and interest that is compounded and paid as part of the accreted value shall be deemed payable on the scheduled redemption, retirement, or repayment date, but not before.

With regard to the issuance of Subordinated Obligations, the term "Debt Service" means, for any Fiscal Year, the sum of (a) the interest payable during such Fiscal Year on all Outstanding Obligations, assuming that all Outstanding Serial Obligations are retired as scheduled and that all Outstanding Term Obligations are redeemed or paid from sinking fund payments as scheduled (except to the extent that such interest is to be paid from the proceeds of sale of any Obligations), (b) that portion of the principal amount of all Outstanding Serial Obligations maturing on the next succeeding principal payment date which falls in such Fiscal Year (excluding Serial Obligations which at the time of issuance are intended to be paid from the sale of a corresponding amount of other Obligations) (c) that portion of the principal amount of all Outstanding Term Obligations required to be redeemed or paid on any redemption date which falls in such Fiscal Year (together with the redemption premiums, if any, thereon) provided that, (1) as to any Balloon Indebtedness, Tender Indebtedness, and Variable Rate Indebtedness, interest thereon shall be calculated as provided in the definition of Maximum Annual Debt Service and principal shall be deemed due at the nominal maturity dates thereof; (2) the amount on deposit in a Reserve Fund on any date of calculation of Debt Service shall be deducted from the amount of principal due at the final

maturity of the Obligations for which such Reserve Fund was established and in each preceding year, until such amount is exhausted; and (3) the amount of payments on account of Obligations which are redeemed, retired, or repaid on the basis of the accreted value due on the scheduled redemption, retirement, or repayment date shall be deemed principal payments, and interest that is compounded and paid as part of the accreted value thereof shall be deemed payable on the scheduled redemption, retirement, or repayment date, but not before.

**Default Rate**

The term "Default Rate" means the Maximum Rate.

**Defaulted Obligations**

The term "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.

**Fiscal Year**

The term "Fiscal Year" means the period beginning on July 1 of each year and ending on the next succeeding June 30, or any other twelve-month period selected and designated as the official Fiscal Year of the City.

**Independent Certified Public Accountant**

The term "Independent Certified Public Accountant" means any firm of certified public accountants appointed by the City, and each of whom is independent pursuant to the Statement on Auditing Standards No. 1 of the American Institute of Certified Public Accountants.

**Independent Engineer**

The term "Independent Engineer" means any registered engineer or firm of registered engineers of national reputation generally recognized to be well qualified in engineering matters relating to water systems, appointed and paid by but not under the control of the City.

**Installment Payment Date**

The term "Installment Payment Date" means any date on which an Installment Payment is due as specified in the Installment Purchase Agreement or determined pursuant to a Supplement.

**Installment Payments**

The term "Installment Payments" means the Installment Payments scheduled to be paid by the City under and pursuant to the Installment Purchase Agreement and any Supplement.

**Installment Payment Obligations**

The term "Installment Payment Obligations" means Obligations consisting of or which are supported in whole by Installment Payments.

**Issuing Instrument**

The term "Issuing Instrument" means any indenture, trust agreement, loan agreement, lease, installment purchase agreement, or the Installment Purchase Agreement, including any Supplement or other instrument under which Obligations are issued or created.

**Law**

The term "Law" means the Charter and all applicable laws of the State.

**Maintenance and Operation Costs of the Water System**

The term "Maintenance and Operation Costs of the Water System" means (a) any Qualified Take or Pay Obligation, and (b) the reasonable and necessary costs spent or incurred by the City for maintaining and operating the Water System, calculated in accordance with generally accepted accounting principles, including, without limitation, the costs of the purchase, delivery or storage of water, the reasonable expenses of maintenance and repair and other expenses necessary to maintain and preserve the Water System in good repair and working order, and including administrative costs of the City attributable to the Water System, including the Project and the Installment Purchase Agreement, salaries and wages of employees of the Water System, payments to such employees' retirement systems (to the extent paid from System Revenues), overhead, taxes (if any), fees of auditors, accountants, attorneys, or engineers and insurance premiums, and including all other reasonable and necessary costs of the City or charges required to be paid by it to comply with the terms of the Obligations, including the Installment Purchase Agreement, including any amounts required to be deposited in the Rebate Fund pursuant to a Tax Certificate, and fees and expenses payable to any Credit Provider (other than in repayment of a Credit Provider Reimbursement Obligation), but excluding in all cases (1) depreciation, replacement and obsolescence charges or reserves therefor, (2) amortization of intangibles or other bookkeeping entries of a similar nature, (3) costs of capital additions, replacements, betterments, extensions or improvements to the Water System which under generally accepted accounting principles are chargeable to a capital account or to a reserve for depreciation, (4) charges for the payment of principal of and interest on any general obligation bond issued for Water System purposes, and (5) charges for the payment of principal of and interest on any debt service on account of any Obligation on a parity with or subordinate to the Installment Payments.

**Maximum Annual Debt Service**

The term "Maximum Annual Debt Service" means,

(a) with respect to Parity Obligations then Outstanding, the maximum amount of principal and interest becoming due on the Parity Obligations in the then-current or any future Fiscal Year, calculated by the City or by an Independent Certified Public Accountant in accordance with the Installment Purchase Agreement and provided to the Trustee. For purposes of calculating Maximum Annual Debt Service, the following assumptions shall be used to calculate the principal and interest becoming due in any Fiscal Year:

(i) in determining the principal amount due in each Fiscal Year, payments shall (except to the extent a different subsection of this definition applies for purposes of determining principal maturities or amortization) be assumed to be made in accordance with any amortization schedule established for such debt, including the amount of any Parity Obligations which or have the characteristics of commercial paper and which not intended at the time of issuance to be retired from the sale of a corresponding amount of Parity Obligations, and including any

scheduled mandatory redemption or prepayment of Parity Obligations on the basis of accreted value due upon such redemption or prepayment, and for such purpose, the redemption payment or prepayment shall be deemed a principal payment; provided, however, that with respect to Parity Obligations which are or have the characteristics of commercial paper and which are intended at the time of issuance to be retired from the sale of a corresponding amount of other Obligations, which other Obligations would not constitute Balloon Indebtedness, each maturity thereof shall be treated as if it were to be amortized in substantially equal installments of principal and interest over a term of 30 years, commencing in the year of such stated maturity; in determining the interest due in each Fiscal Year, interest payable at a fixed rate shall (except to the extent paragraph (A)(ii) or (iii) of this definition applies) be assumed to be made at such fixed rate and on the required payment dates;

(ii) if all or any portion or portions of an Outstanding Series of Parity Obligations constitute Balloon Indebtedness or if all or any portion or portions of a Series of Parity Obligations or such payments then proposed to be issued would constitute Balloon Indebtedness, then, for purposes of determining Maximum Annual Debt Service, each maturity which constitutes Balloon Indebtedness shall be treated as if it were to be amortized in substantially equal annual installments of principal and interest over a term of 30 years, commencing in the year the stated maturity of such Balloon Indebtedness occurs, the interest rate used for such computation shall be determined as provided in paragraph (A)(iv) or (v) below, as appropriate, and all payments of principal and interest becoming due prior to the year of the stated maturity of the Balloon Indebtedness shall be treated as described in paragraph (A)(i) above;

(iii) if any Outstanding Series of Parity Obligations constitutes Tender Indebtedness or if Parity Obligations proposed to be issued would constitute Tender Indebtedness, then for purposes of determining Maximum Annual Debt Service, Tender Indebtedness shall be treated as if the principal amount of such Parity Obligations were to be amortized in accordance with the amortization schedule set forth in the Supplement or Issuing Instrument for such Tender Indebtedness or in the standby purchase or liquidity facility established with respect to such Tender Indebtedness, or if no such amortization schedule is set forth, then such Tender Indebtedness shall be deemed to be amortized in substantially equal annual installments of principal and interest over a term of 30 years commencing in the year in which such Series is first subject to tender, the interest rate used for such computation shall be determined as provided in paragraph (A)(iv) or (v) below, as appropriate;

(iv) if any Outstanding Series of Parity Obligations constitutes Variable Rate Indebtedness, the interest rate on such Obligations shall be assumed to be 110% of the daily average interest rate on such Parity Obligations during the 12 months ending with the month preceding the date of calculation, or such shorter period that such Parity Obligations shall have been Outstanding;

(v) if Parity Obligations proposed to be issued will be Variable Rate Indebtedness, then such Parity Obligations shall be assumed to bear interest at 80% of the average Revenue Bond Index during the calendar quarter preceding the calendar quarter in which the calculation is made, or if that index is no longer published, another similar index selected by the City, or if the City fails to select a replacement index, an interest rate equal to 80% of the yield for outstanding United States Treasury bonds having an equivalent maturity, or if there are no such Treasury bonds having such maturities, 100% of the lowest prevailing prime rate of any of the five largest commercial banks in the United States ranked by assets; and

(vi) if moneys or Permitted Investments have been deposited by the City into a separate fund or account or are otherwise held by the City or by a fiduciary to be used to pay principal of and/or interest on specified Parity Obligations, then the principal and/or interest to be paid from such moneys, Permitted Investments, or from the earnings thereon shall be disregarded and not included in calculating Maximum Annual Debt Service.

(b) with regard to all Obligations then Outstanding, the maximum amount of principal and interest becoming due on the Obligations in the then-current or any future Fiscal Year, calculated by the City or by an Independent Certified Public Accountant in accordance with this subsection and provided to the Trustee. For purposes of calculating Maximum Annual Debt Service, the following assumptions shall be used to calculate the principal and interest becoming due in any Fiscal Year:

(i) in determining the principal amount due in each Fiscal Year, payments shall (except to the extent a different subsection of this definition applies for purposes of determining principal maturities or amortization) be assumed to be made in accordance with any amortization schedule established for such debt, including the amount of any Obligations which are or have the characteristics of commercial paper and which are not intended at the time of issuance to be retired from the sale of a corresponding amount of Obligations, and including any scheduled mandatory redemption or prepayment of Obligations on the basis of accreted value due upon such redemption or prepayment, and for such purpose, the redemption payment or prepayment shall be deemed a principal payment; provided, however, that with respect to Obligations which are or have the characteristics of commercial paper and which are intended at the time of issuance to be retired from the proceeds of sale of a corresponding amount of other Obligations, and which would not constitute Balloon Indebtedness, each maturity thereof shall be treated as if it were to be amortized in substantially equal installments of principal and interest over a term of 30 years, commencing in the year of such stated maturity; in determining the interest due in each Fiscal Year, interest payable at a fixed rate shall (except to the extent paragraph (B)(ii) or (iii) of this definition applies) be assumed to be made at such fixed rate and on the required payment dates;

(ii) if all or any portion or portions of an Outstanding Series of Obligations constitute Balloon Indebtedness or if all or any portion or portions of a Series of Obligations or such payments then proposed to be issued would constitute Balloon Indebtedness, then, for purposes of determining Maximum Annual Debt Service, each maturity which constitutes Balloon Indebtedness shall be treated as if it were to be amortized in substantially equal annual installments of principal and interest over a term of 30 years, commencing in the year the stated maturity of such Balloon Indebtedness occurs, the interest rate used for such computation shall be determined as provided in paragraph (B)(iv) or (v) below, as appropriate, and all payments of principal and interest becoming due prior to the year of the stated maturity of the Balloon Indebtedness shall be treated as described in paragraph (B)(i) above;

