CITY OF MODESTO
RESOLUTION NO. 2006-648

A RESOLUTION OF THE CITY COUNCIL OF THE CITY OF MODESTO RELATING TO WATER REVENUE CERTIFICATES OF PARTICIPATION, 2006 SERIES A; APPROVING THE FORMS OF AND AUTHORIZING THE EXECUTION AND DELIVERY OF A 2006 SUPPLEMENTAL INSTALLMENT PURCHASE CONTRACT, A PURCHASE CONTRACT, A CONTINUING DISCLOSURE AGREEMENT, AND AN INSURANCE AND REIMBURSEMENT AGREEMENT; AUTHORIZING THE DISTRIBUTION OF AN OFFICIAL STATEMENT IN CONNECTION THERewith; AND AUTHORIZING CERTAIN OTHER RELATED ACTIONS

WHEREAS, the City of Modesto is a charter city and municipal corporation duly organized and existing under and by virtue of the Constitution and laws of the State of California (the “City”); and

WHEREAS, the City and the Modesto Public Financing Authority (the “Authority”), a joint exercise of powers authority duly organized and existing under and by virtue of the laws of the State of California, have previously entered into a Master Installment Purchase Contract, dated as of November 1, 1997 (the “Master Installment Purchase Contract”) in order to provide for the financing and refinancing from time to time of the costs of acquisition and construction of various additions, betterments, extensions and improvements to the City’s Water Utility System; and

WHEREAS, the City previously refinanced certain improvements to its Water Utility System, pursuant to the 1997 Supplemental Installment Purchase Contract, dated as of November 1, 1997, by and between the City and the Authority, supplementing the Master Installment Purchase Contract, with proceeds of the City’s $25,585,000 in aggregate principal amount of Refunding Revenue Certificates of Participation (1997 Water Utility System Refinancing Project) executed and delivered pursuant to a Trust Agreement, dated as of
November 1, 1997, by and between the Authority and State Street Bank and Trust Company of California, N.A. (which has been succeeded by U.S. Bank National Association), as trustee; and

WHEREAS, pursuant to Article III of the Master Installment Purchase Contract, the City may incur additional obligations payable on a parity thereunder, including by execution of a supplemental installment purchase contract; and

WHEREAS, the City now desires to finance the cost of various additional improvements to its Water Utility System (the “2006 Project”), and in connection therewith the City and the Authority propose to execute and enter into a 2006 Supplemental Installment Purchase Contract (the “2006 Supplemental Installment Purchase Contract”), supplementing the Master Installment Purchase Contract, whereby the City will purchase the 2006 Project from the Authority, and the City will be obligated to make installment payments to the Authority as the purchase price therefor; and

WHEREAS, pursuant to a Trust Agreement (the “2006 Trust Agreement”) proposed to be executed and entered into by and between the Authority and The Bank of New York Trust Company, N.A., as trustee (the “2006 Trustee”), the Authority proposes to assign certain of its rights under the 2006 Supplemental Installment Purchase Contract, including its right to receive the payments to be made by the City thereunder; and

WHEREAS, in consideration of such assignment and the execution and entering into of the 2006 Trust Agreement by the 2006 Trustee and the Authority, the 2006 Trustee has agreed to execute and deliver Water Revenue Certificates of Participation, Series 2006 A (the “2006 Certificates”), evidencing and representing proportionate interests of the owners thereof in installment payments to be made by the City; and
WHEREAS, the 2006 Certificates are expected to be initially executed and delivered as auction rate securities; and

WHEREAS, the City proposes to execute and enter into a Purchase Contract (the "Purchase Contract") with Banc of America Securities LLC (the "Underwriter") and the Authority, pursuant to which the Underwriter will purchase the 2006 Certificates for reoffering to the public; and

WHEREAS, the City proposes to deem final for purposes of Rule 15c(2) 12 of the Securities Exchange Act of 1934, as amended, and to execute and deliver an Official Statement (the "Official Statement") relating to the 2006 Certificates and to authorize the distribution of such Official Statement to prospective and actual purchasers of the 2006 Certificates; and

WHEREAS, the City proposes to execute and enter into a Continuing Disclosure Agreement (the "Continuing Disclosure Agreement") with the 2006 Trustee, as dissemination agent (the "Dissemination Agent"), for the benefit of the owners of the 2006 Certificates and to assist the Underwriter in complying with Rule 15c(2)-12 of the Securities Exchange Act of 1934, as amended; and

WHEREAS, the City proposes to execute and deliver an Insurance and Reimbursement Agreement (the "Insurance and Reimbursement Agreement") with the 2006 Trustee and MBIA Insurance Corporation, as insurer of the 2006 Certificates and of certain swap payments to be made by the City under the interest rate swap agreement previously authorized by the City Council to be entered into by the City in connection with the 2006 Certificates (the "Insurer"), in order to secure the obligations of the City to reimburse the Insurer for any payment made by the
Insurer under the municipal bond insurance policy for the 2006 Certificates and the swap insurance policy for the interest rate swap agreement relating to the 2006 Certificates; and

WHEREAS, all acts, conditions and things required by the laws of the State of California to exist, to have happened and to have been performed precedent to and in connection with the consummation of the transactions authorized hereby do exist, have happened and have been performed in regular and due time, form and manner as required by law, and the City is now duly authorized and empowered, pursuant to each and every requirement of law, to consummate such transactions for the purpose, in the manner and upon the terms herein provided;

NOW, THEREFORE, BE IT RESOLVED by the City Council of the City of Modesto, as follows:

Section 1. Findings. The City Council hereby specifically finds and determines that the actions authorized hereby constitute and are with respect to the public affairs of the City and that the statements, findings and determinations of the City set forth above and in the preambles of the documents approved herein are true and correct and that the consummation of the transactions contemplated therein shall result in significant public benefits to the City.

Section 2. 2006 Supplemental Installment Purchase Contract. The 2006 Supplemental Installment Purchase Contract, proposed to be executed and entered into by and between the City and the Authority, in the form presented at this meeting and on file with the City Clerk of the City, is hereby approved. Each of the City Manager and the Finance Director, acting singly, is hereby authorized and directed, for and in the name and on behalf of the City, to execute and deliver to the Authority the 2006 Supplemental Installment Purchase Contract in substantially said form, with such changes therein as such officer executing the 2006 Supplemental
Installment Purchase Contract may require or approve, such approval to be conclusively evidenced by the execution and delivery thereof; provided, that the schedule of the installment payments to be contained in the 2006 Supplemental Installment Purchase Contract and to be attached as an exhibit thereto shall be determined by the City Manager or the Finance Director of the City upon the sale of the 2006 Certificates, the aggregate principal amount of 2006 Certificates to be executed and delivered shall not exceed $52,000,000, the final principal payment date of the 2006 Certificates shall not be later than 35 years from the initial installment payment, and the 2006 Certificates initially shall be issued as auction rate securities.

Section 3. Purchase Contract. The Purchase Contract, proposed to be executed and entered into by and among the City, the Authority, and the Underwriter, in the form presented at this meeting and on file with the City Clerk, is hereby approved, and each of the City Manager and the Finance Director, acting singly, is hereby authorized and directed, for and in the name and on behalf of the City, to execute and deliver to the Underwriter and the Authority the Purchase Contract in substantially said form, with such changes therein as such officer executing the Purchase Contract may require or approve, such approval to be conclusively evidenced by the execution and delivery thereof.

Section 4. Official Statement. The Official Statement, in the form presented at this meeting and on file with the City Clerk, is hereby approved. Each of the Mayor, the City Manager and the Finance Director, acting singly, is hereby authorized and directed to cause the Official Statement, in substantially said form, with such changes therein as such officer may require or approve, to be deemed final for purposes of Rule 15c(2)-12 of the Securities Exchange Act of 1934, as amended, and to be distributed to potential and actual purchasers of the 2006 Certificates. Each of the Mayor, the City Manager and the Finance Director, acting singly, is
hereby authorized and directed, for and in the name and on behalf of the City, to execute and
deliver the Official Statement in substantially said form, with such changes therein as such
officer executing the Official Statement may require or approve, such approval to be
conclusively evidenced by the execution and delivery thereof.

Section 5. Continuing Disclosure Agreement. The Continuing Disclosure Agreement,
proposed to be executed and entered into by and between the City and the 2006 Trustee, as
Dissemination Agent thereunder, in the form presented at this meeting and on file with the City
Clerk, is hereby approved and each of the City Manager and the Finance Director, acting singly,
is hereby authorized and directed for and in the name and on behalf of the City to execute and
deliver to the 2006 Trustee the Continuing Disclosure Agreement in substantially said form, with
such changes therein as such officer executing the Continuing Disclosure Agreement may
require or approve, such approval to be conclusively evidenced by the execution and delivery
thereof.

Section 6. Insurance and Reimbursement Agreement. The Insurance and
Reimbursement Agreement, proposed to be executed and entered into by and among the City, the
2006 Trustee and the Insurer, in the form presented at this meeting and on file with the City
Clerk, is hereby approved and each of the City Manager and the Finance Director, acting singly,
is hereby authorized and directed for and in the name and on behalf of the City to execute and
deliver to the 2006 Trustee and the Insurer the Insurance and Reimbursement Agreement in
substantially said form, with such changes therein as such officer executing the Insurance and
Reimbursement Agreement may require or approve, such approval to be conclusively evidenced
by the execution and delivery thereof.
Section 7. **Attestations.** The City Clerk is hereby authorized and directed to attest the signature of the Mayor, the City Manager and the Finance Director and to affix and attest the seal of the City, as may be required or appropriate in connection with the execution and delivery of the 2006 Certificates and the documents approved by this Resolution.

Section 8. **Other Actions.** The officers of the City are hereby authorized and directed, jointly and severally, to do any and all things and to execute and deliver any and all documents which they may deem necessary or desirable in order to consummate the transactions authorized hereby and to consummate the sale, execution and delivery of the 2006 Certificates and otherwise to carry out, give effect to and comply with the terms and intent of this Resolution, the 2006 Supplemental Installment Purchase Contract, the Purchase Contract, the Continuing Disclosure Agreement, the Insurance and Reimbursement Agreement, the Official Statement, and the 2006 Certificates; and all such actions heretofore taken by such officers are hereby ratified, confirmed and approved.

Section 9. **Effective Date.** This Resolution shall take effect immediately upon its passage.
The foregoing resolution was introduced at a meeting of the City of Modesto held on the 10th day of October, 2006, by Councilmember Hawn, who moved its adoption, which motion being duly seconded by Councilmember Dunbar, was upon roll call carried and the resolution adopted by the following vote:

AYES: Councilmembers: Dunbar, Hawn, Keating, Marsh, O’Bryant, Olsen, Mayor Ridenour

NOES: Councilmembers: None

ABSENT: Councilmembers: None

APPROVED AS TO FORM:

By: ____________________________
    SUSANA ALCALA WOOD,
    City Attorney

ATTEST: ____________________________
        JEAN MORRIS,
        City Clerk
2006 SUPPLEMENTAL INSTALLMENT PURCHASE CONTRACT

by and between the

CITY OF MODESTO

and the

MODESTO PUBLIC FINANCING AUTHORITY

Dated as of November 1, 2006
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2006 SUPPLEMENTAL INSTALLMENT PURCHASE CONTRACT

The 2006 Supplemental Installment Purchase Contract (the “2006 Supplemental Contract”), dated as of November 1, 2006, by and between the City of Modesto, California, a charter city and municipal corporation duly organized and existing under and by virtue of the Constitution and laws of the State of California (the “City”), and the Modesto Public Financing Authority, a joint exercise of powers authority duly organized and existing under and by virtue of the laws of the State of California (the “Authority”);

WITNESSETH:

WHEREAS, the City and the Authority have executed and entered into a Master Installment Purchase Contract, dated as of November 1, 1997 (the “Master Contract”), for the acquisition from time to time of various additions, betterments, extensions and improvements to the Water Utility System of the City; and

WHEREAS, the City previously refinanced certain improvements to its Water Utility System (the “1997 Project”) pursuant to the 1997 Supplemental Installment Purchase Contract, dated as of November 1, 1997 (the “1997 Supplemental Contract”), by and between the Authority and the City, supplementing the Master Contract, under which the City is obligated to make certain payments (the “1997 Payments”) to the Authority as payment of the purchase price for the 1997 Project; and

WHEREAS, pursuant to Article III of the Master Contract, the City may incur additional Parity Obligations, including pursuant to a Supplemental Contract to the Master Contract, subject to the terms and conditions set forth therein; and

WHEREAS, the City now desires to finance the costs of various additional improvements (the “2006 Project”) to the Water Utility System, and in connection therewith to enter into this 2006 Supplemental Installment Purchase Contract (the “2006 Supplemental Contract”) with the Authority, supplementing the Master Contract, pursuant to which the City will obligate itself to make certain payments (the “2006 Payments”) to the Authority as payment of the purchase price of the 2006 Project; and

WHEREAS, pursuant to the 2006 Trust Agreement (as defined herein), the Authority has assigned to The Bank of New York Trust Company, N.A., as trustee (the “Trustee”) under the 2006 Trust Agreement, certain of its rights under the 2006 Supplemental Contract, including its right to receive the 2006 Payments to be made by the City under this 2006 Supplemental Contract; and

WHEREAS, in consideration of such assignment and the execution and entering into of the 2006 Trust Agreement by the Trustee and the Authority, the Trustee has agreed to execute and deliver $_________ Water Revenue Certificates of Participation, 2006 Series A (the “2006 Certificates”), evidencing and representing proportionate interests in the 2006 Payments payable hereunder; and

WHEREAS, the City has determined that the foregoing is necessary and proper for the City; and
WHEREAS, the City and the Authority have determined that all acts, conditions and things required by law to exist, to have happened and to have been performed precedent to and in connection with the execution and delivery of the 2006 Supplemental Contract do exist, have happened and have been performed in regular and due time, form and manner as required by law, and the parties hereto are now duly authorized to execute and enter into the 2006 Supplemental Contract;

NOW, THEREFORE, IN CONSIDERATION OF THE PREMISES AND OF THE MUTUAL AGREEMENTS AND COVENANTS CONTAINED HEREIN AND FOR OTHER VALUABLE CONSIDERATION, THE PARTIES HERETO DO HEREBY AGREE AS FOLLOWS:
ARTICLE I
DEFINITIONS

Section 1.01. Definitions. Except as provided in Section 1.02 hereof or unless the context otherwise requires, the terms defined in this Section shall for all purposes hereof and of any opinion or report or other document mentioned herein have the meanings defined herein, the following definitions to be equally applicable to both the singular and plural forms of any of the terms defined herein:

"Continuing Disclosure Agreement" means the Continuing Disclosure Agreement, dated November __, 2006, by and between the City and the Trustee, delivered in connection with the execution and delivery of the 2006 Certificates.

"Rebate Requirement" shall have the meaning given such term in Section 2.06(b) hereof.

"Special Counsel" shall have the meaning given such term in the 2006 Trust Agreement.

"2006 Certificate Insurance Policy" means the municipal bond insurance policy issued by the 2006 Certificate Insurer guaranteeing the scheduled payment of principal of and interest evidenced and represented by the 2006 Certificates.

"2006 Certificate Insurer" means MBIA Insurance Corporation, its successors and assigns.

"2006 Certificates" means the City of Modesto Water Revenue Certificates of Participation, 2006 Series A, evidencing and representing proportionate interests of the owners thereof in the 2006 Payments to be made by the City, executed and delivered pursuant to the 2006 Trust Agreement.

"2006 Insurance Agreement" means the Insurance and Reimbursement Agreement, dated as of November 1, 2006, by and among the City, the Authority, the Trustee and the 2006 Certificate Insurer, which 2006 Insurance Agreement shall constitute a Parity Bank Agreement for purposes of the Master Contract and hereof.

"2006 Interest Rate Swap Agreement" means, collectively, the ISDA Master Agreement (Local Currency—Single Jurisdiction 1992), the U.S. Municipal Counterparty Schedule thereto, a Credit Support Annex and a Confirmation, each dated ____________, 2006, between Bank of America, N.A., as a Qualified Counterparty, and the City.

"2006 Payment Date" means each Interest Payment Date and each day on which payments of principal evidenced and represented by the 2006 Certificates become due (whether at maturity or because of prepayment or acceleration).

"2006 Payments" means the Payments scheduled to be paid by the City under and pursuant to the terms hereof.
“2006 Project” means the improvements to the Water Utility System to be financed with the proceeds of the 2006 Certificates, as shown on Exhibit B hereto.

“2006 Project Account” means the account of the Improvement Fund established pursuant to Section 2.06(a) hereof.

“2006 Rebate Fund” means the City of Modesto Water Utility System 2006 Rebate Fund established pursuant to Section 2.06(b) hereof.

“2006 Supplemental Contract” means this 2006 Supplemental Installment Purchase Contract, dated as of November 1, 2006, by and between the City and the Authority, as originally executed and as it may from time to time be amended or supplemented in accordance herewith.

“2006 Supplemental Contract Payment Account” means the account by that name within the Parity Obligation Payment Fund established pursuant to Section 2.04 hereof.

“2006 Swap Insurance Policy” the interest rate swap insurance policy issued by the 2006 Certificate Insurer guaranteeing certain payments due by the City under the 2006 Interest Rate Swap Agreement.

“2006 Tax Certificate” means the Tax Certificate concerning certain matters pertaining to the use and investment of proceeds of the 2006 Certificates executed and delivered by the City on the date of initial delivery of the 2006 Certificates, including any and all exhibits attached thereto.

“2006 Trust Agreement” means that certain Trust Agreement, dated as of November 1, 2006, by and between the Authority and the Trustee, as originally executed and as it may from time to time be amended or supplemented in accordance with its terms.

Section 1.02. Clarification and Definitions in Master Contract and 2006 Trust Agreement.

(a) To cure a possible ambiguity therein, the definition of “Parity Obligations” contained in Section 1.01 of the Master Contract is hereby clarified to read as follows:

“Parity Obligations” means the payment obligations under the Treatment and Delivery Agreement which constitute debt service, the payment obligations under the CDWR Loan Agreement, and all Supplemental Contracts and all other obligations hereafter incurred by the City the payment of which constitutes a charge and lien on the Gross Revenues equal to and on a parity with the charge and lien upon the Gross Revenues for the payment of the Payments, other than (i) such portion of the payment obligations (including certain payments due upon an early termination thereof) under any Parity Payment Agreement to the extent such obligations are expressly subordinate to Parity Obligations pursuant to the terms of such Parity Payment Agreement and (ii) Parity Bank Agreements; provided that no amounts have been drawn under any such Parity Bank Agreements which have not been reimbursed by the City.

(b) Except as otherwise herein defined or unless the context otherwise requires, the terms defined in the Master Contract or the 2006 Trust Agreement shall for all purposes hereof
and of any amendment hereof or supplement hereto and of any report or other document mentioned herein have the meanings defined therein, such definitions to be equally applicable to both the singular and plural forms of any of the terms defined therein. With respect to any defined term which is given a different meaning under this 2006 Supplemental Contract than under the Master Contract or the 2006 Trust Agreement, as used herein it shall have the meaning given herein.
ARTICLE II
TERMS OF THE 2006 SUPPLEMENTAL CONTRACT

Section 2.01. Authority for the 2006 Supplemental Contract. The City has reviewed all proceedings heretofore taken relative to the authorization of this 2006 Supplemental Contract and has found, as a result of such review, and hereby finds and determines that all acts, conditions and things required by law to exist, happen or be performed precedent to and in connection with the execution hereof do exist, have happened and have been performed in due time, form and manner as required by law, and the City is now duly authorized, pursuant to each and every requirement of law, to execute and enter into the 2006 Supplemental Contract in the manner and form provided herein for the financing of the costs of the 2006 Project.

Section 2.02. Purpose of the 2006 Supplemental Contract. In accordance with Section 2.01 of the Master Contract, the Authority hereby agrees to finance the costs of acquisition and construction of the 2006 Project and to sell the 2006 Project to the City. The City agrees to acquire the 2006 Project from the Authority pursuant to the terms hereof, to cause the acquisition and construction of the 2006 Project as agent for the Authority in accordance with Section 2.01 of the Master Contract and in accordance with the terms hereof and of the 2006 Trust Agreement. Immediately upon completion of each separately acquirable component of the 2006 Project, all right, title and interest in and to each such component of the 2006 Project shall transfer to the City from the Authority without any further action by the City or the Authority.

Section 2.03. 2006 Supplemental Contract Payment Account. There is hereby established within the Parity Obligation Payment Fund the 2006 Supplemental Contract Payment Account. On or before the third Business Day immediately preceding each 2006 Payment Date or the date on which any net payment or insured termination payment is due under the 2006 Interest Rate Swap Agreement, the City shall, from the money in the Parity Obligation Payment Fund, deposit in the 2006 Supplemental Contract Payment Account (i) a sum equal to the amount of the interest and principal components of the 2006 Payments becoming due and payable under the 2006 Supplemental Contract on the next succeeding 2006 Payment Date and (ii) the net payments and any insured termination payment, if applicable, due under the 2006 Interest Rate Swap Agreement, except that no such deposit need be made if the amount then on deposit in the 2006 Supplemental Contract Payment Account is at least equal to the amount of the interest and principal components of the 2006 Payments becoming due and payable under the 2006 Supplemental Contract on the next succeeding 2006 Payment Date plus the net payments and any insured termination payment paid by the 2006 Certificate Insurer, if applicable, due under the 2006 Interest Rate Swap Agreements on such next succeeding due date therefor. Moneys on deposit in the 2006 Supplemental Contract Payment Account shall (i) be transferred by the City to the Trustee on the Business Day immediately preceding each 2006 Payment Date to make and satisfy the 2006 Payment due on such 2006 Payment Date and (ii) be transferred by the City on the due date therefor to satisfy the net payment and any insured termination payment paid by the 2006 Certificate Insurer, if applicable, due under the 2006 Interest Rate Swap Agreement, all in accordance with the Master Contract.

Section 2.04. Payment of 2006 Payments. The City shall, subject to any rights of prepayment provided in Section 2.05 hereof, pay the Authority as the purchase price for the 2006
Project the sum of $___________, without offset or deduction of any kind, by paying the principal installments of the 2006 Payments annually on October 1 in each year in accordance with Exhibit A attached hereto and incorporated herein, together with interest installments of the 2006 Payments, which interest installments shall be payable in accordance with Section 2.03 hereof in the amounts and on the 2006 Payment Dates so as to enable interest evidenced by the 2006 Certificates to be paid on a timely basis, and which interest shall constitute interest paid on the principal amount of the City's obligation hereunder.

The obligation of the City to pay the 2006 Payments is, subject to Section 7.01 of the Master Contract, absolute and unconditional, and until such time as the 2006 Payments shall have been paid in full (or provision for the payment thereof shall have been made pursuant to Article VI of the Master Contract), the City will not discontinue or suspend any 2006 Payments required to be paid by it under this Section 2.04 when due, whether or not the Water Utility System or any part thereof (including the 2006 Project) is operating or operable, or its use is suspended, interfered with, reduced, curtailed or terminated in whole or in part, and such payments shall not be subject to reduction whether by offset, abatement or otherwise and shall not be conditional upon the performance or nonperformance by any party to any agreement for any cause whatsoever.

The City shall receive a credit against its obligation to pay 2006 Payments that constitute Sinking Fund Payments under the 2006 Trust Agreement if, during the 12-month period immediately preceding the Sinking Fund Payment date with respect to such Sinking Fund Payment, the City or the Authority has deposited Term Certificates with the Trustee (together with a request of the Authority or the City to apply such Certificates so deposited to the Sinking Fund Payment due on said Sinking Fund Payment date) and the full principal amount evidenced and represented thereby has been applied to reduce said Sinking Fund Payment in accordance with Section 2.03 of the 2006 Trust Agreement.

In addition to the 2006 Payments, the City shall also pay such amounts ("Additional Payments") as shall be required for the payment of all fees and administrative costs of the Authority and the Trustee under the 2006 Trust Agreement or otherwise relating to the 2006 Certificates, including, without limitation, payments required to satisfy the Rebate Requirement, all expenses, compensation and indemnification of the Authority and the Trustee payable hereunder and under the 2006 Trust Agreement, fees of auction agents, broker-dealers, remarketing agents, auditors, accountants, attorneys or engineers, and all other necessary administrative costs of the Authority or charges required to be paid by it to comply with the terms of this 2006 Supplemental Contract, the 2006 Certificates, the 2006 Certificate Insurance Policy, and the 2006 Trust Agreement.

Section 2.05. Prepayment of 2006 Payments.

(a) The City may optionally prepay 2006 Payments as follows:

(1) The City may prepay all or a portion of the 2006 Payments in accordance with Section 6.01(c) of the Master Contract by depositing cash or Federal Securities with the Trustee subject to the terms and conditions set forth in Article IX of the 2006 Trust
Agreement, sufficient to pay the principal of, premium, if any, and interest evidenced by
the 2006 Certificates to be paid or prepaid with such 2006 Payments; or

(2) The City may prepay all or a portion of the 2006 Payments from any
source of available funds, on any date on which 2006 Certificates may be optionally
prepaid, by paying (A) all or a portion (in an amount equal to an Authorized
Denomination under the 2006 Trust Agreement), as elected by the City, of such 2006
Payments, (B) an amount equal to the accrued but unpaid interest on the 2006 Certificates
to be prepaid from the proceeds of such prepaid 2006 Payments to the date of such
prepayment, and (C) an amount equal to any premium to be paid upon the optional
prepayment of the 2006 Certificates to be prepaid from the proceeds of such prepaid 2006
Payments.

(b) The 2006 Payments shall be subject to mandatory prepayment to the extent
required to effect the mandatory prepayment of Liquidity Provider Certificates in accordance
with Section 2.03(b) of the 2006 Trust Agreement.

(c) If less than all of the 2006 Payments are prepaid pursuant to this Section 2.05
then, as of the date of such prepayment pursuant to this Section, the schedule of 2006 Payments
attached as Exhibit B hereto shall be recalculated by the City in order to take such prepayment
into account. The City shall deliver a copy of such revised schedule to the Trustee and such
revised schedule shall automatically supersede and replace the previous form of Exhibit B.

(d) Before making any prepayment pursuant to this Section, the City shall give
written notice to the Authority specifying the date on which the prepayment will be paid and the
order thereof, which date shall be not less than 50 days from the date such notice is given;
provided, that notwithstanding any such prepayment, the City shall not be relieved of its
obligations hereunder, including specifically its obligations under this article, until the 2006
Payments and all amounts due under the 2006 Insurance Agreement shall have been fully paid
(or provision for payment thereof shall have been made pursuant to Article VI of the Master
Contract).

Section 2.06. Establishment of 2006 Funds and Accounts.

(a) 2006 Project Account. There is hereby established the “2006 Project Account”
within the Improvement Fund, which account the City agrees to maintain until the completion of
the acquisition and construction of the 2006 Project. As provided in the Master Contract, all
money in the 2006 Project Account of the Improvement Fund shall be used and withdrawn by
the City to pay the costs of the acquisition and construction of the 2006 Project (or to reimburse
the City for such costs) upon receipt of a Request of the City. The City shall maintain on file a
record of all expenditures from the 2006 Project Account of the Improvement Fund, including
appropriate Requests of the City evidencing the person to whom payment is to be made, the
amount of money to be paid, the purpose for which the obligation to be paid was incurred and
that such payment was a proper charge against the 2006 Project Account of the Improvement
Fund and has not been the subject of a previous Request of the City. When the acquisition and
construction of the 2006 Project has been completed to the satisfaction of the City, any
remaining balance in the 2006 Project Account allocable to the 2006 Project shall be transferred by the City to the Revenue Fund.

(b) **2006 Rebate Fund.** The City hereby agrees to establish and maintain, so long as any 2006 Certificates remain Outstanding, a fund separate from any other fund established and maintained hereunder designated the “City of Modesto Water Utility System 2006 Rebate Fund.” All amounts at any time on deposit in the 2006 Rebate Fund shall be held by the City to the extent required to satisfy the requirement to make rebate payments to the United States (the “Rebate Requirement”) pursuant to Section 148 of the Code and the Treasury Regulations promulgated thereunder (the “Treasury Regulations”). Such amounts shall be free and clear of any lien under the Master Contract and the 2006 Supplemental Contract and shall be governed by this Section 2.06(b) and by the 2006 Tax Certificate.

(1) Within 60 days of the end of each Certificate Year (as such term is defined in the 2006 Tax Certificate), or such other period ending no later than 60 days after the end of the fifth Certificate Year, (i) the City shall calculate or cause to be calculated with respect to the 2006 Supplemental Contract the amount that would be considered the “rebate amount” within the meaning of Section 1.148-3 of the Treasury Regulations, using as the “computation date” for this purpose the end of such Certificate Year, and (ii) the City shall deposit to the 2006 Rebate Fund from amounts on deposit in the Revenue Fund or other amounts received by the City, if and to the extent required, amounts sufficient to cause the balance in the 2006 Rebate Fund to be equal to the “rebate amount” so calculated.

The City shall not be required to deposit any amount to the 2006 Rebate Fund in accordance with preceding sentence if the amount on deposit in the 2006 Rebate Fund prior to the deposit required to be made under this paragraph (1) equals or exceeds the “rebate amount” calculated in accordance with the preceding sentence. Such excess may be withdrawn from the 2006 Rebate Fund to the extent permitted under paragraph (2) of this Section.

The City shall not be required to calculate the “rebate amount,” and shall not be required to deposit any amount to the 2006 Rebate Fund in accordance with this paragraph (1), with respect to all or a portion of the proceeds of the 2006 Certificates (including amounts treated as proceeds of the 2006 Certificates) (i) to the extent such proceeds satisfy the expenditure requirements of Section 148(f)(4)(g) or Section 148(f)(4)(C) of the Code or Section 1.148-7(d) of the Treasury Regulations, whichever is applicable, and otherwise qualify for the exception to the Rebate Requirement pursuant to whichever of said sections is applicable, (ii) to the extent such proceeds are subject to an election by the City under Section 148(f)(4)(C)(vii) of the Code to pay a 11/2% penalty in lieu of arbitrage rebate in the event any of the percentage expenditure requirements of Section 148(f)(4)(C) are not satisfied, or (iii) to the extent such proceeds qualify for the exception to arbitrage rebate under Section 148(f)(4)(A)(ii) of the Code for amounts in a “bona fide debt service fund.”

(2) Any funds remaining in the 2006 Rebate Fund after payment of all the 2006 Payments hereunder and any amounts described in clause (ii) of paragraph (3) of
this Section, or provision made therefor, including accrued interest, shall be transferred by the City to the Revenue Fund.

(3) Subject to the exceptions contained in paragraph (1) of this Section to the requirement to calculate the "rebate amount" and make deposits to the 2006 Rebate Fund, the City shall pay to the United States, from amounts on deposit in the 2006 Rebate Fund,

(i) not later than 60 days after the end of (A) the fifth Certificate Year, and (B) each fifth Certificate Year thereafter, an amount that, together with all previous rebate payments, is equal to at least 90% of the "rebate amount" calculated as of the end of such Certificate Year in accordance with Section 1.148-3 of the Treasury Regulations; and

(ii) not later than 60 days after the payment of all 2006 Certificates, an amount equal to 100% of the "rebate amount" calculated as of the date of such payment (and any income attributable to the "rebate amount" determined to be due and payable) in accordance with Section 1.148-3 of the Treasury Regulations.

(4) Each payment required to be made pursuant to paragraph (3) of this Section shall be made to the Internal Revenue Service on or before the date on which such payment is due, and shall be accompanied by Internal Revenue Service Form 8038-T, which shall be completed by or on behalf of the City.

(5) In the event that, prior to the time any payment is required to be made from the 2006 Rebate Fund, the amount in the 2006 Rebate Fund is not sufficient to make such payment when such payment is due, the City shall calculate the amount of such deficiency and deposit an amount equal to such deficiency into the 2006 Rebate Fund prior to the time such payment is due.

(6) In the event that immediately following the calculation required by paragraph (1) of this Section, but prior to any deposit made under said subsection, the amount on deposit in the 2006 Rebate Fund exceeds the "rebate amount" calculated in accordance with said subsection, the City shall transfer the excess from the 2006 Rebate Fund to the Revenue Fund.

(7) The City shall retain records of all determinations made hereunder until six years after the final payment or discharge of all 2006 Certificates.

(8) Notwithstanding anything in the Master Contract or the 2006 Supplemental Contract to the contrary, the Rebate Requirement shall survive the payment in full or discharge of the 2006 Certificates and the 2006 Payments.

Section 2.07. Tax Covenants. The City hereby covenants it shall 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 portion of the 2006 Payments constituting interest under Section 103 of the Code. The City shall not, directly or indirectly, use or permit the use of proceeds of the 2006 Supplemental Contract or any of the property financed or refinanced with proceeds of the 2006 Supplemental Contract, or any portion thereof, by any person other than a
governmental unit (as such term is used in Section 141 of the Code), in such manner or to such extent as would result in the loss of exclusion from gross income for federal income tax purposes of the portion of the 2006 Payments constituting interest.

The City shall not take any action, or fail to take any action, if any such action or failure to take action would cause any obligations delivered in connection with the 2006 Supplemental Contract to be “private activity bonds” within the meaning of Section 141 of the Code, and in furtherance thereof, shall not make any use of the proceeds of the 2006 Supplemental Contract or any of the property financed or refinanced with proceeds of the 2006 Supplemental Contract, or any portion thereof, or any other funds of the City, that would cause any of the 2006 Certificates on other obligations delivered in connection with the 2006 Supplemental Contract to be “private activity bonds” within the meaning of Section 141 of the Code. To that end, so long as any 2006 Payments are unpaid, the City, with respect to such proceeds and property and such other funds, will comply with applicable requirements of the Code and all regulations of the United States Department of the Treasury issued thereunder to the extent such requirements are, at the time, applicable and in effect. The City shall establish reasonable procedures necessary to ensure continued compliance with Section 141 of the Code and the continued qualification of any obligations delivered in connection with the 2006 Supplemental Contract as “governmental bonds.”

The City shall not, directly or indirectly, use or permit the use of any proceeds of the 2006 Supplemental Contract, or of any property financed or refinanced thereby, or other funds of the City, or take or omit to take any action, that would cause any obligations delivered in connection with the 2006 Supplemental Contract to be “arbitrage bonds” within the meaning of Section 148 of the Code. To that end, the City shall comply with all requirements of Section 148 of the Code and all regulations of the United States Department of the Treasury issued thereunder to the extent such requirements are, at the time, in effect and applicable to the 2006 Supplemental Contract.

The City shall not make any use of the proceeds of the 2006 Supplemental Contract or any other funds of the City, or take or omit to take any other action, that would cause the 2006 Supplemental Contract to be “federally guaranteed” within the meaning of Section 149(b) of the Code.

In furtherance of the foregoing tax covenants, the City covenants that it will comply with the provisions of the 2006 Tax Certificate, which is incorporated herein as if fully set forth herein. These covenants shall survive payment in full or discharge of the 2006 Certificates and the 2006 Payments.

The Authority and the City covenant that, in the event of any change in the 2006 Trust Agreement, this 2006 Supplemental Contract or other relevant documents relating to the 2006 Certificates, or any other actions taken or omitted by the City or the Authority, upon the advice or with the approving opinion of Special Counsel other than Sidley Austin LLP, Special Counsel in connection with the original execution and delivery of the 2006 Certificates, the Authority and the City will, upon the making of any such change, or the taking or omission of any such other action, cause to be delivered an opinion of Special Counsel (together with a reliance letter thereon addressed to the 2006 Certificate Insurer and the Trustee) nationally recognized in the
area of municipal bonds to the effect that the portion of each 2006 Payment due under this 2006 Supplemental Contract designated as and comprising interest with respect to the 2006 Certificates is excluded from gross income for federal income tax purposes.

Section 2.08. Continuing Disclosure. The City hereby covenants and agrees that it will comply with and carry out all of its obligations under the Continuing Disclosure Agreement delivered in connection with the execution and delivery of the 2006 Certificates. Notwithstanding any other provision of the Master Contract or hereof, failure of the City to comply with the Continuing Disclosure Agreement shall not be considered an Event of Default under the Master Contract or hereunder.

Section 2.09. Provisions Related to the 2006 Certificate Insurance Policy. For so long as, and only during such time as, the 2006 Certificate Insurance Policy is in effect and the 2005 Certificate Insurer is not in default thereunder, the following provisions shall be in effect, and any conflict between the provisions of this Section 2.09 and the provisions of any other Section hereof shall be governed by the provisions of this Section 2.09:

(a) In determining whether a payment default has occurred hereunder, or whether a 2006 Payment has been made hereunder, no effect shall be given to payments made under the 2006 Certificate Insurance Policy.

(b) Any acceleration of the unpaid 2006 Payments pursuant to Section 5.01 of the Contract or any annulment thereof shall be subject to the prior written consent of the 2006 Certificate Insurer.

(c) Neither the City nor the Authority will use the 2006 Certificate Insurer’s name in any public document including, without limitation, a press release or presentation, announcement or forum without the 2006 Certificate Insurer’s prior consent; provided, however, such prohibition on the use of the 2006 Certificate Insurer’s name shall not relate to the use of the 2006 Certificate Insurer’s standard approved form of disclosure in public documents issued in connection with the 2006 Certificates to be issued in accordance with the terms of the 2006 Certificate Insurer’s commitment letter; and provided further such prohibition shall not apply to the use of the 2006 Certificate Insurer’s name in order to comply with public notice, public meeting or public reporting requirements.

(d) The 2006 Certificate Insurer shall be a third-party beneficiary of this 2006 Supplemental Contract.

(e) The Authority and the City shall provide the 2006 Certificate Insurer with a copy of any notice required to be given by such party hereunder, such notice to be delivered at the address for the 2006 Certificate Insurer set forth in the 2006 Trust Agreement.

Section 2.10. 2006 Interest Rate Swap Agreement. The City and the Authority hereby agree and acknowledge that the 2006 Interest Rate Swap Agreement (excluding the obligations thereunder to post collateral under certain circumstances and to make termination payments upon any early termination event or event of default except to the extent such termination payment is insured under the terms of the 2006 Swap Insurance Policy) constitutes a Parity Payment Agreement and a Parity Obligation payable solely from and secured by a pledge of Gross
Revenues on a parity with all other existing and future Parity Obligations. The City and the Authority hereby agree and acknowledge that obligations under the 2006 Interest Rate Swap Agreement to post collateral under certain circumstances or to make termination payments upon an early termination event or event of default under the 2006 Interest Rate Swap Agreement (other than to the extent such termination payment is insured under the terms of the 2006 Swap Insurance Policy) are Subordinate Obligations payable solely from and secured by a pledge of Gross Revenues on a subordinate basis to the Parity Obligations. Amounts payable by the City as a termination payment under the 2006 Interest Rate Swap Agreement upon an event of default with respect to the City thereunder and the designation of an early termination by the 2006 Certificate Insurer pursuant to the terms of the 2006 Interest Rate Swap Agreement (which payments are insured under the terms of the 2006 Swap Insurance Policy constitute a Parity Obligation payable solely from and secured by a pledge of Gross Revenues on a parity with all other existing and future Parity Obligations. In the event any obligation of the City to post collateral or to make payments upon an early termination or event of default under the 2006 Interest Rate Swap Agreement constituting a Subordinate Obligation shall arise, the City shall establish a fund as necessary for the purpose of satisfying such obligation. As provided and on the dates under Section 2.04 of the Master Contract and Section 2.03 hereof, the City shall from the money in the Revenue Fund deposit in the 2006 Supplemental Contract Payment Account of the Parity Obligation Payment Fund a sum equal to the scheduled payments next due on the 2006 Interest Rate Swap Agreement. The City shall not be required to advance any moneys derived from any source of income other than the Gross Revenues for the payments due under the 2006 Interest Rate Swap Agreement or for the performance of any agreements or covenants required to be performed by it contained in the 2006 Interest Rate Swap Agreement. The general fund of the City is not liable, and neither the faith and credit nor the taxing power of the City is pledged, for the payments under the 2006 Interest Rate Swap Agreement.

Section 2.11. Maintaining Liquidity Facility. The City agrees that at any time when the 2006 Certificates bear interest in a Daily Mode, a Weekly Mode, a Flexible Mode or a Term Mode, it will maintain a Liquidity Facility, as required by Section 3.11 of the 2006 Trust Agreement, acceptable to the 2006 Certificate Insurer, in the Required Stated Amount or in such other amount as may be required by the 2006 Certificate Insurer and the Rating Agencies then rating the 2006 Certificates. The City shall replace such Liquidity Facility if the Liquidity Facility’s rating is withdrawn, suspended or lowered below a rating that is acceptable to the 2006 Certificate Insurer. The City covenants that it will not voluntarily terminate a Liquidity Facility then in effect without either: (i) providing for an Alternate Liquidity Facility prior to the effective date of the termination; or (ii) converting the Daily Mode, Weekly Mode, Flexible Mode or Term Mode to a Fixed Rate Mode. If 2006 Certificates bearing interest in the Daily Mode, the Weekly Mode, the Flexible Mode or the Term Mode are then Outstanding, the Trustee shall not release the applicable Liquidity Facility until it has received the Alternate Liquidity Facility. The City shall give, or cause to be given pursuant to Section 3.11(c) of the 2006 Trust Agreement, written notice of its intention to terminate a Liquidity Facility and exercise its option to provide an Alternate Liquidity Facility to the Trustee and each of the other Notice Parties thirty (30) days before the proposed termination date of the Liquidity Facility and the effective date of such Alternate Liquidity Facility. The City shall provide notice of any expiration, termination, extension or substitution of the Liquidity Facility to the Rating Agencies.
ARTICLE III
MISCELLANEOUS

Section 3.01. Amendment of 1997 Supplemental Contract. Section 2.11(e) of the 1997 Supplemental Contract is hereby amended to read as follows:

“(e) Except for any Supplemental Contract delivered for the purpose of providing for the execution of Parity Obligations in compliance with Article III of the Contract, any amendment of or supplement to the Contract shall be subject to the prior written consent of the 1997 Certificate Insurer as if and to the extent the 1997 Certificate Insurer shall be deemed the sole Owner of the 1997 Certificates for purposes of obtaining the required consent of the Owners of the 1997 Certificates thereto pursuant to Section [4.05] of the 1997 Trust Agreement. Any rating agency rating the Certificates must receive notice of each such amendment or supplement and a copy thereof at least 15 days in advance of its execution or adoption. The 1997 Certificate Insurer shall be provided with a full transcript of all proceedings relating to the execution of any such amendment or supplement.”

Section 3.02. Terms of the 2006 Supplemental Contract Subject to the Master Contract. This 2006 Supplemental Contract constitutes a Parity Obligation and a Supplemental Contract under the Master Contract and, as such, shall be subject to the provisions of the Master Contract and shall have all of the advantages, benefits, interests and security afforded Parity Obligations and Supplemental Contracts pursuant to the Master Contract. Every term and condition contained in the Master Contract shall apply to the 2006 Supplemental Contract with the same force and effect as if the same were herein set forth at length, with such omissions, variations and modifications thereof as may be appropriate to make the same conform to the 2006 Supplemental Contract.

Section 3.03. Assignment of the 2006 Supplemental Contract. The City hereby acknowledges that the Authority, for good and valuable consideration, has transferred, assigned and sent over to the Trustee, pursuant to the provisions of the 2006 Trust Agreement, all of the 2006 Payments and any and all rights and privileges it has under the Master Contract and hereunder. The Trustee shall not assume any responsibilities for any duties or covenants or warranties of the Authority hereunder.

Section 3.04. California Law. This 2006 Supplemental Installment Purchase Contract shall be construed and governed in accordance with the laws of the State of California.
IN WITNESS WHEREOF, the parties hereto have executed and attested the 2006 Supplemental Installment Purchase Contract by their officers thereunto duly authorized as of the day and year first written above.

CITY OF MODESTO

By ________________________________
Director of Finance

Attest:

______________________________
City Clerk

MODESTO PUBLIC FINANCING AUTHORITY

By ________________________________
Auditor and Treasurer

Attest:

______________________________
Secretary
CONSENT OF INSURER

BY EXECUTION HEREOF, Financial Guaranty Insurance Company, as 1997 Certificate Insurer of the outstanding 1997 Certificates, pursuant to Section 2.11 of the 1997 Supplemental Installment Purchase Contract hereby consents to the foregoing 2006 Supplemental Installment Purchase Contract and the amendments to the Contracts effected thereby.

FINANCIAL GUARANTY INSURANCE COMPANY

By: ____________________________

[TITLE]
TRUSTEE CONSENT

BY EXECUTION HEREOF, ________________________ as Trustee for the outstanding 1997 Certificates and 2006 Certificates hereby consents to the foregoing 2006 Supplemental Installment Purchase Contract and the amendments to the Contracts effected thereby.

[TRUSTEE]

By: ________________________

Authorized Officer
EXHIBIT A

Schedule of Principal Installments
Relating to
2006 Payments

<table>
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<th>Principal Payment Date (October 1)</th>
<th>Principal Installment</th>
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</table>

Pursuant to Section 2.03 of the 2006 Supplemental Contract, the 2006 Payments should be made no later than three (3) Business Days preceding the due date therefor. In addition to the foregoing principal payments, the 2006 Payments shall include interest payable on each Interest Payment Date under the 2006 Trust Agreement in an amount equal to the interest due on the 2006 Certificates on each Interest Payment Date.
EXHIBIT B

Description of the 2006 Project

The City of Modesto (City) is proposing to fund the costs of improvements required to be made by the City in connection with the expansion of the Modesto Regional Water Treatment Plant (MRWTP), including the construction of several new downstream water facilities, and various water distribution system improvements to the Water System to ensure the reliability of water supply to both existing and future customers. The 2006 Project will include the acquisition of land and right-of-way, and design and construction costs related to the new facilities and improvements. The facilities include the acquisition, construction and installation of three storage tanks and connecting transmission facilities, construction and improvement of transmission/distribution mains and associated pump stations, and installation of motor-operated control valves which will control the flow of treated surface water from the MRWTP to the City system. The 2006 Project facilities and improvements will help replace lost reliable groundwater production capacity, improve the City’s ability to maintain desired system operational pressures during high demand periods and meet other operational criteria. These facilities will also improve system distribution capabilities to future customers.

Proceeds of the 2006 Certificates may also be used for other improvements to the Water Utility System approved by the City Council.
EXHIBIT C

FORM OF 2006 PROJECT ACCOUNT REQUEST

Request of the City
Requisition From 2006 Project Account of the Improvement Fund

TO: City Treasurer of the City of Modesto

RE: Disbursement from the 2006 Project Account of the Improvement Fund pursuant to Section 2.06(a) of the 2006 Supplemental Installment Purchase Contract, dated as of November 1, 2006 (the "2006 Supplemental Contract"), by and between the City of Modesto (the "City"), and the Modesto Public Financing Authority (the "Authority")

REQUEST NO. __________

You are hereby instructed to pay to the parties listed on Schedule A hereto the sum listed opposite such parties names as a payment of the cost of the projects (collectively, the "2006 Project") for the items listed on the Schedule attached hereto and the expenses incidental thereto (which may include reimbursement to the City for certain of such costs or expenses) from the 2006 Project Account of the Improvement Fund as provided in Section 2.06(a) of the 2006 Supplemental Contract. This cost has been properly incurred, is a proper charge under the 2006 Supplemental Contract against payment of the costs of the 2006 Project (as defined in the 2006 Supplemental Contract) and has not been the basis of any previous disbursements. The amount remaining in the 2006 Project Account of the Improvement Fund, together with interest earnings thereon will, after payment of the amount set forth in this requisition, be sufficient to pay all remaining costs of the 2006 Project as presently estimated.

I hereby certify that:

(i) an obligation in the stated amount has been properly incurred under and pursuant to the 2006 Supplemental Contract and each such obligation is a proper charge against the Improvement Fund and has not been subject of any previous Request of the City;

(ii) there has not been filed with or served upon the City or the Authority a stop notice or any other notice of any lien, right to lien or attachment upon, or claim affecting the right to receive payment of, any of the money payable to the person named in this Request of the City which has not been released or will not be released with the payment of such obligation, other than materialmen's or mechanics' liens accruing by mere operation of laws;

(iii) in the case of each payment made under any contract for installation or construction, insofar as such obligation was incurred for work, materials, equipment or supplies, such work was actually performed or such materials, equipment or supplies were actually installed in furtherance of the 2006 Project or delivered at the site for that purpose or delivered for storage or fabrication at a place or places approved by the City;
(iv) in the case of increased costs of the 2006 Project, the amount of such increase has been made available by the City; and

(v) no event of default under the Contract has occurred and is continuing.

Very truly yours,

[City Representative]
<table>
<thead>
<tr>
<th>PAYEE</th>
<th>DESCRIPTION</th>
<th>AMOUNT ($)</th>
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</table>

Schedule A

DISBURSEMENT INSTRUCTIONS
2006 PROJECT ACCOUNT OF IMPROVEMENT FUND
CONSENT OF INSURER

BY EXECUTION HEREOF, Financial Guaranty Insurance Company, as 1997 Certificate Insurer of the outstanding 1997 Certificates, pursuant to Section 2.11 of the 1997 Supplemental Installment Purchase Contract hereby consents to the foregoing 2006 Supplemental Installment Purchase Contract and the amendments to the Contracts effected thereby.

FINANCIAL GUARANTY INSURANCE COMPANY

By: ____________________________
Name: Timothy Tattam
Authorized Representative
$______

CITY OF MODESTO
WATER REVENUE CERTIFICATES OF PARTICIPATION
2006 SERIES A

PURCHASE CONTRACT

_______, 2006

Modesto Public Financing Authority
1010 10th Street
Modesto, California 95354

City of Modesto
1010 10th Street
Modesto, California 95354

Ladies and Gentlemen:

Banc of America Securities LLC (the "Underwriter") offers to enter into this Purchase Contract (the "Purchase Contract") with the Modesto Public Financing Authority (the "Authority") and the City of Modesto (the "City") for the purchase by the Underwriter of the City of Modesto Water Revenue Certificates of Participation 2006 Series A (the "Certificates") that will be executed and delivered pursuant to the Trust Agreement, dated as of November 1, 2006 (the "Trust Agreement"), between the Authority and The Bank of New York Trust Company, N.A., as trustee (the "Trustee").

This offer is made subject to the Authority's and the City's acceptance by execution of this Purchase Contract and delivery of the same to the Underwriter on or before 11:59 p.m. on the date hereof, and, if not so accepted, will be subject to withdrawal by the Underwriter upon notice delivered to the Authority and the City at any time prior to such acceptance. Upon the Authority's and the City's acceptance hereof, the Purchase Contract will be binding upon the Authority, the City and the Underwriter. Capitalized terms used in this Purchase Contract and not otherwise defined herein shall have the respective meanings set forth for such terms in the Trust Agreement.

Section 1. Purchase, Sale and Delivery. Upon the terms and conditions and upon the basis of the representations set forth in this Purchase Contract, the Underwriter agrees to purchase, and the Authority and the City agree to cause the sale and delivery to the Underwriter, all (but not less than all) of the Certificates at a purchase price of $______ (being an amount equal to the principal amount of the Certificates less an underwriter's discount of $______).
In connection with the execution and delivery of the Certificates, the Trustee and The Bank of New York Trust Company, N.A., as auction agent (the “Auction Agent”) will enter into an Auction Agreement, dated as of November 1, 2006 (the “Auction Agreement”) providing, among other things, the auction procedures the Auction Agent will follow for the purposes of determining the Auction Rate applicable to the Certificates and the Authority and the Auction Agent will enter into a Broker-Dealer Agreement, dated as of November 1, 2006 (the “Broker-Dealer Agreement”) with Banc of America Securities LLC, as the broker-dealer with respect to the Certificates for the purposes of conducting each Auction. The Auction Agreement and the Broker-Dealer Agreement are referred to collectively as the “Auction Rate Agreements.”

Section 2. Terms; Authorizing Instruments; Purpose.

(a) The Certificates will be dated their date of delivery and mature on October 1, 2036. The Certificates will initially be executed and delivered as auction rate securities and initially evidence and represent interest for the first Auction Period as shown in Exhibit A attached hereto and thereafter at the rate calculated in accordance with the Trust Agreement. The Certificates will evidence and represent the proportionate interests of the owners thereof in the 2006 Payments to be paid to the Authority by the City pursuant to the Contract.

(b) The proceeds of the sale of the Certificates will be used to (1) finance certain additional additions, betterments, extensions and improvements to the City’s water system (the “Water Utility System”), (2) fund a deposit to the Parity Reserve Fund to be maintained under the Contract pursuant to the Trust Agreement, (3) capitalize interest on the Certificates and pay Broker-Dealer fees and Auction Agent fees through October 1, 2007 and (4) pay certain expenses related to the execution and delivery of the Certificates.

(c) The payment of the principal and interest evidenced by the Certificates when due will be guaranteed by a municipal bond insurance policy (the “Insurance Policy”) issued by MBIA Insurance Corporation (the “Insurer”) simultaneously with the delivery of the Certificates.

Section 3. Official Statement; Continuing Disclosure.

(a) The City has delivered the final official statement, dated _____, 2006 (as amended and supplemented from time to time pursuant to Section 5(i) or Section 6(i) of this Purchase Contract, the “Official Statement”) to the Underwriter pursuant to Section 4 herein.

(b) The City has authorized the use of the Official Statement and the information contained therein by the Underwriter in connection with the public offering and the sale of the Certificates prior to the date hereof.

(c) In connection with issuance of the Certificates, and in order to assist the Underwriter with complying with the provisions of Rule 15c2-12, the City will enter into a continuing disclosure agreement countersigned by The Bank of New York Trust Company, N.A., as dissemination agent (the “Continuing Disclosure Agreement”), under which the City will undertake to provide certain financial and operating data as required by Rule 15c2-12. The form of the Continuing Disclosure Agreement is attached as an appendix to the Official Statement.
Section 4. Agreement to Notify Underwriter Regarding Official Statement. The City has supplied or caused to be supplied to the Underwriter the Official Statement in sufficient quantity as requested by the Underwriter to comply with Securities and Exchange Commission Rule 15c2-12(b)(4) and the rules of the Municipal Securities Rulemaking Board (the “MSRB”). The Underwriter hereby agrees that it will not send any confirmation requesting payment for the purchase of any Certificates unless the confirmation is accompanied by or preceded by the delivery of a copy of the Official Statement. The Underwriter agrees to: (i) provide the City with final pricing information on the Certificates on a timely basis prior to the Closing Date (as defined in Section 7 hereof); (ii) promptly file a copy of the Official Statement, including any supplements prepared by the City, with a nationally recognized municipal securities information repository; (iii) promptly notify the City of the end of the underwriting period (as such term is defined in Rule 15c2-12); provided, that the underwriting period will be assumed to have ended on the Closing Date unless the Underwriter shall have notified the City in writing to the contrary; and (iv) take any and all other actions necessary to comply with applicable Securities and Exchange Commission rules and MSRB rules governing the offering, sale and delivery of the Certificates to ultimate purchasers.

Section 5. Representations, Warranties and Covenants of the City. The City hereby represents, warrants and agrees with the Underwriter that:

(a) The City is and will be on the Closing Date a charter city and municipal corporation, organized and existing pursuant to the Constitution laws of the State of California (the “State”), with the full power and authority to execute and deliver the Official Statement, and to enter into the 2006 Supplemental Contract, the Continuing Disclosure Agreement and this Purchase Contract (collectively, the “2006 City Agreements” and, together with the Master Contract and the 1997 Supplemental Contract, the “City Agreements”).

(b) The city council of the City (the “City Council”) has taken official action by resolution (the “1997 City Resolution”) adopted by a majority of the members of the City Council at a meeting duly called, noticed and conducted, at which a quorum was present and acting throughout, on October 21, 1997, all action necessary to be taken by it for the execution, delivery and due performance of the Master Contract and 1997 Supplemental Contract and the taking of any and all such action as may be required on the part of the City to carry out, give effect to and consummate the transactions contemplated thereby and by resolution (the “2006 City Resolution” and, together with the 1997 Resolution, the “City Resolutions”) adopted by a majority of the members of the City Council at a meeting duly called, noticed and conducted, at which a quorum was present and acting throughout, on [October 10], 2006, all action necessary to be taken by it for the execution, delivery and due performance of the City Agreements and the Official Statement and the taking of any and all such action as may be required on the part of the City to carry out, give effect to and consummate the transactions contemplated thereby.

(c) The execution and delivery of the 2006 City Agreements and the Official Statement, and compliance with the provisions on the City’s part contained herein and therein, will not in any material respect conflict with or constitute a breach of or default under any law, administrative regulation, judgment, decree, loan agreement, indenture, bond, note, resolution, agreement or other instrument to which the City is a party or is otherwise subject, nor will any such execution, delivery, adoption or compliance result in the creation or imposition of any lien,
charge or other security interest or encumbrance of any nature whatsoever upon any of the properties or assets of the City under the terms of any such law, administrative regulation, judgment, decree, loan agreement, indenture, bond, note, resolution, agreement or other instrument, except as provided in the 2006 City Agreements.

(d) The City is not in any material respect in breach of or default under any applicable law or administrative regulation of the State or the United States of America or any applicable judgment or decree or any loan agreement, indenture, bond, note, resolution, agreement or other instrument to which the City is a party or is otherwise subject, and no event has occurred and is continuing which, with the passage of time or the giving of notice or both, would constitute a default or an event of default under any such instrument.

(e) Except as disclosed in the Official Statement, there is no action, suit, proceeding, inquiry or investigation, at law or in equity, before or by any court, governmental agency, public board or body pending or, to the best knowledge of the City, threatened against the City in any material respect affecting the existence of the City or the titles of its officers to their respective offices or seeking to prohibit, restrain or enjoin the sale, execution or delivery of the Certificates or the pledge of the Payments under the Contract or in any way contesting or affecting the validity or enforceability of the City Agreements or contesting the powers of the City or its authority to enter into, adopt or perform its obligations under any of the foregoing, or which would have a material adverse effect on the City’s ability to perform its obligations under the City Agreements or contesting in any way the completeness or accuracy of the Official Statement, or any amendment or supplement thereto.

(f) The City will furnish such information, execute such instruments and take such other action in cooperation with the Underwriter as the Underwriter may reasonably request in order (i) to qualify the Certificates for offer and sale under the Blue Sky or other securities laws and regulations of such states and other jurisdictions of the United States as the Underwriter may designate, and (ii) to determine the eligibility of the Certificates for investment under the laws of such states and other jurisdictions, and will use its best efforts to continue such qualification in effect so long as required for distribution of the Certificates; provided, however, that in no event shall the City be required to take any action which would subject it to general or unlimited service of process in any jurisdiction in which it is not now so subject.

(g) As of the date hereof, and except for statements regarding the Insurer and DTC and excluding the information contained in the Official Statement under the captions “THE AUTHORITY” and “LITIGATION” (solely as it relates to the Authority), as to which the City does not make any representation or warranty, the Official Statement does not contain any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made therein, in the light of the circumstances under which they were made, not misleading.

(h) As of the date thereof and at all times subsequent thereto to and including the date which is 25 days following the End of the Underwriting Period (as defined in subparagraph (k) hereof) for the Certificates, and except for statements regarding the Insurer and DTC and excluding the information contained in the Official Statement under the captions “THE AUTHORITY” and “LITIGATION” (solely as it relates to the Authority), as to which the City
does not make any representation or warranty, the Official Statement did not and will not contain any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made therein, in the light of the circumstances under which they were made, not misleading.

(i) If between the date hereof and the date which is 25 days after the End of the Underwriting Period for the Certificates, and except for statements regarding the Insurer and DTC and excluding the information contained in the Official Statement under the captions “THE AUTHORITY” and “LITIGATION” (solely as it relates to the Authority), as to which the City does not make any representation or warranty, an event occurs which would cause the information contained in the Official Statement, as then supplemented or amended, to contain any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made therein, in the light of the circumstances under which they were made, not misleading, the City will notify the Underwriter, and, if in the opinion of the City, the Underwriter or their respective counsel, such event requires the preparation and publication of a supplement or amendment to the Official Statement, the City will forthwith prepare and furnish to the Underwriter (at the expense of the City) a reasonable number of copies of an amendment of or supplement to the Official Statement (in form and substance satisfactory to the Underwriter) which will amend or supplement the Official Statement so that it will not contain any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made therein, in the light of the circumstances under which they were made, not misleading. For the purposes of this subsection, between the date hereof and the date which is 25 days after the End of the Underwriting Period for the Certificates, the City will furnish such information with respect to itself as the Underwriter may from time to time reasonably request.

(j) If the information contained in the Official Statement is amended or supplemented pursuant to subparagraph (i) hereof, at the time of each supplement or amendment thereto and (unless subsequently again supplemented or amended pursuant to such subparagraph) at all times subsequent thereto up to and including the date which is 25 days after the End of the Underwriting Period for the Certificates, the portions of the Official Statement so supplemented or amended (including any financial and statistical data contained therein), except for statements regarding the Insurer and DTC and excluding the information contained in the Official Statement under the captions “THE AUTHORITY” and “LITIGATION” (solely as it relates to the Authority), as to which the City does not make any representation or warranty, will not contain any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made therein, in the light of the circumstances under which they were made, not misleading.

(k) As used herein and for the purposes of the foregoing, the term “End of the Underwriting Period” for the Certificates shall mean the earlier of (i) the Closing Date unless the City shall have been notified in writing to the contrary by the Underwriter on or prior to the Closing Date, or (ii) the date on which the End of the Underwriting Period for the Certificates has occurred under Rule 15c2-12; provided, however, that the City may treat as the End of the Underwriting Period for the Certificates the date specified as such in a notice from the Underwriter stating the date which is the End of the Underwriting Period.
(l) The financial statements of, and other financial information regarding, the Water Utility System contained in the Official Statement fairly present the financial position and results of the operations of the Water Utility System as of the dates and for the periods therein set forth, and, to the best of the City's knowledge, (i) the audited financial statements have been prepared in accordance with generally accepted accounting principles consistently applied, and (ii) the other financial information has been determined on a basis substantially consistent with that of the City's audited financial statements included in the Official Statement and except as disclosed in the Official Statement or otherwise disclosed in writing to the Underwriter, there has not been any materially adverse change in the financial condition of the City since June 30, 2005 and there has been no occurrence, circumstance or combination thereof which is reasonably expected to result in any such materially adverse change.

(m) Except as disclosed in the Official Statement or otherwise disclosed in writing to the Underwriter, the City has not previously failed to comply in all material respects with any undertakings under Rule 15c2-12.

Section 6. Representations, Warranties and Covenants of the Authority. The Authority hereby represents, warrants and agrees with the Underwriter that:

(a) The Authority is a public body corporate and politic, organized and existing pursuant to the laws of the State of California, including Section 6500 et seq. of the California Government Code, as amended, and the Joint Exercise of Powers Agreement, dated as of December 1, 1989 (the "JPA Agreement"), by and between the Authority and the Industrial Development Authority of the City of Modesto.

(b) The governing board of the Authority (the "Governing Board") has taken official action by resolution (the "1997 Authority Resolution") adopted by a majority of the members of the Governing Board at a meeting duly called, noticed and conducted, at which a quorum was present and acting throughout, on ____________, 199_, all action necessary to be taken by it for the execution, delivery and due performance of the Contract, and the taking of any and all such action as may be required on the part of the Authority to carry out, give effect to and consummate the transactions contemplated thereby and by resolution (the "2006 Authority Resolution" and, together with the 1997 Authority Resolution, the "Authority Resolutions" and, together with the City Resolutions, the "Resolutions") adopted by a majority of the members of the Governing Board at a meeting duly called, noticed and conducted, at which a quorum was present and acting throughout, on [October 10], 2006, all action necessary to be taken by it for the execution, delivery and due performance of the Trust Agreement, the Contract, the Auction Rate Agreements and this Purchase Contract (collectively, the "2006 Authority Agreements" and, together with the Master Contract and the 1997 Supplemental Contract, the "Authority Agreements") and the Official Statement and the taking of any and all such action as may be required on the part of the Authority to carry out, give effect to and consummate the transactions contemplated thereby.

(c) The execution and delivery of the 2006 Authority Agreements and the Official Statement, and compliance with the provisions on the Authority's part contained herein and therein, will not in any material respect conflict with or constitute a breach of or default under any law, administrative regulation, judgment, decree, loan agreement, indenture, bond, note,
resolution, agreement or other instrument to which the Authority is a party or is otherwise
subject, nor will any such execution, delivery, adoption or compliance result in the creation or
imposition of any lien, charge or other security interest or encumbrance of any nature whatsoever
upon any of the properties or assets of the Authority under the terms of any such law,
administrative regulation, judgment, decree, loan agreement, indenture, bond, note, resolution,
agreement or other instrument, except as provided in the 2006 Authority Agreements.

(d) The Authority is not in any material respect in breach of or default under any
applicable law or administrative regulation of the State or the United States of America or any
applicable judgment or decree or any loan agreement, indenture, bond, note, resolution,
agreement or other instrument to which the Authority is a party or is otherwise subject, and no
event has occurred and is continuing which, with the passage of time or the giving of notice or
both, would constitute a default or an event of default under any such instrument.

(e) Except as disclosed in the Official Statement, there is no action, suit, proceeding,
inquiry or investigation, at law or in equity, before or by any court, governmental agency, public
board or body pending or, to the best knowledge of the Authority, threatened against the
Authority in any material respect affecting the existence of the Authority or the titles of its
officers to their respective offices or seeking to prohibit, restrain or enjoin the sale, execution or
delivery of the Certificates or the collection of the Payments under the Contract or in any way
contesting or affecting the validity or enforceability of the Authority Agreements or contesting
the powers of the Authority or its authority to enter into, adopt or perform its obligations under
any of the foregoing, or which would have a material adverse effect on the Authority’s ability to
perform its obligations under the Authority Agreements or contesting in any way the
completeness or accuracy of the Official Statement, or any amendment or supplement thereto.

(f) The Authority will furnish such information, execute such instruments and take
such other action in cooperation with the Underwriter as the Underwriter may reasonably request
in order (i) to qualify the Certificates for offer and sale under the Blue Sky or other securities
laws and regulations of such states and other jurisdictions of the United States as the Underwriter
may designate, and (ii) to determine the eligibility of the Certificates for investment under the
laws of such states and other jurisdictions, and will use its best efforts to continue such
qualification in effect so long as required for distribution of the Certificates; provided, however,
that in no event shall the Authority be required to take any action which would subject it to
general or unlimited service of process in any jurisdiction in which it is not now so subject.

(g) As of the date hereof, the information contained in the Official Statement under
the captions “THE AUTHORITY” and “LITIGATION” (solely as it relates to the Authority)
does not contain any untrue statement of a material fact or omit to state a material fact necessary
in order to make the statements made therein, in the light of the circumstances under which they
were made, not misleading.

(h) As of the date thereof and at all times subsequent thereto to and including the date
which is 25 days following the End of the Underwriting Period (as defined in subparagraph (k)
hereof) for the Certificates, the information contained in the Official Statement under the
captions “THE AUTHORITY” and “LITIGATION” (solely as it relates to the Authority) did not
and will not contain any untrue statement of a material fact or omit to state a material fact
necessary in order to make the statements made therein, in the light of the circumstances under which they were made, not misleading.

(i) If between the date hereof and the date which is 25 days after the End of the Underwriting Period for the Certificates, an event occurs which would cause the information contained in the Official Statement under the captions “THE AUTHORITY” or “LITIGATION” (solely as it relates to the Authority), as then supplemented or amended, to contain any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made therein, in the light of the circumstances under which they were made, not misleading, the Authority will notify the Underwriter, and, if in the opinion of the Authority, the Underwriter or their respective counsel, such event requires the preparation and publication of a supplement or amendment to the Official Statement, the Authority will forthwith prepare and furnish to the Underwriter (at the expense of the Authority) a reasonable number of copies of an amendment of or supplement to the Official Statement (in form and substance satisfactory to the Underwriter) which will amend or supplement the Official Statement so that it will not contain any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made therein, in the light of the circumstances under which they were made, not misleading. For the purposes of this subsection, between the date hereof and the date which is 25 days after the End of the Underwriting Period for the Certificates, the Authority will furnish such information with respect to itself as the Underwriter may from time to time reasonably request.

(j) If the information contained in the Official Statement under the captions “THE AUTHORITY” or “LITIGATION” (solely as it relates to the Authority) is amended or supplemented pursuant to subparagraph (i) hereof, at the time of each supplement or amendment thereto and (unless subsequently again supplemented or amended pursuant to such subparagraph) at all times subsequent thereto up to and including the date which is 25 days after the End of the Underwriting Period for the Certificates, the portions of the Official Statement so supplemented or amended will not contain any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made therein, in the light of the circumstances under which they were made, not misleading.

(k) As used herein and for the purposes of the foregoing, the term “End of the Underwriting Period” for the Certificates shall mean the earlier of (i) the Closing Date unless the City shall have been notified in writing to the contrary by the Underwriter on or prior to the Closing Date, or (ii) the date on which the End of the Underwriting Period for the Certificates has occurred under Rule 15c2-12; provided, however, that the City may treat as the End of the Underwriting Period for the Certificates the date specified as such in a notice from the Underwriter stating the date which is the End of the Underwriting Period.

Section 7. The Closing.