(iii) if any Outstanding Series of Obligations constitutes Tender Indebtedness or if Obligations proposed to be issued would constitute Tender Indebtedness, then for purposes of determining Maximum Annual Debt Service, Tender Indebtedness shall be treated as if the principal amount of such Obligations were to be amortized in accordance with the amortization schedule set forth in the Supplement or Issuing Instrument for such Tender Indebtedness or in the standby purchase or liquidity facility established with respect to such Tender Indebtedness, or if no such amortization schedule is set forth, then such Tender Indebtedness shall be deemed to be amortized in substantially equal annual installments of principal and interest over a term of 30 years, commencing in the year in which such Obligations are first subject to tender, the interest rate used for such computation shall be determined as provided in paragraph (B)(iv) or (v) below, as appropriate;

(iv) if any Outstanding Series of Obligations constitute Variable Rate Indebtedness, the interest rate on such Series of Obligations shall be assumed to be 110% of the daily average interest rate on such Series of Obligations during the 12 months ending with the month preceding the date of calculation, or such shorter period that such Series of Obligations shall have been Outstanding;

(v) if Obligations proposed to be issued will be Variable Rate Indebtedness, then such Obligations shall be assumed to bear interest at 80% of the average Revenue Bond Index during the calendar quarter preceding the calendar quarter in which the calculation is made, or if that index is no longer published, another similar index selected by the City, or if the City fails to select a replacement index, an interest rate equal to 80% of the yield for outstanding United States Treasury bonds having an equivalent maturity, or if there are no such Treasury bonds having such maturities, 100% of the lowest prevailing prime rate of any of the five largest commercial banks in the United States ranked by assets; and

(vi) if moneys or Permitted Investments have been deposited by the City into a separate fund or account or are otherwise held by the City or by a fiduciary to be used to pay principal and/or interest on specified Obligations, then the principal and/or interest to be paid from such moneys, Permitted Investments or from the earnings thereon shall be disregarded and not included in calculating Maximum Annual Debt Service.

**Maximum Rate**

The term "Maximum Rate" means, on any day, the maximum interest 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 subordinate in right of payment to other Installment Payments.

**Parity Obligations**

The term "Parity Obligations" means (a) Parity Installment Obligations, (b) Obligations, the principal of and interest on which are payable on a parity with Parity Installment Obligations, and (c) Reserve Fund Obligations.

**Payment Fund**

The term "Payment Fund" means the fund designated in the Issuing Instrument as the fund into which Installment Payments are to be deposited for the purposes of paying principal of or interest on related Obligations.

**Permitted Investments**

The term "Permitted Investments" means investments which, pursuant to the Issuing Instrument, are permissible for the investment of funds received from the sale of Obligations pursuant to the Issuing Document or from other funds held pursuant to the Issuing Document.

**Purchase Price**

The term "Purchase Price" means the principal amount, plus interest thereon, owed by the City to the Corporation under the terms of the Installment Purchase Agreement for the purchase of Project Components, as specified in the Installment Purchase Agreement or in a Supplement.

**Qualified Take or Pay Obligation**

The term "Qualified Take or Pay Obligation" means the obligation of the City to make or use any facility, property, or services, or some portion of the capacity thereof, or to pay therefor from System Revenues, or both, whether or not such facilities, properties, or services are ever made available to the City for use, and there is provided to the City a certificate of the City or of an Independent Engineer to the effect that the incurrence of such obligation will not adversely affect the ability of the City to comply with the provisions of the Installment Purchase Agreement.

**Rate Stabilization Fund**

The term "Rate Stabilization Fund" means the fund by that name established pursuant to the Installment Purchase Agreement.

**Rebate Requirement**

The term "Rebate Requirement" shall have the meaning specified in the Tax Certificate.

**Reserve Fund**

The term "Reserve Fund" shall refer to the fund by that name established under an 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" means a letter of credit, line of credit, surety bond, insurance policy or similar facility deposited in the Reserve Fund established under an Issuing Instrument in lieu of or in partial substitution for cash or securities on deposit therein.

**Reserve Requirement**

The term "Reserve Requirement" shall have the meaning given to such term in any Issuing Instrument or Supplement.

**Revenue Bond Index**

The term "Revenue Bond Index" means the Revenue Bond Index by that name published from time to time in The Bond Buyer.

**Secondary Purchase Fund**

The term "Secondary Purchase Fund" means any fund by that name established pursuant to the Installment Purchase Agreement.

**Serial Obligations**

The term "Serial Obligations" means Obligations for which no sinking fund payments are provided.

**Serial Parity Obligations**

The term "Serial Parity Obligations" means Serial Obligations which are Parity Installment Payments or are payable on a parity with Parity Installment Obligations.

**Series**

The term "Series" means Obligations issued at the same time or sharing some other common term or characteristic and designated as a separate Series.

**Subordinated Credit Provider**

The term "Subordinated Credit Provider" means any municipal bond insurance company, bank, or other financial institution or organization which is performing in all respects its obligations under any Subordinated Credit Support Instrument for some or all of the Subordinated Obligations.

**Subordinated Credit Provider Reimbursement Obligations**

The term "Subordinated Credit Provider Reimbursement Obligations" means obligations of the City to repay, from Net System Revenues, amounts advanced by a Subordinated Credit Provider as credit support or liquidity for Subordinated Obligations, which obligations shall constitute Subordinated Obligations.

**Subordinated Credit Support Instrument**

The term "Subordinated Credit Support Instrument" means a policy of insurance, a letter of credit, a standby purchase agreement, revolving credit agreement, or other credit arrangement pursuant to which a Subordinated Credit Provider provides credit support or liquidity with respect to the payment of interest, principal, or the purchase price of any Subordinated Obligations.

**Subordinated Obligations**

The term "Subordinated Obligations" means any Obligations, the payment of which is subordinate 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;

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[*] These items of System Revenue may not be used to pay Maintenance and Operation Costs of the Water System.

(c) the proceeds derived by the City directly or indirectly from the lease of a part of the Water System;

(d) any amount received from the levy or collection of taxes which are solely available and are earmarked for the support of the operation of the Water System;

(e) amounts received under contracts or agreements with governmental or private entities and designated for capital costs for the Water System*; and

(f) grants for maintenance and operations received from the United States of America or from the State; provided, however, that System Revenues shall not include (1) in all cases, customers' deposits or any other deposits or advances subject to refund until such deposits or advances have become the property of the City; and (2) the proceeds of borrowings; but

(g) notwithstanding the foregoing, there shall be deducted from System Revenues any amounts transferred into a Rate Stabilization Fund as contemplated by the Installment Purchase Agreement, and any amounts transferred from current System Revenues to the Secondary Purchase Fund as contemplated by the Installment Purchase Agreement, and there shall be added to System Revenues any amounts transferred out of such Rate Stabilization Fund or the Secondary Purchase Fund to pay Maintenance and Operation Costs of the Water System.

**Tax-Exempt Installment Payment Obligations**

The term "Tax-Exempt Installment Payment Obligations" means Installment Payment Obligations, the interest component of which is excluded from gross income pursuant to Section 103 of the Code.

**Tender Indebtedness**

The term "Tender Indebtedness" means any Obligations or portions of Obligations, a feature of which is an option, on the part of the holders thereof, or an obligation, under the terms of such Obligations, to tender all or a portion of such Obligations to the City, a Trustee or other fiduciary or agent for payment or purchase and requiring that such Obligations or portions of Obligations or that such rights to payments or portions of payments be purchased if properly presented. Tender Indebtedness may consist of either Parity Obligations or Subordinated Obligations.

**Term Parity Obligations**

The term "Term Parity Obligations" means Term Obligations which are Parity Obligations or are payable on a parity with Parity Installment Obligations.

**Term Obligations**

The term "Term Obligations" means Obligations which are payable on or before their specified maturity dates from sinking fund payments established for that purpose and calculated to retire such Obligations on or before their specified maturity dates.

**Variable Rate Indebtedness**

The term "Variable Rate Indebtedness" means any portion of indebtedness evidenced by Obligations, the interest rate for which is subject to adjustment periodically through a remarketing process

or according to a stated published index for similar obligations in the municipal markets. Variable Rate Indebtedness may consist of either Parity Obligations or Subordinated Obligations.

**Water Service**

The term "Water Service" means the collection, conservation, production, storage, treatment, transmission, furnishing, and distribution services made available or provided by the Water System.

**Water Utility Fund**

The term "Water Utility Fund" means the fund by that name established by the Charter.

**Installment Payments**

***Purchase Price.***

(a) The City will pay the Purchase Price for any Components being purchased as provided in a Supplement. The Purchase Price to be paid by the City to the Corporation pursuant to any Supplement, solely from Net System Revenues and from no other sources, is the sum of the principal amount of the City's obligations under such Supplement plus the interest to accrue on the unpaid balance of such principal amount from the effective date thereof over the term thereof, subject to prepayment as provided therein.

(b) The principal amount of the Installment Payments to be made by the City under a Supplement shall be paid at least three Business Days prior to the date such Installment Payments are payable as specified in such Supplement or at such other earlier time or times and in the manner or manners as specified in such Supplement. In the event the principal amount of an Installment Payment is not paid by the date the same is due and payable as specified in such Supplement, the same shall bear interest at the Default Rate, commencing on the day the same as due, to, but not including, the payment date.

(c) The interest to accrue on the unpaid balance of such principal amount shall be paid at least three Business Days prior to the date such interest is payable as specified in a Supplement or at such other earlier time or times as specified in such Supplement, and shall be paid by the City as and constitute interest paid in the principal amount of the City's obligations thereunder. Interest shall be payable in an amount not exceeding the Maximum Rate at the time of incurring such obligation, at such intervals and according to such interest rate formulas as shall be specified in a Supplement or by reference to any Issuing Instrument to which such Supplement relates, and shall be payable with such frequency as shall be specified therein. In the event that interest is not paid by the date such interest is payable, to the extent permitted by applicable law, such interest shall thereafter bear interest at the Default Rate, commencing on the day the same is due, to, but not including, the payment date.

***Installment Payments; Reserve Fund Payments.***

(a) The City shall, subject to any rights of prepayment provided for in a Supplement, pay to the Corporation, solely from Net System Revenues and from no other sources, the Purchase Price in Installment Payments over a period not to exceed the maximum period permitted by law, all as specified in a Supplement.

(b) In the event that a Trustee notifies the City that the amount on deposit in a Reserve Fund or Reserve Account is less than the Reserve Requirement, the City shall deposit or cause to be deposited,

solely from Net System Revenues in accordance with the Installment Purchase Agreement, in such Reserve Fund or Reserve Account such amounts on a monthly basis as are necessary to increase the amount on deposit therein to the Reserve Requirement in the ensuing twelve months.

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

**System Revenues**

***Commitment of the Net System Revenues.***

(a) All Parity Obligations, including Parity Installment Payment Obligations, shall be secured by a first priority lien on and pledge of Net System Revenues. The City grants such first priority lien on and pledge of Net System Revenues to secure Parity Obligations. All Parity Obligations shall be of equal rank with each other without preference, priority, or distinction of any Parity Obligations over any other Parity Obligations.