(a) At 8:00 a.m., San Francisco time, on [November 2], 2006, or on such earlier or later date as we mutually agree upon (the “Closing Date”), the City will deliver or cause to be delivered to the Underwriter, at a location or locations to be designated by the Underwriter in New York, New York, the Certificates (delivered through the Trustee via the F.A.S.T. delivery book-entry system of The Depository Trust Company, New York, New York (“DTC”)), duly executed, and at the offices of Sidley Austin LLP (“Special Counsel”) in San Francisco,
California, or such other place as we mutually agree upon, the other documents described herein. The Underwriter shall accept such delivery and pay the purchase price of the Certificates as set forth in Section 1 of this Purchase Contract in immediately available funds to the order of the Trustee, less the premium for the Insurance Policy in the aggregate amount of $\_\_\_\_\_, which the Underwriter will wire directly to the Insurer.

(b) The Certificates shall be issued in fully registered form and shall be prepared and delivered as one certificate for each maturity registered in the name of a nominee of DTC. It is anticipated that CUSIP identification numbers will be inserted on the Certificates, but neither the failure to provide such numbers nor any error with respect thereto shall constitute a cause for failure or refusal by the Underwriter to accept delivery of the Certificates in accordance with the terms of this Purchase Contract.

Section 8. Conditions to Underwriter's Obligations. The Underwriter has entered into this Purchase Contract in reliance upon the representations and warranties of the City and the Authority contained herein and to be contained in the documents and instruments to be delivered on the Closing Date, and upon the performance by the City and the Authority of their respective obligations to be performed hereunder and under such documents and instruments to be delivered at or prior to the Closing Date. The Underwriter's obligations under this Purchase Contract are and shall also be subject to the following conditions:

(a) The representations and warranties of the City and the Authority contained in this Purchase Contract shall be true and correct in all material respects on the date of this Purchase Contract and on and as of the Closing Date as if made on the Closing Date;

(b) As of the Closing Date, the Official Statement may not have been amended, modified or supplemented, except in any case as may have been agreed to by the Underwriter;

(c) (i) As of the Closing Date, the Resolutions, the City Agreements and the Authority Agreements shall be in full force and effect, and shall not have been amended, modified or supplemented, except as may have been agreed to by the Underwriter; and (ii) the City and the Authority shall perform or have performed all of their respective obligations required under or specified in the Resolutions, the City Agreements and the Authority Agreements to be performed at or prior to the Closing Date;

(d) As of the Closing Date, all necessary official action of the City and the Authority relating to the City Agreements, the Authority Agreements, the Resolutions, and the Official Statement, shall have been taken and shall be in full force and effect and shall not have been amended, modified or supplemented in any material respect;

(e) Subsequent to the date of this Purchase Contract, up to and including the Closing Date, there shall not have occurred any change in or particularly affecting the City or the Water Utility System, as these matters are described in the Official Statement, which in the reasonable professional judgment of the Underwriter materially impairs the investment quality of the Certificates;

(f) As of or prior to the Closing Date, the Underwriter shall have received each of the following documents:
(1) Certified copies of the 2006 City Resolution and the 2006 Authority Resolution.

(2) The 2006 City Agreements and 2006 Authority Agreements, each duly executed on behalf of the respective parties thereto.

(3) The Insurance Policy, together with such legal opinions and certificates as may be reasonably requested by Special Counsel, executed on behalf of the Insurer by its duly authorized officer.

(4) The Official Statement duly executed on behalf of the City and the Authority.

(5) An approving opinion of Special Counsel, dated the Closing Date, as to the validity of the Certificates and the exclusion of interest with respect to the Certificates from federal gross income and State income taxation, addressed to the City substantially in the form attached as an appendix to the Official Statement, with a reliance letter to the Underwriter.

(6) A supplemental opinion of Special Counsel, addressed to the Underwriter, to the effect that:

(i) The Certificates are not subject to registration pursuant to the registration requirements of the Securities Act of 1933, are municipal securities within the meaning of the Securities Exchange Act of 1934, as amended, and the Trust Agreement is exempt from qualification as an Trust Agreement pursuant to the Trust Indenture Act of 1939.

(ii) The Purchase Contract has been duly authorized, executed and delivered by the City and the Authority, and, assuming due authorization, execution and delivery by the other parties thereto, constitute the legal, valid and binding agreement of the City and the Authority enforceable in accordance with its terms, subject to laws relating to bankruptcy, insolvency or other laws affecting the enforcement of creditors' rights generally and the application of equitable principles if equitable remedies are sought and to the limitations on legal remedies against public agencies in the State of California; and

(iii) The statements in the Official Statement under the captions “THE 2006 CERTIFICATES” (excluding information under the sub-caption “Special Considerations for Purchasers of Auction Rate Certificates”), “SECURITY FOR THE 2006 CERTIFICATES” and “TAX MATTERS” and in APPENDIX B – “DEFINITIONS AND SUMMARY OF PRINCIPAL LEGAL DOCUMENTS,” APPENDIX C – “ARS PROVISIONS” and APPENDIX D – “PROPOSED FORM OF OPINION OF SPECIAL COUNSEL” to the extent they purport to summarize certain provisions of the City Agreements, the Authority Agreements, the Certificates and the opinion of such counsel, present a fair and accurate summary of such provisions and opinion for purposes of use in the Official Statement.
(7) The opinion of the City Attorney, dated the Closing Date and addressed to the Underwriter, to the effect that (i) the City is a charter city and municipal corporation organized and existing pursuant to the Constitution and laws of the State; (ii) the City Resolutions were duly adopted at meetings of the City Council which were called and held pursuant to law and with all public notice required by law and at which a quorum was present and acting throughout; (iii) to the best knowledge of such counsel after reasonable investigation, there is no action, suit, proceeding or investigation at law or in equity before or by any court, public board or body, pending or threatened against or affecting the City, challenging the existence of the City or the titles of its officers to their respective offices or seeking to prohibit, restrain or enjoin the sale, execution or delivery of the Certificates or the pledge of the Payments under the Contract or in any way contesting or affecting the validity or enforceability of the City Agreements or contesting the powers of the City or its authority to enter into, adopt or perform its obligations under any of the foregoing, or which would have a material adverse effect on the City's ability to perform its obligations under the City Agreements or contesting in any way the completeness or accuracy of the Official Statement; (iv) the execution and delivery of the 2006 City Agreements and the Official Statement, the adoption of the City Resolutions, and compliance by the City with the provisions of the foregoing, under the circumstances contemplated thereby, do not and will not in any material respect conflict with or constitute, on the part of the City, a breach or default under any agreement or instrument to which the City is a party or by which it is bound or, to the best knowledge of such counsel, any existing law, regulation, court order or consent decree to which the City is subject; (v) the Official Statement has been duly authorized, executed and delivered, and the City Agreements have been duly authorized, executed and delivered by the City and, assuming due authorization, execution and delivery by the other parties thereto, constitute legal, valid and binding agreements of the City enforceable in accordance with their respective terms, subject to laws relating to bankruptcy, insolvency or other laws affecting the enforcement of creditors' rights generally and the application of equitable principles if equitable remedies are sought and to the limitations on legal remedies against cities in the State of California; (vi) except as described in the Official Statement, no authorization, approval, consent, or other order of the State or any other governmental authority or agency within the State having jurisdiction over the City is required for the valid authorization, execution, delivery and performance by the City of the City Agreements or for the adoption of the City Resolutions which has not been obtained; and (vii) to the best of such counsel's knowledge, the information contained in the Official Statement (except for any financial or statistical data or forecasts, estimates, projections, assumptions or expressions of opinion, and information relating to DTC, the book-entry system, the Insurer, the Insurance Policy as to which no opinion need be expressed), does not contain any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made therein, in the light of the circumstances under which they were made, not misleading;

(8) The opinion of counsel to the Authority, dated the Closing Date and addressed to the Underwriter, to the effect that (i) the Authority is a joint exercise of powers authority, duly organized and existing pursuant to the JPA Agreement and the laws of the State; (ii) the Authority Resolutions were duly adopted at meetings of the Governing Board which were called and held pursuant to law and with all public notice
required by law and at which a quorum was present and acting throughout; (iii) to the best knowledge of such counsel after reasonable investigation, there is no action, suit, proceeding or investigation at law or in equity before or by any court, public board or body, pending or threatened against or affecting the Authority, challenging the existence of the Authority or the titles of its officers to their respective offices or seeking to prohibit, restrain or enjoin the sale, execution or delivery of the Certificates or the collection of the Payments under the Contract or in any way contesting or affecting the validity or enforceability of the Authority Agreements or contesting the powers of the Authority or its authority to enter into, adopt or perform its obligations under any of the foregoing, or which would have a material adverse effect on the Authority’s ability to perform its obligations under the Authority Agreements or contesting in any way the completeness or accuracy of the Official Statement; (iv) the execution and delivery of the 2006 Authority Agreements, the adoption of the Authority Resolutions, and compliance by the Authority with the provisions of the foregoing, under the circumstances contemplated thereby, do not and will not in any material respect conflict with or constitute, on the part of the Authority, a breach or default under the JPA Agreement or any other agreement or other instrument to which the Authority is a party or by which it is bound or, to the best knowledge of such counsel, any existing law, regulation, court order or consent decree to which the Authority is subject; (v) the Authority Agreements have been duly authorized, executed and delivered by the Authority and, assuming due authorization, execution and delivery by the other parties thereto, constitute legal, valid and binding agreements of the Authority enforceable in accordance with their respective terms, subject to laws relating to bankruptcy, insolvency or other laws affecting the enforcement of creditors’ rights generally and the application of equitable principles if equitable remedies are sought and to the limitations on legal remedies against authorities in the State of California; (vi) except as described in the Official Statement, no authorization, approval, consent, or other order of the State or any other governmental authority or agency within the State having jurisdiction over the Authority is required for the valid authorization, execution, delivery and performance by the Authority of the Authority Agreements or for the adoption of the Authority Resolutions which has not been obtained; and (vii) to the best of such counsel’s knowledge, the information regarding the Authority contained in the Official Statement (except for any financial or statistical data or forecasts, estimates, projections, assumptions or expressions of opinion, information relating to DTC, the book-entry system, the Insurer, the Insurance Policy as to which no opinion need be expressed) does not contain any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made therein, in the light of the circumstances under which they were made, not misleading;

(9) A certificate, dated the Closing Date, signed by a duly authorized representative of the City satisfactory to the Underwriter, in form and substance satisfactory to the Underwriter, to the effect that:

(i) the representations and warranties of the City contained in Section 5 of this Purchase Contract are accurate in all material aspects, as and if made on the Closing Date;
(ii) the City Agreements have been duly executed and delivered and each constitutes a valid and legally binding obligation of the City enforceable in accordance with its terms, subject to laws relating to bankruptcy, insolvency or other laws affecting the enforcement of creditors' rights generally and the application of equitable principles if equitable remedies are sought;

(iii) the City Resolutions are in full force and effect at the Closing Date and have not been amended, modified or supplemented, except as agreed to by the City and the Underwriter;

(iv) the City has complied with all the agreements and satisfied all the conditions on its part to be performed or satisfied on or prior to the Closing Date;

(v) subsequent to the date of the Official Statement and on or prior to the date of such certificate, there has been no material adverse change in the condition (financial or otherwise) of the City or the Water Utility System, whether or not arising in the ordinary course of the operations of the City, as described in the Official Statement; and

(vi) the Official Statement does not contain any untrue or misleading statement of a material fact and does not omit to state any material fact necessary to make the statements therein, in the light of the circumstances under which they are made, not misleading.

(10) A certificate, dated the Closing Date, signed by a duly authorized representative of the Authority satisfactory to the Underwriter, in form and substance satisfactory to the Underwriter, to the effect that:

(i) the representations and warranties of the Authority contained in Section 6 of this Purchase Contract are accurate in all material aspects, as and if made on the Closing Date;

(ii) the Authority Agreements have been duly executed and delivered and each constitutes a valid and legally binding obligation of the Authority enforceable in accordance with its terms, subject to laws relating to bankruptcy, insolvency or other laws affecting the enforcement of creditors' rights generally and the application of equitable principles if equitable remedies are sought;

(iii) the Authority Resolutions are in full force and effect at the Closing Date and have not been amended, modified or supplemented, except as agreed to by the Authority and the Underwriter;

(iv) the Authority has complied with all the agreements and satisfied all the conditions on its part to be performed or satisfied on or prior to the Closing Date; and

(v) the information contained in the Official Statement under the captions "THE AUTHORITY" and "LITIGATION" (solely as it relates to the
Authority) does not contain any untrue or misleading statement of a material fact and does not omit to state any material fact necessary to make the statements therein, in the light of the circumstances under which they are made, not misleading.

(11) A certificate of an authorized officer of the Insurer, dated the Closing Date to the effect that the information relating to the Insurer, the Insurance Policy contained in the Official Statement, as of its date and as of the Closing Date, is true and correct in all material respects.

(12) The opinion, dated the Closing Date and addressed to the Underwriter and the City, of Stradling Yocca Carlson & Rauth, a Professional Corporation, disclosure counsel (“Disclosure Counsel”) to the effect that:

(i) the Certificates are not subject to the registration requirements of the Securities Act of 1933, as amended, and the Trust Agreement is exempt from qualification pursuant to the Trust Indenture Act of 1939, as amended. No opinion is expressed with respect to the Insurance Policy; and

(ii) based on Disclosure Counsel’s participation in conferences with representatives of the Underwriter, Orrick, Herrington & Sutcliffe LLP, as Underwriter’s counsel (“Underwriter’s Counsel”), the City, the City Attorney, the Authority, counsel to the Authority, Public Financial Management, Inc., as financial advisor, Special Counsel and others, during which conferences the contents of the Official Statement and related matters were discussed, and in reliance thereon and on the records, documents, certificates and opinions described therein, Disclosure Counsel advises the Underwriter and the City that, during the course of its engagement as disclosure counsel on this matter, no information came to its attention that caused it to believe that the Official Statement as of its date and as of the date of such opinion (except for any financial or statistical data or forecasts, numbers, charts, estimates, projections, assumptions or expressions of opinion, Appendices A through D and F through H or any information about book-entry, the DTC, the Insurer, the Insurance Policy included therein, as to which no opinion or view need be expressed) contained or contains any untrue statement of a material fact or omitted or omits to state a material fact necessary in order to make the statements made therein, in the light of the circumstances under which they were made, not misleading.

(13) The opinion of counsel of the Trustee, dated the Closing Date, addressed to the City and the Underwriter to the effect that:

(i) The Trustee is a national banking association duly organized, validly existing and in good standing under the laws of the United States of America, having full powers and authority and being qualified to enter into, accept and administer the trust created under the Trust Agreement and to enter into the Trust Agreement, the Continuing Disclosure Agreement and the Auction Agreement.
(ii) The performance by the Trustee of the duties required under the Trust Agreement, the Continuing Disclosure Agreement and the Auction Agreement has been duly authorized by all necessary corporate action on the part of the Trustee, and under present law do not contravene any law or government regulation or order presently binding on the Trustee or contravene any law or governmental regulation or order presently binding on the Trustee or the articles of association/articles of incorporation/charter, as applicable, or the bylaws of the Trustee or contravene any provision of or constitute a default under any indenture, trust agreement, contract or other instrument to which the Trustee is a party or by which the Trustee is bound.

(iii) The performance by the Trustee of the duties required under the Trust Agreement, the Continuing Disclosure Agreement and the Auction Agreement does not require the consent or approval of, the giving of notice to, the registration with, or the taking of any other action in respect of, any federal, state or other governmental agency or authority.

(iv) The Trust Agreement, the Continuing Disclosure Agreement and the Auction Agreement have been duly authorized, executed and delivered by the Trustee, and, assuming due authorization, execution and delivery by the other parties thereto, the Trust Agreement, the Continuing Disclosure Agreement and the Auction Agreement constitute legal, valid and binding agreements of the Trustee enforceable in accordance with their respective terms, subject to laws relating in bankruptcy, insolvency or other laws affecting the enforcement of creditors' rights generally and the application of equitable principles if equitable remedies are sought.

(v) The Trustee has duly authorized the execution and delivery of the Trust Agreement, the Continuing Disclosure Agreement and the Auction Agreement.

(vi) All approvals, consents and orders of any governmental authority or agency having jurisdiction in the matter which would constitute a condition precedent to the performance by the Trustee of its duties and obligations under the Trust Agreement, the Continuing Disclosure Agreement and the Auction Agreement have been obtained and are in full force and effect.

(14) A certificate or certificates, dated the Closing Date, in form and substance acceptable to the Underwriter, of an authorized officer of the Trustee to the effect that:

(i) The Trustee is a national banking association duly organized and validly existing under the laws of the United States of America.

(ii) The Trustee has full corporate trust powers and authority to serve as Trustee under the Trust Agreement and to perform its obligations and duties under the Trust Agreement, the Continuing Disclosure Agreement and the Auction Agreement, and the Trust Agreement, the Continuing Disclosure
Agreement and the Auction Agreement have been executed by a duly authorized officer of the Trustee.

(iii) The Certificates have been duly executed and delivered by the Trustee.

(iv) The Trustee’s action in serving as Trustee under the Trust Agreement is in full compliance with, and does not conflict with, any applicable law or governmental regulation currently in effect, and does not conflict with or violate any contract to which the Trustee is a party or any administrative or judicial decision by which the Trustee is bound.

(15) An arbitrage certificate relating to the Certificates duly signed on behalf of the City.

(16) Evidence of required filings with the California Debt and Investment Advisory Commission.

(17) A copy of the executed Blanket Issuer Letter of Representations by and between the City and DTC relating to the book entry system.

(18) Evidence that insured ratings on the Certificates of “AAA” by Standard & Poor’s Ratings Services (“S&P”) and “Aaa” by Moody’s Investors Service, Inc. (“Moody’s”) and underlying ratings on the Certificates of “A+” by S&P and “A2” by Moody’s are in full force and effect on the Closing Date.

(19) A Certificate of the Auction Agent, dated the Closing Date, executed by an authorized representative of the Auction Agent, to the effect that: (i) the Auction Rate Agreements have been duly authorized, executed and delivered by the Auction Agent; (ii) the Auction Agent has full power and authority to carry out its obligations under the Auction Rate Agreements; and (iii) there is no action, suit, proceeding, inquiry or investigation at law or in equity before or by any court, public board or body pending or known to be threatened against or affecting the Auction Agent where an unfavorable decision, ruling or finding would adversely affect the transactions contemplated by the Auction Rate Agreements;

(20) Such additional legal opinions, certificates, proceedings, instruments and other documents as the Underwriter or Special Counsel may reasonably request to evidence compliance by the City and the Authority with legal requirements, the truth and accuracy, as of the Closing Date, of the representations of the City and the Authority herein contained and of the Official Statement and the due performance or satisfaction by the City at or prior to such time of all agreements then to be performed and all conditions then to be satisfied by the City.

All of the opinions, letters, certificates, instruments and other documents mentioned in this Purchase Contract shall be deemed to be in compliance with the provisions of this Purchase Contract if, but only if, they are in form and substance satisfactory to the Underwriter. If the City or the Authority is unable to satisfy the conditions to the obligations of the Underwriter to
purchase, to accept delivery of and to pay for the Certificates contained in this Purchase Contract or if the obligations of the Underwriter to purchase, to accept delivery of and to pay for the Certificates shall be terminated for any reason permitted by this Purchase Contract, this Purchase Contract shall terminate and neither the Underwriter, the City nor the Authority shall be under further obligations hereunder, except that the respective obligations of the Authority, the City and the Underwriter set forth in Section 9 of this Purchase Contract shall continue in full force and effect.

Section 9. Conditions to the Authority’s and the City’s Obligations. The performance by the Authority and the City of their respective obligations under this Purchase Contract are conditioned upon: (i) the performance by the Underwriter of its obligations hereunder and (ii) receipt by the Authority and the City of opinions addressed to the Authority and the City, and receipt by the Underwriter of opinions addressed to the Underwriter, and the delivery of certificates being delivered on the Closing Date by persons and entities other than the City and the Authority.

Section 10. Termination Events. The Underwriter shall have the right to terminate the Underwriter’s obligations under this Purchase Contract to purchase, to accept delivery of and to pay for the Certificates by notifying the City of its election to do so if, after the execution hereof and prior to the Closing: (1) the marketability of the Certificates or the market price thereof, in the reasonable opinion of the Underwriter, has been materially and adversely affected by any decision issued by a court of the United States (including the United States Tax Court) or of the State of California, by any ruling or regulation (final, temporary or proposed) issued by or on behalf of the Department of the Treasury of the United States, the Internal Revenue Service, or other governmental agency of the United States, or any governmental agency of the State of California, or by a tentative decision or announcement by any member of the House Ways and Means Committee, the Senate Finance Committee, or the Conference Committee with respect to contemplated legislation or by legislation enacted by, pending in, or favorably reported to either the House of Representatives or either House of the Legislature of the State of California, or formally proposed to the Congress of the United States by the President of the United States or to the Legislature of the State of California by the Governor of the State of California in an executive communication, affecting the tax status of the City or the Authority, its property or income, its obligations (including the Certificates) or the interest thereon or any tax exemption granted or authorized by the Internal Revenue Code of 1986, as amended; (2) the United States shall have become engaged in new hostilities which have resulted in a declaration of war or a national emergency, or there shall have occurred any other outbreak or escalation or re-escalation of hostilities, or a local, national or international calamity or crisis, financial or otherwise, the effect of such outbreak, calamity or crisis being such as, in the reasonable opinion of the Underwriter, would affect materially and adversely the ability of the Underwriter to market the Certificates; (3) there shall have occurred a general suspension of trading on the New York Stock Exchange or the declaration of a general banking moratorium by the United States, New York State or California State authorities; (4) a stop order, ruling, regulation or official statement by, or on behalf of, the Securities and Exchange Commission shall be issued or made to the effect that the execution and delivery of the Certificates is or would be in violation of any provision of the Securities Act of 1933, as then in effect, or of the Securities Exchange Act of 1934, as then in effect, or of the Trust Indenture Act of 1939, as then in effect; (5) legislation shall be enacted by the House of Representatives or the Senate of the Congress of the United States of America, or a
decision by a court of the United States of America shall be rendered, or a ruling or regulation by
or on behalf of the Securities and Exchange Commission or other governmental agency having
jurisdiction of the subject matter shall be made or proposed to the effect that the Certificates are
not exempt from registration, qualification or other similar requirements of the Securities Act of
1933, as then in effect, or of the Trust Indenture Act of 1939, as then in effect; (6) in the
reasonable judgment of the Underwriter, the market price of the Certificates, or the market price
generally of obligations of the general character of the Certificates, might be materially and
adversely affected because additional material restrictions not in force as of the date hereof shall
have been imposed upon trading in securities generally by any governmental authority or by any
national securities exchange; (7) the Comptroller of the Currency, The New York Stock
Exchange, or other national securities exchange, or any governmental authority, shall impose, as
to the Certificates or obligations of the general character of the Certificates, any material
restrictions not now in force, or increase materially those now in force, with respect to the
extension of credit by, or the charge to the net capital requirements of, or financial responsibility
requirements of the Underwriter; (8) a general banking moratorium shall have been established
by federal, New York or State authorities; (9) any legislation, ordinance, rule or regulation shall
be introduced in or be enacted by any governmental body, department or agency in the State or a
decision of a court of competent jurisdiction within the State shall be rendered, which, in the
reasonable opinion of the Underwriter, after consultation with the City, materially adversely
affects the market price of the Certificates; (10) any federal or California court, authority or
regulatory body shall take action materially and adversely affecting the collection or pledge of
the Payments under the Contract; (11) any event occurring, or information becoming known
which, in the reasonable opinion of the Underwriter, makes untrue in any material respect any
statement or information contained in the Official Statement, or has the effect that the Official
Statement contains any untrue statement of a material fact or omits to state a material fact
necessary in order to make the statements made therein, in the light of the circumstances under
which they were made, not misleading; or (12) the withdrawal or downgrading of the rating of
the Certificates to less than “Aaa” by Moody’s or less than “AAA” by S&P.

Section 11. Payment of Expenses.

(a) The Underwriter shall be under no obligation to pay, and the City shall pay the
following expenses incident to the performance of the City’s obligations hereunder:

(i) the fees and disbursements of Special Counsel and Disclosure Counsel;

(ii) the cost of printing and delivering the Certificates, the Official Statement
(and any amendment or supplement prepared pursuant to Section 5 or 6 of this Purchase
Contract);

(iii) the fees and disbursements of accountants, advisers and of any other
experts or consultants retained by the City;

(iv) the premium for the Insurance Policy; and

(v) any other expenses and costs of the City incident to the performance of its
obligations in connection with the authorization, issuance and sale of the Certificates, including,
but not limited to, out of pocket expenses and regulatory expenses, and any other expenses agreed to by the parties.

(b) The Underwriter shall pay all expenses incurred by them in connection with the public offering and distribution of the Certificates including, but not limited to:

(i) all advertising expenses in connection with the offering of the Certificates;

and

(ii) the fees and expenses of Underwriter’s Counsel;

(iii) all out-of-pocket disbursements and expenses incurred by the Underwriter in connection with the offering and distribution of the Certificates, except as provided in (a) above or as otherwise agreed to by the Underwriter and the City.

Section 12. Notices. Any notice or other communication to be given to the City under this Purchase Contract may be given by delivering the same in writing to the City at the address set forth on the first page of this Purchase Contract, and any notice or other communication to be given to the Underwriter under this Purchase Contract may be given by delivering the same in writing to Banc of America Securities LLC, CA5-801-18-36, 600 Montgomery Street, Suite 1800, San Francisco, California 94111-2719, Attention: Scott Nagelson, Principal.

Section 13. Survival of Representations, Warranties, Agreements. All of the City’s representations, warranties and agreements contained in this Purchase Contract shall remain operative and in full force and effect regardless of: (a) any investigations made by or on behalf of the Underwriter; or (b) delivery of and payment for the Certificates pursuant to this Purchase Contract. The agreements contained in this Section and in Section 9 shall survive any termination of this Purchase Contract.

Section 14. Benefit; No Assignment. This Purchase Contract is made solely for the benefit of the City, the Authority and the Underwriter (including its successors and assigns), and no other person shall acquire or have any right hereunder or by virtue hereof. The rights and obligations created by this Purchase Contract are not subject to assignment by the Underwriter, the Authority or the City without the prior written consent of the other party hereto.

Section 15. Severability. In the event that any provision of this Purchase Contract is held invalid or unenforceable by any court of competent jurisdiction, such holding shall not invalidate or render unenforceable any other provision of this Purchase Contract.

Section 16. Counterparts. This Purchase Contract may be executed in any number of counterparts, all of which taken together shall constitute one agreement, and any of the parties hereto may execute the Purchase Contract by signing any such counterpart.

Section 17. Governing Law. The validity, interpretation and performance of this Purchase Contract shall be governed by the laws of the State of California.
Section 18. Effectiveness. This Purchase Contract shall become effective upon the execution of the acceptance hereof by an authorized officer of the City, and shall be valid and enforceable as of the time of such acceptance.

Very truly yours,

BANC OF AMERICA SECURITIES LLC

By: ____________________________
    Principal

Accepted:

CITY OF MODESTO

By: ____________________________
    Director of Finance/Treasurer

MODESTO PUBLIC FINANCING AUTHORITY

By: ____________________________
    Auditor and Treasurer
EXHIBIT A

TERM OF THE CERTIFICATES

The initial Auction Rate for the Certificates is ____%.
THE CITY LLP, San Francisco, California. Special Counsel, based on existing statutes, regulations, rulings and judicial decisions and assuming compliance with certain covenants in the documents pertaining to the 2006 Certificates and requirements of the Internal Revenue Code of 1986, as amended, as described herein, the portion of each 2006 Payment due under the 2006 Contract designated as and comprising interest with respect to the 2006 Certificates is not includable in the gross income of the owners of the 2006 Certificates for federal income tax purposes. In the further opinion of Special Counsel, the portion of each 2006 Payment due under the 2006 Contract designated as and comprising interest with respect to the 2006 Certificates is not treated as an item of tax preference in calculating the federal alternative minimum taxable income of individuals and corporations. Such portion of each 2006 Payment, however, is included as an adjustment in the calculation of federal corporate alternative minimum taxable income and may therefore affect a corporation’s alternative minimum tax liability. In the further opinion of Special Counsel, the portion of each 2006 Payment due under the 2006 Contract designated as and comprising interest with respect to the 2006 Certificates is exempt from personal income taxes imposed by the State of California. See “TAX MATTERS” herein.

$46,200,000
CITY OF MODESTO, CALIFORNIA
WATER REVENUE CERTIFICATES OF PARTICIPATION
2006 SERIES A

Dated: Date of Delivery

The 2006 Certificates are being executed and delivered pursuant to the 2006 Trust Agreement, dated as of November 1, 2006, by and between the Modesto Public Financing Authority and The Bank of New York Trust Company, N.A., as trustee, for the principal purpose of financing the acquisition, installation and construction of certain improvements to the City of Modesto’s Water Utility System. The 2006 Certificates are payable solely from installment payments to be made by the City of Modesto to the Authority pursuant to the Master Installment Purchase Contract, dated as of November 1, 1997, as supplemented by the 2006 Supplemental Installment Purchase Contract, dated as of November 1, 2006, by and between the City and the Authority. The obligation of the City to make such installment payments is a special obligation of the City payable solely from Gross Revenues of its Water Utility System and certain funds and accounts created under the 2006 Trust Agreement. As described herein, those Gross Revenues are also pledged to the payment of certain other Party Obligations of the City.

The 2006 Certificates will be initially executed and delivered as Auction Rate Securities in denominations of $25,000 or any integral multiple thereof. The interest with respect to the 2006 Certificates will initially be evidenced at ARS Rates for generally successive 7-day Auction Periods. Each ARS Rate will, except in certain cases, be equal to the annual interest rate that results from the implementation of the ARS Provisions described in Appendix C hereto. At the election of the City, the Auction Period for the 2006 Certificates may be changed or the 2006 Certificates may be converted to other Interest Periods as described herein. The 2006 Certificates will be subject to mandatory tender for purchase upon a conversion to an Interest Period other than the ARS Rate Period in the manner described herein. While the 2006 Certificates evidence interest at the ARS Rate, a beneficial owner of a 2006 Certificate may sell, transfer or dispose of a 2006 Certificate only in accordance with the ARS Provisions. This Official Statement describes the 2006 Certificates only while they evidence interest at the ARS Rate.

The 2006 Certificates are being executed and delivered in book-entry form only and when executed and delivered will be registered in the name of Cede & Co., as nominee of The Depository Trust Company, New York, New York. Purchasers of the 2006 Certificates will not receive certificates representing their beneficial ownership in the 2006 Certificates but will receive credit balances on the books of their respective nominees. The principal of and interest evidenced by the 2006 Certificates are payable by the Trustee to Cede & Co.; and such interest and principal payments are to be disbursed to the beneficial owners of the 2006 Certificates through their nominees.

While in an ARS Rate Period, the 2006 Certificates are subject to optional prepayment and mandatory sinking fund prepayment prior to maturity as described herein. The 2006 Certificates will not be subject to optional tender, nor will they be purchased in the event Sufficient Clearing Bids do not exist in any Auction, although they will be subject to mandatory purchase upon conversion to another Interest Period, as described herein.

The scheduled payments of principal and interest with respect to the 2006 Certificates when due will be guaranteed under an insurance policy to be issued concurrently with the delivery of the 2006 Certificates by MBIA Insurance Corporation.

[MBIA’S LOGO]


THIS COVER PAGE CONTAINS CERTAIN INFORMATION FOR GENERAL REFERENCE ONLY. IT IS NOT A SUMMARY OF THIS ISSUE. INVESTORS ARE ADVISED TO READ THE ENTIRE OFFICIAL STATEMENT TO OBTAIN INFORMATION ESSENTIAL TO THE MAKING OF AN INFORMED INVESTMENT DECISION.

The 2006 Certificates are offered when, as and if delivered and received by the Underwriter, subject to the approval of legality by Sidley Austin LLP, San Francisco, California, Special Counsel, and certain other conditions. Certain legal matters will be passed upon for the Underwriter by Orrick, Herrington & Sutcliffe LLP; for the City and the Authority by the City Attorney of the City and by Stradling Yocca Carlson & Rath, a Professional Corporation, Newport Beach, California, Disclosure Counsel; for the Trustee by its General Counsel; and for the 2006 Certificate Insurer by its General Counsel. It is anticipated that the 2006 Certificates will be available for delivery to The Depository Trust Company or its agent on or about November 2, 2006.

Banc of America Securities LLC

Dated: October __, 2006

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$46,200,000
CITY OF MODESTO, CALIFORNIA
WATER REVENUE CERTIFICATES OF PARTICIPATION
2006 SERIES A

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The 2006 Certificates will evidence interest from the date of original delivery through the Initial Auction Date set forth above at the rate established by Banc of America Securities LLC, Underwriter for the 2006 Certificates, prior to the date of delivery. Thereafter, the 2006 Certificates will evidence interest for generally successive 7-day Auction Periods, until the Auction Period is changed or the 2006 Certificates are converted to a different Interest Period as described herein. Interest will be payable on the Initial Interest Payment Date set forth above and thereafter on the day following the end of each Auction Period for the 2006 Certificates unless the Auction Period is changed to a daily Auction Period or a Special Auction Period of more than 182 days or unless a different Interest Period is applicable to the Certificates.

The Bank of New York will act as the Auction Agent and Banc of America Securities LLC will act as the Broker-Dealer for the 2006 Certificates.

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CITY OF MODESTO, CALIFORNIA
1010 10th Street
P.O. Box 642
Modesto, California 95353
(209) 577-5369
TDD (209) 526-9211 Hearing and Speech Impaired Only

CITY COUNCIL

Jim Ridenour, Mayor
Will O'Bryant, Vice Mayor
Bob Dunbar
Brad Hawn
Janice Keating
Garrad Marsh
Kristen Olsen

CITY OFFICIALS

George W. Britton, City Manager
Susana Alcala Wood, City Attorney
Wayne Padilla, Finance Director/Treasurer
Gregory M. Baird, Deputy Director of Finance
Nick Pinhey, Director of Public Works

SPECIAL SERVICES

Special Counsel
Sidley Austin LLP
San Francisco, California

Trustee
The Bank of New York Trust Company, N.A.
San Francisco, California

Financial Advisor
Public Financial Management, Inc.
San Francisco, California

Disclosure Counsel
Stradling Yocca Carlson & Rauth, a Professional Corporation
Newport Beach, California

Auction Agent
The Bank of New York
New York, New York
All the information which the City of Modesto intends to present investors regarding the City, the Authority, and the 2006 Certificates is contained in this Official Statement. While the City maintains an internet website for various purposes, none of the information on that website is intended to assist investors in making any investment decision, or to provide any continuing information, with respect to the 2006 Certificates or any other obligations of the City. Moreover, none of the information on the website is incorporated herein by reference. No dealer, broker, salesperson or other person has been authorized by the City, the Authority, the 2006 Certificate Insurer or the Underwriter to give any information or to make any representations other than those contained in this Official Statement in connection with the offering made hereby and, if given or made, such other information or representations must not be relied upon as having been authorized by the City, the Authority, the 2006 Certificate Insurer or the Underwriter. 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 2006 Certificates by a person in any jurisdiction in which it is unlawful for such person to make such an offer, solicitation or sale.

This Official Statement is not to be construed as a contract with the purchasers of the 2006 Certificates. Statements contained in this Official Statement which involve estimates, forecasts or matters of opinion, whether or not expressly so described herein, are intended solely as such and are not to be construed as a representation of facts.

The information set forth herein has been obtained from sources which are believed to be reliable, but it is not guaranteed as to accuracy or completeness. The information and expression of opinions herein are subject to change without notice and neither 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 or the 2006 Certificate Insurer since the date hereof. All summaries of documents contained herein are made subject to the provisions of such documents and do not purport to be complete statements of any or all such provisions.

The Underwriter has provided the following sentence for inclusion in this Official Statement:

_The Underwriter has reviewed the information in this Official Statement in accordance with, and as part of, its responsibilities to investors under the federal securities laws as applied to the facts and circumstances of this transaction, but the Underwriter does not guarantee the accuracy or completeness of such information._

CAUTIONARY INFORMATION REGARDING FORWARD-LOOKING STATEMENTS IN THIS OFFICIAL STATEMENT

Certain statements included or incorporated by reference in this Official Statement constitute “Forward-Looking Statements” within the meaning of the United States Private Securities Litigation Reform Act of 1995, Section 21E of the United States Securities Exchange Act of 1934, as amended, and Section 27A of the United States Securities Act of 1933, as amended. Such statements are generally identifiable by the terminology used, such as “plan,” “expect,” “estimate,” “budget” and other similar words and include, but are not limited to, statements that describe possible future connections to and revenues and expenses of the Water Utility System.

The achievement of certain results or other expectations contained in such forward-looking statements involves known and unknown risks, uncertainties and other factors which may cause actual results, performance or achievements described to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. While the City has agreed to provide certain on-going financial and operating data (see “CONTINUING DISCLOSURE” and APPENDIX E hereto), it does not plan to issue any updates or revisions to those forward-looking statements if or when its expectations or events, conditions or circumstances on which statements are based change.

THE 2006 CERTIFICATES HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED, IN RELIANCE UPON AN EXEMPTION CONTAINED IN SUCH ACT. THE 2006 CERTIFICATES HAVE NOT BEEN REGISTERED OR QUALIFIED UNDER THE SECURITIES LAWS OF ANY STATE.
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CITY OF MODESTO, CALIFORNIA
WATER REVENUE CERTIFICATES OF PARTICIPATION
2006 SERIES A

INTRODUCTION

General

This Official Statement, including the cover page and all appendices attached hereto, provides certain information concerning the City of Modesto Water Revenue Certificates of Participation, 2006 Series A (the “2006 Certificates”), evidencing and representing the proportionate interests of the Owners thereof in 2006 Payments to be made by the City of Modesto, California (the “City”). Descriptions and summaries of various documents hereinafter set forth do not purport to be comprehensive or definitive, and reference is made to each document for complete details of all terms and conditions thereof. Capitalized terms used and not otherwise defined herein shall have the meanings ascribed to them in APPENDIX B — “DEFINITIONS AND SUMMARY OF PRINCIPAL LEGAL DOCUMENTS” or in APPENDIX C — “ARS PROVISIONS.”

The 2006 Certificates are being executed and delivered primarily to finance the acquisition and construction of various additions, betterments, extensions and improvements (collectively, the “2006 Project”) to the City’s water system (the “Water Utility System”) as further described under the caption “THE 2006 PROJECT” below. Proceeds derived from the sale of the 2006 Certificates will also be used to fund the Parity Reserve Fund, to fund interest with respect to the 2006 Certificates in an amount estimated to equal the interest estimated to accrue through October 1, 2007, and to pay the costs of executing and delivering the 2006 Certificates and the fees of the Broker-Dealer and the Auction Agent through October 1, 2007. See “ESTIMATED SOURCES AND USES OF FUNDS.”

The 2006 Certificates

The 2006 Certificates represent the proportionate undivided interests of the registered owners thereof (the “Owners”) in installment payments (the “2006 Payments”) payable by the City under the Master Installment Purchase Contract, dated as of November 1, 1997 (the “Master Contract”), by and between the City and the Modesto Public Financing Authority, a California joint exercise of powers agency (the “Authority”), as supplemented by the 1997 Supplemental Installment Purchase Contract, dated as of November 1, 1997, by and between the City and the Authority (the “1997 Contract”) and by the 2006 Supplemental Installment Purchase Contract, dated as of November 1, 2006 by and between the City and the Authority (the “2006 Contract” and, collectively with the Master Contract and the 1997 Contract, the “Contract”). The 2006 Certificates are being executed and delivered pursuant to the Trust Agreement, dated as of November 1, 2006 (the “2006 Trust Agreement”), by and between the Authority and The Bank of New York Trust Company, N.A., as trustee (the “Trustee”). Pursuant to the 2006 Trust Agreement, the Authority has assigned to the Trustee for the benefit of the Owners of the 2006 Certificates substantially all its rights under the Contract, including its right to receive 2006 Payments payable under the Contract and its right to enforce payment by the City of the 2006 Payments when due.

The 2006 Certificates will be dated as of the date on which they are executed and delivered and will mature on October 1, 2036 (the “Maturity Date”). The 2006 Certificates will be initially
issued in denominations of $25,000 and any integral multiple thereof as Auction Rate Securities ("ARS") and will initially evidence interest at ARS Rates determined in accordance with the ARS Provisions set forth in the 2006 Trust Agreement. When they evidence interest at ARS Rates, the 2006 Certificates are referred to as "ARS Certificates." See APPENDIX C — "ARS PROVISIONS." The 2006 Certificates are subject to mandatory tender for purchase upon conversion to a new Interest Period, and they are also subject to optional and mandatory prepayment prior to the Maturity Date as described herein. See "THE 2006 CERTIFICATES.

Security for the 2006 Certificates

General. The 2006 Certificates represent the proportionate, undivided interests of the Owners in the 2006 Payments. The City is required to make the 2006 Payments pursuant to the provisions of the Contract. The 2006 Payments represent the purchase price of the improvements to the Water Utility System (the "2006 Project") which the Authority is selling to the City.

The Master Contract. The Master Contract establishes the terms and conditions upon which certain obligations of the City will be incurred and secured. Pursuant to the Master Contract, all Gross Revenues (as defined in the Master Contract) of the Water Utility System are pledged to the payment of the 2006 Payments, all payments required to be made under all other Parity Obligations and Maintenance and Operations Costs; and amounts on deposit in the Parity Reserve Fund are pledged to the payment of the 1997 Payments (defined below), the 2006 Payments and any other obligations hereafter issued in connection with a Supplemental Contract. The City has previously incurred, and may in the future incur, obligations payable from Gross Revenues on a parity with the 2006 Payments ("Parity Obligations") pursuant to the terms and conditions of the Master Contract. See "SECURITY FOR THE 2006 CERTIFICATES — Existing and Future Parity Obligations." To provide additional security for the 2006 Certificates and Parity Obligations, the Master Contract contains a rate covenant which requires the City to fix, prescribe, and collect certain minimum rates, fees and charges for the water service, calculated in accordance with the Master Contract. See "SECURITY FOR THE 2006 CERTIFICATES — Rate Covenant."

The 1997 Contract. The City has previously financed and refinanced certain improvements to its Water Utility System pursuant to the 1997 Contract, under which the City is obligated to make certain payments (the "1997 Payments") to the Authority as payment of the purchase price for those improvements. The 1997 Payments are payable from Gross Revenues on a parity with the 2006 Payments.

The 2006 Contract. The 2006 Contract is a Parity Obligation executed and delivered under the provisions of the Master Contract. In consideration of the Authority’s agreement to finance the 2006 Project pursuant to the provisions of the 2006 Contract, the City agrees to pay to the Authority, solely from Gross Revenues, the 2006 Payments as provided in the 2006 Contract. The obligation of the City to make the 2006 Payments from Gross Revenues is absolute and unconditional; and, until such time as the 2006 Payments have been paid in full (or provision for the payment thereof shall have been made pursuant to the Master Contract), the City will not discontinue or suspend any such payments required to be made by it under the 2006 Contract when due whether or not the Water Utility System or any part thereof is operating or operable, or its use is suspended, interfered with, reduced, curtailed or terminated in whole or in part. See "SECURITY FOR THE 2006 CERTIFICATES — The 2006 Contract."

Certificate Insurance

MBIA Insurance Corporation ("MBIA" or the "2006 Certificate Insurer") has issued a commitment to issue, simultaneously with the delivery of the 2006 Certificates, a municipal bond insurance policy (the "2006 Certificate Insurance Policy") relating to the 2006 Certificates, effective as of the date of delivery of the 2006 Certificates. By the terms of the 2006 Certificate Insurance Policy, MBIA agrees to pay the principal and interest represented by the 2006 Certificates which come due for payment but which are unpaid, to the extent that the Trustee has not received sufficient funds from the City with which to make such payment. See "CERTIFICATE INSURANCE" and APPENDIX G — "SPECIMEN CERTIFICATE INSURANCE POLICY."

In connection with the issuance of the 2006 Certificate Insurance Policy, the City and the Trustee will enter into an agreement with MBIA (the "Insurance and Reimbursement Agreement"), and the City's obligations thereunder will be Parity Obligations.

Swap Agreement

In connection with the execution and delivery of the 2006 Certificates, the City has entered into an interest rate swap agreement in the form of an ISDA Master Agreement, the U.S. Municipal Counterparty Schedule thereto, a Credit Support Annex and a Confirmation, each dated September 27, 2006 (collectively, the "Swap Agreement") with Bank of America, N.A. (the "Swap Provider"). The Swap Agreement will become effective on November 2, 2006 and is scheduled to expire on the Maturity Date of the 2006 Certificates; and the notional amount of the Swap Agreement is scheduled to be reduced on the same dates and in the same amounts as the principal evidenced by the 2006 Certificates is scheduled to be reduced. Pursuant to the Swap Agreement, the City will be required to make periodic payments to the Swap Provider calculated on the basis of a fixed rate of interest on an initial notional amount equal to the principal amount represented by the 2006 Certificates. In return, the Swap Provider will be required to make periodic payments to the City calculated on the basis of a variable rate of interest equal to a percentage of LIBOR on the same notional amount. The amounts payable by each party pursuant to the Swap Agreement are netted against the payments to be received by such party thereunder.

Certain of the amounts that may be payable by the City to the Swap Provider will be insured pursuant to a policy of interest rate swap insurance to be issued by MBIA pursuant to the Insurance and Reimbursement Agreement (the "Swap Policy").

The City's obligations under the Swap Agreement to make scheduled payments and certain termination payments (but only if such termination payments are insured pursuant to the Swap Policy) are Parity Obligations. No arrangements made in respect of the Swap Agreement will alter the City's obligation to make the 2006 Payments.
Both the City and the Swap Provider have the right to terminate the Swap Agreement prior to its stated termination date under certain conditions. Any such termination could result in an obligation on the part of the City or the Swap Provider to make termination payments to the other party, and the amount of such termination payments could be substantial. Any obligation on the part of the City to make such a termination payment (other than a termination payment that is insured under the terms of the Swap Policy) will not be a Parity Obligation and will be subordinate to the City's liabilities with respect to Parity Obligations.

Neither the Trustee nor the Owners will have any rights under the Swap Agreement or against the Swap Provider.

The Swap Provider and Banc of America Securities LLC, the Underwriter and Broker-Dealer, are affiliates, both being subsidiaries of the Bank of America Corporation.

The City

The City was incorporated in 1884, is the county seat of Stanislaus County, had an estimated population of approximately 208,107 as of January 1, 2006, and covers approximately 36 square miles. The City operates under a council-manager form of government pursuant to a charter adopted in 1963. It is located in Central California, approximately 93 miles east of San Francisco. See APPENDIX H — “CERTAIN INFORMATION ABOUT THE CITY.”

The Water Utility System

The Water Utility System provides potable water service to residential, commercial and industrial consumers located within the incorporated area of the City and in neighboring areas of Stanislaus County. The City owns, operates and maintains the Water Utility System, which is the sole retail provider of water service in the City. See “THE WATER UTILITY SYSTEM.”

Tax Matters

For description of the tax status of interest with respect to the 2006 Certificates, see “TAX MATTERS” herein and see the complete copy of the proposed form of opinion of Special Counsel set forth in APPENDIX D — “PROPOSED FORM OF OPINION OF SPECIAL COUNSEL.”

Continuing Disclosure

The City has agreed to provide, or cause to be provided, certain annual financial information and operating data to each nationally recognized municipal securities information repository and any public or private repository or entity designated by the State as a state repository for purposes of the Securities and Exchange Commission's Rule 15c2-12(b)(5) by no later than 270 days after the end of each Fiscal Year and, in a timely manner, notice of certain material events to said repositories or to the Municipal Securities Rulemaking Board. The City has agreed to do so in order to assist the Underwriter in complying with Rule 15c2-12(b)(5). See “CONTINUING DISCLOSURE” herein for a further discussion of the City's disclosure obligation and APPENDIX E — “FORM OF CONTINUING DISCLOSURE AGREEMENT” for the form of its Continuing Disclosure Agreement.
THE 2006 PROJECT

The 2006 Project consists of improvements required to be made by the City in connection with the Modesto Irrigation District's expansion of the Modesto Regional Water Treatment Plant (the "Water Treatment Plant"), including the construction of several new downstream water facilities and various water distribution system improvements to insure the reliability of water supply to both existing and future customers. The 2006 Project includes the acquisition of land and rights of way as well as design and construction costs related to the new facilities and improvements. The facilities include the acquisition, construction and installation of three storage tanks and connecting transmission facilities, construction and improvement of transmission/distribution mains and associated pump stations, and installation of motor-operated control valves which will control the flow of treated surface water from the Water Treatment Plant to the City system. The 2006 Project facilities and improvements will help replace less reliable groundwater production capacity, improve the City's ability to maintain desired system operational pressures during high-demand periods and meet other operational criteria. These facilities will also improve system distribution capabilities to future customers. Proceeds of the 2006 Certificates may also be used for other improvements to the Water Utility System approved by the City Council.

The Water Treatment Plant was constructed and is owned and operated by the Modesto Irrigation District ("MID"). Pursuant to an agreement with the City (the "Treatment and Delivery Agreement"), MID has agreed to an expansion of the Water Treatment Plant, doubling its rated capacity from approximately 30 million gallons per day to approximately 60 million gallons per day. (The Water Treatment Plant has been designed to accommodate a possible further expansion subject to a future agreement between the City and MID.) In order to finance this expansion, MID is expected to issue bonds in the spring of 2007 in an amount that will yield approximately $53,000,000 to $60,000,000 in net proceeds.
The table below sets forth the estimated sources and uses of the proceeds of the 2006 Certificates:

<table>
<thead>
<tr>
<th>Sources:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Principal Amount of the 2006 Certificates</td>
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<tr>
<td>Less: Underwriter’s Discount</td>
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</tr>
<tr>
<td>Total</td>
<td></td>
</tr>
<tr>
<td>Uses:</td>
<td></td>
</tr>
<tr>
<td>Parity Reserve Fund(1)</td>
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<tr>
<td>2006 Capitalized Interest and Fees Subaccount(2)</td>
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</tr>
<tr>
<td>2006 Project Account of Improvement Fund(3)</td>
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</tr>
<tr>
<td>Costs of Issuance(4)</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td></td>
</tr>
</tbody>
</table>

(1) The Reserve Fund Requirement, which is described herein under the caption “SECURITY FOR THE 2006 CERTIFICATES — Parity Reserve Fund,” will be satisfied in connection with the execution and delivery of the 2006 Certificates by the deposit of this amount together with the existing 1997 Certificate Reserve Policy.

(2) Represents estimated interest with respect to the 2006 Certificates and Auction Agent and Broker-Dealer fees due through October 1, 2007.

(3) A portion of the proceeds deposited to the 2006 Project Account will be used to reimburse the City for certain costs of the 2006 Project paid for by the City prior to the execution and delivery of the 2006 Certificates.

(4) Includes the premium for the 2006 Certificate Insurance Policy, fees and expenses of Special Counsel, Disclosure Counsel, Financial Advisor, Trustee, and Auction Agent, and printing and other miscellaneous expenses.

THE 2006 CERTIFICATES

General

The 2006 Certificates represent the proportionate, undivided interests of the Owners in the 2006 Payments. The 2006 Certificates initially will be executed and delivered as Auction Rate Securities in the principal amount set forth on the cover page to this Official Statement. The 2006 Certificates will be dated the date of their initial execution and delivery and will mature on the Maturity Date set forth on the cover page of this Official Statement, subject to earlier prepayment. While they are in an ARS Rate Period, the 2006 Certificates will be issuable in fully registered form without coupons in denominations of $25,000 or any integral multiple thereof. Upon delivery, the 2006 Certificates will be registered in the name of Cede & Co., as nominee of The Depository Trust Company, New York, New York (“DTC”). DTC will act as securities depository for the 2006 Certificates. Ownership interests in the 2006 Certificates may be purchased in book entry form only. See “Book-Entry-Only System.”

Book-Entry-Only System

The 2006 Certificates will be executed and delivered in book-entry form only. Purchasers of the 2006 Certificates will not receive certificates representing their ownership interests in the 2006 Certificates purchased. All payments with respect to the 2006 Certificates are to be made by the Trustee directly to DTC. DTC is expected to credit such payments to the respective accounts of its Direct Participants which, in turn, are expected to make payment thereof to the purchasers of the 2006 Certificates.
As long as Cede & Co. is the registered owner of the 2006 Certificates, references herein to the Owners of the 2006 Certificates shall refer to Cede & Co. and not to the beneficial owners of the 2006 Certificates (the “Beneficial Owners”). Neither the Authority nor the City gives any assurance that DTC, its Participants or others will distribute payments with respect to the 2006 Certificates or notices concerning the 2006 Certificates to the Beneficial Owners thereof or that DTC will otherwise serve and act in the manner described in this Official Statement. See APPENDIX F — “INFORMATION CONCERNING DTC” for a further description of DTC and its book-entry system. The information presented therein is based solely on information provided by DTC.

The Authority may decide to discontinue the use of book-entry transfers through DTC (or a successor Securities Depository). In that event, the 2006 Certificates will be printed and delivered to the Beneficial Owners and will be governed by the provisions of the 2006 Trust Agreement with respect to the payment of principal and interest and rights of exchange and transfer.

Interest Rate Provisions

Initially, the ARS Rate for the 2006 Certificates will be determined in most cases for generally successive 7-day Auction Periods through the implementation of the ARS Provisions summarized in APPENDIX C — “ARS PROVISIONS.” Interest with respect to the 2006 Certificates while they are in an ARS Rate Period will be payable on the date specified for such payment on the inside front cover hereof and on the Business Day immediately following each Auction Period (generally a _ ) unless the Auction Period is a daily Auction Period or a Special Auction Period of longer than 182 days. The Auction Period for the 2006 Certificates may be changed in accordance with the procedures set forth in the ARS Provisions; and, at the election of the Authority, the Interest Period for the 2006 Certificates may be changed to one that is not an ARS Rate Period.

This Official Statement in general describes the 2006 Certificates only while the 2006 Certificates are in an ARS Rate Period. In the event the 2006 Certificates are converted to another Interest Period, the City will deliver a new offering document. Investors should not rely upon the information in this Official Statement in the event the 2006 Certificates are converted to an Interest Period other than an ARS Rate Period.

ARS Provisions

While the 2006 Certificates are in an ARS Rate Period, except as specifically otherwise provided in the 2006 Trust Agreement, the provisions of the 2006 Trust Agreement summarized in APPENDIX B — “DEFINITIONS AND SUMMARY OF PRINCIPAL LEGAL DOCUMENTS” and the ARS Provisions summarized in APPENDIX C — “ARS PROVISIONS” will govern the interest rates per annum and the payment terms of the 2006 Certificates. Banc of America Securities LLC will act as the initial broker-dealer with respect to the 2006 Certificates (in that capacity, the “Broker-Dealer”), and The Bank of New York (the “Auction Agent”) will act as the initial Auction Agent.

ARS Rate

While the 2006 Certificates are in an ARS Rate Period interest with respect to them will be payable at rates established pursuant to the Auction Procedures described in APPENDIX C — “ARS PROVISIONS.” In general, for each Auction Period (i) if Sufficient Clearing Bids exists, the rate
applicable to the 2006 Certificates shall be the Winning Bid Rate, provided that if all of the ARS Certificates are the subject of Submitted Hold Orders, such rate shall be the All Hold Rate and (ii) if Sufficient Clearing Bids do not exist, such rate shall be the Maximum Interest Rate. In no case may the ARS Rate exceed the Maximum Interest Rate.

The Initial Period will commence on the date on which the 2006 Certificates are executed and delivered and will extend to but not include ________, 2006. Thereafter, each Auction Period shall be established pursuant to the ARS Provisions.

The first Interest Payment Date with respect to the 2006 Certificates will be the date specified as such on the inside front cover hereof. Thereafter, “Interest Payment Date” with respect to the 2006 Certificates while they are in an ARS Rate Period means (a) when used with respect to any Auction Period other than a daily Auction Period or a Special Auction Period, the Business Day immediately following such Auction Period, (b) when used with respect to a daily Auction Period, the first Business Day of the month immediately succeeding such Auction Period, (c) when used with respect to a Special Auction Period of (i) 7 or more but fewer than 183 days, the Business Day immediately following such Special Auction Period or (ii) more than 182 days, each April 1 and October 1 and the Business Day immediately following such Special Auction Period.

Interest with respect to the 2006 Certificates accruing at an ARS Rate shall be commuted on the basis of a 360-day year for the actual number of days elapsed if the Auction Period is less than 180 days and on the basis of a 360-day year composed of 12 30-day months if the Auction Period is 180 days or more.

Mandatory Tender for Purchase Upon Conversion

The interest rate applicable to the 2006 Certificates may be converted from the ARS Rate to another rate at the election of the Authority upon the satisfaction of certain conditions as set forth in the 2006 Trust Agreement. In the event of such a conversion, the 2006 Certificates will be subject to mandatory tender for purchase on the first day of a new Interest Period at a Purchase Price equal to the principal amount thereof; and the Trustee is required to give notice of such mandatory tender in the manner set forth in the 2006 Trust Agreement.

Special Considerations for Purchasers of Auction Rate Securities

Prospective purchasers of the 2006 Certificates should note the following:

During an ARS Rate Period, the 2006 Certificates will not be supported by a liquidity facility of any kind, and the Beneficial Owner of a 2006 Certificate may sell, transfer or dispose of a 2006 Certificate only pursuant to a Bid or Sell Order in accordance with the ARS Provisions or through a Broker-Dealer. The ability of a Beneficial Owner to sell his or her Certificate in any Auction is directly contingent upon the Auction Agent’s receipt of sufficient bids to purchase all of the 2006 Certificates at an interest rate not in excess of the Maximum Interest Rate. Thus, if an Existing Owner were to submit a Sell Order or a Bid subject to an interest rate that is determined to be greater than the Maximum Interest Rate and Sufficient Clearing Bids are not obtained on such Auction Date, such Existing Owner may not have its 2006 Certificates purchased through the Auction Procedures on such Auction Date. In such event, no assurance can be given that a broker-dealer will purchase or will otherwise be able to locate a purchaser for such 2006 Certificates or that Sufficient Clearing Bids will be obtained on any succeeding Auction Date. The Broker-Dealer has
advised the City that it intends to make a market in the 2006 Certificates between Auctions. However, the Broker-Dealer is not obligated to make such a market; and no assurance can be given that such a secondary market for the 2006 Certificates will develop. If a Beneficial Owner places a Bid to retain 2006 Certificates at an Auction only at a specified rate and that specified rate exceeds the rate set at the Auction, he or she will not retain his or her 2006 Certificates. Moreover, if a Beneficial Owner submits a Hold Order for 2006 Certificates and the Auction establishes a below-market rate, the Beneficial Owner may receive a below-market rate of return on his or her 2006 Certificates. See APPENDIX C — “ARS PROVISIONS.”

As noted above, if there are more 2006 Certificates offered for sale than there are buyers for those Certificates in any Auction the Auction will fail and the Beneficial Owner of a 2006 Certificate may not be able to sell it at that time. The relative buying and selling interest of market participants in the 2006 Certificates and in the auction rate securities market as a whole vary over time and may be adversely affected by, among other things, news relating to the issuer of such securities, the attractiveness of alternative investments, the perceived risk of owning the security (whether related to credit, liquidity or any other risk), the tax treatment accorded the instruments, the accounting treatment accorded auction rate securities, including recent clarifications of U.S. generally accepted accounting principles relating to the treatment of ARS, reactions to regulatory actions or press reports, financial reporting cycles and market sentiment generally. Shifts of demand in response to any of factors listed above cannot be predicted and may be short-lived or exist for longer periods.

During an Auction Period in which there is no duly appointed Broker-Dealer, it will not be possible to hold Auctions, and the provisions of the 2006 Trust Agreement which are described in the next paragraph will apply. The Broker-Dealer Agreement, dated as of November 1, 2006, among the Auction Agent, the Authority and the Broker-Dealer (the “Broker-Dealer Agreement”) provides that the Auction Agent may terminate the Broker-Dealer Agreement at any time, upon the written direction of the Authority, upon 5 Business Days’ notice to the other parties. The Broker-Dealer Agreement permits the Broker-Dealer to resign at any time upon 30 days' notice to the Authority, the Auction Agent and the Trustee, but it also permits the Broker-Dealer to suspend its duties thereunder on five Business Days’ notice if the Broker-Dealer determines in its reasonable judgment, that it is not advisable to attempt to auction the 2006 Certificates for any of the following reasons: (i) a pending or proposed change in applicable tax laws, (ii) hostilities involving the United States, (iii) a down-rating of the 2006 Certificates, or (iv) an imposition of material restrictions on the 2006 Certificates or similar obligations.

The 2006 Trust Agreement provides that in the event the Auction Agent fails to calculate or, for any reason (including, but not limited to, the lack of a duly appointed Broker-Dealer), fails to provide the Auction Rate for any Auction Period, then (i) if the preceding Auction Period was a period of 35 days or less, the new Auction Period shall be the same as the preceding Auction Period and the ARS Rate for the new Auction Period shall be the same as the ARS Rate for the preceding Auction Period, and (ii) if the preceding Auction Period was a period of greater than 35 days, the preceding Auction Period will be extended to the next seventh day following the day that would have been the last day of such Auction Period had it not been extended (or if such seventh day is not followed by a Business Day, then to the next succeeding day which is followed by a Business Day) and the ARS Rate in effect for the preceding Auction Period will continue in effect for the Auction Period as so extended. Notwithstanding the foregoing, the 2006 Trust Agreement provides that no ARS Rate shall be extended for more than 35 days and, if at the end of 35 days, the Auction Agent fails to calculate or provide the Auction Rate, the ARS Rate shall be the Maximum Interest Rate.
During an Auction Period in which there is no duly appointed Auction Agent, it will not be possible to hold Auctions, and the Auction Rate for the next Auction Period shall be the Maximum Interest Rate and the Auction Period shall be a seven-day Auction Period. Thereafter, succeeding Auction Periods shall be seven-day Auction Periods until subsequently changed in accordance with the ARS Provisions, and the Auction Rate for succeeding Auction Periods shall be determined in accordance with the ARS Provisions. See APPENDIX C — "ARS PROVISIONS.” The Auction Agreement, dated as of November 1, 2006, between the Trustee and the Auction Agent and acknowledged and agreed to by the Authority (the “Auction Agreement”), provides that the Auction Agent may resign from its duties as Auction Agent by giving (i) at least 90 days’ written notice to the Authority and the Trustee, provided that a successor Auction Agent approved by the 2006 Certificate Insurer has been appointed or (ii) at least 45 days’ notice if the Auction Agent has not been paid its fee, even if a successor Auction Agent has not been appointed. In addition, the Auction Agreement provides that the Trustee shall remove the Auction Agent at any time at the written direction of the Authority.

Ratings assigned to the 2006 Certificates do not address the likelihood that any Auction will be successful or that a Beneficial Owner will be able to sell Certificates in any Auction. However, reduction in ratings may affect the ability of any Beneficial Owner of Certificates to sell such Certificates in any Auction.

The Broker-Dealer routinely submits orders for its own account in auctions involving other auction rate securities and may do so in any particular Auction involving the 2006 Certificates. If the Broker-Dealer submits an Order for its own account in any Auction it will have an advantage over other Bidders in that it would have knowledge of other Orders placed through it in that Auction (but it would not have knowledge of Orders placed through other Broker-Dealers, if there were any). As a result of bidding by the Broker-Dealer in an Auction, the ARS Rate is likely to be higher or lower than the rate that would have prevailed had the Broker-Dealer not bid. The Broker-Dealer may bid in an Auction in order to prevent what would otherwise be a failed Auction or the implementation of an ARS Rate that the Broker-Dealer believes, in its sole judgment, does not reflect a market rate for the 2006 Certificates. However, the Broker-Dealer is not obligated to continue to place such Bids or to place such a Bid in connection with any particular Auction. A Bid by the Broker-Dealer is likely to affect the allocation of the 2006 Certificates being auctioned (including displacing other prospective Bidders); and in certain instances, this is likely to prevent the Auction Rate from becoming the Maximum Interest Rate. The Broker-Dealer may also encourage additional or revised investor bidding in order to prevent an “all-hold” Auction or an Auction clearing at a rate which the Broker-Dealer believes, in its sole judgment at the time of making its Bid, to be too low given prevailing market conditions. The Broker-Dealer may, but is not obligated to, advise Beneficial Owners of the 2006 Certificates that the rate which will apply in an “all-hold” Auction is often a lower rate then would apply if such Beneficial Owners submit Bids; and such advice, if given, may facilitate the submission of Bids by Beneficial Owners that would avoid the occurrence of an “all-hold” Auction. The Broker-Dealer may, but is not obligated to, encourage additional or revised investor bidding in order to prevent an “all-hold” Auction.

In May 2006 the Securities and Exchange Commission (the "SEC") announced the institution of proceedings (Administrative Proceeding 33-8684) against 15 broker-dealers (including the Broker-Dealer) for engaging in one or more practices in the auction rate securities market between January 2003 and June 2004 that were not adequately disclosed to investors, which constituted violations of the securities laws. Information concerning the proceedings and the alleged violative conduct is set forth in the SEC’s Press Release No. 2006-83. While neither admitting nor denying
the findings in the SEC's order, the Broker-Dealer, along with the other firms named in the order, consented to the entry of the order which censured each firm and required each firm to (i) cease and desist from committing or causing any violations and future violations of Sections 17(a)(2) of the Securities Act; (ii) pay a penalty; (iii) provide certain disclosure of its material and current auction practices and procedures; and (iv) have its chief executive officer or general counsel certify, not later than six months after the date of the order, that it has implemented procedures that are reasonably designed to prevent and detect failures to conduct the auction process in accordance with the auction procedures disclosed in the disclosure documents and other supplemental disclosures and that the firm is in compliance with the order. The Broker-Dealer's penalty of $750,000 (rather than the $1,500,000 penalty assessed to other firms with relatively larger shares of the auction rate securities market) was; according to the SEC, based on the quality of the Broker-Dealer's self-monitoring capabilities in the auction rate securities area which it had demonstrated to the SEC. No assurances are given as to how the settlement might affect the market for auction rate securities in general or for the 2006 Certificates in particular.

Prepayment

**Optional Prepayment.** During an ARS Rate Period, each 2006 Certificate may be prepaid at the option of the Authority at a prepayment price equal to 100% of the principal amount thereof, without premium, on any Interest Payment Date immediately following the end of an Auction Period, provided that, in the event of a partial optional prepayment, the aggregate principal amount of the affected 2006 Certificates that will remain Outstanding after any such optional prepayment shall not be less than $10,000,000 unless otherwise consented to by the Broker-Dealer.

**Mandatory Sinking Fund Prepayment.** The 2006 Certificates are subject to mandatory prepayment from Sinking Fund Payments prior to the Maturity Date, in part by lot, on October 1 of each year on and after October 1, 2008, in accordance with the schedule set forth below upon notice hereinafter described, from and in the amount of the principal installment of the 2006 Payments due and payable on such dates, at a prepayment price equal to the sum of the principal amount evidenced and represented thereby plus accrued and unpaid interest evidenced and represented thereby to the Prepayment Date, without a prepayment premium; provided that, during an ARS Rate Period, if such October 1 is not an Interest Payment Date, the Prepayment Date relating to such mandatory sinking fund payment shall occur on the ARS Interest Payment Date immediately preceding such October 1. In addition, if any 2006 Certificates have been optionally prepaid, the amounts of such Sinking Fund Payments shall be reduced as directed by the Authority, or if not so directed, proportionality in increments of Authorized Denominations, by the principal amount evidenced and represented by all such 2006 Certificates so optionally prepaid.
<table>
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<tr>
<th>Mandatory Sinking Fund Payment Date (October 1)</th>
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<td>2022</td>
<td>400,000</td>
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**Notice of Prepayment.** When the prepayment of 2006 Certificates is authorized as described above, the Trustee is required to give notice thereof. Such notice must state the date of such notice, the prepayment price, the place of prepayment (including the name and appropriate address of the Trustee), the CUSIP number (if any) of the 2006 Certificates to be prepaid, and, if less than all of the 2006 Certificates are to be prepaid, the distinctive certificate numbers thereof to be prepaid and, in the case of 2006 Certificates to be prepaid in part only, the respective portions of the principal amount evidenced and represented thereby to be prepaid. Each such notice shall also state that on said date there will become due and payable on each of said 2006 Certificates the prepayment price thereof and, in the case of a 2006 Certificate to be prepaid in part only, the specified portion of the principal amount evidenced and represented thereby to be prepaid, together with accrued and unpaid interest evidenced and represented thereby to the prepayment date, and that from and after such prepayment date interest evidenced and represented thereby shall cease to accrue; and such notice shall require that said 2006 Certificates be then surrendered at the address of the Trustee specified in the prepayment notice.

Such notice must be mailed by the Trustee, at least 30 but not more 60 days before the date fixed for prepayment to the respective Owners of the 2006 Certificates designated for prepayment at their addresses appearing on the registration books of the Trustee. Such notice is also required to be provided to Securities Depositories and Information Services. Failure to receive such notice shall not invalidate any of the proceedings taken in connection with such prepayment.

Any prepayment may be cancelled if the notice of such prepayment has not been mailed to the respective Owners of the 2006 Certificates or if such notice expressly conditioned the prepayment upon the occurrence of one or more events. Notice of any such cancellation shall be given in the same manner as the notice of prepayment was given at least 3 Business Days prior to the date scheduled for prepayment.