(b) All Subordinated Obligations shall be secured by a second priority lien on and pledge of Net System Revenues that is junior and subordinate to the lien on and pledge of Net System Revenues securing Parity Obligations. The City grants such second priority lien on and pledge of Net System Revenues to secure Subordinated Obligations. All Subordinated Obligations shall be of equal rank with each other without preference, priority, or distinction of any Subordinated Obligations over any other Subordinated Obligations.

(c) The City represents and states that it has not granted any lien or charge on any of the Net System Revenues except as provided in the Installment Purchase Agreement; provided, however, that out of Net System Revenues there may be apportioned such sums for such purposes as are expressly permitted by the Installment Purchase Agreement.

(d) Nothing contained in the Installment Purchase Agreement shall affect the ability of the City to grant liens on and pledges of the Net System Revenues that are subordinate to the liens on and pledges of Net System Revenues for the benefit of Parity Obligations and Subordinated Obligations contained therein.

***Allocation of System Revenues.***

(a) In order to carry out and effectuate the commitment and pledge contained in the Installment Purchase Agreement, the City agrees and covenants that all System Revenues shall be received by the City in trust and shall be deposited when and as received in the Water Utility Fund, which fund the City agrees and covenants to maintain so long as any Installment Payment Obligations remain unpaid, and all moneys in the Water Utility Fund shall be so held in trust and applied and used solely as provided in the Installment Purchase Agreement. The City shall pay from the Water Utility Fund: (1) directly or as otherwise required all Maintenance and Operation Costs of the Water System; and (2) to the Trustee, for deposit in the Payment Fund for Parity Obligations, including Reserve Fund Obligations that

are Parity Obligations, the amounts specified in any Issuing Instrument, as payments due on account of Parity Obligations (including any Credit Provider Reimbursement Obligations that are Parity Obligations). In the event there are insufficient Net System Revenues to make all of the payments contemplated by clause (2) of the immediately preceding sentence, then said payments should be made as nearly as practicable, pro rata, based upon the respective unpaid principal amounts of said Parity Obligations.

(b) After the payments contemplated by subsection (a) above have been made, and in any event not less frequently than January 15 and July 15 of each year, any remaining Net System Revenues shall be used to make up any deficiency in the Reserve Funds for Parity Obligations. Notwithstanding the use of a Reserve Fund Credit Facility in lieu of depositing funds in the related Reserve Fund for Parity Obligations, in the event of any draw on the related Reserve Fund Credit Facility, there shall be deemed a deficiency in such Reserve Fund for Parity Obligations until the amount of the Reserve Fund Credit Facility is restored to its pre-draw amount. In the event there are insufficient Net System Revenues to make up all deficiencies in all Reserve Funds for Parity Obligations, such payments into the Reserve Funds shall be made as nearly as practicable pro rata based on the respective unpaid principal amount of all Parity Obligations. Any amounts thereafter remaining in the Water Utility Fund may from time to time be used to pay the amounts specified in any Issuing Instrument as payments due on account of Subordinated Obligations (including any Reserve Fund Obligations for Subordinated Obligations, any Credit Provider Reimbursement Obligations that are Subordinated Obligations and any Subordinated Credit Provider Reimbursement Obligations), provided the following conditions are met:

(i) all Maintenance and Operation Costs of the Water System are being and have been paid and are then current; and

(ii) all deposits and payments contemplated by clause (2) of paragraph (a) above shall have been made in full and no deficiency in any Reserve Fund for Parity Obligations shall exist, and there shall have been paid, or segregated within the Water Utility Fund, the amounts payable during the current month pursuant to clause (2) of paragraph (a) above.

After deposits contemplated above have been made, any amounts thereafter remaining in the Water Utility Fund may be used for any lawful purpose of the Water System.

***Additional Obligations.***

(a) The City may not create any Obligations, the payments of which are senior or prior in right to the payment by the City of Parity Obligations.

(b) Without regard to paragraph (c) below, the City may at any time enter into or create an obligation or commitment which is a Reserve Fund Obligation, provided that the Obligation to which the Reserve Fund Obligation relates is permitted to be entered into under the terms of the Installment Purchase Agreement.

(c) After the initial issuance of Parity Obligations under the Installment Purchase Agreement, the City reserved the right, at any time and from time to time, to issue or create any other Parity Obligations, provided that:

(i) there shall not have occurred and be continuing an Event of Default under the terms of the Installment Purchase Agreement, any Issuing Instrument or any Credit Support Instrument; and

(ii) the City obtains or provides a certificate or certificates, prepared by the City or at the City's option by a Consultant, showing that:

(A) the Net System Revenues as shown by the books of the City for any 12-consecutive-month period within the 18 consecutive months ending immediately prior to the incurring of such additional Parity Obligations shall have amounted to or exceeded the greater of (i) at least 1.20 times the Maximum Annual Debt Service on all Parity Obligations to be Outstanding immediately after the issuance of the proposed Parity Obligations or (ii) at least 1.00 times the Maximum Annual Debt Service on all Obligations to be Outstanding immediately after the issuance of the proposed Parity Obligations. For purposes of preparing the certificate or certificates described above, the City or its Consultant may rely upon audited financial statements, or, if audited financial statements for the period are not available, financial statements prepared by the City that have not been subject to audit by an Independent Certified Public Accountant; or

(B) the estimated Net System Revenues for the five Fiscal Years following the earlier of (i) the end of the period during which interest on those Parity Obligations is to be capitalized or, if no interest is to be capitalized, the Fiscal Year in which the Parity Obligations are issued, or (ii) the date on which substantially all new Components to be financed with such Parity Obligations are expected to commence operations, will be at least equal to 1.20 times the Maximum Annual Debt Service for all Parity Obligations which will be Outstanding immediately after the issuance of the proposed Parity Obligations.

(d) For purposes of the computations to be made as described in paragraph (c)(ii)(B) above, the determination of Net System Revenues:

(i) may take into account any increases in rates and charges which relate to the Water System and which have been approved by the City Council, and shall take into account any reduction in such rates and charges which have been approved by the City Council, which will, for purposes of the test described in paragraph (c)(ii)(B) above, be effective during a Fiscal Year ending within the five-Fiscal Year period for which such estimate is being made; and

(ii) may take into account an allowance for any estimated increase in such Net System Revenues from any revenue-producing additions or improvements to or extensions of the Water System to be made with the proceeds of such additional indebtedness or with the proceeds of Parity Obligations previously issued, all in an amount equal to the estimated additional average annual Net System Revenues to be derived from such additions, improvements and extensions during the five-Fiscal Year period contemplated by paragraph (c)(ii)(B) above, all as shown by such certificate of the City or its Consultant, as applicable; and

(iii) for the period contemplated by paragraph (c)(ii)(B), Maintenance and Operation Costs of the Water System shall initially be deemed to be equal to such costs for the 12 consecutive months immediately prior to incurring such other Parity Obligations for the first Fiscal Year of the five-Fiscal Year period, but adjusted if deemed necessary by the City or its Consultant, as applicable, for any increased Maintenance and Operations Costs of the Water System which are, in the judgment of the City or such Consultant, as applicable, essential to maintaining and operating the Water System and which will occur during any Fiscal Year ending within the period contemplated by paragraph (c)(ii)(B) above.

(e) The certificate or certificates described above in paragraph (c)(ii)(B) shall not be required if the Parity Obligations being issued are for the purpose of (1) issuing the Parity Obligations initially issued under the Installment Purchase Agreement or (2) refunding (A) any then Outstanding Parity Obligations if at the time of the issuance of such Parity Obligations a certificate of an Authorized City Representative shall be delivered showing that the sum of Adjusted Debt Service on all Parity Obligations Outstanding for all remaining Fiscal Years after the issuance of the refunding Parity Obligations will not exceed the sum of Adjusted Debt Service on all Parity Obligations Outstanding for all remaining Fiscal Years prior to the issuance of such refunding Parity Obligations; or (B) then Outstanding Balloon Indebtedness, Tender Indebtedness or Variable Rate Indebtedness, but only to the extent that the principal amount of such indebtedness has been put, tendered to or otherwise purchased pursuant to a standby purchase or other liquidity facility relating to such indebtedness.

(f) Without regard to paragraph (c) above, if (A) no Event of Default has occurred and is continuing and (B) no event of default or termination event attributable to an act of or failure to act by the City under any Credit Support Instrument has occurred and is continuing, the City may issue or incur Subordinated Obligations, and such Subordinated Obligations shall be paid in accordance with the provisions of the Installment Purchase Agreement, provided that:

(i) City obtains or provides a certificate or certificates, prepared by the City or at the City's option by a Consultant, showing that;

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

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

(ii) For purposes of preparing the certificate or certificates described in clause (1) of paragraph (f)(i) above, the City and its Consultant(s) may rely upon audited financial statements or, if audited financial statements for the period are not available, financial statements prepared by the City that have not been subject to audit by an Independent Certified Public Accountant.

(iii) For purposes of the computations to be made as described in clause (2) of paragraph (f)(i) above, the determination of Net System Revenues:

(1) may take into account any increases in rates and charges which relate to the Water System and which have been approved by the City Council and shall take into account any reduction in such rates and charges which have been approved by the City Council, which will, for purposes of the test described in clause (2) of paragraph (f)(i) above, be effective during any Fiscal Year ending within the five-Fiscal Year period for which such estimate is made; and

(2) may take into account an allowance for any estimated increase in such Net System Revenues from any revenue-producing additions or improvements to or extensions of the Water System to be made with the proceeds of such additional indebtedness, with the proceeds of Obligations previously issued or with cash contributions made or to be made by the City, all in an amount equal to the estimated additional average annual Net System Revenues to be derived from such additions, improvements and extensions during the five-Fiscal Year period contemplated by clause (2) of paragraph (f)(i) above, all as shown by such certificate of the City or its Consultant, as applicable; and

(3) for the period contemplated by clause (2) of paragraph (f)(i) above, shall initially include Maintenance and Operation Costs of the Water System in an amount equal to such costs for any 12-consecutive month period within the 24 consecutive months ending immediately prior to incurring such Subordinated Obligations for the first Fiscal Year of the five-Fiscal Year period, but adjusted if deemed necessary by the City or its Consultant, as applicable, for any increased Maintenance and Operations Costs of the Water System which are, in the judgment of the City or its Consultant, as applicable, essential to maintaining and operating the Water System and which will occur during any Fiscal Year ending within the period contemplated by clause (2) of paragraph (f)(i) above.

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

**Covenants of the City**

***Compliance With Installment Purchase Agreement and Ancillary Agreements.***

(a) The City will punctually pay Parity Obligations in strict conformity with the terms of the Installment Purchase Agreement and thereof; and will faithfully observe and perform all the agreements, conditions, covenants and terms contained in the Installment Purchase Agreement required to be observed and performed by it, and will not terminate the Installment Purchase Agreement for any cause including, without limiting the generality of the foregoing, any acts or circumstances that may constitute failure of consideration, destruction of or damage to the Project, commercial frustration of purpose, any change in the tax or other laws of the United States of America or of the State or any political subdivision of either or any failure of the Corporation to observe or perform any agreement, condition, covenant or term contained in the Installment Purchase Agreement required to be observed and performed by it, whether express or implied, or any duty, liability or obligation arising out of or connected therewith or the insolvency, or deemed insolvency, or bankruptcy or liquidation of the Corporation or any force majeure, including acts of God, tempest, storm, earthquake, war, rebellion, riot, civil disorder, acts of public

enemies, blockade or embargo, strikes, industrial disputes, lock outs, lack of transportation facilities, fire, explosion, or acts or regulations of governmental authorities.

(b) The City will faithfully observe and perform all the agreements, conditions, covenants and terms contained in the Installment Purchase Agreement, including Supplements, and any Issuing Instrument or Credit Support Instrument relating to Parity Obligations required to be observed and performed by it, and it is expressly understood and agreed by and between the parties to the Installment Purchase Agreement that each of the agreements, conditions, covenants and terms contained therein is an essential and material term of the purchase of and payment for each Component by the City pursuant to, and in accordance with, and as authorized under the Law.

(c) The City will faithfully observe and perform all of the agreements and covenants of the City contained in each Authorizing Ordinance and will not permit the same to be amended or modified so as to adversely affect the Owners of Installment Payment Obligations.

(d) The City shall be unconditionally and irrevocably obligated, so long as any Installment Payment Obligations remain Outstanding and unpaid, to take all lawful action necessary or required to continue to entitle the City to collect and deposit such System Revenues in the Water Utility Fund for use as provided in the Installment Purchase Agreement; provided, however, that such obligation does not, in any way, limit the City's ability to undertake any and all legal actions, including any appeals, in the defense of a federal court order dictating a water system configuration other than that approved and adopted by the City.

***Against Encumbrances***. The City will not make any pledge of or place any lien on the Net System Revenues except as otherwise provided or permitted in the Installment Purchase Agreement.

***Debt Service Reserve Fund***. The City will maintain or cause to be maintained each Reserve Fund at the applicable Reserve Requirement. In the event the amount in any such fund or account falls below the applicable Reserve Requirement, the City will replenish such fund or account up to the applicable Reserve Requirement pursuant to the Installment Purchase Agreement.

***Against Sale or Other Disposition of Property.***

(a) The City will not sell, lease or otherwise dispose of the Water System or any part thereof essential to the proper operation of the Water System or to the maintenance of the System Revenues, except as provided in the Installment Purchase Agreement. Further, the City will not, except as otherwise provided in the Installment Purchase Agreement, enter into any agreement or lease that impairs the operation of the Water System or any part thereof necessary to secure adequate Net System Revenues for the payment of the Parity Obligations or that would otherwise impair the rights of the Corporation with respect to the System Revenues or the operation of the Water System.

(b) The City may dispose of any of the works, plant properties, facilities, or other parts of the Water System, or any real or personal property comprising a part of the Water System, only upon the approval of the City Council and consistent with one or more of the following:

(i) the City in its discretion may carry out such a disposition if the facilities or property being disposed of are not material to the operation of the Water System, or shall have become unserviceable, inadequate, obsolete, or unfit to be used in the operation of the Water System or are no longer necessary, material or useful to the operation of the Water System, and if such disposition will not materially reduce the Net System Revenues and if the proceeds of such disposition are deposited in the Water Utility Fund;

(ii) the City in its discretion may carry out such a disposition if the City receives from the acquiring party an amount equal to the fair market value of the portion of the Water System disposed of. As used in this clause (ii), "fair market value" means that the portion being disposed of should bring in a competitive and open market under all conditions requisite to a fair sale, the willing buyer and willing seller each acting prudently and knowledgeably, and assuming that the price is not affected by coercion or undue stimulus. The proceeds of the disposition shall be used (A) first, promptly to redeem, or irrevocably set aside for the redemption of, Parity Obligations, and second, promptly to redeem, or irrevocably set aside for the redemption of, Subordinated Obligations, and/or (B) to provide for a part of the cost of additions to and betterments and extensions of the Water System; provided, however, that before any such disposition under this clause (2), the City must obtain (i) a certificate of an Independent Engineer to the effect that upon such disposition and the use of the proceeds of the disposition as proposed by the City, the remaining portion of the Water System will retain its operational integrity and the estimated Net System Revenues for the five Fiscal Years following the Fiscal Year in which the disposition is to occur will be equal to or exceed the greater of (i) at least 1.20 times the Adjusted Debt Service on all Outstanding Parity Obligations during the five Fiscal Years following the Fiscal Year in which the disposition is to occur, or (ii) at least 1.00 times the Adjusted Debt Service on all Outstanding Obligations during the first five Fiscal Years following the Fiscal Year in which the disposition is to occur, taking into account (aa) the reduction in revenue resulting from the disposition, (bb) the use of any proceeds of the disposition for the redemption of Parity Obligations and/or Subordinated Obligations, (cc) the Independent Engineer's estimate of revenue from customers anticipated to be served by any additions to and betterments and extensions of the Water System financed in part by the proceeds of the disposition, and (dd) any other adjustment permitted in the preparation of a certificate in accordance with the Installment Purchase Agreement as summarized herein in paragraph (c)(2)(B) under the caption "INSTALLMENT PURCHASE AGREEMENT – System Revenues – Additional Obligations," and (ii) confirmation from the Rating Agencies to the effect that the rating then in effect on any Outstanding Parity Obligations will not be reduced or withdrawn upon such disposition.

(c) The City will operate the Water System in an efficient and economic manner, provided that the City may remove from service on a temporary or permanent basis such part or parts of the Water System as the City shall determine, so long as (1) Net System Revenues are at least equal to the greater of (i) 100% of all Obligations payable in the then-current Fiscal Year or (ii) 120% of Adjusted Debt Service for the then-current Fiscal Year, after giving effect to any defeasance of Parity Obligations and/or Subordinated Obligations occurring incident to such removal, and for each Fiscal Year thereafter to and including the Fiscal Year during which the last Installment Payment is due, after giving effect to such defeasance, as evidenced by (i) an Engineer's Report on file with the City, or (ii) a Certificate of the City, (2) the value of the parts of the Water System to be so removed is less than 5% of the total Water System Plant assets, each as shown on the most recent audited financial statements that include the Water Utility Fund, and (3) the City shall have filed with each Trustee an opinion of Bond Counsel to the effect that the removal of such part or parts of the Water System will not adversely affect the exclusion from-gross income for federal income tax purposes of the interest on Tax-Exempt Installment Payment Obligations.

***Prompt Acquisition and Construction***. The City shall take all necessary and appropriate steps to construct, acquire and install the Project, as agent of the Corporation, with all practicable dispatch and in an expeditious manner and in conformity with law so as to complete the same as soon as possible.

***Maintenance and Operation of the Water System; Budgets***. The City shall maintain and preserve the Water System in good repair and working order at all times and shall operate the Water System in an efficient and economical manner and will pay all Maintenance and Operation Costs of the Water System as they become due and payable. The City shall adopt and make available to the

Corporation, on or before the effective date of the Installment Purchase Agreement, a budget approved by the City Council of the City setting forth the estimated Maintenance and Operation Costs of the Water System for the period from such date until the close of the then-current Fiscal Year. On or before August 1 of each Fiscal Year, the City shall adopt, and on or before the day that is 120 days after the beginning of the Fiscal Year, make available to the Corporation a budget approved by the City Council of the City setting forth the estimated Maintenance and Operation Costs of the Water System for such Fiscal Year. Any budget may be amended at any time during any Fiscal Year and such amended budget shall be filed by the City with the Corporation.

***Amount of Rates and Charges; Rate Stabilization Fund; Other Funds.***

(a) The City shall fix, prescribe and collect rates and charges for the Water Service which will be at least sufficient to yield the greater of (1) Net System Revenues sufficient to pay during each Fiscal Year all Obligations payable in such Fiscal Year or (2) Adjusted Net System Revenues during each Fiscal Year equal to 120% of the Adjusted Debt Service for such Fiscal Year. The City may make adjustments from time to time in such rates and charges and may make such classification thereof as it deems necessary, but shall not reduce the rates and charges then in effect unless the Net System Revenues from such reduced rates and charges will at all times be sufficient to meet the requirements of these provisions.

(b) The City may establish, as a fund within the Water Utility Fund, a fund denominated the "Rate Stabilization Fund." From time to time, the City may deposit into the Rate Stabilization Fund, from current System Revenues, such amounts as the City shall determine and the amount of available current System Revenues shall be reduced by the amount so transferred. Amounts may be transferred from the Rate Stabilization Fund solely and exclusively to pay Maintenance and Operation Costs of the Water System, and any amounts so transferred shall be deemed System Revenues when so transferred. All interest or other earnings upon amounts in the Rate Stabilization Fund may be withdrawn therefrom and accounted for as System Revenues.

(c) The City may establish, as a fund within the Water Utility Fund, a fund denominated the "Secondary Purchase Fund." From time to time, the City may deposit into the Secondary Purchase Fund, from any lawful source, which may or may not consist of current System Revenues, such amounts as the City shall determine, and the amount of available System Revenues shall be reduced by the amount so transferred, but only to the extent that amounts so transferred consist of then-current System Revenues. Amounts may be transferred from the Secondary Purchase Fund solely and exclusively to pay Maintenance and Operation Costs of the Water System, and any amounts so transferred shall be deemed System Revenues when so transferred. All interest or other earnings upon amounts in the Secondary Purchase Fund may be withdrawn therefrom and accounted for as System Revenues.

***Payment of Claims***. The City will pay and discharge any and all lawful claims for labor, materials or supplies which, if unpaid, might become a lien on the System Revenues or any part thereof or on any funds in the hands of the City or the Trustee might impair the security of the Installment Payments, but the City shall not be required to pay such claims if the validity thereof shall be contested in good faith.

***Compliance with Contracts***. The City will comply with, keep, observe and perform all agreements, conditions, covenants and terms, express or implied, required to be performed by it contained in all contracts for the use of the Water System and all other contracts affecting or involving the Water System to the extent that the City is a party thereto.

***Insurance.***

(a) The City will procure and maintain or cause to be procured and maintained insurance on the Water System with responsible insurers, in such amounts and against such risks (including accident to or destruction of the Water System) as are usually covered in connection with water systems similar to the Water System, or it will self-insure or participate in an insurance pool or pools with reserves adequate, in the reasonable judgment of the City, to protect the Water System against loss. In the event of any damage to or destruction of the Water System caused by the perils covered by such insurance or self insurance, the Net Proceeds thereof shall be applied to the reconstruction, repair or replacement of the damaged or destroyed portion of the Water System. The City shall begin such reconstruction, repair or replacement promptly after such damage or destruction shall occur, and shall continue and properly complete such reconstruction, repair or replacement as expeditiously as possible, and shall pay out of such Net Proceeds all costs and expenses in connection with such reconstruction, repair or replacement so that the same shall be completed and the Water System shall be free and clear of all claims and liens unless the City determines that such property or facility is not necessary to the efficient or proper operation of the Water System and therefore determines not to reconstruct, repair or replace such project or facility. If such Net Proceeds exceed the costs of such reconstruction, repair or replacement, then the excess Net Proceeds shall be deposited in the Water Utility Fund and be available for other proper uses of funds deposited in the Water Utility Fund.