**Effect of Prepayment.** If notice of prepayment has been duly given as described above and money for the payment of the prepayment price of the 2006 Certificates called for prepayment
together with any accrued interest to the date fixed for prepayment is held by the Trustee, then on the prepayment date designated in such notice, the 2006 Certificates so called for prepayment will become due and payable on the date fixed for prepayment at the prepayment price specified in such notice; and from and after the date so designated, interest evidenced and represented by such 2006 Certificates so called for prepayment shall cease to accrue, such 2006 Certificates shall cease to be entitled to any lien, benefit or security under the 2006 Trust Agreement, and the Owners of such 2006 Certificates shall have no rights in respect thereof except to receive payment of the prepayment price thereof.

Purchase in Lieu of Prepayment

Subject to the provisions of the 2006 Trust Agreement, the Authority has the option to purchase any 2006 Certificate on any date on which it would be subject to optional prepayment at a purchase price equal to the then applicable prepayment price plus accrued interest thereon to the date of purchase.

Parity Obligations

The City has previously incurred obligations payable from Gross Revenues of its Water Utility System on a parity with the 2006 Payments; and, under the terms of the Master Contract, the City may incur additional such obligations in the future. In addition to the 1997 Payments and its obligation to make the scheduled payments required pursuant to the Swap Agreement, its obligation to make termination payments under the Swap Agreement (but only if such payments are insured under the Swap Policy) and its obligations under the Insurance and Reimbursement Agreement, the City currently has outstanding unpaid Parity Obligations with MID and the State of California Department of Water Resources ("CDWR"). See "SECURITY FOR THE 2006 CERTIFICATES — Existing and Future Parity Obligations."

SECURITY FOR THE 2006 CERTIFICATES

General

Each 2006 Certificate represents a proportionate, undivided interest in the 2006 Payments to be made by the City under the 2006 Contract. Pursuant to the 2006 Trust Agreement, the Authority has assigned substantially all of its right, title and interest in the 2006 Contract to the Trustee for the benefit of the Owners of the 2006 Certificates. The rights so assigned include the Authority's right to receive the 2006 Payments and its right to exercise any remedies provided in the 2006 Contract in the event of a default by the City thereunder.

Pursuant to the 2006 Contract, the City will purchase the 2006 Project from the Authority at the purchase price specified in the 2006 Contract, which is equal to the aggregate principal amount evidenced by the 2006 Certificates. The City is obligated to make such purchase by paying the 2006 Payments specified in the 2006 Contract including the interest on such payments.

2006 Payments

Pursuant to the 2006 Trust Agreement, the Authority transfers, assigns and sets over to the Trustee all of the 2006 Payments and any and all rights and privileges it has under the 2006 Contract.
with respect to the 2006 Certificates, including, without limitation, the right to collect and receive
directly all of the 2006 Payments and the right to hold and enforce any security interest.

The 2006 Payments under the 2006 Contract represent the purchase price of the 2006 Project,
which the City is transferring to the Authority and the Authority in turn is selling to the City pursuant
to the 2006 Contract for the purpose of financing the 2006 Project. The obligation of the City to pay
the 2006 Payments from Gross Revenues is absolute and unconditional; and, until such time as the
2006 Payments shall have been paid in full (or provision for the payment thereof shall have been
made pursuant to the Master Contract), the City will not discontinue or suspend any 2006 Payments
required to be paid by it under the 2006 Contract when due, whether or not the Water Utility System
or any part thereof (including the 2006 Project) is operating or operable, or its use is suspended,
interfered with, reduced, curtailed or terminated in whole or in part; and such payments are not
subject to reduction whether by offset, abatement or otherwise and are not conditional upon the
performance or nonperformance by any party to any agreement for any cause whatsoever.
Notwithstanding anything contained in the Contract, however, the City is not required to advance any
moneys derived from any source of income other than the Gross Revenues for the payment of the
2006 Payments or for the performance of any agreements or covenants required to be performed by it
contained in the Contract.

As more fully described below, under the Contract, Gross Revenues of the Water Utility
System are pledged as security for the payment of the 1997 Payments, the 2006 Payments, any other
Parity Obligations and the Maintenance and Operation Costs, as defined below.

"Water Utility System" is defined under the Master Contract to mean (i) all property rights,
contractual rights and facilities of the City relating to water, including all facilities, properties,
establishments or works for the treatment, conservation, storage, transmission and distribution of water
now owned by the City and (ii) all additions, betterments, extensions or improvements to such
facilities, properties, structures or works or any part thereof hereafter acquired and constructed.

"Gross Revenues" is defined under the Master Contract to mean all gross income and
revenue received or receivable by the City from the ownership or operation of the Water Utility
System, determined in accordance with Generally Accepted Accounting Principles, including all
rates, fees and charges (including all Connection Fees, contributions in aid of construction, and
charges and standby water availability charges legally available for debt service) received by the City
for the Water Service and the other services and facilities of the Water Utility System and all net
proceeds of insurance covering business interruption loss relating to the Water Utility System and all
other income and revenue howsoever derived by the City from the ownership or operation of the
Water Utility System or arising from the Water Utility System, and including all Payment Agreement
Receipts, and including all income from the deposit or investment of any money in the Revenue Fund
or, to the extent deposited in the Revenue Fund, in the Parity Reserve Fund, but excluding in all cases
any proceeds of taxes and any refundable deposits made to establish credit and advances.

"Maintenance and Operation Costs" is defined under the Master Contract to mean the costs
paid or incurred by the City for maintaining and operating the Water Utility System, determined in
accordance with Generally Accepted Accounting Principles, including, but not limited to, (a) all
reasonable expenses of management and repair and other expenses necessary to maintain and
preserve the Water Utility System in good repair and working order, (b) all costs of water purchased
by the City including all costs under the Treatment and Delivery Agreement by and among the City,
the Del Este Water Company and MID (which has since been amended and restated) which do not
constitute debt service thereunder, (c) all administrative costs of the City that are charged directly or apportioned to the operation of the Water Utility System, such as salaries and wages of employees, overhead, taxes (if any) and insurance premiums, payments into pension funds, and (d) all other reasonable and necessary costs of the City or charges required to be paid by it to comply with the terms of the Master Contract or of any resolution authorizing the execution of any Parity Obligation or of such Parity Obligation, such as compensation, reimbursement and indemnification of the trustee or remarketing agent for any such Parity Obligation, letter of credit fees for any such Parity Obligations, and fees and expenses of Independent Certified Public Accountants and Independent Consultants, but excluding in all cases (1) depreciation, replacement and obsolescence charges or reserves therefor and amortization of intangibles, premiums and discounts, (2) interest expense, (3) amounts paid from funds of the City other than Gross Revenues, and (4) in-lieu transfers or recoupment of contributed capital to the City’s general fund.

Pledge of Gross Revenues

Pursuant to the Contract, all Gross Revenues of the Water Utility System are irrevocably pledged to the payment of the 1997 Payments, the 2006 Payments, any other Parity Obligations and the Maintenance and Operation Costs; and the Gross Revenues of the Water Utility System may not be used for any other purpose while any of the 1997 Payments or the 2006 Payments remain unpaid; provided, however, that out of Gross Revenues there may be apportioned such sums for such purposes as are expressly permitted by the Contract. Such pledge constitutes a first pledge of and charge and lien upon the Gross Revenues of the Water Utility System for the payment of the amounts due with respect to the Contract, other Parity Obligations and the Maintenance and Operation Costs in accordance with the terms of the Contract.

Rate Covenant

Pursuant to the Master Contract, the City covenants that it will at all times fix, prescribe and collect rates, fees and charges for the Water Service during each Fiscal Year which are reasonably fair and nondiscriminatory and which will be at least sufficient to yield Adjusted Annual Net Revenues for such Fiscal Year equal to at least 125% of Annual Debt Service to be paid during such Fiscal Year (the “Rate Covenant”).

“Adjusted Annual Net Revenues” is defined under the Master Contract to mean, for any Fiscal Year or any designated 12-month period in question, the Adjusted Annual Gross Revenues during such Fiscal Year or 12-month period less the Maintenance and Operation Costs during such Fiscal Year or 12-month period.

“Adjusted Annual Gross Revenues” is defined under the Master Contract to mean, for any Fiscal Year or any designated 12-month period in question, the Gross Revenues during such Fiscal Year or 12-month period, plus deposits to the City of Modesto Water Utility System Revenue Fund (the “Revenue Fund”) from amounts on deposit in the Rate Stabilization Fund, but only as and to the extent specified in the Master Contract, minus (y) amounts transferred from the Revenue Fund to the Rate Stabilization Fund in accordance with the Master Contract and, (z) for purposes of determining compliance with the rate covenant described above only, earnings from the investments in the Parity Reserve Fund that are deposited in the Revenue Fund in such Fiscal Year or 12-month period.

“Adjusted Annual Debt Service” is defined under the Master Contract to mean, for any Fiscal Year or any designated 12-month period in question, the Annual Debt Service for such Fiscal Year or
12-month period minus the sum of (i) for purposes of the rate covenant described above only, the earnings from the investments in the Parity Reserve Fund that are deposited in the Revenue Fund in such Fiscal Year or 12-month period, and (ii) the amount of the Annual Debt Service paid from the proceeds of Parity Obligations or interest earned thereon (other from the Parity Reserve Fund), all as set forth in a Certificate of the City.

"Annual Debt Service" is generally defined under the Master Contract to mean, for any Fiscal Year or any designated 12-month period in question, the payments required to be made with respect to all Outstanding Parity Obligations in such Fiscal Year or 12-month period; provided, that for purposes of determining compliance with the rate covenant described above, the Reserve Fund Requirement and conditions for the execution of Parity Obligations, certain additional provisions are applicable as described in APPENDIX B — "DEFINITIONS AND SUMMARY OF PRINCIPAL LEGAL DOCUMENTS."

The City’s ability to comply with the Rate Covenant may be limited by provisions of the California Constitution. See “THE WATER UTILITY SYSTEM — Impact of Proposition 218 on Water Utility System Fees and Charges.” The opinion of Sidley Austin LLP, Special Counsel, with respect to the 2006 Certificates will state that the enforceability of the Contract is subject to the limitations on the imposition by the City of certain fees and charges relating to the Water Utility System under Articles XIIIC and XIIID of the California Constitution. See APPENDIX D — “PROPOSED FORM OF OPINION OF SPECIAL COUNSEL.” The City’s ability to comply with the Rate Covenant may also be adversely affected by other factors. See “RISK FACTORS.”

Parity Reserve Fund

The Parity Reserve Fund was initially established pursuant to a trust agreement, dated as of November 1, 1997 (the “1997 Trust Agreement”), which provided for the execution and delivery of the City’s Refunding Revenue Certificates of Participation (1997 Water Utility System Refinancing Project) (the “1997 Certificates”). The 1997 Certificates represent the proportionate, undivided interests in the 1997 Payments pursuant to the 1997 Contract. All amounts on deposit in the Parity Reserve Fund are available to be transferred to pay principal and interest evidenced and represented by both the 1997 Certificates and the 2006 Certificates and any other obligations in connection with a future supplement to the Contract (collectively, the “Parity Certificates”) as described in greater detail below.

In connection with the execution and delivery of the 1997 Certificates, the City caused to be delivered to the then Trustee to be held in the Parity Reserve Fund in satisfaction of the Reserve Fund Requirement a municipal bond debt service reserve fund policy (the “1997 Certificate Reserve Policy”) issued by Financial Guaranty Insurance Company, doing business in California as FGIC Insurance Company (“FGIC”). The 1997 Certificate Reserve Policy unconditionally guarantees the payment of that portion of the principal and interest represented by the Parity Certificates which has become due for payment, but which is unpaid by reason of nonpayment by the City, provided that the aggregate amount paid under the 1997 Certificate Reserve Policy may not exceed the maximum amount then available thereunder (currently, $1,935,855). FGIC is required to make such payments to the Trustee on the later of the date on which such principal and interest is due or on the business day next following the day on which FGIC shall have received telephonic or telegraphic notice, subsequently confirmed in writing, or written notice by registered or certified mail from the Trustee of the nonpayment of such amount by the City. The term “nonpayment” in this context includes any payment of principal or interest made to an owner of a Parity Certificate which has been recovered.
from such owner pursuant to the United States Bankruptcy Code by a trustee in bankruptcy in accordance with a final nonappealable order of a court having competent jurisdiction. The 1997 Certificate Reserve Policy is non-cancellable and covers failure to pay principal represented by the Parity Certificates on their respective stated payment dates or dates on which the same shall have been called for mandatory sinking fund prepayment, and not on any other date on which Parity Certificates may have been accelerated, and also covers the failure to pay an installment of interest on the stated date for its payment. Additional information with respect to the 1997 Certificate Reserve Policy is available in the Official Statement relating to the 1997 Certificates (the "1997 Official Statement").

FGIC, a New York stock insurance corporation, is a direct, wholly owned subsidiary of FGIC Corporation, a Delaware corporation. Information with respect to FGIC is available from the company at 125 Park Avenue, New York, New York 10017, Attention: Corporate Communications Department. FGIC's telephone number is (212) 312-3000.

Pursuant to the 2006 Trust Agreement, the Trustee will maintain the Parity Reserve Fund so long as the Contract has not been discharged or any 2006 Certificates remain Outstanding. A portion of the proceeds of the 2006 Certificates in an amount sufficient to cause the balance on deposit in the Parity Reserve Fund to equal the Reserve Fund Requirement will be deposited in the Parity Reserve Fund.

"Reserve Fund Requirement" is defined under the Master Contract to mean, as of any date of determination and excluding any Parity Obligations which are not Supplemental Contracts and the debt service thereon, the least of (a) 10% of the initial offering price to the public of the Parity Obligations as determined under the Code, or (b) the Maximum Annual Debt Service, or (c) 125% of the Average Annual Debt Service, all as computed and determined by the City and specified in writing to the Trustee; provided, that such requirement (or any portion thereof) may be provided by one or more policies of municipal bond insurance or surety bonds issued by a municipal bond insurer or by a letter of credit issued by a bank or other institution if the obligations insured by such insurer or issued by such bank or other institution, as the case may be, have ratings at the time of issuance of such policy or surety bond or letter of credit equal to "Aa" or higher assigned by Moody's (if Moody's is then rating any of the Parity Obligations) and "AA" or higher assigned by S&P (if S&P is then rating any of the Parity Obligations) and that maintain at all times ratings at least equal to the lowest ratings (without giving effect to municipal bond insurance or other credit enhancement) on any of the Parity Obligations provided by Moody's (if Moody's is then rating any of the Parity Obligations) and by S&P (if S&P is then rating any of the Parity Obligations) (all such instruments collectively, "Reserve Funding Instruments"). If at any time, obligations insured by any such municipal bond insurer issuing a policy of municipal bond insurance or surety bond or a bank or other institution issuing a letter of credit as permitted by the definition of Reserve Fund Requirement shall no longer maintain such ratings as required in accordance with the immediately preceding sentence, the City shall provide or cause to be provided cash or a substitute municipal bond insurance policy or surety bond or a letter of credit meeting such requirements.

Pursuant to the 2006 Trust Agreement, the Trustee is to (i) withdraw and use all cash, if any, on deposit in the Parity Reserve Fund prior to using and withdrawing any amounts derived from payments under any Reserve Funding Instruments and (ii) draw on all Reserve Funding Instruments on a pro rata basis, based on the draw limit of each Reserve Funding Instrument. Amounts received by the Trustee from the City pursuant to the Master Contract as a replenishment of amounts
withdrawn from the Parity Reserve Fund shall be applied first on a pro rata basis to reimburse draws on Reserve Funding Instruments and then to replenish cash withdrawn from the Parity Reserve Fund.

The 1997 Certificate Reserve Policy is scheduled to terminate on October 1, 2022, which is the final payment date with respect to the 1997 Certificates. Subsequent to October 1, 2022, the Annual Debt Service with respect to the 2006 Certificates is scheduled to increase substantially. As a result thereof, in the absence of additional deposits to the Parity Reserve Fund the balance then on deposit in the Parity Reserve Fund will be less than the Reserve Fund Requirement; and the Authority will be required to immediately deposit or cause to be deposited with the Trustee for deposit in the Parity Reserve Fund cash or one or more Reserve Funding Instruments in an aggregate amount equal to the amount necessary to restore the Parity Reserve Fund to an amount equal to the Reserve Fund Requirement.

Moneys on deposit in the Parity Reserve Fund will be transferred by the Trustee to the debt service fund established pursuant to the 1997 Trust Agreement and/or to the 2006 Debt Service Fund established pursuant to the 2006 Trust Agreement to pay principal and interest evidenced and represented by the 1997 Certificates and by the 2006 Certificates, respectively, on any date on which interest is payable with respect thereto in the event amounts on deposit in the applicable debt service fund are insufficient for such purposes. The Trustee will also, from such amounts on deposit in the Parity Reserve Fund, transfer or cause to be transferred to any applicable debt service fund established under any other trust agreement under which any obligations are issued in connection with a Supplemental Contract, without preference or priority between transfers made pursuant to this sentence and the preceding sentence, and in the event of any insufficiency of such moneys ratably without discrimination or preference, that sum or sums, if any, equal to the amount required to be deposited therein pursuant to such trust agreement under which any obligations are issued in connection with a Supplemental Contract. Following the valuation of investments in the Parity Reserve Fund on or before each October 1, all moneys on deposit in the Parity Reserve Fund in excess of the Reserve Fund Requirement will be transferred by the Trustee to the City for deposit in the Revenue Fund. However, prior to the completion of the 2006 Project (which completion shall be evidenced by delivery to the Trustee of a Certificate of the City to such effect), investment earnings on amounts deposited to the Parity Reserve Fund from proceeds of the 2006 Certificates are required to be transferred to the City for deposit in the 2006 Project Account of the Improvement Fund established pursuant to the 2006 Contract.

Flow of Funds

Contract Provisions. The City agrees and covenants in the Contract that all Gross Revenues it receives will be deposited when and as received in the Revenue Fund, which the City established under the Master Contract and which the City agrees and covenants to maintain separate and apart from other moneys of the City so long as any Parity Obligations remain unpaid, and all money on deposit in the Revenue Fund is to be applied and used as follows. The City will pay at the following times in the following order of priority:

1. Payment of Maintenance and Operation Costs and Parity Obligation Payment Fund Deposits. The City will, from the money in the Revenue Fund, without preference or priority, and in the event of any insufficiency of such moneys, ratably, without preference or priority (i) pay charges for Maintenance and Operation Costs of the Water Utility System (including amounts reasonably required to be set aside in contingency reserves for Maintenance and Operation Costs the payment of which is not then immediately required).
as such charges are due and payable, and (ii) deposit in the City of Modesto Water Utility System Parity Obligation Payment Fund established under the Master Contract, on the last Business Day of each month (1) an amount equal to the interest which has accrued or will accrue under all Parity Obligations during the next succeeding month calculated as if such interest has accrued or will accrue on a daily basis during such period, and (2) an amount equal to the principal which has accrued or will accrue (as a result of maturity, mandatory sinking fund payments or mandatory prepayment or otherwise) under all Parity Obligations during the next succeeding month calculated as if such principal has accrued or will accrue on a daily basis during such period, plus (3) the net payments due or which will be due on all Parity Payment Agreements calculated as if such net payments accrued or will accrue on a daily basis during such period, except that no such deposit need be made if the City then holds money in the Parity Obligation Payment Fund at least equal to the amount of interest and principal due or becoming due and payable under all Parity Obligations on the next succeeding date on which interest or principal becomes due and payable under any Parity Obligation plus the net payments due on all Parity Payment Agreements on such next succeeding due date therefor. Moneys on deposit in the Parity Obligation Payment Fund will be transferred by the City to make and satisfy the payments due on the next applicable date on which interest or principal becomes due and payable under any Parity Obligation or any net payment becomes due and payable by the City under any Parity Payment Agreement at least one Business Day prior to such next applicable due date.

(2) Parity Reserve Fund Deposits. On or before the last Business Day of each month, the City will, from the remaining money on deposit in the Revenue Fund after deposits and transfers pursuant to paragraph (1) above, transfer to the Trustee for deposit in the Parity Reserve Fund that sum, if any, necessary to restore the Parity Reserve Fund to an amount equal to the Reserve Fund Requirement. The City will also, from such remaining moneys in the Revenue Fund, transfer or cause to be transferred to the applicable reserve fund or account for any Parity Obligations for which a separate reserve has been funded, without preference or priority between transfers made in accordance with this sentence and the preceding sentence, and in the event of any insufficiency of such moneys ratably without any discrimination or preference, the sum or sums, if any, equal to the amount required to be deposited therein pursuant to such Parity Obligations.

After making the foregoing deposits and transfers, the City may apply any remaining money in the Revenue Fund for any lawful purpose of the City, including for the payment of any Subordinate Obligations in accordance with the instruments authorizing such Subordinate Obligations.

Pursuant to the Master Contract, the City has established the Rate Stabilization Fund, which has a balance of $3,000,000 on deposit therein. The City may deposit in the Rate Stabilization Fund any Gross Revenues, after providing for the payment of Parity Obligations and Maintenance and Operation Costs, and any other money received and available to be used therefor, provided that deposits from such Gross Revenues for each Fiscal Year may be made until (but not after) 180 days after the end of such Fiscal Year. The City may withdraw amounts from the Rate Stabilization Fund only for inclusion in Adjusted Annual Net Revenues, such withdrawal to be made until (but not after) 180 days after the end of such Fiscal Year. All interest or other earnings upon deposits in the Rate Stabilization Fund will be accounted for as Gross Revenues. Notwithstanding the foregoing, no Gross Revenues will be deposited in the Rate Stabilization Fund to the extent that such amount was included by the City in Adjusted Annual Net Revenues for purposes of determining compliance with the rate covenant set forth in the Master Contract or the conditions for the execution of Parity
Obligations contained in the Master Contract and deduction of the amounts to be deposited in the Rate Stabilization Fund would have caused noncompliance with such rate covenant or conditions.

The City's ability to set rates, fees and charges for the Water Service at levels which would permit the City to make deposits into the Rate Stabilization Fund may be limited by amendments to the California Constitution. See “THE WATER UTILITY SYSTEM — Impact of Proposition 218 on Water Utility System Fees and Charges.” See also “THE WATER UTILITY SYSTEM — Summary of Projected Operating Results” for currently anticipated deposits into and withdrawals from the Rate Stabilization Fund.

The 2006 Contract establishes within the Parity Obligation Payment Fund the 2006 Supplemental Contract Payment Account. On or before the third Business Day immediately preceding each 2006 Payment Date or the date on which any net payment or insured termination payment is due under the Swap Agreement, the City shall, from the money in the Parity Obligation Payment Fund, deposit in the 2006 Supplemental Contract Payment Account (i) a sum equal to the amount of the interest and principal components of the 2006 Payments becoming due and payable under the 2006 Supplemental Contract on the next succeeding 2006 Payment Date and (ii) the net payments and any insured termination payment, if applicable, due under the Swap Agreement, except that no such deposit need be made if the amount then on deposit in the 2006 Supplemental Contract Payment Account is at least equal to the amount of the interest and principal components of the 2006 Payments becoming due and payable under the 2006 Contract on the next succeeding 2006 Payment Date plus the net payments and any insured termination payment due under the Swap Agreement on such next succeeding due date therefor. Moneys on deposit in the 2006 Supplemental Contract Payment Account shall (i) be transferred by the City to the Trustee on the Business Day immediately preceding each 2006 Payment Date to make and satisfy the 2006 Payment due on such 2006 Payment Date and (ii) be transferred by the City on the due date therefor to satisfy the net payment and any insured termination payment due under the Swap Agreement, all in accordance with the Master Contract.

2006 Trust Agreement Provisions. Pursuant to the 2006 Trust Agreement, the Trustee is required to deposit the 2006 Payments in a separate fund established by it and designated as the 2006 Debt Service Fund. The 2006 Debt Service Fund will contain two accounts: the 2006 Interest Account (with a 2006 Capitalized Interest and Fees Subaccount therein) and the 2006 Principal Account (with a 2006 Prepayment Subaccount and a 2006 Sinking Fund Subaccount therein).

On the Business Day immediately preceding each Interest Payment Date, the Trustee is required to set aside from the 2006 Debt Service Fund and deposit in the 2006 Interest Account an amount equal to the amount of interest evidenced and represented by the 2006 Certificates becoming due and payable on such Interest Payment Date, except that the Trustee is required to make such transfer from the 2006 Capitalized Interest and Fees Subaccount to the 2006 Interest Account until the 2006 Capitalized Interest and Fees Subaccount is depleted. The Trustee is also required to apply amounts on deposit in the 2006 Capitalized Interest and Fees Subaccount to pay Auction Agent and Broker-Dealer fees as the same shall become due on each due date therefor through October 1, 2007. No deposit is required to be made in the 2006 Interest Account if the amount contained therein is at least equal to the aggregate amount of interest evidenced and represented by the 2006 Certificates becoming due and payable on the applicable Interest Payment Date. All money in the 2006 Interest Account is required to be used and withdrawn by the Trustee solely for the purpose of paying the interest as it shall become due and payable (including accrued interest evidenced and represented by any 2006 Certificates purchased or prepaid prior to their respective Certificate Payment Date).
On the Business Day immediately preceding each October 1, commencing on October 1, 2008, the Trustee is required to set aside from the 2006 Debt Service Fund and deposit in the 2006 Principal Subaccount (i) an amount equal to the principal amount evidenced and represented by the Outstanding Serial Certificates with a Certificate Payment Date of such October 1 (at the time of the execution and delivery of the 2006 Certificates, none of the 2006 Certificates will be Serial Certificates) and (ii) in the 2006 Sinking Fund Subaccount the amount of all Sinking Fund Payments required to be made on such October 1. Amounts to be applied to the optional prepayment of the principal component of the 2006 Certificates are to be deposited in the 2006 Prepayment Subaccount. No deposit need be made in the 2006 Principal Account if the amount contained therein is at least equal to the aggregate amount of the principal evidenced and represented by the Outstanding Serial Certificates with a Certificate Payment Date of such October 1 and the amount contained in the 2006 Sinking Fund Subaccount is at least equal to the aggregate amount of all Sinking Fund Payments required to be made on such October 1.

All money in the 2006 Principal Account is required to be used and withdrawn by the Trustee solely for the purpose of paying the principal evidenced and represented by the Serial Certificates as they shall become due and payable, whether at their respective Certificate Payment Dates or on prior prepayment, and all money in the 2006 Sinking Fund Subaccount is required to be used and withdrawn by the Trustee only to purchase or to prepay or pay Term Certificates, and with respect to the 2006 Sinking Fund Subaccount, on each Sinking Fund Payment Date, the Trustee is required to apply the Sinking Fund Payment required on that date to the prepayment (or payment at the Certificate Payment Date, as the case may be) of the Term Certificates upon the notice and in the manner provided in the 2006 Trust Agreement, provided that at any time prior to giving notice of such prepayment, the Trustee may, upon the Written Request of the Authority and receipt of sufficient moneys therefor, purchase for cancellation Term Certificates in accordance with the 2006 Trust Agreement.

**Existing and Future Parity Obligations**

Upon the execution and delivery of the 2006 Certificates, the obligation of the City to pay the 2006 Payments will be secured on a parity lien basis with certain existing Parity Obligations. In the Master Contract (as clarified in the 2006 Contract), “Parity Obligations” is specifically defined as the payment obligations under the Treatment and Delivery Agreement which constitute debt service, the payment obligations under the CDWR Loan Agreement, and all Supplemental Contracts and all other obligations hereafter incurred by the City the payment of which constitutes a charge and lien on the Gross Revenues equal to and on a parity with the charge and lien upon the Gross Revenues for the payment of the Payments, other than (i) such portion of the payment obligations (including certain payments due upon an early termination thereof) under any Parity Payment Agreement to the extent such obligations are expressly subordinate to Parity Obligations pursuant to the terms of such Parity Payment Agreement and (ii) Parity Bank Agreements; provided that no amounts have been drawn under any such Parity Bank Agreements which have not been reimbursed by the City. Under the Master Contract “CDWR Loan” means the loan to the City from the State of California Department of Water Resources in the principal amount of $3,607,343.72 (of which $2,058,028.02 was outstanding as of October 1, 2006); and “Treatment and Delivery Agreement” means the Treatment and Delivery Agreement by and among the City of Modesto, the Del Este Water Company and MID. The Treatment and Delivery Agreement has since been amended and restated and is now called “Amended and Restated Treatment and Delivery Agreement Between Modesto Irrigation District and City of Modesto.” Under the Treatment and Delivery Agreement, the City has agreed to pay all debt service on bonds issued by MID for the construction of the Water Treatment Plant, a raw water...
charge, project operation, administrative services and maintenance costs, insurance on the plant and the cost of electrical energy provided to the plant. The outstanding principal amount of bonds issued for the Water Treatment Plant as of September 1, 2006 was $73,780,000, and MID is expected to issue, or to cause to be issued, bonds yielding net proceeds of approximately $53,000,000 to $60,000,000 in the spring of 2007 in order to provide financing for the expansion of the Water Treatment Plan. See “THE WATER UTILITY SYSTEM — Treatment and Delivery Agreement” for a description of the Treatment and Delivery Agreement and “THE WATER UTILITY SYSTEM — Summary of Projected Operating Results” for additional information concerning existing Parity Obligations. See also APPENDIX B — “DEFINITIONS AND SUMMARY OF PRINCIPAL DOCUMENTS.” In addition to the Parity Obligations specifically defined as such in the Master Contract, the Swap Agreement (to the extent described above), the 1997 Contract and the Insurance and Reimbursement Agreement also constitute Parity Obligations. The principal amount of the 1997 Payments currently outstanding is $19,670,000.

In addition to the existing Parity Obligations, the City may at any time execute additional Parity Obligations, but subject to the specific conditions set forth in the Master Contract, including the conditions that there be on file with the Trustee either:

(1) A Certificate of the City demonstrating that during any 12 consecutive calendar months out of the immediately preceding 18 calendar month period, the Adjusted Annual Net Revenues were at least equal to 125% of the Maximum Annual Debt Service for all existing Parity Obligations plus the Parity Obligations proposed to be executed; provided, that for the purpose of providing this Certificate, the City may adjust the foregoing Adjusted Annual Net Revenues to reflect:

(i) An allowance for Gross Revenues that would have been derived from each new connection to the Water Utility System that was made prior to the execution of such Parity Obligations but which, during all or any part of said 12 month period, was not in existence, in an amount equal to the estimated additional Gross Revenues that would have been derived from each such connection if it had been made prior to the beginning of said 12 month period, and

(ii) An allowance for Gross Revenues that would have been derived from any increase in the rates, fees and charges fixed and prescribed for Water Service which became effective prior to the execution of such Parity Obligations but which, during all or any part of said 12 month period, was not in effect, in an amount equal to the estimated additional Gross Revenues that would have been derived from such increase in rates, fees and charges if it had been in effect prior to the beginning of said 12 month period; or

(2) A Consultant’s Report showing that the Adjusted Annual Net Revenues for the Fiscal Year next following the end of the period during which interest on the Parity Obligations proposed to be executed is to be capitalized or, if no interest is capitalized, the Fiscal Year in which the Parity Obligations proposed to be executed are executed, will be at least equal to 125% of the Maximum Annual Debt Service; provided, that for the purpose of providing the Consultant’s Report, the Independent Consultant may adjust the foregoing Adjusted Annual Net Revenues to reflect:
(i) An allowance for Gross Revenues that would have been derived from any increase in the rates, fees and charges prescribed for Water Service in effect and being charged, or rates, fees and charges for Water Service that are expected to be charged in accordance with a program of specific rates, fees, charges, rate levels or increases in overall Gross Revenue approved by a resolution of the City Council; and

(ii) An allowance for Gross Revenues from customers of the Water Utility System anticipated to be served by the facilities or improvements financed in substantial part by the Parity Obligations proposed to be executed together with any additional Parity Obligations expected to be executed prior to the Fiscal Year of determination.

Notwithstanding the foregoing, the Master Contract specifies that there shall be no limitations on the ability of the City to execute any Parity Obligation at any time to refund any outstanding Parity Obligation.

CERTIFICATE INSURANCE

The following information has been provided by MBIA Insurance Corporation. It has not been verified by the Authority or the City, and neither the Authority nor the City guarantees its accuracy or completeness.

Certificate Insurance Policy

The following information has been furnished by MBIA Insurance Corporation ("MBIA") for use in this Official Statement. Reference is made to Appendix G for a specimen of MBIA's policy (the "2006 Certificate Insurance Policy").

MBIA does not accept any responsibility for the accuracy or completeness of this Official Statement or any information or disclosure contained herein, or omitted herefrom, other than with respect to the accuracy of the information regarding the 2006 Certificate Insurance Policy and MBIA set forth under the heading "CERTIFICATE INSURANCE." Additionally, MBIA makes no representation regarding the 2006 Certificates or the advisability of investing in the 2006 Certificates.

The 2006 Certificate Insurance Policy unconditionally and irrevocably guarantees the full and complete payment required to be made by or on behalf of the City to the Trustee or its successor of an amount equal to (i) the principal of (either at the stated maturity or by an advancement of maturity pursuant to a mandatory sinking fund payment) and interest evidenced by, the 2006 Certificates as such payments shall become due but shall not be so paid (except that in the event of any acceleration of the due date of such principal by reason of mandatory or optional prepayment or acceleration resulting from default or otherwise, other than any advancement of maturity pursuant to a mandatory sinking fund payment, the payments guaranteed by the 2006 Certificate Insurance Policy shall be made in such amounts and at such times as such payments of principal would have been due had there not been any such acceleration, unless MBIA elects in its sole discretion, to pay in whole or in part any principal due by reason of such acceleration); and (ii) the reimbursement of any such payment which is subsequently recovered from any Owner of the 2006 Certificates pursuant to a final judgment by a court of competent jurisdiction that such payment constitutes an avoidable preference to such Owner within the meaning of any applicable bankruptcy law (a "Preference").
The 2006 Certificate Insurance Policy does not insure against loss of any prepayment premium which may at any time be payable with respect to any 2006 Certificates. The 2006 Certificate Insurance Policy does not, under any circumstance, insure against loss relating to: (i) optional or mandatory prepayments (other than mandatory sinking fund prepayments); (ii) any payments to be made on an accelerated basis; (iii) payments of the purchase price of 2006 Certificates upon tender by an owner thereof; or (iv) any Preference relating to (i) through (iii) above. The 2006 Certificate Insurance Policy also does not insure against nonpayment of principal of or interest evidenced by the 2006 Certificates resulting from the insolvency, negligence or any other act or omission of the Trustee or any paying agent for the 2006 Certificates.