(b) The City will procure and maintain such other insurance which it shall deem advisable or necessary to protect its interests and the interests of the Corporation, which insurance shall afford protection in such amounts and against such risks as are usually covered in connection with water systems similar to the Water System; provided that any such insurance may be maintained under a self-insurance program so long as such self-insurance is maintained in the amounts and in the manner usually maintained in connection with water systems similar to the Water System.

(c) All policies of insurance required to be maintained under the Installment Purchase Agreement shall, to extent reasonably obtainable, provide that the Corporation and each Trustee shall be given 30 days' written notice of any intended cancellation thereof or reduction of coverage provided thereby. The City shall certify to the Corporation and each Trustee annually on or before August 31 that it is in compliance with the insurance requirements under the Indenture.

***Accounting Records; Financial Statements and Other Reports.***

(a) The City will keep appropriate accounting records in which complete and correct entries shall be made of all transactions relating to the Water System, which records shall be available for inspection by the Corporation and the Trustee at reasonable hours and under reasonable conditions.

(b) The City will prepare and file with the Corporation annually (commencing with the Fiscal Year ending June 30, 2016), within 270 days of the close of each Fiscal Year, financial statements that include the Water Utility Fund for the preceding Fiscal Year prepared in accordance with generally accepted accounting principles, together with an Accountant's Report thereon.

(c) The City will furnish a copy of the financial statements referred to in paragraph (b) above to any Owner of the Certificates requesting a copy thereof, which may be in electronic form.

***Payment of Taxes and Compliance with Governmental Regulations***. The City shall pay and discharge all taxes, assessments and other governmental charges which may be lawfully imposed upon the Water System or any part thereof or upon the System Revenues when the same shall become due, except that the City may contest in good faith any taxes, assessments and other governmental charges so

long as the City shall have budgeted for the amount being contested and, if appropriate, such amount shall have been included as a Maintenance and Operation Costs of the Water System. The City shall duly observe and conform with all valid regulations and requirements of any governmental authority relative to the operation of the Water System or any part thereof, but the City shall not be required to comply with any regulations or requirements so long as the validity or application thereof shall be contested by the City in good faith.

***Collection of Rates and Charges; No Free Service***. The City shall have in effect at all times rules and regulations for the payment of bills for Water Service. Such regulations may provide that where the City furnishes water to the property receiving Water Service, the Water Service charges shall be collected together with the water rates upon the same bill providing for a due date and a delinquency date for each bill. In each case where such bill remains unpaid in whole or in part after it becomes delinquent, the City may disconnect such premises from the Water System, and such premises shall not thereafter be reconnected to the Water System except in accordance with City operating rules and regulations governing such situations of delinquency. To the extent permitted by law, the City shall not permit any part of the Water System or any facility thereof to be used or taken advantage of free of charge by any authority, firm or person, or by any public agency (including the United States of America, the State and any city, county, district, political subdivision, public authority or agency thereof).

***Eminent Domain Proceeds***. If all or any part of the Water System shall be taken by eminent domain proceedings, then subject to the provisions of any Authorizing Ordinance, the Net Proceeds thereof shall be applied to the replacement of the property or facilities so taken, unless the City determines that such property or facility is not necessary to the efficient or proper operation of the Water System and therefore determines not to replace such property or facilities. Any Net Proceeds of such award not applied to replacement or remaining after such work has been completed shall be deposited in the Water Utility Fund and be available for other proper uses of funds deposited in the Water Utility Fund.

***Tax Covenants***. There shall be included in each Supplement relating to Tax-Exempt Installment Payment Obligations such covenants as are deemed necessary or appropriate by Bond Counsel for the purpose of assuring that interest on such Installment Payment Obligations shall be excluded from gross income under section 103 of the Code.

***Subcontracting***. Nothing contained in the Installment Purchase Agreement to the contrary shall prevent the City from delegating the power to be an operator of some or all of the Water System, even though the City continues to retain ownership of the Water System and its operations, and no such subcontracting arrangement shall relieve the City of any of its obligations under the Indenture. Prior to the effective date of any such delegation, the City shall deliver to the Trustee an opinion of Bond Counsel to the effect that the proposed delegation will not have an adverse effect on the exclusion from gross income for federal income tax purposes of the interest component of Tax-Exempt Installment Payment Obligations.

**Prepayments of Installment Payments**

***Prepayment of Installment Payments***. Provisions may be made in any Supplement for the prepayment of Installment Payments, in whole or in part, in such multiples and in such order of maturity and from funds of any source, and with such prepayment premiums and other terms as are specified in the Supplement. Said Supplement shall also provide for any notices to be given relating to such prepayment.

**Events of Default and Remedies of the Corporation**

***Events of Default and Acceleration of Maturities***. If one or more of the following Events of Default shall happen, that is to say:

(a) if default shall be made in the due and punctual payment of or on account of any Parity Obligation as the same shall become due and payable;

(b) if default shall be made by the City in the performance of any of the agreements or covenants required in the Installment Purchase Agreement to be performed by it (other than as specified in subsection (a) above), and such default shall have continued for a period of 60 days after the City shall have been given notice in writing of such default by the Corporation or any Trustee;

(c) if any Event of Default specified in any Supplement, Authorizing Ordinance or Issuing Instrument shall have occurred and be continuing; or

(d) if the City shall file a petition or answer seeking arrangement or reorganization under the federal bankruptcy laws or any other applicable law of the United States of America or any state therein, or if a court of competent jurisdiction shall approve a petition filed with the consent of the City seeking arrangement or reorganization under the federal bankruptcy laws or any other applicable law of the United States of America or any state therein, or if under the provisions of any other law for the relief or aid of debtors any court of competent jurisdiction shall assume custody or control of the City or of the whole or any substantial part of its property;

then, and in each and every such case during the continuance of such Event of Default, the Corporation shall upon the written request of the Owners of 25% or more of the aggregate principal amount of all Series of Parity Installment Obligations Outstanding, voting collectively as a single class, by notice in writing to the City, declare the entire unpaid principal amount thereof and the accrued interest thereon to be due and payable immediately, and upon any such declaration the same shall become immediately due and payable, anything contained in the Installment Purchase Agreement to the contrary notwithstanding; provided, that with respect to a Series of Parity Installment Obligations that is credit enhanced by a Credit Support Instrument, acceleration shall not be effective unless the declaration is consented to by the related Credit Provider. The foregoing provisions, however, are subject to the condition that if at any time after the entire principal amount of all Parity Installment Obligations and the accrued interest thereon shall have been so declared due and payable and before any judgment or decree for the payment of the moneys due shall have been obtained or entered, the City shall deposit with the Corporation a sum sufficient to pay the unpaid principal amount of all such Parity Installment Obligations and the unpaid payments of any other Parity Obligations referred to in clause (a) above due prior to such declaration and the accrued interest thereon, with interest on such overdue installments at the rate or rates applicable thereto in accordance with their terms, and the reasonable expenses of the Corporation, and any and all other defaults known to the Corporation (other than in the payment of the entire principal amount of the unpaid Parity Installment Obligations and the accrued interest thereon due and payable solely by reason of such declaration) shall have been made good or cured to the satisfaction of the Corporation or provision deemed by the Corporation to be adequate shall have been made therefor, then and in every such case the Corporation, by written notice to the City, may rescind and annul such declaration and its consequences; but no such rescission and annulment shall extend to or shall affect any subsequent default or shall impair or exhaust any right or power consequent thereon.

As provided in the Indenture, so long as any Senior Bonds remain outstanding, no Owners of Subordinated Bonds shall have the right to declare an Event of Default, to declare any Bonds immediately due and payable, to direct the Trustee with respect to any Event of Default or to waive any Event of

Default and, for such purposes, any reference to the Owners of a percentage of the principal amount of "Bonds then Outstanding" shall be deemed to refer to the Owners of such percentage of Senior Bonds then Outstanding.

The Owners of Subordinated Obligations may enforce the provisions of the Installment Purchase Agreement for their benefit by appropriate legal proceedings. The payment of Subordinated Obligations will be subordinate in right of payment to payment of the Parity Obligations (except for any payment in respect of Subordinated Obligations from the Reserve Fund securing such Subordinated Obligations). Upon the occurrence and during the continuance of any Event of Default, Owners of Parity Obligations will be entitled to receive payment thereof in full before the Owners of Subordinated Obligations are entitled to receive payment thereof (except for any payment in respect of Subordinated Obligations from the Reserve Fund securing such Subordinated Obligations) and the Owners of the Subordinated Obligations will become subrogated to the rights of the Owners of Parity Obligations to receive payments with respect thereto.

So long as any Senior Bonds remain Outstanding, no amounts, other than amounts in the Subordinated Bonds Payment Fund and the Subordinated Bonds Reserve Fund, shall be applied to the payment of Subordinated Bonds.

***Application of Net System Revenues Upon Acceleration***. All Net System Revenues received after the date of the declaration of acceleration by the Corporation as provided in the Installment Purchase Agreement shall be applied in the following order:

(a) First, to the payment of the costs and expenses of the Corporation and the Trustee, if any, in carrying out the provisions of the Installment Purchase Agreement, including reasonable compensation to its accountants and counsel;

(b) Second, to the payment of the entire principal amount of the unpaid Parity Installment Obligations and the unpaid principal amount of all other Parity Obligations and the accrued interest thereon, with interest on the overdue installments at the rate or rates of interest applicable thereto in accordance with their respective terms. In the event there are insufficient Net System Revenues to pay the entire principal amount of and accrued interest on all Parity Obligations, then accrued interest shall first be paid and any remaining amount shall be paid on account of principal, and in the event there are insufficient Net System Revenues to fully pay either interest or principal in accordance with the foregoing, then payment shall be prorated within a priority based upon the total amounts due in that priority; and

(c) Third, to the payment of the entire principal amount of the unpaid Subordinated Obligations and the accrued interest thereon, with interest on the overdue installments at the rate or rates of interest applicable thereto in accordance with their respective terms. In the event there are insufficient Net System Revenues to pay the entire principal amount of and accrued interest on all Subordinated Obligations, then accrued interest shall first be paid and any remaining amount shall be paid on account of principal, and in the event there are insufficient Net System Revenues to fully pay either interest or principal in accordance with the foregoing, then payment shall be prorated within a priority based upon the total amounts due in that priority.

**Discharge of Installment Payment Obligations**

***Discharge of Installment Payment Obligations***. If the City shall pay or cause to be paid or there shall otherwise be paid to the Owners all Outstanding Installment Payment Obligations of a Series, the principal thereof and the interest and redemption premiums, if any, thereon or if all such Outstanding

Installment Payment Obligations shall be deemed to have been paid at the times and in the manner stipulated in the applicable Issuing Instrument, then, as to any such Series, all agreements, covenants and other obligations of the City under the Indenture shall thereupon cease, terminate and become void and be discharged and satisfied, except for the obligation of the City to pay or cause to be paid all sums due under the Installment Purchase Agreement.

**Miscellaneous**

***Liability of Authority Limited to Revenues and Subordinated Revenues.***

(a) Notwithstanding anything contained in the Indenture, the Authority shall not be required to advance any money derived from any source of income other than the Revenues and the Subordinated Revenues, as provided in the Indenture for the payment of the interest on, or principal of, or premiums, if any, on the Bonds or for the performance of any agreements or covenants contained in the Installment Purchase Agreement. The Authority may, however, advance funds for any such purpose so long as such funds are derived from a source legally available for such purpose without incurring an indebtedness.

(b) The Senior Bonds shall be limited obligations of the Authority and shall be payable solely from the Revenues and amounts on deposit in the funds and accounts established under the Installment Purchase Agreement (other than amounts on deposit in the Subordinated Bonds Payment Fund, the Subordinated Bonds Reserve Fund and the Rebate Fund created pursuant to the Indenture). The Subordinated Bonds shall be limited obligations of the Authority and shall be payable solely from the Subordinated Bonds Revenues and amounts on deposit in the Subordinated Bonds Payment Fund and the Subordinated Bonds Reserve Fund. The Bonds do not constitute a debt or liability of the Authority, the City or of the State of California and neither the faith and credit of the Authority, the City nor of the State are pledged to the payment of the principal of or interest on the Bonds.

***Amendments.***

(a) The Installment Purchase Agreement may be amended with respect to a Series of Installment Payment Obligations in writing as may be mutually agreed by the City and the Corporation, with the written consent of any Credit Provider for any Installment Payment Obligations or, as to Installment Obligations for which there is no Credit Support Instrument, the Owners of a majority in aggregate principal amount of such Series of Installment Payment Obligations then Outstanding, provided that no such amendment shall (1) extend the payment date of any Installment Payment, or reduce the amount of any Installment Payment without the prior written consent of the Owner of each Obligation so affected; or (2) reduce the percentage of Installment Payment Obligations the consent of the Owners of which is required for the execution of any amendment of the Installment Purchase Agreement without the prior written consent of each of the Owners so affected.

(b) The Installment Purchase Agreement and the rights and obligations of the City and the Corporation thereunder may also be amended for supplemented at any time by an amendment or supplement to the Installment Purchase Agreement that shall not adversely affect the interests of the Owners of the Installment Payment Obligations and that shall become binding upon execution by the City and the Corporation, without the written consents of any Owner of Installment Payment Obligations or any Credit Provider, but only to the extent permitted by law and only upon receipt of an unqualified opinion of Bond Counsel to the effect that such amendment or supplement is permitted by the provisions of the Installment Purchase Agreement and is not inconsistent with the Installment Purchase Agreement and does not adversely affect the exclusion of the interest portion of the Installment Payments received by the Owners from gross income for federal income tax purposes, and only for any one or more of the following purposes:

(1) to add to the covenants and agreements of the Corporation or the City contained in the Installment Purchase Agreement other covenants and agreements thereafter to be observed or to surrender any right or power in the Installment Purchase Agreement reserved to or conferred upon the Corporation or the City;

(2) to cure, correct or supplement any ambiguous or defective provision contained in the Installment Purchase Agreement or in regard to questions arising under the Installment Purchase Agreement, as the Corporation or the City may deem necessary or desirable;

(3) to make other amendments or modifications that shall not materially adversely affect the interests of the Owners of the Installment Payment Obligations;

(4) to provide for the issuance of Parity Installment Payment Obligations; and

(5) to provide for the issuance of Subordinated Obligations.

***Net Contract***. The Installment Purchase Agreement shall be deemed and construed to be a net contract, and the City shall pay absolutely net during the term thereof the Installment Payments arid all other payments required under the Indenture, free of any deductions and without abatement, diminution or setoff whatsoever.

**Governing Law**

The Installment Purchase Agreement will be governed by the laws of the State of California applicable to contracts made and performed in the State.

## 2016 SUPPLEMENT

The 2016 Supplement to Amended and Restated Master Installment Purchase Agreement (the "2016 Supplement"), sets forth certain terms and conditions of the purchase of the 2016 Components of the Project by the City. Certain definitions and provision of the 2016 Supplement are given and summarized below:

***Sale and Purchase of 2016 Components***. In consideration of the agreement by the City to make 2016 Subordinated Installment Payments, the Corporation will sell, transfers, and assigns the 2016 Components to the City and the City will agree to purchase and accept the 2016 Components, as more particularly described in the 2016 Supplement.

***2016 Subordinated Installment Payments***. In consideration of the payment by the Authority, on behalf of the Corporation, of the proceeds of the 2016 Bonds and the sale of the 2016 Components by the Corporation to the City pursuant to the 2016 Supplement, the City will agree to pay a portion of the Purchase Price on each 2016 Subordinated Installment Payment Date as 2016 Subordinated Installment Payments, solely from Net System Revenues, as provided in the Installment Purchase Agreement.

***Subordinated Obligations***. The 2016 Subordinated Installment Payments shall be Subordinated Obligations under the Installment Purchase Agreement and the payment of the 2016 Subordinated Installment Payments shall be on parity in right of payment to the 2012A Subordinated Installment Payments under the Installment Purchase Agreement. No Owner of the Obligations shall have any right to take any action or enforce any right that has a materially adverse effect on the interests of the Owners of the Installment Payment Obligations.

***Additional Covenants Relating to Tax Exemption.***

(a) The City shall not directly or indirectly use or permit the use of any proceeds of the 2016 Bonds or any other funds of the City or of the 2016 Components or take or omit to take any action that would cause the 2016 Bonds to be "private activity bonds" within the meaning of Section 141 of the Code, or obligations that are "federally guaranteed" within the meaning of Section 149(b) of the Code.

(b) The City will covenant that it will not take any action, or fail to take any action, if any such action or failure to take action would adversely affect the exclusion from gross income of the interest on the 2016 Bonds under Section 103 of the Code. The City shall not directly or indirectly use or permit the use of any proceeds of the 2016 Bonds or any other funds of the City, or take or omit to take any action, that would cause the 2016 Bonds to be "arbitrage bonds" within the meaning of Section 148(a) of the Code. To that end, the City shall comply with all requirements of Section 148 of the Code to the extent applicable to the 2016 Bonds. If, at any time, the City is of the opinion that for purposes of this section it is necessary to restrict or limit the yield on the investment of any moneys held by the Trustee under the Indenture or otherwise, then the City shall so instruct the Trustee in writing, and shall cause the Trustee to take such action as may be necessary in accordance with such instructions.

(c) Without limiting the generality of the foregoing, the City will agree that there shall be paid from time to time all amounts required to be rebated to the United States of America pursuant to Section 148(f) of the Code and any Treasury Regulations promulgated thereunder as may be applicable to the 2016 Bonds from time to time. This covenant shall survive payment in full or defeasance of the 2016 Bonds. The City will covenant to pay or cause to be paid to the United States of America at the times and in the amounts determined under this section the rebate requirement, as described in the Tax Certificate, and to otherwise comply with the provisions of the Tax Certificate executed by the City and the Authority in connection with the execution and delivery of the 2016 Bonds.

(d) Notwithstanding any provision of this section, if the City provides to the Trustee an opinion of Bond Counsel to the effect that any action required under this section is no longer required, or to the effect that some further action is required, to maintain the exclusion from gross income of the interest on the 2016 Bonds pursuant to Section 103 of the Code, then the City may rely conclusively on such opinion in complying with the provisions of the Indenture, and the covenants under the Installment Purchase Agreement shall be deemed to be modified to that extent.

The Authority covenants and agrees to comply with the terms of that certain Tax Certificate delivered on the 2016 Closing Date with respect to the 2016 Bonds, it being acknowledged and agreed that Bond Counsel will rely upon the same in delivering its opinion respecting the tax status of the 2016 Bonds.

***Continuing Disclosure***. The City covenants and agrees in the 2016 Supplement that it will comply with and carry out all of the provisions of the Continuing Disclosure Certificate to be executed and delivered by the City in connection with the issuance of the 2016 Bonds. Notwithstanding any other provision of the 2016 Supplement, failure of the City to comply with the Continuing Disclosure Certificate shall not be considered a default of any kind under the 2016 Supplement; provided, however, that the Trustee may (and, at the request of any participating underwriter or the Owners of at least twenty-five percent (25%) in aggregate principal amount of the Outstanding 2016 Bonds, shall), or any Owner or Beneficial Owner may, take such actions as may be necessary and appropriate, including seeking mandate or specific performance by court order, to cause the City to comply with its obligations under such Continuing Disclosure Certificate. For purposes of this paragraph, "Beneficial Owner" means any person that has or shares the power, directly or indirectly, to make investment decisions concerning ownership of

any 2016 Bond (including, any persons holding any 2016 Bond through nominees, depositories, or other intermediaries).

## ASSIGNMENT AGREEMENT

The Assignment Agreement provides for the granting, sale, assignment, and transfer by the Corporation to the Authority, for the benefit of the Owners of the 2016 Bonds, all of the Corporation's right, title, and interest in and to the 2016 Supplement, including, without limitation, its right to receive the 2016 Subordinated Installment Payments to be paid by the City under and pursuant to the 2016 Supplement. The Authority accepts such assignment for the benefit of the Owners of the 2016 Bonds, subject to the terms and provisions of the Indenture.

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## APPENDIX B

## FORM OF BOND COUNSEL OPINION

*As a condition to the delivery of the 2016 Bonds, Orrick, Herrington & Sutcliffe LLP, Bond Counsel to the Authority, is expected to render its final approving opinion with respect to the 2016 Bonds in substantially the following form:*

[Closing Date]

Board of Commissioners
Public Facilities Financing Authority
of the City of San Diego
San Diego, California

Public Facilities Financing Authority of the City of San Diego
Subordinated Water Revenue Bonds, Series 2016A
(Payable Solely From Subordinated Installment Payments
Secured by Net System Revenues of the Water Utility Fund)

and

Public Facilities Financing Authority of the City of San Diego
Subordinated Water Revenue Bonds, Refunding Series 2016B
(Payable Solely From Subordinated Installment Payments
Secured by Net System Revenues of the Water Utility Fund)
(Final Opinion)

Ladies and Gentlemen:

We have acted as Bond Counsel to the Public Facilities Financing Authority of the City of San Diego (the "Authority") in connection with the issuance by the Authority of $_____ aggregate principal amount of the Public Facilities Financing Authority of the City of San Diego Subordinated Water Revenue Bonds, Series 2016A (Payable Solely From Subordinated Installment Payments Secured by Net System Revenues of the Water Utility Fund) (the "2016A Bonds") and $_____ aggregate principal amount of the Public Facilities Financing Authority of the City of San Diego Subordinated Water Revenue Bonds, Refunding Series 2016B (Payable Solely From Subordinated Installment Payments Secured by Net System Revenues of the Water Utility Fund) (the "2016B Bonds" and, together with the 2016A Bonds, the "Bonds"), pursuant to the Indenture, dated as of January 1, 2009, as amended and supplemented by the First Supplemental Indenture, dated as of June 1, 2009, the Second Supplemental Indenture, dated as of June 1, 2010, the Third Supplemental Indenture, dated as of April 1, 2012, and the Fourth Supplemental Indenture, dated as of June 1, 2016 (collectively, the "Indenture"), each between the Authority and U.S. Bank National Association, as successor trustee (the "Trustee"). Capitalized terms not otherwise defined herein shall have the meanings ascribed to them in the Indenture and in the Amended and Restated Master Installment Purchase Agreement, dated as of January 1, 2009

(the "Master Installment Purchase Agreement"), as supplemented prior to the date hereof and as supplemented by the 2016 Supplement to Amended and Restated Master Installment Purchase Agreement, dated as of June 1, 2016 (the "2016 Supplement"), each between the City of San Diego (the "City") and the San Diego Facilities and Equipment Leasing Corporation (the "Corporation").