Upon receipt of telephonic or telegraphic notice, such notice subsequently confirmed in writing by registered or certified mail, or upon receipt of written notice by registered or certified mail, by MBIA from the Trustee or any Owner of a 2006 Certificate the payment of an insured amount for which is then due, that such required payment has not been made, MBIA on the due date of such payment or within one business day after receipt of notice of such nonpayment, whichever is later, will make a deposit of funds, in an account with U.S. Bank Trust National Association, in New York, New York, or its successor, sufficient for the payment of any such insured amounts which are then due. Upon presentment and surrender of such 2006 Certificates or presentment of such other proof of ownership of the 2006 Certificates, together with any appropriate instruments of assignment to evidence the assignment of the insured amounts due on the 2006 Certificates as are paid by MBIA, and appropriate instruments to effect the appointment of MBIA as agent for such Owners of the 2006 Certificates in any legal proceeding related to payment of insured amounts on the 2006 Certificates, such instruments being in a form satisfactory to U.S. Bank Trust National Association, U.S. Bank Trust National Association shall disburse to such owners or the Trustee payment of the insured amounts due on such 2006 Certificates, less any amount held by the Trustee for the payment of such insured amounts and legally available therefor.

MBIA Insurance Corporation

MBIA Insurance Corporation ("MBIA") is the principal operating subsidiary of MBIA Inc., a New York Stock Exchange listed company (the "Company"). The Company is not obligated to pay the debts of or claims against MBIA. MBIA is domiciled in the State of New York and licensed to do business in and subject to regulation under the laws of all 50 states, the District of Columbia, the Commonwealth of Puerto Rico, the Commonwealth of the Northern Mariana Islands, the Virgin Islands of the United States and the Territory of Guam. MBIA, either directly or through subsidiaries, is licensed to do business in the Republic of France, the United Kingdom and the Kingdom of Spain and is subject to regulation under the laws of those jurisdictions.

The principal executive offices of MBIA are located at 113 King Street, Armonk, New York 10504 and the main telephone number at that address is (914) 273-4545.

Regulation. As a financial guaranty insurance company licensed to do business in the State of New York, MBIA is subject to the New York Insurance Law which, among other things, prescribes minimum capital requirements and contingency reserves against liabilities for MBIA, limits the classes and concentrations of investments that are made by MBIA and requires the approval of policy rates and forms that are employed by MBIA. State law also regulates the amount of both the aggregate and individual risks that may be insured by MBIA, the payment of dividends by MBIA, changes in control with respect to MBIA and transactions among MBIA and its affiliates.

**Financial Strength Ratings of MBIA.** Moody’s Investors Service, Inc. rates the financial strength of MBIA “Aaa.”

Standard & Poor’s, a division of The McGraw-Hill Companies, Inc. rates the financial strength of MBIA “AAA.”

Fitch Ratings rates the financial strength of MBIA “AAA.”

Each rating of MBIA should be evaluated independently. The ratings reflect the respective rating agency’s current assessment of the creditworthiness of MBIA and its ability to pay claims on its policies of insurance. Any further explanation as to the significance of the above ratings may be obtained only from the applicable rating agency.

The above ratings are not recommendations to buy, sell or hold the 2006 Certificates, and such ratings may be subject to revision or withdrawal at any time by the rating agencies. Any downward revision or withdrawal of any of the above ratings may have an adverse effect on the market price of the 2006 Certificates. MBIA does not guaranty the market price of the 2006 Certificates nor does it guaranty that the ratings on the 2006 Certificates will not be revised or withdrawn.

**MBIA Financial Information.** As of December 31, 2005, MBIA had admitted assets of $11.0 billion (audited), total liabilities of $7.2 billion (audited), and total capital and surplus of $3.8 billion (audited), each as determined in accordance with statutory accounting practices prescribed or permitted by insurance regulatory authorities. As of June 30, 2006, MBIA had admitted assets of $11.3 billion (unaudited), total liabilities of $6.9 billion (unaudited), and total capital and surplus of $4.3 billion (unaudited), each as determined in accordance with statutory accounting practices prescribed or permitted by insurance regulatory authorities.

For further information concerning MBIA, see the consolidated financial statements of MBIA and its subsidiaries as of December 31, 2005 and December 31, 2004 and for each of the three years in the period ended December 31, 2005, prepared in accordance with generally accepted accounting principles, included in the Annual Report on Form 10-K of the Company for the year ended December 31, 2005 and the consolidated financial statements of MBIA and its subsidiaries as of June 30, 2006 and for the six month periods ended June 30, 2006 and June 30, 2005 included in the Quarterly Report on Form 10-Q of the Company for the period ended June 30, 2006, which are hereby incorporated by reference into this Official Statement and shall be deemed to be a part hereof.

Copies of the statutory financial statements filed by MBIA with the State of New York Insurance Department are available over the Internet at the Company’s web site at http://www.mbia.com and at no cost, upon request to MBIA at its principal executive offices.

**Incorporation of Certain Documents by Reference.** The following documents filed by the Company with the Securities and Exchange Commission (the “SEC”) are incorporated by reference into this Official Statement:
The Company's Annual Report on Form 10-K for the year ended December 31, 2005; and


Any documents, including any financial statements of MBIA and its subsidiaries that are included therein or attached as exhibits thereto, filed by the Company pursuant to Sections 13(a), 13(c), 14 or 15(d) of the Exchange Act after the date of the Company’s most recent Quarterly Report on Form 10-Q or Annual Report on Form 10-K, and prior to the termination of the offering of the 2006 Certificates offered hereby shall be deemed to be incorporated by reference in this Official Statement and to be a part hereof from the respective dates of filing such documents. Any statement contained in a document incorporated or deemed to be incorporated by reference herein, or contained in this Official Statement, shall be deemed to be modified or superseded for purposes of this Official Statement to the extent that a statement contained herein or in any other subsequently filed document which also is or is deemed to be incorporated by reference herein modifies or supersedes such statement. Any such statement so modified or superseded shall not be deemed, except as so modified or superseded, to constitute a part of this Official Statement.

The Company files annual, quarterly and special reports, information statements and other information with the SEC under File No. 1-9583. Copies of the Company's SEC filings (including (1) the Company’s Annual Report on Form 10-K for the year ended December 31, 2005, and (2) the Company’s Quarterly Reports on Form 10-Q for the quarters ended March 31, 2006 and June 30, 2006 are available (i) over the Internet at the SEC’s web site at http://www.sec.gov; (ii) at the SEC’s public reference room in Washington, D.C. (iii) over the Internet at the Company's web site at http://www.mbia.com; and (iv) at no cost, upon request to MBIA at its principal executive offices.

In the event MBIA were to become insolvent, any claims arising under a policy of financial guaranty insurance are excluded from coverage by the California Insurance Guaranty Association, established pursuant to Article 14.2 (commencing with Section 1063) of Chapter 1 of Part 2 of Division 1 of the California Insurance Code.

THE WATER UTILITY SYSTEM

History of the Water Utility System

The origin of the City's municipal water system dates back to 1876 when a privately-owned utility, later known as the Modesto Water Company, was established to provide water service to the village of Modesto. In 1895, the City purchased the Modesto Water Company, and in subsequent years it purchased other local water systems that have been incorporated in the present Water Utility System.

In April 1992, the City entered into the original Treatment and Delivery Agreement with MID and the Del Este Water Company ("Del Este"), providing for a supply of treated water for the City and Del Este from the Water Treatment Plant, which was constructed and is owned and operated by MID. See “Sources of Water” below. In July 1995, the City purchased substantially all of the assets and assumed substantially all of the liabilities of Del Este, the last private water company within City limits. The acquisition included Del Este's other water service areas including the communities of Salida, Waterford, Empire, Hickman, Grayson, and parts of Turlock, Ceres and Del Rio Estates. As a consequence of the varying operating conditions among these communities, the
City initially operated the Water Utility System in three separate zones. However, the three zones were essentially merged into a single zone for rate purposes when the City Council adopted a new rate structure that went into effect on January 1, 2005.

The original Treatment and Delivery Agreement provided the terms and conditions under which the City agreed to provide payments for, and MID agreed to finance, construct, own and operate, the Water Treatment Plant. Pursuant to the terms of the original Treatment and Delivery Agreement, the City was entitled to receive 30 million gallons per day of treated water from the Phase One Water Treatment Plant. The original Treatment and Delivery Agreement was amended and restated in 2005 to provide for the funding and construction of Phase Two of the Water Treatment Plant. Upon completion of Phase Two, the City will be entitled to receive 60 million gallons per day of treated water for use within the portion of the City’s service area that is within MID’s authorized service area. See “Treatment and Delivery Agreement” below.

In general terms, the City’s total water service area consists of one large contiguous area and several outlying, non-contiguous service areas. The contiguous water area includes all of the property currently within the corporate boundaries of the City as well as the property located within its sphere of influence and properties located within the communities of Ceres, Empire and Salida. There are five outlying non-contiguous water service areas. They are the communities of Del Rio, Grayson, Hickman and Waterford, as well as portions of the City of Turlock.

A map showing the City’s water service area appears on page ___.

Existing Facilities

The principal facilities of the existing Water Utility System consist of 125 domestic wells (111 of which are currently active), over 900 miles of mains, seven storage tanks, the MID’s Water Treatment Plant and a terminal storage area serving surface water and/or groundwater to its customers through nearly 77,000 water connections. A diagram showing the principal components of the existing Water Utility System appears on page ___.

MID surface water is treated at the Water Treatment Plant and conveyed to the City via transmission mains for direct use in the contiguous portion of the City’s water service area. The City’s facilities are designed to deliver both surface water and groundwater. The Water Treatment Plant does not provide surface water to the outlying portions of the City’s water service areas including those portions that are outside of MID’s authorized service boundaries.

Groundwater is pumped directly from the wells into the distribution system, which consists of 900 miles of water mains and pipelines. Most of the larger water mains are 10- and 12-inch diameter pipelines which have been installed by the City. The installation of smaller pipelines in subdivisions is typically the responsibility of the subdivider. Seven ground level tanks and booster pump stations provide storage capacities ranging from 500,000 to 1,300,000 gallons each.

The following table sets forth statistical information relating to the Water Utility System during the periods shown.
WATER UTILITY SYSTEM STATISTICS
Calendar Years

<table>
<thead>
<tr>
<th>Number of Service Accounts</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Water Production (MG)(1)</td>
<td>26,320</td>
<td>27,060</td>
<td>27,000</td>
<td>26,580</td>
<td>25,720</td>
</tr>
<tr>
<td>Capacity (MGD)(2)</td>
<td>166</td>
<td>166</td>
<td>166</td>
<td>166</td>
<td>166</td>
</tr>
<tr>
<td>Peak Daily Distribution (MGD)</td>
<td>124.6</td>
<td>131.2</td>
<td>133.6</td>
<td>124.9</td>
<td>129.8</td>
</tr>
<tr>
<td>Average Daily Distribution (MGD)</td>
<td>72.4</td>
<td>75.4</td>
<td>73.7</td>
<td>72.4</td>
<td>70.4</td>
</tr>
</tbody>
</table>

(1) "MG" means million gallons.
(2) "MGD" means million gallons per day. The actual capacity of the Water Utility System during each of the years shown varied slightly from the 166 MGD figure depending upon the number and capacity of the wells going in and out of service in each of said years.

Source: City of Modesto.

During the five year period covered by the table the City’s population grew by approximately 7.4% while the aggregate volume of water sold remained essentially flat. Thus, on a per capita basis, consumption of water in the City’s service area has been reduced over the course of this period. This reduction has been the result of many variables including water conservation efforts, weather, system repairs, more efficient water consumption by customers and the availability of alternative water sources (onsite private wells).

Sources of Water

The City’s primary sources of water supply are surface water provided by MID under the Treatment and Delivery Agreement (described below) and its local groundwater sources. During the 1990’s, MID, the City, and Del Este partnered to develop a new municipal water supply. This was implemented by the original Treatment and Delivery Agreement, under which the 30 MGD Water Treatment Plant and delivery system came on line in January 1995. The Water Treatment Plant serves as the baseline supply, and seasonal demands are served by the groundwater wells. In general the Water Treatment Plant currently supplies approximately 60% of the City’s water requirement during the winter and approximately 35% thereof during the summer season. Groundwater supplies the remainder. MID is expected to commence the expansion of the Water Treatment Plant in 2007, and the expansion is expected to increase the capacity of the Water Treatment Plant to 60 MGD.

The following table sets forth the total water production for the Water Utility System during the last five calendar years.
WATER UTILITY SYSTEM
Service Area Total Production (Billion Gallons)

<table>
<thead>
<tr>
<th>Year Ending December 31</th>
<th>Groundwater</th>
<th>Surface Water</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001</td>
<td>14.94</td>
<td>11.38</td>
<td>26.32</td>
</tr>
<tr>
<td>2002</td>
<td>16.01</td>
<td>11.05</td>
<td>27.06</td>
</tr>
<tr>
<td>2003</td>
<td>15.49</td>
<td>11.51</td>
<td>27.00</td>
</tr>
<tr>
<td>2004</td>
<td>15.15</td>
<td>11.43</td>
<td>26.58</td>
</tr>
<tr>
<td>2005</td>
<td>15.13</td>
<td>10.59</td>
<td>25.72</td>
</tr>
</tbody>
</table>

Source: City of Modesto.

Outside of the City corporate limits there are no regulations controlling the number of water wells that are drilled or the quantity of water pumped from such wells. Prior to the availability of surface water from the Water Treatment Plant, the groundwater pumpage had been increasing and water levels had been declining since the early 1950's. As a result thereof, the groundwater resources of the Water Utility System were subject to long-term overdraft, i.e., the depletion of the water table was greater than the replenishment, of an average of 3,000 acre-feet per year. With the introduction of surface water from the Water Treatment Plant, this long-term overdraft was halted, and the City's dependency upon groundwater was reduced. The City expects that the expansion of the Water Treatment Plant and the installation of the various capital projects associated therewith, including the 2006 Project, will further reduce its reliance on groundwater supplies.

Treatment and Delivery Agreement

In April 1992, MID entered into the original Treatment and Delivery Agreement with the City and Del Este. Pursuant to the Treatment and Delivery Agreement, MID agreed to finance, construct, own and operate the Water Treatment Plant and certain related facilities, and the City agreed to pay the costs of acquisition, construction and operation of the Water Treatment Plant. Pursuant to the Treatment and Delivery Agreement, the City was initially allocated a 70% share of the Water Treatment Plant, and was likewise responsible for 70% of its costs; Del Este was allocated a 30% share and was likewise responsible for 30% of its cost.

The Modesto Irrigation District Financing Authority ("MIDFA") issued its Series 1992A Water Notes in the aggregate principal amount of $39,990,000 to provide construction financing for Del Este's 30% of the estimated acquisition and construction costs of the Water Treatment Plant. MIDFA also issued its Series 1992A Water Bonds and Series 1992B Water Bonds in the aggregate principal amount of $77,385,000 in order to finance the City's 70% share of the estimated acquisition and construction costs of the Water Treatment Plant. In 1995, MIDFA issued its Series 1995C Water Bonds in an aggregate principal amount of $24,235,000 to repay the Series 1992A Water Notes; and in 1998, MIDFA issued its Series 1998D Water Bonds in an aggregate principal amount of $94,715,000 to defease all of the outstanding Series 1992B Water Bonds and Series 1995C Water Bonds. (MIDFA's Series 1998D Water Bonds are referred to as the "Domestic Water Bonds.")

In July 1995, the City purchased substantially all of the assets and liabilities of Del Este and in accordance with the provisions of the original Treatment and Delivery Agreement assumed all interests, rights and obligations of Del Este under the original Treatment and Delivery Agreement.
Accordingly, Del Este had no further obligation to make payments under the Treatment and Delivery Agreement or otherwise with respect to the Domestic Water Bonds.

Construction of the Water Treatment Plant began in October 1992, and the Water Treatment Plant was placed into operation in May 1995. It is located directly south of the Modesto Reservoir on an approximately 30-acre site, about 15 miles east of the City. Treated water is pumped from a five million gallon treated water storage reservoir through approximately 14 miles of transmission pipeline to two five million gallon terminal-storage reservoirs. The water is then distributed to distribution mains in the City water system.

The water which MID treats and delivers to the City through the Water Treatment Plant is available to MID through (i) various water rights owned by MID, including a pre-1914 water right, which total approximately 300,000 acre feet of Tuolumne River water every year and (ii) water available to it under a license held by MID and Turlock Irrigation District (License 11058) which authorizes the two districts to store up to 1,046,800 acre feet of water in New Don Pedro Reservoir between November 1 and the succeeding July 31 for irrigation and recreational use. MID petitioned for and received an order from the State Water Resources Control Board (WR Order 2005-0022-DWR) which amended License 11058 and authorized a long-term transfer of up to 67,200 acre feet of water per year to the City and which added municipal and industrial uses to the uses of water permitted under the transfer. This long-term transfer is effective through December 31, 2054. During the period of the long-term transfer, MID is required to comply with all of the terms and conditions required by the Federal Energy Regulatory Commission for the New Don Pedro Project. In addition, pursuant to California Water Code Sections 100 and 275 as well as the common law public trust doctrine, all rights and privileges under the long-term transfer order, including method of diversion, method of use and quantity of water diverted, are subject to the continuing authority of the State Water Board in accordance with law and in the interest of the public welfare to protect public trust uses and to prevent waste, unreasonable use, unreasonable method of use or unreasonable method of diversion.

The original Treatment and Delivery Agreement provided that the City would receive 30 million gallons per day of treated water. The terms of the original Treatment and Delivery Agreement were subsequently amended and restated to provide for an expansion of the Water Treatment Plant upon the completion of which the City will be entitled to receive 60 million gallons per day of treated water on an average annual basis.

In accordance with the Treatment and Delivery Agreement, MID owns, operates, and maintains the Water Treatment Plant for the purposes of treatment and delivery of water to the City. MID may not assign its maintenance and operation responsibility for the Water Treatment Plant without the consent of the City. The City is granted a permanent beneficial interest in the Water Treatment Plant output, which may not be transferred or assigned without the consent of MID.

The City has agreed to pay all costs and expenses of all phases of the Water Treatment Plant, including (i) payments of Debt Service in connection with the financing of the Water Treatment Plant (a Parity Obligation), (ii) raw water charges for raw water furnished to the Water Treatment Plant by MID, (iii) payments of operation, maintenance, repair, replacement and modification costs attributable to the operation of the Water Treatment Plant, (iv) costs of administrative services of MID attributable to the operation of the Water Treatment Plant and the administration of the Treatment and Delivery Agreement, (v) costs of insurance required to be maintained by MID pursuant to the Treatment and Delivery Agreement (as described below), (vi) cost of electric energy
provided to the Water Treatment Plant by MID, and (vii) other payments or costs (and deductions from payments or costs from the reserve and contingency fund and the certain reserve funds relating to the Domestic Water Bonds) and other amounts as specified by the Treatment and Delivery Agreement.

Some of the key provisions of the Treatment and Delivery Agreement, as amended and restated, are:

The City will continue to receive raw water at the same unit cost as MID’s agricultural users.

The City will reimburse MID for all capital and operating costs associated with the treatment of the water.

Reductions in water deliveries required as a result of a drought will be borne proportionately by the City and MID’s agricultural customers.

MID’s commitments to its agricultural customers and to the City must be met before MID may transfer any water for delivery outside of its boundaries.

The Policy Committee, which advises the Board of Directors of MID and City Council of the City on matters related to the project, consists of two members of the City Council and two members of the MID Board.

**Delivery of Treated Water.** MID currently makes available 33,602 acre feet of treated water from the Water Treatment Plant to the City annually, subject to a lesser allocation of treated water in the event of drought or other contingencies as provided in the Treatment and Delivery Agreement. As noted above, upon completion of the expansion of the Water Treatment Plant, the amount of treated water to which the City will be entitled will be approximately doubled. The City may exchange groundwater for use by MID’s irrigation system for treated water in the event of a reduced allocation. The City will bear all costs, including the costs of additional capital facilities, if any are necessary, associated with delivering the groundwater supply to MID’s irrigation system. MID may not sell any treated water from the Water Treatment Plant without first offering such water to the City. Treated water delivered by MID to the City must be utilized by the City within MID’s irrigation service area. MID will consult with the City regularly with respect to the scheduling of delivery of treated water from the Water Treatment Plant, MID shall be excused from its obligation to deliver treated water in the event that MID is rendered unable, wholly or in part, by force majeure to carry out its obligations under the Treatment and Delivery Agreement. Upon the occurrence of any event of force majeure which impacts MID’s ability to deliver treated water, the provisions of the Treatment and Delivery Agreement shall be determinative as to whether the City is excused from its obligation to pay debt service and fixed costs pursuant to the Treatment and Delivery Agreement.

Pursuant to the Treatment and Delivery Agreement two advisory committees are formed for the purposes of the Water Treatment Plant, the Policy Committee and the Technical Committee. Each of these Committees include representatives from MID and the City.

The Board of Directors of MID has the authority to make final decisions with respect to the Water Treatment Plant, subject to the rights of the City to review and advise MID with respect to certain budgetary matters as provided in the Treatment and Delivery Agreement.
**Conservation Program.** The City has an ongoing water conservation program which includes limitations on watering hours and certain water uses. In the event of drought, the City will likely expand its water conservation program to include additional water use restrictions, such as imposing limitations on the landscaping of new developments.

**Water Quality**

Land use in the vicinity of the City is a mixture of rural, residential, agricultural, commercial and industrial uses. Potential sanitary hazards include the percolation of agricultural chemicals and fertilizers in adjacent fields and underground storage of fuels in single contained tanks. All wells are adequately located away from sewer lines and sewage disposal facilities. Above-ground on-site fuel storage tanks are or will be provided with a containment system.

Historically, the overall well system has not required major treatment facilities to deliver potable water supplies to date. However, over the past ten years, the number of natural and man-made contaminants which the City is required to monitor has increased from 22 to 96 and there have been significant changes in the maximum contaminant levels permitted under regulations adopted by federal and State regulatory agencies. As a result, concerns over water quality have necessitated the closure of wells with poor water quality and has led to the requirement for treatment of several groundwater wells. The City has commenced litigation to protect, and/or to recover damages to, its groundwater supplies. See “DBCP Settlement Agreement” and “PCE Litigation” below.

The operation of the wells is performed automatically in response to system pressure and reservoir water level. All wells are monitored in accordance with State water quality monitoring regulations. Samples are collected for general physical, general mineral, inorganic chemical, radioactivity and organic chemical analysis. Additional monitoring is conducted for bacteriological and general mineral analysis on a routine basis. Bacteriological quality of the groundwater sources is generally good. Follow-up samples on positive total coliform test results are generally negative.

In addition to water wells as a domestic supply source, the City manages approximately 9,500 rock wells for the drainage of stormwater. Stormwater runoff occurs when rainfall intensity exceeds the infiltration rate of the soil. Suspended solids, heavy metals, and oil and grease are the major types of pollutants conveyed by runoff water to drainage facilities. The pollutant loading in runoff typically increases with increased urbanization. About 70 percent of the City service area employs rock wells which vary in depth from 25 to 50 feet. As a precaution to any risk of pollutants from stormwater and other wastewater entering the rock wells and percolating into the usable groundwater aquifer, the City seals its water wells at appropriate depths in relation to rock wells. After 40 years of operation of rock wells, no pollutants attributable to urban drainage have been detected in the drinking water supply. Recent studies of the federal Environmental Protection Agency conclude that properly operated rock wells provide significant treatment and removal of pollutants from percolating water.

**DBCP Settlement Agreement**

In January 1997, the City came to a settlement in litigation with certain defendants who are the manufacturers and distributors of dibromochloropropane (“DBCP”), which was impacting the drinking water quality throughout the combined City and former Del Este water systems. The settlement agreement (the “Settlement Agreement”) compensated the City for past expenses related to complying with drinking water standards and providing well-head treatment. The Settlement
Agreement and the damage recovery covers the City’s entire current and projected service area over the 40 years following the execution of the Settlement Agreement. The Settlement Agreement provides a formula by which the majority of future capital and operating expenses for DBCP mitigation will be compensated by the defendants, The Settlement Agreement includes cost escalation indexes and requires that these payments be used in the area where the damage occurs, as a protection for the defendants against possible Del Este ratepayer actions, The Settlement Agreement puts a variety of operating obligations on the City to ensure that the contamination is managed economically and in compliance with applicable regulations.

The annual proceeds from Settlement Agreement are included in the Historical Operating Results and the Projected Operating Results of the Water Utility System described below. For operating costs, the City receives a specified amount for each well which is receiving well head treatment for DBCP, escalated annually by the Producer Price Index ("PPI"). For each additional or new well requiring GAC equipment, 90% of the capital costs, escalated by the PPI, will be compensated. The actual amount will depend on the type of GAC unit needed for the specific well. The process for compensation provides that the City file an annual claim with the trustee, for operation and maintenance and capital costs for the preceding year, The defendants are required to maintain a certain balance in the trustee account, the balance declining over the 40 year life of the Settlement Agreement. The City is responsible for any difference between actual operating and capital expense and the stipulated compensation formula. Any shortfall would then be covered by the City through appropriate action, including without limitation a rate adjustment to assure compliance with the covenants in the Settlement Agreement.

Water supplied by the City has and continues to meet all federal and State requirements for quality standards. The City has in place a program to monitor and evaluate proposed regulatory water quality standards. The City anticipates that it will be able to meet increasingly stringent water standards.

**PCE Litigation**

The City of Modesto Redevelopment Agency brought an action in 1998 against numerous defendants, alleging causes of action for strict liability, negligence, negligence per se, continuing trespass, private and public nuisance, private and public nuisance per se, response costs and declaratory relief under the Carpenter-Presley-Tanner Hazardous Substance Account Act (Health & Safety Code Section 25300 et seq.), ultrahazardous activity, and cost recovery under the Polanco Redevelopment Act (Health & Safety Code Section 33459 et seq.) (San Francisco County Superior Court Case No. 999345). Simultaneously with the filing of that action, the City, along with the City of Modesto Sewer District No. 1, brought another action against a nearly identical group of defendants seeking damages for solvent contamination under many of the same legal theories; but this action did not include a Polanco Redevelopment Act cause of action (San Francisco County Superior Court Case No. 999643). The defendants included chlorinated solvent manufacturers, distributors of solvents and dry cleaning equipment, chlorinated solvent equipment manufacturers, and dry cleaning retailers.

The complaints alleged that two cleaning solvents, perchloroethylene ("PERC" or "PCE") and trichloroethylene, cause risks to health and the environment, that dry cleaners customarily dumped solvent wastewater into the public sewer systems, and that dry cleaners experienced a habitual problem of chlorinated solvents leaking into the environment. According to the complaints, the defendants who manufactured and supplied solvents and equipment instructed dry cleaners that
chlorinated solvents could be discharged into sewers and/or failed to issue recalls or warnings regarding the equipment and solvents.

The plaintiffs tried five “bellweather” suits before a jury from February to June of 2006, and won a verdict for compensatory damages of $3.1 million and a verdict for punitive damages of $175 million, later lowered to $12 million. This result has stalled settlement negotiations while both sides appeal various liability and damage issues. In any event, previous settlements and insurance payments have rendered the litigation essentially cost neutral to the City’s Water and Sewer Enterprise Funds, which have funded the litigation to date on a roughly equal basis. It is not anticipated that the cost/settlement ratio will change dramatically in the 15 months following the execution and delivery of the 2006 Certificates, which is as far as the City believes reasonable forecasting may be done on the cost issue.

Employees

The Public Works Director has primary responsibility for the management of the Water Utility System, as well as for the sewer system, solid waste system, streets and storm drains. The Water Utility System currently has 75 full-time employees. Employees are represented by the Modesto City Employees Association whose current Memorandum of Understanding expires in July, 2007. The City has never experienced a labor strike.

Retirement Programs

All permanent employees of the City are covered under the Public Employees’ Retirement System (PERS) of the State of California, a defined benefit plan. Pension costs are funded by monthly contributions from the City. Required contributions by the City during fiscal year 2005-06 were $11,748,699 of which $566,188 was allocated to the Water Utility System. The City’s net assets available for benefits as of June 30, 2004 (the latest data available) were $44,341,594 less than pension benefit obligations.

As of June 30, 2006, most employee contributions (9 percent for fire and police and 7 percent for miscellaneous employees, including Water Utility System employees) are paid by the City on behalf of the employees. The City is also required to contribute all remaining amounts necessary to fund the benefits for its members, using the actuarial basis recommended by the PERS actuaries and actuarial consultants and adopted by the Board of Administration.

In addition to the defined benefit plan described above, the City also maintains a program providing “other post-employment benefits” (“OPEB”) for its employees. The City has created an internal service fund to track the OPEB liability, annual expenses and revenues and has been disclosing its liability for OPEB in its Comprehensive Annual Financial Statements for over ten years.

As of October 4, 2004 the Entry Age Actuarial Accrued Liability was $55,726,958. The City has been funding the current cost of annual benefits and a portion of the long-term cost in each of the years that the liability has been disclosed in its financial statements.

A recent review performed by the City’s external auditors of the OPEB plan design, actuarial assumptions and prior reporting has provided the City with a list of options to consider as the City moves to fully implement Government Accounting Standards Board Pronouncement 45 during the
2007-08 fiscal year. Among the options that will be considered by the City Council during the current fiscal year will be the use of an irrevocable trust to hold the assets that will be used to pay both the current and long-term portion of the OPEB liability.

Insurance

The City is exposed to various risks of loss including those related to torts as well as the theft of, damage to and destruction of its assets. The City maintains an Insurance Internal Service Fund to account for and finance its risks of loss. Under this program, the City is self-insured for the following risks up to the maximum amount per claim as follows: workers' compensation $750,000, liability $1,000,000, employee disability $216,000 and dental care $1,200. The City purchases commercial insurance for property loss, airport liability and claims in excess of the preceding self-insured coverage amounts. For liability claims, the City is one of twelve members of the Authority for California Cities Excess Liability risk pool. This pool covers City claims between $1 million and $4 million. Commercial insurance covers claims over $4 million up to an additional $30 million per claim.

The City currently maintains insurance against damage to the Water Utility System. Coverage thereunder is currently $10,000,000, but damage resulting from earthquakes is not covered.

Service Area and Customers

The water service area of the Water Utility System is within the metropolitan area of the City, located in the central portion of Stanislaus County, consisting of approximately 36 square miles as well as the communities of Salida, Waterford, Empire, Hickman, Grayson, and portions of Turlock, Ceres and Del Rio Estates.

The following tables set forth the revenues for the periods indicated and the ten largest water customers of the Water Utility System in terms of total water sales and total billings for the fiscal year ended June 30, 2005. During calendar year 2005, the Water Utility System delivered approximately 25.72 billion gallons of water to an average of approximately 75,000 customers. Residential accounts (single family as well as multi-family accounts) represent approximately 75% of the City's water consumption and water sales revenues. Commercial, industrial and municipal accounts represent approximately 25% of the City's water consumption and water sales revenues. The City's ten largest customers represented approximately 6.9% of total water sales in fiscal year 2005-06.
WATER UTILITY SYSTEM

Sale of Water

Fiscal Year Ended June 30

Revenues ($000)

<table>
<thead>
<tr>
<th></th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Residential</td>
<td>$16,206</td>
<td>$16,419</td>
<td>$16,682</td>
<td>$16,849</td>
<td>$19,117</td>
<td>$26,591</td>
</tr>
<tr>
<td>Commercial, Industrial and Municipal (Metered)</td>
<td>9,928</td>
<td>10,233</td>
<td>10,075</td>
<td>10,524</td>
<td>10,847</td>
<td>14,516</td>
</tr>
<tr>
<td>Total</td>
<td>$26,134</td>
<td>$26,652</td>
<td>$26,757</td>
<td>$27,323</td>
<td>$29,964</td>
<td>$41,107</td>
</tr>
</tbody>
</table>

(1) Reflects estimated, unaudited amounts.
Source: City of Modesto.

WATER UTILITY SYSTEM

Ten Largest Customers
(Fiscal Year ended June 30, 2006)

<table>
<thead>
<tr>
<th>Customer</th>
<th>Business Type</th>
<th>Usage (ccf)</th>
<th>Water Sales Revenues</th>
<th>% of Total Water Sales Revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>Modesto City School District</td>
<td>School District</td>
<td>411,000</td>
<td>$ 568,550</td>
<td>1.38%</td>
</tr>
<tr>
<td>Signature Fruit</td>
<td>Cannery</td>
<td>500,854</td>
<td>526,371</td>
<td>1.28%</td>
</tr>
<tr>
<td>Stanislaus Food Products</td>
<td>Cannery</td>
<td>405,504</td>
<td>484,140</td>
<td>1.18%</td>
</tr>
<tr>
<td>Foster Farms</td>
<td>Dairy Processor</td>
<td>354,358</td>
<td>328,126</td>
<td>0.80%</td>
</tr>
<tr>
<td>Modesto Irrigation District</td>
<td>Government</td>
<td>192,520</td>
<td>211,782</td>
<td>0.52%</td>
</tr>
<tr>
<td>E&amp;J Gallo Winery</td>
<td>Winery</td>
<td>135,862</td>
<td>159,492</td>
<td>0.39%</td>
</tr>
<tr>
<td>Yosemite Community College</td>
<td>Community College</td>
<td>119,235</td>
<td>158,231</td>
<td>0.38%</td>
</tr>
<tr>
<td>Sylvan Unified School District</td>
<td>School District</td>
<td>123,987</td>
<td>154,324</td>
<td>0.38%</td>
</tr>
<tr>
<td>Del Monte Foods</td>
<td>Cannery</td>
<td>109,911</td>
<td>117,906</td>
<td>0.29%</td>
</tr>
<tr>
<td>Memorial Hospital</td>
<td>Hospital</td>
<td>98,364</td>
<td>110,139</td>
<td>0.29%</td>
</tr>
<tr>
<td>Top Ten Total</td>
<td></td>
<td>2,451,595</td>
<td>$ 2,819,061</td>
<td>6.86%</td>
</tr>
<tr>
<td>Total Flat/Metered Revenues</td>
<td></td>
<td></td>
<td>$41,107,000</td>
<td></td>
</tr>
</tbody>
</table>

(1) “ccf” means hundred cubic feet
Source: City of Modesto.

Water Charges and Billing

Water Service Rates. Water rates are fixed by the City Council and are not subject to regulation by the California Public Utility Commission or any other State or federal agency. Customer service charges for single family residential accounts were historically generally based on a flat monthly service charge, which varied only based on the size of the lot and in which of three zones the lot was located. However, under a new rate structure which went into effect on January 1, 2005, a uniform rate for each applicable lot size has been established for all three zones. See “Rate Setting Process” below for a discussion of the process followed by the City in implementing the new rate structure.

Historically, the City has not metered water use by its single family residential customers; however, since 1992 all new construction has been equipped with a meter; and those single family residential properties that are equipped with water meters that are read for billing purposes are charged the metered water rate. Pursuant to State legislation, the City will be required to install meters and to read and bill for water service based on metered rates by 2025. The City Council has
adopted a metering plan schedule pursuant to which those requirements would be satisfied by 2019; and, in connection therewith, the City Council recently approved contracts with Automatic Meter Reading in order to provide the most cost efficient and manner of implementing its plan.