In such connection, we have reviewed the Indenture, the Master Installment Purchase Agreement, the 2016 Supplement, the Assignment Agreement, dated as of June 1, 2016 (the "Assignment Agreement"), by and between the Authority and the Trustee, the Tax Certificate of the City and the Authority, dated the date hereof (the "Tax Certificate"), an opinion of the City Attorney, certificates of the Authority, the City, the Corporation, the Trustee and others, and such other documents, opinions and matters to the extent we deemed necessary to render the opinions set forth herein.

The opinions expressed herein are based on an analysis of existing laws, regulations, rulings and court decisions and cover certain matters not directly addressed by such authorities. Such opinions may be affected by actions taken or omitted or events occurring after the date hereof. We have not undertaken to determine, or to inform any person, whether any such actions are taken or omitted or events do occur or any other matters come to our attention after the date hereof. Accordingly, this letter speaks only as of its date and is not intended to, and may not, be relied upon or otherwise used in connection with any such actions, events or matters. Our engagement with respect to the Bonds has concluded with their issuance, and we disclaim any obligation to update this letter. We have assumed the genuineness of all documents and signatures presented to us (whether as originals or as copies) and the due and legal execution and delivery thereof by, and validity against, any parties other than the Authority. We have assumed, without undertaking to verify, the accuracy of the factual matters represented, warranted or certified in the documents, and of the legal conclusions contained in the opinions, referred to in the second paragraph hereof. Furthermore, we have assumed compliance with all covenants and agreements contained in the Indenture, the Master Installment Purchase Agreement, the 2016 Supplement and the Tax Certificate, including (without limitation) covenants and agreements compliance with which is necessary to assure that future actions, omissions or events will not cause interest on the Bonds to be included in gross income for federal income tax purposes. We call attention to the fact that the rights and obligations under the Bonds, the Indenture, the Master Installment Purchase Agreement, the 2016 Supplement and the Tax Certificate and their enforceability may be subject to bankruptcy, insolvency, receivership, reorganization, arrangement, fraudulent conveyance, moratorium and other laws relating to or affecting creditors' rights, to the application of equitable principles, to the exercise of judicial discretion in appropriate cases and to the limitations on legal remedies against public entities like the City and the Authority in the State of California. We express no opinion with respect to any indemnification, contribution, liquidated damages, penalty (including any remedy deemed to constitute a penalty), right of set-off, arbitration, judicial reference, choice of law, choice of forum, choice of venue, non-exclusivity of remedies, waiver or severability provisions contained in the foregoing documents, nor do we express any opinion with respect to the state or quality of title to or interest in any of the assets described in or as subject to the lien of the Indenture, the Master Installment Purchase Agreement or the 2016 Supplement, or the accuracy or sufficiency of the description contained therein of, or the remedies available to enforce liens on, any such assets. Our services did not include financial or other non-legal advice. Finally, we undertake no responsibility for the accuracy, completeness or fairness of the Official Statement or other offering material relating to the Bonds and express no opinion with respect thereto.

Based on and subject to the foregoing, and in reliance thereon, as of the date hereof, we are of the following opinions:

1. The Bonds constitute the valid and binding limited obligations of the Authority.

2. The 2016 Supplement has been duly executed and delivered by the City and the obligation of the City to pay the 2016 Subordinated Installment Payments under the 2016 Supplement constitutes a valid and binding limited obligation of the City.

3. The Fourth Supplemental Indenture has been duly executed and delivered by, and constitutes a valid and binding limited obligation of, the Authority. The Indenture creates the valid pledge, to secure the payment of the principal of and interest on the Bonds, of the 2016 Subordinated Installment Payments, subject to the provisions of the Indenture permitting the application thereof for the purposes and on the terms and conditions set forth in the Indenture.

4. Interest on the Bonds is excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986 and is exempt from State of California personal income taxes. Interest on the Bonds is not a specific preference item for purposes of the federal individual or corporate alternative minimum taxes, although we observe that it is included in adjusted current earnings when calculating corporate alternative minimum taxable income. We express no opinion regarding other tax consequences related to the ownership or disposition of, or the amount, accrual or receipt of interest on, the Bonds.

Faithfully yours,

ORRICK, HERRINGTON & SUTCLIFFE LLP

per

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## APPENDIX C

## FORM OF CONTINUING DISCLOSURE CERTIFICATE

This Continuing Disclosure Certificate, dated as of June 1, 2016 (the "Disclosure Certificate"), is executed and delivered by the City of San Diego (the "City") in connection with the issuance by the Public Facilities Financing Authority of the City of San Diego (the "Authority") of $_____ Public Facilities Financing Authority of the City of San Diego Subordinated Water Revenue Bonds, Series 2016A (Payable Solely From Subordinated Installment Payments Secured by Net System Revenues of the Water Utility Fund) and $_____ Public Facilities Financing Authority of the City of San Diego Subordinated Water Revenue Bonds, Refunding Series 2016B (Payable Solely From Subordinated Installment Payments Secured by Net System Revenues of the Water Utility Fund) (collectively, the "Bonds"). The Bonds are being issued pursuant to that certain Indenture, dated as of January 1, 2009, as amended and supplemented by a First Supplemental Indenture, dated as of June 1, 2009, a Second Supplemental Indenture, dated as of June 1, 2010, a Third Supplemental Indenture, dated as of April 1, 2012, and a Fourth Supplemental Indenture, dated as of June 1, 2016 (collectively, the "Indenture"), each by and between the Authority and U.S. Bank National Association, as successor trustee (the "Trustee"). In connection therewith, the City, as an "obligated person" with respect to the 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 on behalf of the Authority for the benefit of the Holders and Beneficial Owners of the Bonds and in order to assist the Participating Underwriters in complying with the Rule.

Section 2. Definitions. In addition to the definitions set forth in the Indenture, which apply to any capitalized term used in this Disclosure Certificate unless otherwise defined in this Section, the following capitalized terms shall have the following meanings:

"Annual Report" shall mean any Annual Report provided by the City pursuant to, and as described in, Sections 3 and 4 of this Disclosure Certificate.

"Beneficial Owner" shall mean any person which (a) has the power, directly or indirectly, to vote or consent with respect to, or dispose of ownership of, any Bonds (including persons holding Bonds through nominees, depositories or other intermediaries), or (b) is treated as the owner of any Bonds for federal income tax purposes.

"Dissemination Agent" shall mean the City and any Person designated by the City to serve as Dissemination Agent.

"Holder" shall mean the person in whose name any Bond shall be registered.

"MSRB" shall mean the Municipal Securities Rulemaking Board through its Electronic Municipal Market Access system.

"Notice Event" shall mean any of the events listed in Section 5(a) or (b) of this Disclosure Certificate.

"Official Statement" shall mean the Official Statement, dated June __, 2016, prepared and distributed in connection with the initial sale of the Bonds.

"Participating Underwriters" shall mean any of the original purchasers of the Bonds required to comply with the Rule in connection with offering of the Bonds.

"Person" shall mean any individual, corporation, partnership, joint venture, association, joint stock company, trust, unincorporated organization or government or any agency or political subdivision thereof.

"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, and including any official interpretations thereof issued either before or after the effective date of this Certificate which are applicable to this Certificate.

Section 3. Provision of Annual Reports.

(a) The City shall, or upon written direction, shall cause the Dissemination Agent (if other than the City) to, not later than April 10 after the end of the City's Fiscal Year (which currently ends June 30), or the next succeeding business day if that day is not a business day, commencing with the report for the fiscal year ending June 30, 2016 (each, a "Filing Date"), provide to the MSRB an Annual Report that is consistent with the requirements of Section 4 of this Disclosure Certificate. As of the date of this Disclosure Certificate, the format prescribed by the MSRB is the Electronic Municipal Market Access ("EMMA") system.

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 Notice Event under Section 5(c) hereof.

(b) Not later than fifteen (15) business days prior to each Filing Date for providing the Annual Report to the MSRB, the City shall provide the Annual Report to the Dissemination Agent (if other than the City). If the City is unable to provide to the MSRB an Annual Report by the Filing Date, the City shall, in a timely manner, send a notice to the MSRB.

(c) The Dissemination Agent (if other than the City) shall:

(i) determine each year prior to the date for providing the Annual Report the format for filing with the MSRB; and

(ii) file a report with the City certifying that the Annual Report has been provided to the MSRB pursuant to this Disclosure Certificate, and stating the date the Annual Report was so provided.

Section 4. Content of Annual Reports. The City's Annual Report shall contain or incorporate by reference the following:

(a) The audited financial statements of the City for the most recently completed Fiscal Year prepared in accordance with generally accepted accounting principles as applicable to state and local governments in the United States of America. 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

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 Public Utilities Department and the Water Utility Fund, for the most recently completed Fiscal Year of the type included in the Official Statement, in the following categories (to the extent not included in the City's audited financial statements):

(i) An update of the information substantially in the form contained in Table 2 (entitled "Historical Number of Retail Connections to Water System") for the most recently completed Fiscal Year;

(ii) An update of the information substantially in the form contained in Table 3 (entitled "Major Retail Customers") for the most recently completed Fiscal Year;

(iii) An update of the information substantially in the form substantially in the form contained in Table 4 (entitled "Raw Water Reservoirs") for the most recently completed Fiscal Year;

(iv) An update of the information substantially in the form contained in Table 5 (entitled "Capacity and Demand of Water System Water Treatment Plants") for the most recently completed Fiscal Year;

(v) An update of the information substantially in the form contained in Table 8 (entitled "Water Supplies for the City of San Diego") for the most recently completed Fiscal Year;

(vi) An update of the information substantially in the form contained in Table 12 (entitled "Five-Year Water Service Charge History for Single Family Residential, Multi-Family, Non-Residential, Irrigation, and Temporary Construction") for the most recently completed Fiscal Year;

(vii) An update of the information substantially in the form contained in Table 13 (entitled "Water Utility Fund Historical Capacity Charge Revenues") for the most recently completed Fiscal Year;

(viii) An update of the information substantially in the form contained in Table 14 (entitled "Water Customer Accounts Receivable and Shut-Offs by Fiscal Year") for the most recently completed Fiscal Year;

(ix) An update of the information substantially in the form contained in Table 15 (entitled "Historical Sources of Water Sales Revenues") for the most recently completed Fiscal Year;

(x) An update of the information substantially in the form contained in Table 16 (entitled "Statements of Revenues, Expenses, and Changes in Fund Net Assets for the Water Utility Fund") for the most recently completed Fiscal Year;

(xi) An update of the information substantially in the form contained in Table 17 (entitled "Calculation of Historic Debt Service Coverage") for the most recently completed Fiscal Year;

(xii) An update of the information substantially in the form contained in Table 18 (entitled "Reserves and Total Cash and Cash Equivalents In Water Utility Fund") for the most recently completed Fiscal Year;

(xiii) An update of the information substantially in the form contained in Table 20 (entitled "Outstanding Debt") for the most recently completed Fiscal Year;

(xiv) An update of the information substantially in the form contained in Table 21 (entitled "Water Utility Fund Liability Claims Budget and Expenditures") for the most recently completed Fiscal Year;

(xv) An update of the information substantially in the form contained in Table 24 (entitled "City of San Diego Schedule of Funding Progress") for the most recently completed Fiscal Year;

(xvi) An update of the information substantially in the form contained in Table 25 (entitled "City of San Diego and Water Utility Fund Pension Contribution") for the most recently completed Fiscal Year;

(xvii) An update of the information substantially in the form contained in Table 27 (entitled "City of San Diego – Schedule of Funding Progress (DB OPEB Plan)") for the most recently completed Fiscal Year; and

(xviii) An update of the information substantially in the form contained in Table 28 (entitled "City of San Diego and Water Utility Fund Retiree Health Contribution") 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 the MSRB. The City shall clearly identify each such other document so included by reference.