Multifamily residential units are currently metered. Each commercial account pays a monthly service charge and a volume charge per hundred cubic feet of water delivered. All regular customers are liable for service charges unless service is permanently discontinued. In addition, all new regular water service connections, increases in meter sizes, and the connection of additional dwelling units to existing services require the payment of a connection fee.

As noted above, the City Council established a new rate structure that went into effect on January 1, 2005. The new rate structure established a single service area, combining all three prior water zones into a single zone. The new rates include a uniform volume-based charge reflecting the volume of water consumed. Residential metered and flat rates are designed so that monthly bills for these types of customers will be comparable were water consumption is estimated to be comparable. Residential flat rates are standardized by lot size (previously, the size ranges varied between water zones) based upon the number of parcels in each range and patterns of water use.

The rate increases and individual customer bills in fiscal year 2004-05 varied by customer class and zone with the majority of the Zone 1 customers experiencing a 35% increase (the actual increase ranged from 14% to 43%). The Zone 2 adjustments ranged from a decrease of 19% to an increase of 15%, and the Zone 3 increases ranged from 28% to 81%. The adjustments to volume-based charges for metered customers in Zone 1 represented an increase of 2.7%. In Zone 2 such adjustments resulted in a 16% decrease, while in Zone 3 they represented a 40% increase.

**WATER UTILITY SYSTEM**

<table>
<thead>
<tr>
<th>Customer Classes</th>
<th>Pre 1/1/05 Rates</th>
<th>1/1/05 Rates &amp; % Change</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Zone 1</td>
<td>Zone 2</td>
</tr>
<tr>
<td>Flat Rate Residential</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5,001 - 7,000 sq. ft.</td>
<td>$20.60</td>
<td>$24.61</td>
</tr>
<tr>
<td>7,001 - 11,000 sq. ft.</td>
<td>$23.08</td>
<td>$28.58</td>
</tr>
<tr>
<td>Metered Charges</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Uniform Vol. Charge ($/hcf)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5/8&quot;-3/4&quot;</td>
<td>$0.82</td>
<td>$1.005</td>
</tr>
<tr>
<td>1&quot;</td>
<td>$13.63</td>
<td>$8.12</td>
</tr>
<tr>
<td>1-1/2&quot;</td>
<td>$18.14</td>
<td>$10.17</td>
</tr>
<tr>
<td>2&quot;</td>
<td>$22.54</td>
<td>$15.53</td>
</tr>
<tr>
<td>Fixed Meter Charges</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5/8&quot;-3/4&quot;</td>
<td>$27.20</td>
<td>$21.09</td>
</tr>
</tbody>
</table>

Source: City of Modesto.

In addition to the rate increases described above, the rate structure adopted by the City Council also provided for uniform increases of 20% effective July 1, 2005, 15% effective July 1, 2006, 5% effective July 1, 2007 and 5% effective July 1, 2008. On each July 1, commencing July 1, 2009 rates are expected to be adjusted to reflect increases in the Consumer Price Index.
The following table sets forth the volume charges for commercial accounts, effective as of July 1, 2006.

### WATER UTILITY SYSTEM

**Current Water Rates and Charges**

**Commercial Accounts**

*(Effective July 1, 2006)*

<table>
<thead>
<tr>
<th>Meter Size</th>
<th>Per Meter</th>
</tr>
</thead>
<tbody>
<tr>
<td>3/4&quot;</td>
<td>$12.44</td>
</tr>
<tr>
<td>1&quot;</td>
<td>17.64</td>
</tr>
<tr>
<td>1-1/2&quot;</td>
<td>30.53</td>
</tr>
<tr>
<td>2&quot;</td>
<td>46.06</td>
</tr>
<tr>
<td>3&quot;</td>
<td>87.53</td>
</tr>
<tr>
<td>4&quot;</td>
<td>134.13</td>
</tr>
<tr>
<td>6&quot;</td>
<td>263.51</td>
</tr>
<tr>
<td>8&quot;</td>
<td>418.82</td>
</tr>
<tr>
<td>10&quot;</td>
<td>600.07</td>
</tr>
<tr>
<td>12&quot;</td>
<td>1,117.74</td>
</tr>
</tbody>
</table>

Source: City of Modesto.

In addition, each commercial account pays a volume charge of $1.16 per hundred cubic feet of water delivered.

The following table sets forth connection fees for all users except multi-family units by meter size for fiscal year 2006-07.

### WATER UTILITY SYSTEM

**Connection Fees for All Users Except Multiple Family Units**

*(Fiscal Year 2006-07)*

<table>
<thead>
<tr>
<th>Meter Size</th>
<th>Connection Fees</th>
</tr>
</thead>
<tbody>
<tr>
<td>5/8&quot;</td>
<td>$1,960</td>
</tr>
<tr>
<td>1&quot;</td>
<td>4,900</td>
</tr>
<tr>
<td>1-1/2&quot;</td>
<td>9,800</td>
</tr>
<tr>
<td>2&quot;</td>
<td>15,680</td>
</tr>
<tr>
<td>3&quot;</td>
<td>31,360</td>
</tr>
<tr>
<td>4&quot;</td>
<td>49,000</td>
</tr>
<tr>
<td>6&quot;</td>
<td>98,000</td>
</tr>
<tr>
<td>8&quot;</td>
<td>156,800</td>
</tr>
<tr>
<td>10&quot;</td>
<td>225,400</td>
</tr>
<tr>
<td>12&quot; or larger</td>
<td>421,400</td>
</tr>
</tbody>
</table>

Source: City of Modesto.
Comparison of Rates and Charges. The following table lists certain water suppliers in the Modesto region and their average monthly residential water service charges.

<table>
<thead>
<tr>
<th>WATER UTILITY SYSTEM</th>
<th>Comparison of</th>
<th>Average Monthly Water Rates</th>
<th>Flat Rate (1&quot; Service)</th>
<th>As of July 1, 2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>City</td>
<td>Typical Home</td>
<td></td>
<td>Flat Rate</td>
<td></td>
</tr>
<tr>
<td>Modesto</td>
<td>$38.38</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tracy</td>
<td>33.00</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Stockton</td>
<td>30.00</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Turlock</td>
<td>24.40</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sacramento</td>
<td>24.00</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Merced</td>
<td>22.05</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Atwater</td>
<td>15.65</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ceres</td>
<td>15.30</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: City of Modesto.

The City’s water rates reflect the steps the City has taken to assure a long-term water supply by entering into the regional water management partnership with MID. The rates of the other nearby cities reflect the particular circumstances of each city’s water system, such as the degree to which it relies on ground water or surface water. The rates also reflect their specific circumstances with regard to the cost of current and prospective water supplies.

Rate Setting Process. In connection with its consideration of the new water rate structure which took effect on January 1, 2005, the City Council followed a process which it believes satisfies the requirements of Article XIIIID of the California Constitution. See “Impact of Proposition 218 on Water System Fees and Charges” below. Specifically, by October 8, 2004, nearly 75,000 notices of the proposed increase in water rates had been mailed to the owners of record of the parcels within the City’s water service area. The notices advised property owners of their right to file written protests to the proposed increase and of a public hearing, set for November 23, 2004, at which such protests would be considered. The number of protests received prior to the completion of the November 23, 2004 public hearing was 8,856, far less than the majority required in order to prevent the implementation of the proposed rate increase. Following the completion of the public hearing, the City Council proceeded to adopt the rate increase as described above. See “Water Charges and Billing” above.

Rate Study. Prior to adopting the new water rate structure which took effect on January 1, 2005, the City Council engaged an outside consultant to prepare a water rate study that was ultimately presented to the City Council. In early 2005, the City’s staff noted differences between the amount of revenue actually realized from the initial water rate increases adopted by the City Council and the revenue projections contained in the rate study. In light of those differences, the Water Utility System budgets for fiscal years 2005-06 and 2006-07 use revenue estimates based on actual levels of income received from Water Utility System rates and charges and not on projections.
included in the rate study. Similarly, the projected operating results of the Water Utility System set forth below under the caption “Summary of Projected Operating Results of the Water Utility System” are also based on the actual amount of income that is being received by the Water Utility System and not on the forecast thereof shown in the rate study.

The errors in the revenue forecast which have been thus far identified in the rate study have been traced to one table in the rate study which contains a series of errors unrelated to the formulas underlying the current water rate structure, and the City believes that there is nothing at this time indicating that the rate structure itself is flawed.

**Challenges to Rates.** The 2005/2006 Stanislaus County Civil Grand Jury received complaints from Del Rio, an outlying community that receives its water from the City’s Water Utility System Modesto. Del Rio is a wealthy area which includes homes on large lots that had previously received flat rate water. Part of the City’s new rate structure (see “Water Charges and Billing—Water Service Rates” above) required metering rates for Del Rio, which had the effect of accentuating the accompanying rate hikes. However, the Civil Grand Jury found no evidence to support Del Rio’s contention that the City’s Proposition 218 notice informing the public of the new rate schedule was inadequate. Del Rio also charged that the City’s water rate policy violated a Proposition 218 requirement that a parcel be charged only its proportional costs. The Civil Grand Jury concluded there is no difference in the rate structure between Del Rio and the rest of the City’s water customers that are billed a metered rate; and the Civil Grand Jury made no recommendation regarding the proportionality issues. Del Rio further charged that there was a misuse of funds by using water collections for purposes other than water. While it did make study recommendations, the Civil Grand Jury ultimately determined that the City is accounting for water costs and revenues separately from non-water related accounts. Del Rio’s last charge was that unfairness in the rate process led to Del Rio paying more than other water customers. The Civil Grand Jury could not substantiate this charge, but rather made study recommendations regarding actual customer costs between metered and flat rates, and a further recommendation that conversion from flat to metered rates occur as quickly as possible.

**Delinquencies**

The City’s municipal water department has historically accounted for water system revenues on a full accrual basis. The City has developed procedures for handling delinquent accounts. There has not generally been a significant delinquency problem. The threatened suspension of water delivery is normally sufficient incentive to induce customers to make payment on their billings. In addition, the City customers may have tax liens placed on their property when water bills are delinquent. Uncollectible accounts have historically been less than 1% of revenues.
Historical Operating Results

The following table summarizes operating revenues, operating expenses and net income of the Water Utility System for the five fiscal years 2001-02 through 2005-2006. The information for the four fiscal years ended June 30, 2005 was prepared by the City on the basis of its audited financial statements.

### WATER UTILITY SYSTEM
#### Historical Debt Service Coverage

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>GROSS OPERATING REVENUES</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Charges for services</td>
<td>$27,376,240</td>
<td>$27,985,082</td>
<td>$31,353,046</td>
<td>$31,315,920</td>
<td>$42,670,821</td>
</tr>
<tr>
<td>DBCP Settlement</td>
<td>230,241</td>
<td>214,803</td>
<td>210,834</td>
<td>2,960,781</td>
<td>1,259,610</td>
</tr>
<tr>
<td>Connection charges</td>
<td>1,248,689</td>
<td>1,189,995</td>
<td>1,159,296</td>
<td>1,371,898</td>
<td>1,728,973</td>
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<tr>
<td>Interest and Rental Income</td>
<td>929,353</td>
<td>964,817</td>
<td>316,688</td>
<td>279,616</td>
<td>532,794</td>
</tr>
<tr>
<td>Draw from Rate Stab. Fund</td>
<td>0</td>
<td>153,200</td>
<td>0</td>
<td>0</td>
<td>(153,200)</td>
</tr>
<tr>
<td>GROSS OPERATING REVENUES</td>
<td>$29,784,523</td>
<td>$30,488,897</td>
<td>$33,039,864</td>
<td>$35,928,275</td>
<td>$46,038,398</td>
</tr>
<tr>
<td>OPERATING EXPENSES:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total operating expenses</td>
<td>$25,968,732</td>
<td>$27,815,253</td>
<td>$26,757,108</td>
<td>$29,227,465</td>
<td>$25,884,448</td>
</tr>
<tr>
<td>Less: Depreciation</td>
<td>(2,297,851)</td>
<td>(1,884,769)</td>
<td>(2,173,845)</td>
<td>(2,305,933)</td>
<td>N/A</td>
</tr>
<tr>
<td>T&amp;D debt service component paid to MID(1)</td>
<td>(6,715,638)</td>
<td>(6,713,244)</td>
<td>(6,700,881)</td>
<td>(6,705,344)</td>
<td>(6,990,994)</td>
</tr>
<tr>
<td>Property taxes</td>
<td>71,579</td>
<td>77,676</td>
<td>89,921</td>
<td>82,673</td>
<td>84,556</td>
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<tr>
<td>Plus: Operating Transfers</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>218,802</td>
</tr>
<tr>
<td>TOTAL OPERATING EXPENSES</td>
<td>$17,026,822</td>
<td>$19,294,917</td>
<td>$17,972,303</td>
<td>$20,517,773</td>
<td>$19,373,395</td>
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<tr>
<td>NET OPERATING REVENUES</td>
<td>$12,757,701</td>
<td>$11,193,980</td>
<td>$15,067,561</td>
<td>$15,410,522</td>
<td>$26,665,003</td>
</tr>
<tr>
<td>TOTAL DEBT SERVICE:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Revenue bonds:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1997 Certificates of Participation</td>
<td>$1,771,768</td>
<td>$1,774,093</td>
<td>$1,780,288</td>
<td>$1,784,908</td>
<td>$1,790,658</td>
</tr>
<tr>
<td>Treatment &amp; Delivery Agreement</td>
<td>6,715,638</td>
<td>6,713,244</td>
<td>6,700,881</td>
<td>6,705,344</td>
<td>6,690,994</td>
</tr>
<tr>
<td>CDWR Loan</td>
<td>264,654</td>
<td>264,654</td>
<td>264,654</td>
<td>264,654</td>
<td>264,654</td>
</tr>
<tr>
<td>TOTAL DEBT SERVICE</td>
<td>$8,753,060</td>
<td>$8,751,993</td>
<td>$8,745,825</td>
<td>$8,754,906</td>
<td>$8,746,306</td>
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<td>DEBT SERVICE COVERAGE</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(Net Operating Revenues/Total Debt Service)</td>
<td>1.46</td>
<td>1.27</td>
<td>1.72</td>
<td>1.76</td>
<td>3.05</td>
</tr>
</tbody>
</table>

(1) Reflects estimated, unaudited amounts.
(2) Based on debt service paid pursuant to the Treatment and Delivery Agreement.
Source: City of Modesto.

### Capital Improvement Program

The capital improvement program of the City for the Water Utility System for fiscal years 2006-07 through 2014-15 includes budgeted or planned programs and projects expected to be funded by the City from annual revenues. Among the projects planned are new wells, well head treatment, Turlock Irrigation District Water Treatment Plant design work, water main extensions and pump replacements. Total expenditures for fiscal year 2006-07 are estimated to be approximately $15.7 million. Improvements associated with the expansion of the Water Treatment Plant (in addition to the 2006 Project) are planned for fiscal years 2007-08 and are expected to be financed through additional Parity Obligations.

The City's capital improvement program is a 10-year plan revised annually. Consequently, projects planned for future years may be cancelled, and new projects not presently anticipated may be undertaken. To the extent that total funds required exceed cash available, the City expects that the projects will either be funded by bond proceeds or deferred or terminated.
Summary of Projected Operating Results of the Water Utility System

The City has prepared the following table of projections of operating results of the Water Utility System for the fiscal years ending June 30, 2007 through 2011. The projected amounts set forth below are based on certain assumptions made by the City. To the extent that actual future conditions vary from those assumed in preparing the projections, the actual results will vary from those set forth herein.

### WATER UTILITY SYSTEM

#### Projected Operating Results

<table>
<thead>
<tr>
<th></th>
<th>Fiscal Year</th>
<th>Fiscal Year</th>
<th>Fiscal Year</th>
<th>Fiscal Year</th>
<th>Fiscal Year</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2007</td>
<td>2008</td>
<td>2009</td>
<td>2010</td>
<td>2011</td>
</tr>
<tr>
<td>Gross Operating Revenues</td>
<td>$48,105,000</td>
<td>$49,257,000</td>
<td>$50,233,000</td>
<td>$51,472,000</td>
<td>$52,743,000</td>
</tr>
<tr>
<td>Charges for services</td>
<td>$48,105,000</td>
<td>$49,257,000</td>
<td>$50,233,000</td>
<td>$51,472,000</td>
<td>$52,743,000</td>
</tr>
<tr>
<td>DBCP Settlement</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
</tr>
<tr>
<td>Connection charges</td>
<td>$2,677,000</td>
<td>$2,995,000</td>
<td>$2,995,000</td>
<td>$3,495,000</td>
<td>$3,495,000</td>
</tr>
<tr>
<td>Interest and Rental Income</td>
<td>$431,000</td>
<td>$431,000</td>
<td>$431,000</td>
<td>$331,000</td>
<td>$331,000</td>
</tr>
<tr>
<td>Draw from Rate Stab. Fund</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
</tr>
<tr>
<td>GROSS OPERATING REVENUES</td>
<td>$51,213,000</td>
<td>$52,683,000</td>
<td>$53,659,000</td>
<td>$55,298,000</td>
<td>$56,469,000</td>
</tr>
<tr>
<td>Operating Expenses</td>
<td>$31,283,000</td>
<td>$34,173,000</td>
<td>$36,458,000</td>
<td>$43,851,000</td>
<td>$44,253,000</td>
</tr>
<tr>
<td>Less: Depreciation</td>
<td>$(6,687,000)</td>
<td>$(6,682,000)</td>
<td>$(6,672,000)</td>
<td>$(10,601,000)</td>
<td>$(10,586,000)</td>
</tr>
<tr>
<td>T&amp;D/A debt service component paid to MID</td>
<td>$6,687,000</td>
<td>$6,682,000</td>
<td>$6,672,000</td>
<td>$10,601,000</td>
<td>$10,586,000</td>
</tr>
<tr>
<td>Property taxes</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
</tr>
<tr>
<td>Plus: Operating Transfers</td>
<td>$500,000</td>
<td>$500,000</td>
<td>$500,000</td>
<td>$500,000</td>
<td>$500,000</td>
</tr>
<tr>
<td>Expenditure Adjustment</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
</tr>
<tr>
<td>TOTAL OPERATING EXPENSES</td>
<td>$25,096,000</td>
<td>$27,991,000</td>
<td>$30,286,000</td>
<td>$33,750,000</td>
<td>$34,167,000</td>
</tr>
<tr>
<td>Net Operating Revenues</td>
<td>$26,118,000</td>
<td>$24,692,000</td>
<td>$23,373,000</td>
<td>$21,548,000</td>
<td>$22,302,000</td>
</tr>
<tr>
<td>Total Debt Service</td>
<td>$8,746,000</td>
<td>$9,993,000</td>
<td>$11,394,000</td>
<td>$15,873,000</td>
<td>$15,858,008</td>
</tr>
<tr>
<td>Revenue bonds:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1997 Certificates of Participation</td>
<td>$1,794,000</td>
<td>$1,792,000</td>
<td>$1,792,000</td>
<td>$1,795,000</td>
<td>$1,794,000</td>
</tr>
<tr>
<td>Treatment &amp; Delivery Agreement</td>
<td>$6,687,000</td>
<td>$6,682,000</td>
<td>$6,672,000</td>
<td>$10,601,000</td>
<td>$10,586,000</td>
</tr>
<tr>
<td>CDWR Loan</td>
<td>$255,000</td>
<td>$265,000</td>
<td>$265,000</td>
<td>$265,000</td>
<td>$265,000</td>
</tr>
<tr>
<td>2006 Certificates</td>
<td>$1,255,000</td>
<td>$1,255,000</td>
<td>$1,255,000</td>
<td>$1,255,000</td>
<td>$1,255,000</td>
</tr>
<tr>
<td>City Bond Tier 2</td>
<td>$1,794,000</td>
<td>$1,792,000</td>
<td>$1,792,000</td>
<td>$1,795,000</td>
<td>$1,794,000</td>
</tr>
<tr>
<td>TOTAL DEBT SERVICE</td>
<td>$8,746,000</td>
<td>$9,993,000</td>
<td>$11,394,000</td>
<td>$15,873,000</td>
<td>$15,858,008</td>
</tr>
</tbody>
</table>

**Debt Service Coverage**

<table>
<thead>
<tr>
<th></th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Net Operating Revenues/Total Debt Service)</td>
<td>2.99</td>
<td>2.47</td>
<td>2.05</td>
<td>1.36</td>
<td>1.41</td>
</tr>
</tbody>
</table>

---

**Impact of Proposition 218 on Water System Fees and Charges**

**General.** An initiative measure entitled the "Right to Vote on Taxes Act" (the "Initiative") was approved by the voters of the State of California at the November 5, 1996 general election. The Initiative added Article XIIIC and Article XIIID to the California Constitution. According to the "Title and Summary" of the Initiative prepared by the California Attorney General, the Initiative limits "the authority of local governments to impose taxes and property-related assessments, fees and charges."

**Article XIIID.** Article XIIID defines the terms "fee" and "charge" to mean "any levy other than an ad valorem tax, a special tax or an assessment, imposed by an agency upon a parcel or upon a parcel."

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DOCSOC/1183217v10/024586-0005
person as an incident of property ownership, including user fees or charges for a property-related service.” A “property-related service” is defined as “a public service having a direct relationship to property ownership.” Article XIIID further provides that reliance by an agency on any parcel map (including an assessor’s parcel map) may be considered a significant factor in determining whether a fee or charge is imposed as an incident of property ownership.

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, if and to the extent that a fee or charge imposed by a local government for water service is ultimately determined to be a “fee” or “charge” as defined in Article XIIID, the local government’s ability to increase such fee or charge may be limited by a majority protest.

In Richmond et al. v. Shasta Community Services District, 32 Cal. 4th 409 (2004) the California Supreme Court ruled that water connection fees are not property related fees or charges subject to Article XIIID while at the same time stating in dicta that fees for ongoing water service through an existing connection were property related fees and charges. On July 24, 2006, in Bighorn-Desert View Water Agency v. Verji, 39 Cal. 4th 205 (2006), in what is technically dicta, the California Supreme Court cited its decision in Richmond, supra in support of its conclusion that a public water agency’s charges for ongoing water delivery are fees and charges within the meaning of Article XIIID. Despite the fact that the statement is dicta, it does represent the unanimous view of the California Supreme Court. The City believes that it has complied with the requirements of Article XIIID, as said article has been construed by the California Supreme Court, in establishing its current rate structure for the Water Service.

In addition, Article XIIID includes a number of limitations applicable to pre-existing fees and charges including provisions to the effect that (i) revenues derived from the fee or charge shall not exceed the funds required to provide the property-related service, (ii) such revenues shall not be used for any purpose other than that for which the fee or charge was imposed, (iii) the amount of a fee or charge imposed upon any parcel or person as an incident of property ownership shall not exceed the proportional cost of the service attributable to the parcel and (iv) no such fee or charge may be imposed for a service unless that service is actually used by, or immediately available to, the owner of the property in question. Property-related fees or charges based on potential or future use of a service are not permitted. It is unclear whether, under the foregoing standards, fees and charges may be established at levels that permit deposits to a rate stabilization fund or maintenance of uncommitted cash reserves.

Article XIIIC. Article XIIIC provides that the initiative power shall not be prohibited or otherwise limited in matters of reducing or repealing any local tax, assessment, fee or charge and that the power of initiative to affect local taxes, assessments, fees and charges shall be applicable to all local governments. Article XIIIC does not define the terms “local tax,” “assessment,” “fee” or “charge.” However, in dicta in its decision in Bighorn-Desert View Water Agency, supra, the California Supreme Court concluded that a public water agency’s charges for ongoing water delivery (which, as noted above, it had concluded were fees and charges within the meaning of Article XIIID) are also fees within the meaning of Article XIIIC and are therefore subject to initiative measures. However, the Court did note that, in doing so:
... [W]e are not holding that the authorized initiative power is free of all limitations. In particular, we are not determining whether the electorate's initiative power is subject to the statutory provision [applicable to Bighorn-Desert View Water Agency] requiring that water service charges be set at a level that "will pay the operating expenses of the agency, ... provide for repairs and depreciation of works, provide a reasonable surplus for improvements, extensions, and enlargements, pay the interest on any bonded debt, and provide a sinking or other fund for the payment of the principal of such debt as it may become due." ... That issue is not currently before us.

Again, while the court's conclusion set forth above is dicta, it does represent the unanimous view of the justices.

While the City does not believe that Article XIIIC grants to the voters within the City the power to repeal or reduce rates and charges for the Water Service in a manner which would impair its ability to meet its contractual obligations, there can be no assurance as to the availability of particular remedies adequate to protect the Beneficial Owners of the 2006 Certificates. Remedies available to Beneficial Owners of the 2006 Certificates in the event of a default by the City are dependent upon judicial actions which are often subject to discretion and delay and could prove both expensive and time-consuming to obtain.

Effect of Proposition 218 and of Possible General Limitations on Enforcement Remedies

The ability of the City to comply with its covenants under the Contract and to generate Gross Revenues sufficient to pay the 1997 Payments, the 2006 Payments and any other Parity Obligations may be adversely affected by actions and events outside of the control of the City and by actions taken (or not taken) under Article XIIIC or Article XIIID by voters, property owners, taxpayers or payers of assessments, fees and charges. Furthermore, any remedies available to the Owners and Beneficial Owners of the 2006 Certificates upon the occurrence of an Event of Default under the 2006 Trust Agreement 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. In addition to the possible limitations on the ability of the City to comply with its covenants under the Contract, the rights and obligations of the City and the Authority under the 2006 Trust Agreement and the Contract may be subject to bankruptcy, insolvency, reorganization, arrangement, fraudulent conveyance, moratorium and other laws relating to or affecting creditors' rights, to the application of equitable principles, to the exercise of judicial discretion in appropriate cases and to limitations on legal remedies against cities in the State of California,

Based on the foregoing, in the event the City fails to comply with its covenants under the Contract, including its covenants to generate sufficient Gross Revenues to pay the 1997 Payments, the 2006 Payments and any other Parity Obligations, there can be no assurance that available remedies will be adequate to fully protect the interests of the Owners or Beneficial Owners of the 2006 Certificates.

Investment Policy

The cash attributable to the Water Utility System must be invested in accordance with the City's Investment Policy, adopted by the City Council during 1984 and most recently revised during
In accordance with Sections 53601 and following of the California Government Code, idle cash management and investment transactions are the responsibility of the City Finance Director/Treasurer and permitted investments include the following:

- Securities of the U.S. Government, or its agencies,
- Certificates of deposit (or time deposits) and negotiable certificates of deposit placed with commercial banks,
- Banker's acceptances,
- Commercial paper of "prime" quality,
- Local Agency Investment Fund (State Pool) Demand Deposits, and
- Repurchase agreements.

Criteria for selecting investments and the order of priority are:

- Safety of Principal- Preservation of principal and interest,
- Liquidity - Ability to readily convert investment to cash at any moment in time, and
- Yield - Potential dollar earnings on an investment.

The City's cash management system is designed to accurately monitor and forecast expenditures and revenues, thus enabling the City to invest funds to the fullest extent possible. The City attempts to obtain the highest yield when selecting an investment, provided the criteria for safety and liquidity are met.

Financial Statements

The City's annual financial report is audited in accordance with generally accepted auditing standards, and contains opinions that the financial statements present fairly, in all material respects, the financial position of the City. The reports include certain notes to the financial statements. Such notes constitute an integral part of the audited financial statements. The annual financial reports of the City have received the Government Finance Officers Association Certificate of Achievement for each of the past 22 years.

The basic financial statements of the City as of June 30, 2005, which are incorporated by reference in and portions of which are included in APPENDIX A to this Official Statement, have been audited by Maze & Associates (the "Auditor"), independent certified public accountants, as set forth in their report. In connection with the incorporation of the financial statements and the report of the Auditor thereon in APPENDIX A to this Official Statement, the City did not request the Auditor to, and the Auditor has not undertaken to, update its report or to take any action intended or likely to elicit information concerning the accuracy, completeness or fairness of the statements made in this Official Statement; and no opinion is expressed by the Auditor with respect to any event subsequent to the date of its report. The Auditor has not been engaged to perform, and has not performed, since the date of its report included herein any procedures on the financial statements addressed in that report.

RISK FACTORS

Some of the factors which could impair the ability of the City to pay the 2006 Payments as they become due under the 2006 Contract are summarized below. This discussion is not meant to be an exhaustive list of the risks associated with the purchase of the 2006 Certificates and does not
necessarily reflect the relative importance of the various factors discussed. Potential investors are advised to consider the following factors, along with all other information in this Official Statement, in evaluating the 2006 Certificates. There can be no assurance that other risk factors will not become material in the future.

General

The payment of principal and interest on the 2006 Certificates is secured solely by a pledge of the Gross Revenues of the Water Utility System and money on deposit in certain funds under the 2006 Trust Agreement. Under the terms of the Master Contract, Gross Revenues are to be deposited in the Revenue Fund and used by the City, ratably, without preference or priority, to (i) pay charges for Maintenance and Operation Costs of the Water Utility System (including amounts reasonably required to be set aside in contingency reserves for Maintenance and Operation Costs the payment of which is not immediately required) as such charges are due and payable and (ii) deposit in the Parity Obligation Payment Fund the amount described in the Master Contract (in general terms, debt service which has accrued or will accrue during the next succeeding month on all Parity Obligations and net payments due or which will be due on all Parity Payment Agreements). See "SECURITY FOR THE 2006 CERTIFICATES — Flow of Funds." The realization of revenues sufficient in amount to meet both of said obligations is subject to, among other things, the capabilities of management of the City, the ability of the City to provide water service to its users, and the ability of the City to establish and maintain water fees and charges sufficient to provide the required debt service coverage as well as pay for Maintenance and Operation Costs.

If Gross Revenues are insufficient to meet both of the requirements described above, the amounts available to pay Maintenance and Operation Costs will be reduced ratably along with the money to be deposited in the Parity Obligation Payment Fund. This could result in an inability on the part of the City to pay Maintenance and Operation Costs as the same become due which, in turn, could adversely affect the ability of the City to operate the Water Utility System thereby further reducing Gross Revenues.

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 Gross Revenues realized by the City.

Earthquakes, Floods and Other Natural Disasters

Earthquakes, floods or other natural disasters could interrupt operation of the Water Utility System and cause increased costs thereby impairing the ability of the City to realize Gross Revenues. The Master Contract requires the City to "procure and maintain such insurance relating to the Water Utility System which it shall deem advisable or necessary to protect its interests and the interests of the Authority, 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 Utility System." Such insurance is permitted to be maintained under a program of self-insurance so long as such program is maintained in the amounts and manner as is, in the opinion of an accredited actuary, actuarially sound. While City currently maintains insurance against damages to its Water Utility System in amounts up to $10,000,000, damages resulting from earthquakes are not covered. MID does not currently maintain insurance for damages to the Water Treatment Plant resulting from either floods or earthquakes.
Natural disasters could also adversely affect the service area of the Water Utility System, leading to reduced demand for water service and could also result in a loss or contamination of groundwater supplies and/or surface water supplies otherwise available to the City.

Demand for Water

There can be no assurance that the demand for water service will occur as described in this Official Statement. Not only is it possible that future increases in demand for water service will not occur at the rate described herein, it is also possible that current levels of demand could be reduced. A reduction in the level of demand could require an increase in rates or charges in order to comply with the Rate Covenant. See “SECURITY FOR THE 2006 CERTIFICATES — Rate Covenant.”

Water Supply

There can be no assurance that the supply of water available to the City to meet potential system-wide demand will be consistent with the assumptions described in this Official Statement. Adequacy of supply could be adversely affected by factors such as prolonged drought or increases in water quality standards which restrict the ability of the City to use existing groundwater supplies to meet demand. See “THE WATER UTILITY SYSTEM — Water Quality.” While the expansion of the Water Treatment Plant and the construction of the 2006 Project and subsequent improvements to the Water Utility System are intended to reduce the City’s dependence upon groundwater supplies, there is no assurance that any of such improvements will be completed or that they will be completed within a time frame and at a cost consistent with the various projections set forth in this Official Statement.

In addition to the potential problems of insufficient water to meet system-wide demand discussed above, it is possible that the supply of water to meet the demands of particular portions of the City’s water service area will be inadequate for such purposes. Some portions of the service area lack the wells necessary to supply them with groundwater, and other portions lack the infrastructure which would be required in order to deliver water from other portions of the service area.

Water Utility System Expenses

There can be no assurance that the Maintenance and Operation Costs will be consistent with the descriptions in this Official Statement. Increases in such costs could require a significant increase in rates or charges in order to pay for existing and future improvements to the Water Utility System and comply with the Rate Covenant.

Rate Process

The passage of Proposition 218 by the California electorate 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 under Proposition 218. See “THE WATER UTILITY SYSTEM — Impact of Proposition 218 on Water System Fees and Charges” and “ — Effect of Proposition 218 and of Possible General Limitations on Enforcement Remedies.”

Statutory and Regulatory Impact

Laws and regulations governing the treatment and delivery of water are enacted and promulgated by governmental agencies on the federal, state and local levels. Compliance with these
laws and regulations may prove costly; and, as more stringent statutory and regulatory standards are developed to protect both the health of consumers and environment, these costs will likely continue to increase. Claims against the City with respect to the Water Utility System could be significant, and such claims will be payable from Gross Revenues. No assurance can be given that the cost of compliance with applicable laws and regulations will not materially adversely affect the ability of the City to comply with the Rate Covenant.

Limitations on Remedies and Bankruptcy

The ability of the City to increase fees and charges for water service and to comply with the Rate Covenant may be adversely affected by actions and events outside of the control of the City and may be adversely affected by actions taken (or not taken) by voters, property owners, taxpayers or payers of fees and charges. See “THE WATER UTILITY SYSTEM — Impact of Proposition 218 on Water System Fees and Charges” and “ — Effect of Proposition 218 and of Possible General Limitations on Enforcement Remedies.” Furthermore, any remedies available to the Owners of the 2006 Certificates upon the occurrence of an event of default under the Contract 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.

In addition to the limitations on remedies contained in the Contract, the rights and obligations under the 2006 Certificates and the Contract may be subject to bankruptcy, insolvency, reorganization, arrangement, fraudulent conveyance, moratorium and other laws relating to or affecting creditors’ rights, to the application of equitable principles, to the exercise of judicial discretion in appropriate cases and to limitations on legal remedies against cities in the State of California. Various legal opinions to be delivered concurrently with the issuance of the 2006 Certificates will be so qualified. In addition, the opinion to be delivered by Sidley Austin LLP; Special Counsel, concurrently with the execution and delivery of the 2006 Certificates, will also state that the enforceability of the Contract is subject to the limitations on the imposition of fees and charges by the City relating to the Water Utility System under Articles XIIIC and XIID of the California Constitution. A copy of the proposed form of opinion of Special Counsel is set forth in APPENDIX D hereto. In the event the City fails to comply with its covenants under the Contract or to pay principal or interest evidenced by the 2006 Certificates, there can be no assurance that available remedies will be adequate to fully protect the interests of the Owners of the 2006 Certificates.