The contents, presentation and format of the Annual Reports may be modified from time to time as determined in the judgment of the City to conform to changes in accounting or disclosure principles or practices and legal requirements followed by or applicable to the City or to reflect changes in the business, structure, operations, legal form of the City or any mergers, consolidations, acquisitions or dispositions made by or affecting the City; provided that any such modifications shall comply with the requirements of the Rule.

Section 5. Reporting of Significant Events.

(a) The City shall give, or cause to be given, notice of the occurrence of any of the following events with respect to the Bonds, in a timely manner not later than ten (10) business days after the occurrence of such Notice Event to the MSRB through EMMA:

(i) Principal and interest payment delinquencies;

(ii) Unscheduled draws on debt service reserves reflecting financial difficulties[1];

(iii) Unscheduled draws on credit enhancements reflecting financial difficulties;

(iv) Substitution of credit or liquidity providers, or their failure to perform;[2]

(v) Adverse tax opinions or issuance by the Internal Revenue Service of proposed or final determination of taxability or of a Notice of Proposed Issue (IRS Form 5701 TEB);

(vi) Tender offers;

(vii) Defeasances;

(viii) Rating changes;[3] or

(ix) Bankruptcy, insolvency, receivership or similar event of the City (such event being considered to occur when any of the following occur: the appointment of a receiver, fiscal agent or similar officer for the City in a proceeding under the U.S. Bankruptcy Code or in any other proceeding under state or federal law in which a court or governmental authority has assumed jurisdiction over substantially all of the assets or business of the obligated person, or if such jurisdiction has been assumed by leaving the existing governing body and officials or officers in possession but subject to the supervision and orders of a court or governmental authority, or the entry of an order confirming a plan of reorganization, arrangement or liquidation by a court or governmental authority having supervision or jurisdiction over substantially all of the assets or business of the City).

(b) The City shall give, or cause to be given, notice of the occurrence of any of the following events with respect to the Bonds, if material, not later than ten (10) business days after the occurrence of the such Notice Event to the MSRB through EMMA:

(i) Unless described in paragraph 5(a)(5), other notices or determinations with respect to the tax status of the Bonds or other events affecting the tax status of the Bonds;

(ii) Modifications to rights of holders of the Bonds;

(iii) Bond calls;[4]

(iv) Release, substitution, or sale of property securing repayment of the Bonds;

(v) Non-payment related defaults;

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[1] Without limiting its reporting obligation, the City advises that it has not established a debt service reserve fund for the Bonds.

[2] Without limiting its reporting obligation, the City advises that it has not obtained or provided any credit enhancement or credit or liquidity providers for the Bonds.

[3] Does not include rating changes related to credit enhancement added by a Holder. In addition, the City's obligation to provide notice of any rating change shall be deemed to be satisfied if the applicable rating agency files such change with EMMA pursuant to the "automated data feeds" that have been established by the MSRB.

[4] Any scheduled redemption of Bonds pursuant to mandatory sinking fund redemption requirements does not constitute a Notice Event within the meaning of the Rule.

(vi) The consummation of a merger, consolidation, or acquisition the City or the sale of all or substantially all of the assets thereof, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms; or

(vii) Appointment of a successor or additional trustee or the change of name of a trustee.

(c) If the City learns of the occurrence of a Notice Event described in Section 5(a), or determines that knowledge of a Listed Event described in Section 5(b) would be material under applicable federal securities laws, the City shall promptly file, or cause to be filed, a notice of such event with the MSRB through EMMA. Notwithstanding the foregoing, notice of the Notice Events described in subsections (a)(vii) or (b)(iii) 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.

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 Bonds. If such termination occurs prior to the final maturity of the Bonds, the City shall give notice of such in the same manner as for a Notice 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, if other than the City, shall not be responsible in any manner for the content of any notice or report prepared by the City pursuant to this Disclosure Certificate.

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 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 Bonds, or the type of business conducted;

(b) the undertakings herein, as proposed to be amended or taking in account such waiver, would, in the opinion of nationally recognized bond counsel, have complied with the requirements of the Rule at the time of the primary offering of the Bonds, after taking into account any amendments or interpretations of the Rule, as well as any change in circumstances; and

(c) The amendment or waiver (i) is approved by the Holders majority of outstanding principal amount of the Bonds, in the same manner as provided in the Indenture for amendments to the Indenture with the consent of the 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 Bonds.

In the event of any amendment or waiver of a provision of this Disclosure Certificate, the City shall describe such amendment in the next Annual Report, and shall include, as applicable, a narrative explanation of the reason for the amendment or waiver and its impact on the type (or in the case of a change of accounting principles, on the presentation) of financial information or operating data being presented by the City. In addition, if the amendment relates to the accounting principles to be followed in

preparing financial statements, (i) notice of such change shall be given in the same manner as for a Notice Event under subsection 5(c), and (ii) the Annual Report for the year in which the change is made should present a comparison (in narrative form and also, if feasible, in quantitative form) between the financial statements as prepared on the basis of the new accounting principles and those prepared on the basis of the former accounting principles.

Section 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 Notice 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 Notice Event in addition to that which is specifically required by this Disclosure Certificate, the City shall have no obligation under this Disclosure Certificate to update such information or include it in any future Annual Report or notice of the occurrence of a Notice Event.

Section 10. Default. In the event of a failure of the City to comply with any provision of this Disclosure Certificate, any Holder or Beneficial Owner 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 this Disclosure Certificate; provided that any Beneficial Owner seeking to require the City to comply with this Certificate shall first provide at least 30 days' prior written notice to the City of the City's failure, giving reasonable detail of such failure, following which notice the City shall have 30 days to comply. 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, and no person or entity shall be entitled to recover monetary damages under this Certificate.

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. The Dissemination Agent, if other than the City, shall have no duty or obligation to review any information provided to it hereunder and shall not be deemed to be acting in any fiduciary capacity for the City, the Authority, the owners of the Bonds, or any other party, and, other than in the case of negligence, gross negligence, or willful misconduct of the Dissemination Agent, the Dissemination Agent shall not have any liability to the owners of the Bonds or any other party for any monetary damages or financial liability of any kind whatsoever related to or arising from any breach of any obligation of the Dissemination Agent. The obligations of the City under this Section shall survive resignation or removal of the Dissemination Agent and payment of the Bonds.

Section 12. Beneficiaries. This Disclosure Certificate shall inure solely to the benefit of the City, the Dissemination Agent, and Holders and Beneficial Owners from time to time of the Bonds, and shall create no rights in any other person or entity.

Section 13. Governing Law. This Disclosure Certificate shall be governed by the laws of the State of California and the federal securities laws.

**IN WITNESS WHEREOF**, the City of San Diego has executed this Continuing Disclosure Certificate as of the date first set forth herein.

THE CITY OF SAN DIEGO

By:_____

Chief Financial Officer

## APPENDIX D

## INFORMATION REGARDING THE BOOK-ENTRY ONLY SYSTEM

*The following description of DTC and its book-entry system has been provided by DTC and has not been verified for accuracy or completeness by the City or the Authority, and neither the City nor the Authority shall have any liability with respect thereto. Neither the City nor the Authority shall have any responsibility or liability for any aspects of the records maintained by DTC relating to or payments made on account of beneficial ownership, or for maintaining, supervising, or reviewing any records maintained by DTC relating to beneficial ownership, of interests in the 2016 Bonds.*

The Depository Trust Company ("DTC"), New York, NY, will act as securities depository for the 2016 Bonds. The 2016 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 will be issued for each issue of the 2016 Bonds, in the aggregate principal amount of such issue, and will be deposited with DTC.

DTC, the world's largest securities depository, is a limited-purpose trust company organized under the New York Banking Law, a "banking organization" within the meaning of the New York Banking Law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code, and a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for over 3.5 million issues of U.S. and non-U.S. equity issues, corporate and municipal debt issues, and money market instruments (from over 100 countries) that DTC's participants ("Direct Participants") deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities, through electronic computerized book-entry transfers and pledges between Direct Participants' accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation ("DTCC"). DTCC is the holding company for DTC, National Securities Clearing Corporation and Fixed Income Clearing Corporation, all of which are registered clearing agencies. DTCC is owned by the users of its regulated subsidiaries. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly ("Indirect Participants"). DTC has a Standard & Poor's rating of AA+. The DTC Rules applicable to its Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at www.dtcc.com, provided that nothing contained in such website is incorporated into this Official Statement.

Purchases of 2016 Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the 2016 Bonds on DTC's records. The ownership interest of each actual purchaser of each 2016 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 2016 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 2016 Bonds, except in the event that use of the book-entry system for the 2016 Bonds is discontinued.

To facilitate subsequent transfers, all 2016 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 2016 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 2016 Bonds; DTC's records reflect only the identity of the Direct Participants to whose accounts such 2016 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. Beneficial Owners of 2016 Bonds may wish to take certain steps to augment the transmission to them of notices of significant events with respect to the 2016 Bonds, such as redemptions, tenders, defaults, and proposed amendments to the Indenture and the Installment Purchase Agreement. For example, Beneficial Owners of 2016 Bonds may wish to ascertain that the nominee holding the 2016 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. If less than all of the 2016 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 2016 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 Authority 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 2016 Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Redemption proceeds, distributions, and dividend payments on the 2016 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 Authority or 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, the Trustee, or the Authority, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of redemption proceeds, distributions, and dividend payments to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the Authority or the Trustee, disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners will be the responsibility of Direct and Indirect Participants.

DTC may discontinue providing its services as depository with respect to the 2016 Bonds at any time by giving reasonable notice to the Authority or the Trustee. Under such circumstances, in the event that a successor depository is not obtained, bonds are required to be printed and delivered. 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, bonds will be printed and delivered to DTC.

The information in this Official Statement concerning DTC and DTC's book-entry system has been obtained from sources that the Authority and the City believes to be reliable, but the Authority and the City takes no responsibility for the accuracy thereof.

PUBLIC FACILITIES FINANCING AUTHORITY OF THE CITY OF SAN DIEGO • SUBORDINATED WATER REVENUE BONDS, SERIES 2016A AND REFUNDING SERIES 2016B

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