The enforcement of the remedies provided in the Contract could prove both expensive and time consuming. In addition, the rights and remedies provided in the Contract may be limited by and are subject to provisions of the federal bankruptcy laws, as now or hereafter enacted, and to other laws or equitable principles that may affect creditors’ rights.

Limited Obligations

The 2006 Certificates are limited obligations of the City are 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 Gross Revenues of the Water Utility System. The obligation of the City to make the 2006 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 AUTHORITY

The Authority was established pursuant to the provisions of Sections 6500 et seq. of the California Government Code and a Joint Exercise of Powers Agreement, dated as of December 1, 1989, by and between the City and the Industrial Development Authority of the City of Modesto. The Authority was established for the purpose of financing the acquisition, construction, improvement and equipping of public capital improvements. The governing board of the Authority consists of the City Council of the City.

APPROVAL OF LEGAL PROCEEDINGS

The legality and enforceability of the 2006 Contract and certain other legal matters are subject to the approval of Sidley Austin LLP, San Francisco, California, acting as Special Counsel. The proposed form of said firm’s legal opinion with respect to the 2006 Contract and the 2006 Certificates is attached hereto as APPENDIX D, and such legal opinion will be attached to each 2006 Certificate. Special Counsel undertakes no responsibility for the accuracy, completeness or fairness of this Official Statement. Certain legal matters will be passed upon for the City and the Authority by the City Attorney and by Stradling Yocca Carlson & Rauth, a Professional Corporation, Newport Beach, California, Disclosure Counsel; for the Underwriter by its counsel, Orrick, Herrington & Sutcliffe LLP; for the Trustee by its General Counsel; and for the 2006 Certificate Insurer by its General Counsel. Both Sidley Austin LLP and Stradling Yocca Carlson & Rauth, a Professional Corporation have represented the Underwriter in transactions not involving the City or the Authority. The payment of the fees of Special Counsel, Disclosure Counsel, Counsel to the Underwriter and the Trustee is contingent upon the execution and delivery of the 2006 Certificates.

LITIGATION

There is no action, suit, proceeding, inquiry or investigation, at law or in equity, before or by any court, regulatory agency, public board or body, pending or, to the knowledge of the City or the Authority, threatened against the City or the Authority affecting the existence of the City or the Authority or the titles of their respective directors or officers to their respective offices or seeking to restrain or to enjoin the sale or delivery of the 2006 Certificates, the application of the proceeds thereof in accordance with the 2006 Trust Agreement, or in any way contesting or affecting the validity or enforceability of the 2006 Certificates, the 2006 Trust Agreement, the Contract, or any action of the City or the Authority contemplated by any of said documents, or in any way contesting the completeness or accuracy of this Official Statement or any amendment or supplement thereto, or contesting the powers of the City or the Authority or their respective authority with respect to the 2006 Certificates or any action of the City or the Authority contemplated by any of said documents, nor to the knowledge of the City, is there any basis therefor.

TAX MATTERS

In the opinion of Sidley Austin LLP, San Francisco, California, Special Counsel, based on existing statutes, regulations, rulings and judicial decisions and assuming compliance with certain covenants in the 2006 Trust Agreement and the 2006 Contract and requirements of the Internal Revenue Code of 1986, as amended (the “Code”), regarding the use, expenditure and investment of proceeds of the 2006 Certificates and the timely payment of certain investment earnings to the United States, the portion of each 2006 Payment due under the 2006 Contract designated as and comprising interest with respect to the 2006 Certificates is not includable in the gross income of the Beneficial
Owners of the 2006 Certificates for federal income tax purposes. Failure to comply with such covenants and requirements may cause the portion of each 2006 Payment due under the 2006 Contract designated as and comprising interest with respect to the 2006 Certificates to be included in gross income retroactively to the date of execution and delivery of the 2006 Certificates.

In the further opinion of Special Counsel, the portion of each 2006 Payment due under the 2006 Contract designated as and comprising interest with respect to the 2006 Certificates is not treated as an item of tax preference in calculating the federal alternative minimum taxable income of individuals and corporations. Such portion of each 2006 Payment, however, is included as an adjustment in the calculation of federal corporate alternative minimum taxable income and may therefore affect a corporation's alternative minimum tax liability.

Ownership of, or the receipt of interest on or with respect to, tax-exempt obligations may result in collateral tax consequences to certain taxpayers, including, without limitation, financial institutions, property and casualty insurance companies, certain foreign corporations doing business in the United States, certain S corporations with excess passive income, individual recipients of Social Security or Railroad Retirement benefits, taxpayers that may be deemed to have incurred or continued indebtedness to purchase or carry tax-exempt obligations and taxpayers who may be eligible for the earned income tax credit. Special Counsel expresses no opinion with respect to any collateral tax consequences and, accordingly, prospective purchasers of the 2006 Certificates should consult their tax advisors as to the applicability of any collateral tax consequences.

Certain requirements and procedures contained or referred to in the 2006 Trust Agreement and the 2006 Contract and other relevant documents may be changed, and certain actions may be taken or omitted under the circumstances and subject to the terms and conditions set forth in such documents, upon the advice or with the approving opinion of counsel nationally recognized in the area of tax-exempt obligations. Special Counsel expresses no opinion as to the exclusion from gross income for federal income tax purposes of the portion of each 2006 Payment due under the 2006 Contract designated as and comprising interest with respect to the 2006 Certificates on and after the date on which any such change occurs or action is taken or omitted upon the advice or approval of counsel other than Sidley Austin LLP. The Authority and the City have covenanted in the 2006 Trust Agreement and the 2006 Contract that, in the event of any such change in the 2006 Trust Agreement, the 2006 Contract or any other relevant documents relating to the 2006 Certificates, or any other actions taken or omitted by the City or the Authority upon the advice or with the approving opinion of counsel other than Sidley Austin LLP, the Authority and the City will, upon the making of any such change, or the taking or omission of any such other action, cause to be delivered an opinion of counsel nationally recognized in the area of municipal bonds to the effect that the portion of each 2006 Payment due under the 2006 Contract designated as and comprising interest with respect to the 2006 Certificates is excluded from gross income for federal income tax purposes.

Legislation affecting municipal obligations is continually being considered by the United States Congress. There can be no assurance that legislation enacted after the date of execution and delivery of the 2006 Certificates will not have an adverse effect on the tax-exempt status of the 2006 Certificates. Legislation or regulatory actions and proposals may also affect the economic value of tax exemption or the market price of the 2006 Certificates.

In the further opinion of Special Counsel, the portion of each 2006 Payment due under the 2006 Contract designated as and comprising interest with respect to the 2006 Certificates is exempt from personal income taxes imposed by the State of California.
A copy of the proposed form of opinion of Special Counsel is attached hereto as APPENDIX D.

CONTINUING DISCLOSURE

The City has covenanted for the benefit of the Owners of the 2006 Certificates to provide certain financial information and operating data relating to the 2006 Certificates and the City by not later than 270 days after the end of the City's Fiscal Year (presently June 30) commencing with the report for the City's 2005-06 fiscal year (the "Annual Reports") and to provide notices of the occurrence of certain enumerated events, if deemed by the City to be material. The Annual Reports will be filed by the Trustee, as Dissemination Agent on behalf of the City, with each Nationally Recognized Municipal Securities Information Repository and with any State Repository which may be designated by the State of California (collectively, the "Repositories") and with the Underwriter and the Broker-Dealer. The notices of material events will be filed by the Trustee, as Dissemination Agent on behalf of the City, with the Repositories with copies to the City, the Underwriter and the Broker-Dealer. The specific nature of the information to be contained in the Annual Reports or the notices of material events is set forth in APPENDIX E — "FORM OF CONTINUING DISCLOSURE AGREEMENT." These covenants have been made in order to assist the Underwriter in complying with Rule 15c2 12(b)(5) of the Securities and Exchange Commission (the "Rule").

The City believes that it has never failed in any material respect to comply with an undertaking pursuant to the Rule. However, on October _, 2006, the City caused to be filed supplements to each of the five most recent Annual Reports that had been filed for it pursuant to the Continuing Disclosure Agreement (the "1997 Continuing Disclosure Agreement") executed by the City in connection with the Refunding Revenue Certificates of Participation (1997) Water Utility System Refinancing Project (the "1997 Certificates"). The 1997 Continuing Disclosure Agreement contains language identical to the language in paragraph 4 of Section 4 of the Form of Continuing Disclosure Agreement included in APPENDIX E. That language requires the City to include in its Annual Report, among other things, "Updated information similar to that contained in the tables entitled . . . WATER UTILITY SYSTEM - Ten Largest Customers, appearing under the caption 'WATER UTILITY SYSTEM - Service Area and Customer' of the [1997] Official Statement." (Emphasis added.) In the 1997 Official Statement, that table included (a) the name of the customer, (b) its type of business, (c) its water usage, (d) its percentage of total water usage (e) its water sales revenue and (f) its percentage of total water sales revenue. The Annual Reports filed for the City had included items (a), (b) and (f) as well as the total water sales revenue from which item (e) could be calculated and data with respect to costs of water from which reasonable estimates of item (c) could be established. However, those Annual Reports did not include the customer's percentage of total water usage. The City does not believe that the omitted data represented a material failure to comply with the terms of the 1997 Continuing Disclosure Agreement. However, in the supplements to the Annual Reports referred to above, the City reported those data, and the City intends to include such data in future Annual Reports filed pursuant to the 1997 Continuing Disclosure Agreement. In addition, in the process of preparing the aforesaid supplements, the City rechecked the data set forth in the Annual Reports and made certain revisions to such data. Those revisions show that the top ten customers of the Water Utility System represented a smaller percentage of total water sales revenues than had previously been reported.
RATINGS

Moody's Investors Service, Inc. ("Moody's") and Standard & Poor's Ratings Services ("S&P") are expected to assign their ratings of "Aaa" and "AAA", respectively, to the 2006 Certificates with the understanding that upon delivery of the 2006 Certificates, the 2006 Certificate Insurance Policy will be issued by the 2006 Certificate Insurer. In addition, Moody's has assigned an underlying rating of "A2" to the 2006 Certificates, and S&P has assigned them an underlying rating of "A+". Generally, rating agencies base their ratings on information and material furnished directly to them and on investigations, studies and assumptions made by them. The ratings reflect only the views of such organizations and an explanation of the significance of such ratings may be obtained from Moody's Investors Service, 99 Church Street, New York, New York 10017 and Standard & Poor's Ratings Services, 55 Water Street, New York, New York 10041. There is no assurance that the ratings will continue for any given period of time or that they will not be revised downward or withdrawn entirely by such 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 2006 Certificates.

FINANCIAL ADVISOR

The City has retained Public Financial Management, Inc., of San Francisco, California, as Financial Advisor (the "Financial Advisor") in connection with the execution and delivery of the 2006 Certificates. The Financial Advisor is not obligated to undertake, and has not undertaken to make, an independent verification or assume responsibility for the accuracy, completeness, or fairness of the information contained in this Official Statement. Public Financial Management, Inc., is an independent financial advisory firm and is not engaged in the business of underwriting, trading or distributing municipal securities or other public securities.

CERTAIN RELATIONSHIPS

Banc of America Securities LLC, the Underwriter and Broker-Dealer, and Bank of America, N.A., the Swap Provider, are affiliates, both being subsidiaries of Bank of America Corporation.

UNDERWRITING

The 2006 Certificates will be purchased by Banc of America Securities LLC (the "Underwriter"), under a Certificate Purchase Agreement, dated _______, 2006, pursuant to which the Underwriter has agreed to purchase all, but not less than all, of the 2006 Certificates for an aggregate purchase price of $__________ (representing the principal evidenced thereby less Underwriter's discount of $__________).
MISCELLANEOUS

Insofar as any statements made in this Official Statement involve matters of opinion or of estimates, whether or not expressly stated, they are set forth as such and not as representations of fact. No representation is made that any of such statements made will be realized. Neither this Official Statement nor any statement which may have been made verbally or in writing is to be construed as a contract with the Owners of the 2006 Certificates.

The execution and delivery of this Official Statement have been duly authorized by the City and the Authority.

CITY OF MODESTO, CALIFORNIA

By: ____________________________

MODESTO PUBLIC FINANCING AUTHORITY

By: ____________________________
APPENDIX A

EXCERPTS FROM THE CITY'S FINANCIAL STATEMENTS

The City has filed its Comprehensive Annual Financial Report ("CAFR") for Fiscal Year 2004-05 with the Nationally Recognized Municipal Securities Information Repositories. Such CAFR is incorporated herein by reference. The following are excerpts from the CAFR relating to the Water Utility System.
CITY OF MODESTO
STATEMENT OF NET ASSETS - PROPRIETARY FUNDS
June 30, 2005

<table>
<thead>
<tr>
<th>ASSETS</th>
<th>Water</th>
<th>Sewer</th>
<th>Other Enterprise</th>
<th>Total Enterprise</th>
<th>Internal Service</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current assets:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash and cash equivalents</td>
<td>$11,392,092</td>
<td>$18,567,796</td>
<td>$6,616,346</td>
<td>$36,576,234</td>
<td>$42,889,298</td>
</tr>
<tr>
<td>Cash and cash equivalents with fiscal agent</td>
<td>263,978</td>
<td>4,010,327</td>
<td>666,895</td>
<td>4,881,200</td>
<td></td>
</tr>
<tr>
<td>Receivables:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accounts</td>
<td>82,656</td>
<td>167,761</td>
<td>216,481</td>
<td>384,242</td>
<td>346,802</td>
</tr>
<tr>
<td>Interest</td>
<td>2,367,136</td>
<td>548,874</td>
<td>7,205,330</td>
<td>149,157</td>
<td></td>
</tr>
<tr>
<td>Taxes</td>
<td>3,371</td>
<td>127,064</td>
<td>1,433,934</td>
<td>3,573</td>
<td></td>
</tr>
<tr>
<td>Due from governments</td>
<td>941,175</td>
<td>630,000</td>
<td>941,175</td>
<td>375,519</td>
<td></td>
</tr>
<tr>
<td>Prepaid expenses</td>
<td>2,000,000</td>
<td>2,000,000</td>
<td>3,573</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total current assets</td>
<td>16,972,592</td>
<td>25,414,342</td>
<td>10,119,322</td>
<td>45,760,776</td>
<td></td>
</tr>
</tbody>
</table>

| Noncurrent assets: |       |       |                  |                  |                  |
| Notes receivable, net | 501,259 | 315,232 | 816,491 | |
| Unamortized costs of issuance | 254,452 | 634,777 | 889,229 | |
| Land and construction in progress | 5,811,741 | 24,575,635 | 16,764,678 | 821,033 |
| Other capital assets, net of accumulated depreciation | 66,385,561 | 106,970,689 | 61,044,600 | 17,530,499 |
| Total assets | 90,125,605 | 157,910,675 | 87,928,600 | 335,964,880 | 64,115,404 |

| LIABILITIES |       |       |                  |                  |                  |
| Current liabilities: |       |       |                  |                  |                  |
| Accounts payable | 585,923 | 599,228 | 828,926 | 2,014,077 | 1,194,871 |
| Accrued salaries and benefits | 51,096 | 69,020 | 39,062 | 159,178 | 52,562 |
| Due to other funds | 285,989 | 344,200 | 52,568 | 682,757 | |
| Total current liabilities | 1,952,103 | 2,070,347 | 3,329,964 | 7,352,414 | 8,468,397 |

Noncurrent liabilities:
Payable from restricted assets-refundable deposits | 501,259 | 315,232 | 816,491 |
Compensated absences | 60,221,829 |
Claims liability | 9,129,900 |

Long-term debt:
Revenue bonds payable | 36,697,428 |
Loan payable | 2,156,040 |
Notes payable | 2,156,040 |
Obligations under capital leases | 222,588 |
Certificates of participation | 18,668,167 |
Developer advances | 2,182,336 |
Total liabilities | 45,584,908 |
Invested in capital assets, net of related debt | 50,641,533 |
Restricted for capital projects | 93,568,409 |
Unrestricted | 72,348,208 |
Total net assets | 216,558,150 |
调整 to reflect the consolidation of internal service fund activities related to enterprise funds. | 77,991,160 |
Net assets of business-type activities | 92,547 |

The notes to basic financial statements are an integral part of this statement.
CITY OF MODESTO
STATEMENT OF REVENUES, EXPENSES AND CHANGES
IN FUND NET ASSETS - PROPRIETARY FUNDS
Year Ended June 30, 2005

<table>
<thead>
<tr>
<th>Enterprise</th>
<th>Water</th>
<th>Sewer</th>
<th>Other Enterprise</th>
<th>Total Enterprise</th>
<th>Internal Service</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>OPERATING REVENUES:</strong></td>
<td>$31,315,920</td>
<td>$24,419,607</td>
<td>$11,233,197</td>
<td>$66,968,724</td>
<td>$67,256,696</td>
</tr>
<tr>
<td>Charges for services</td>
<td>$3,034,646</td>
<td>(2,768,263)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sales</td>
<td>1,012,165</td>
<td>700,932</td>
<td>684,216</td>
<td>2,494,293</td>
<td>14,107,245</td>
</tr>
<tr>
<td>Cost of sales</td>
<td>1,728,962</td>
<td>2,263,834</td>
<td>10,114,453</td>
<td>15,107,245</td>
<td>1,357,225</td>
</tr>
<tr>
<td>Maintenance and supplies</td>
<td>3,728,462</td>
<td>2,494,293</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Water purchases</td>
<td>11,751,150</td>
<td>11,751,150</td>
<td>734,120</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Insurance</td>
<td>118,168</td>
<td>980,075</td>
<td>172,803</td>
<td>1,238,667</td>
<td>10,636,951</td>
</tr>
<tr>
<td>Depreciation</td>
<td>2,305,953</td>
<td>5,092,264</td>
<td>3,532,827</td>
<td>10,930,904</td>
<td>2,578,355</td>
</tr>
<tr>
<td><strong>Total operating revenues</strong></td>
<td>$31,315,920</td>
<td>$24,419,607</td>
<td>$11,514,908</td>
<td>$67,250,435</td>
<td>$67,523,079</td>
</tr>
</tbody>
</table>

| **OPERATING EXPENSES:** | $29,227,465 | $21,347,394 | $23,816,475 | $74,391,334 | $67,649,121 |
| Salaries and wages | $4,149,167 | $5,533,764 | 890,050 | 5,593,309 |
| Contractual services | 1,777,564 | 2,263,834 |
| Utilities         | 1,599,480   | 5,092,264   | 450,616      | 1,357,225 |
| Maintenance and supplies | 1,357,225 | 1,357,225 |
| Water purchases   | 11,751,150 | 11,751,150 | 734,120 |
| Insurance         | 118,168     | 980,075     | 172,803       | 1,238,667 |
| Depreciation      | 2,305,953   | 5,092,264   | 3,532,827     | 10,930,904 |
| **Total operating expenses** | $29,227,465 | $21,347,394 | $23,816,475 | $74,391,334 | $67,649,121 |

| **OPERATING INCOME (LOSS)** | $2,088,455 | $3,072,213 | $1,514,908 | $17,140,899 | $1,404,962 |

| NONOPERATING REVENUES (EXPENSES) | $7,525,367 | $260,064 | $20,942 | $36,990,696 |
| Operating grants            | (402,673)  | (90,117) | (20,942) | (193,732) |
| Gain (Loss) on disposition of capital assets | (198,137) |
| Tax revenue                 | (20,942)   | (20,942) | (20,942) | (20,942) |
| Tax expense                 | (3,839)    | (13,839) | (13,839) | (13,839) |
| Interest income             | 247,831    | 545,734  | 221,798 | 1,015,363 |
| Net decrease in fair value of investments | 221,798 |
| Rental income               | 31,785     | 24,158   | 678,577 | 734,320 |
| Settlements and recoveries  | 2,960,781  | 4,435,846 | 7,396,627 | 15,672 |
| Interest expense            | (1,251,395)| (1,182,467)| (318,612) | (2,752,474)|
| Amortization of costs of issuance | (13,839) |
| **Total nonoperating revenues (expenses)** | $1,514,416 | $3,564,978 | $8,159,545 | $12,238,939 |

| INCOME (LOSS) BEFORE CAPITAL CONTRIBUTIONS AND TRANSFERS | $3,602,871 | $6,627,191 | $4,142,022 | $6,098,040 | $322,686 |
| Capital contributions       | 2,738,331  | 1,643,416  | 4,476,661  | 8,498,408 | 706,694 |
| Transfers in                | 528,000    | 327,119    | 846,136    | 1,701,255 | 475,000 |
| Transfers out               | (229,027)  | (134,795)  | (30,519)   | (394,341) | (99,419) |
| Special item                | (898,505)  | (1,040,101)| (1,040,101)| (1,098,606) |
| **CHANGE IN NET ASSETS**    | 5,381,670  | 7,432,830  | 1,150,256  | 13,964,756 | 1,404,961 |
| NET ASSETS, July 1          | 59,284,030 | 111,172,250| 77,593,180| (15,280,717)|
| NET ASSETS, June 30         | $64,665,700| $118,605,080| $78,743,636| ($13,825,756) |

Adjustment to reflect the consolidation of internal service fund activities related to enterprise funds. 882,187
Change in net assets of business-type activities $14,846,943

The notes to basic financial statements are an integral part of this statement.
CITY OF MODESTO
STATEMENT OF CASH FLOWS - PROPRIETARY FUNDS
Year Ended June 30, 2005

<table>
<thead>
<tr>
<th>Enterprise</th>
<th>Water</th>
<th>Sewer</th>
<th>Other Enterprise</th>
<th>Total Enterprise</th>
<th>Internal Service</th>
</tr>
</thead>
<tbody>
<tr>
<td>Receipts from customers and users</td>
<td>$29,713,475</td>
<td>$24,682,311</td>
<td>$12,152,712</td>
<td>$66,548,498</td>
<td>$261,741</td>
</tr>
<tr>
<td>Receipts from interfund services provided</td>
<td>608,112</td>
<td>111,231</td>
<td>23,607</td>
<td>742,950</td>
<td>67,227,001</td>
</tr>
<tr>
<td>Payments to suppliers</td>
<td>(18,484,455)</td>
<td>(6,917,285)</td>
<td>(12,768,257)</td>
<td>(38,169,997)</td>
<td>(16,134,081)</td>
</tr>
<tr>
<td>Payment of insurance claims</td>
<td>(5,011,327)</td>
<td>(6,568,579)</td>
<td>(4,150,754)</td>
<td>(15,730,660)</td>
<td>(38,390,175)</td>
</tr>
<tr>
<td>Payments for interfund services used</td>
<td>(5,212,937)</td>
<td>(4,221,944)</td>
<td>(3,477,582)</td>
<td>(12,912,463)</td>
<td>(2,164,113)</td>
</tr>
<tr>
<td>Net cash provided (used) by operating activities</td>
<td>1,612,868</td>
<td>7,085,734</td>
<td>(8,220,274)</td>
<td>478,328</td>
<td>5,798,602</td>
</tr>
</tbody>
</table>

CASH FLOWS FROM NON CAPITAL FINANCING ACTIVITIES:
- Operating grants received | 6,564,032 |
- Taxes received | 260,064 |
- Settlements and recoveries | 7,396,627 |
- Transfers in | 2,960,781 |
- Transfers out | (229,027) |
| Net cash provided (used) by noncapital financing activities | 3,259,754 |
| CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:
- Acquisition and construction of capital assets | (5,231,056) |
- Proceeds of refunding revenue bonds | 39,235,000 |
- Bond premium | 2,300,405 |
- Payment to refunded bond escrow account | (42,988,215) |
- Costs of issuance | (559,409) |
- Proceeds of capital lease | 290,487 |
- Principal repayments | (994,636) |
- Interest paid | (1,163,784) |
| Net cash used by capital and related financing activities | (6,009,751) |

CASH FLOWS FROM INVESTING ACTIVITIES:
- Interest received | 216,322 |
- Net increase in the fair value of investments | 24,533 |
| Net cash provided by investing activities | 240,855 |

Net increase (decrease) in cash and cash equivalents | (896,254) |

CASH AND CASH EQUIVALENTS, JULY 1 | $12,157,129 |

CASH AND CASH EQUIVALENTS, JUNE 30 | $22,893,355 |

RECONCILIATION TO STATEMENT OF NET ASSETS:
- Cash and cash equivalents | $11,392,092 |
- Cash and cash equivalents with fiscal agent | 263,978 |
- Restricted assets-cash and cash equivalents | 501,259 |
| TOTAL CASH AND CASH EQUIVALENTS | $12,157,129 |

(continued)
### RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES:

<table>
<thead>
<tr>
<th></th>
<th>Enterprise</th>
<th>Water</th>
<th>Sewer</th>
<th>Other Enterprise</th>
<th>Total Enterprise</th>
<th>Internal Serv</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating income (loss)</td>
<td></td>
<td>$ 2,088,455</td>
<td>$ 3,072,213</td>
<td>$(12,201,567)</td>
<td>$(7,140,899)</td>
<td>$ (126,042)</td>
</tr>
<tr>
<td>Adjustments to reconcile operating income (loss) to net cash provided (used) by operating activities:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Depreciation</td>
<td></td>
<td>2,305,953</td>
<td>5,092,264</td>
<td>3,532,687</td>
<td>10,930,904</td>
<td>2,578,355</td>
</tr>
<tr>
<td>Rental income</td>
<td></td>
<td>31,785</td>
<td>24,158</td>
<td>678,577</td>
<td>734,520</td>
<td></td>
</tr>
<tr>
<td>Taxes paid</td>
<td></td>
<td>(82,673)</td>
<td>(90,117)</td>
<td>(19,252)</td>
<td>(192,042)</td>
<td></td>
</tr>
<tr>
<td>Special item</td>
<td></td>
<td>(898,505)</td>
<td>(1,040,101)</td>
<td>(1,938,606)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Change in assets and liabilities:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(Increase) in accounts receivable</td>
<td></td>
<td>963</td>
<td>403,291</td>
<td>(75,154)</td>
<td>329,100</td>
<td>(34,495)</td>
</tr>
<tr>
<td>(Increase) in utilities receivable</td>
<td></td>
<td>(1,024,978)</td>
<td>(63,690)</td>
<td>(71,992)</td>
<td>(1,160,660)</td>
<td></td>
</tr>
<tr>
<td>(Increase) in taxes receivable</td>
<td></td>
<td>(1,391)</td>
<td></td>
<td></td>
<td>(1,391)</td>
<td></td>
</tr>
<tr>
<td>Decrease in notes receivable</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(Increase) in prepaid expenses</td>
<td></td>
<td>(544,385)</td>
<td></td>
<td></td>
<td>(544,385)</td>
<td>28,863</td>
</tr>
<tr>
<td>(Increase) in inventories</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(Decrease) in accounts payable and accrued expenses</td>
<td></td>
<td>(280,499)</td>
<td>(348,275)</td>
<td>(106,616)</td>
<td>(735,390)</td>
<td>(255,974)</td>
</tr>
<tr>
<td>Increase in accrued salaries and benefits</td>
<td></td>
<td>18,855</td>
<td>25,815</td>
<td>14,753</td>
<td>59,423</td>
<td>19,221</td>
</tr>
<tr>
<td>Increase in compensated absences</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(Decrease) in claims liability</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Increase in deferred revenues</td>
<td></td>
<td>(712)</td>
<td>10,176</td>
<td></td>
<td>128,290</td>
<td>128,290</td>
</tr>
<tr>
<td>Increase (decrease) in refundable deposits</td>
<td></td>
<td>(475,587)</td>
<td>4,013,521</td>
<td>4,081,293</td>
<td>7,619,227</td>
<td>5,924,644</td>
</tr>
<tr>
<td>Total adjustments</td>
<td></td>
<td>1,612,868</td>
<td>7,085,734</td>
<td>$(8,220,274)</td>
<td>$ 478,328</td>
<td>$ 5,798,602</td>
</tr>
<tr>
<td>Net cash provided (used) by operating activities</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### NONCASH INVESTING, CAPITAL AND FINANCING ACTIVITIES:

<table>
<thead>
<tr>
<th></th>
<th>Enterprise</th>
<th>Water</th>
<th>Sewer</th>
<th>Other Enterprise</th>
<th>Total Enterprise</th>
<th>Capital asset additions accrued at year end</th>
<th>$ 20,700</th>
<th>$ 5,521</th>
<th>$ 26,221</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital assets transferred in</td>
<td></td>
<td>$ 39,851</td>
<td>3,140,901</td>
<td>3,180,752</td>
<td>$ 706,694</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Developer infrastructure contributions</td>
<td></td>
<td>998,606</td>
<td>891,764</td>
<td>673,936</td>
<td>2,564,306</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The notes to basic financial statements are an integral part of this statement.
APPENDIX B

DEFINITIONS AND SUMMARY OF PRINCIPAL LEGAL DOCUMENTS

[TO COME FROM SPECIAL COUNSEL]
APPENDIX C

ARS PROVISIONS

ARTICLE I

DEFINITIONS

In addition to the words and terms elsewhere in the 2006 Trust Agreement (the "Trust Agreement") the following words and terms have the following meanings with respect to the 2006 Certificates in an ARS Mode, unless the context or use indicates another or different meaning or intent:

Agent Member means a member of, or participant in, the Securities Depository who shall act on behalf of a Bidder.

All Hold Rate means, as of any Auction Date, 55% of the ARS Index in effect on such Auction Date.

ARS means Auction Rate Securities.

ARS Certificates means the 2006 Certificates while the 2006 Certificates evidence interest at the ARS Rate.

ARS Index shall have the meaning specified in Section 2.06 of this Appendix.

ARS Rate means for the 2006 Certificates, the rate of interest to be evidenced by the 2006 Certificates during each Auction Period determined in accordance with Section 2.03 of this Appendix; provided, however, that in no event may the ARS Rate exceed the Maximum Interest Rate.

ARS Rate Conversion Date means the date on which ARS Certificates convert from a Mode other than an ARS Mode to the ARS Mode for an ARS Rate Period and begin to evidence interest at an ARS Rate.

ARS Rate Period means (i) any period of time commencing on the day following the Initial Period to but not including a Conversion Date for the ARS Certificates and (ii) the period from and including an ARS Rate Conversion Date for the 2006 Certificates to but excluding the next Conversion Date for the 2006 Certificates.

Auction means each periodic implementation of the Auction Procedures.

Auction Agent means the auctioneer appointed in accordance with Section 3.01 or 3.02 of this Appendix. The initial Auction Agent shall be The Bank of New York.

Auction Agreement means an agreement between an Auction Agent and the Trustee approved by the 2006 Certificate Insurer pursuant to which an Auction Agent agrees to follow the
procedures specified in this Appendix with respect to ARS Certificates, as such agreement may from
time to time be amended or supplemented.

**Auction Date** means, with respect to ARS Certificates, (a) if the ARS Certificates are in a
daily Auction Period, each Business Day, (b) if the ARS Certificates are in a Special Auction Period,
the last Business Day of the Special Auction Period, and (c) if the ARS Certificates are in any other
Auction Period, the Business Day next preceding each Interest Payment Date for the ARS
Certificates (whether or not an Auction shall be conducted on such date); provided, however, that the
last Auction Date with respect to the ARS Certificates in an Auction Period other than a daily
Auction Period or a Special Auction Period shall be the earlier of (i) the Business Day next preceding
the Interest Payment Date next preceding the Conversion Date for the ARS Certificates and (ii) the
Business Day next preceding the Interest Payment Date next preceding the final Maturity Date; and
provided, further, that if the ARS Certificates are in a daily Auction Period, the last Auction Date
shall be the earlier of (x) the Business Day next preceding the Conversion Date for the ARS
Certificates and (y) the Business Day next preceding the final Maturity Date. The last Business Day
of a Special Auction Period shall be the Auction Date for the Auction Period which begins on the
next succeeding Business Day, if any. On the Business Day preceding the conversion from a daily
Auction Period to another Auction Period, there shall be two Auctions, one for the last daily Auction
Period and one for the first Auction Period following the conversion. The first Auction Date for the
ARS Certificates is ________, 2006.

**Auction Period** means with respect to the ARS Certificates:

(a) a Special Auction Period;

(b) with respect to the ARS Certificates in a daily Auction Period, a period
beginning on each Business Day and extending to but not including the next succeeding
Business Day;

(c) with respect to the ARS Certificates in a seven day Auction Period and with
Auctions generally conducted on (i) Fridays, a period of generally seven days beginning on a
Monday (or the day following the last day of the prior Auction Period if the prior Auction
Period does not end on a Sunday) and ending on the Sunday thereafter (unless such Sunday is
not followed by a Business Day, in which case on the next succeeding day which is followed
by a Business Day), (ii) Mondays, a period of generally seven days beginning on a Tuesday
(or the day following the last day of the prior Auction Period if the prior Auction Period does
not end on a Monday) and ending on the Monday thereafter (unless such Monday is not
followed by a Business Day, in which case on the next succeeding day which is followed
by a Business Day), (iii) Tuesdays, a period of generally seven days beginning on a Wednesday
(or the day following the last day of the prior Auction Period if the prior Auction Period does
not end on a Tuesday) and ending on the Tuesday thereafter (unless such Tuesday is not
followed by a Business Day, in which case on the next succeeding day which is followed
by a Business Day), (iv) Wednesdays, a period of generally seven days beginning on a Thursday
(or the day following the last day of the prior Auction Period if the prior Auction Period does
not end on a Wednesday) and ending on the Wednesday thereafter (unless such Wednesday is
not followed by a Business Day, in which case on the next succeeding day which is followed
by a Business Day), and (v) Thursdays, a period of generally seven days beginning on a
Friday (or the day following the last day of the prior Auction Period if the prior Auction
Period does not end on a Thursday) and ending on the Thursday thereafter (unless such
Thursday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day);

(d) with respect to the ARS Certificates in a 28-day Auction Period and with Auctions generally conducted on (i) Fridays, a period of generally 28 days beginning on a Monday (or the day following the last day of the prior Auction Period if the prior Auction Period does not end on a Sunday) and ending on the fourth Sunday thereafter (unless such Sunday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day), (ii) Mondays, a period of generally 28 days beginning on a Tuesday (or the day following the last day of the prior Auction Period if the prior Auction Period does not end on a Monday) and ending on the fourth Monday thereafter (unless such Monday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day), (iii) Tuesdays, a period of generally 28 days beginning on a Wednesday (or the day following the last day of the prior Auction Period if the prior Auction Period does not end on a Tuesday) and ending on the fourth Tuesday thereafter (unless such Tuesday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day), (iv) Wednesdays, a period of generally 28 days beginning on a Thursday (or the day following the last day of the prior Auction Period if the prior Auction Period does not end on a Wednesday) and ending on the fourth Wednesday thereafter (unless such Wednesday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day), and (v) Thursdays, a period of generally 28 days beginning on a Friday (or the day following the last day of the prior Auction Period if the prior Auction Period does not end on a Thursday) and ending on the fourth Thursday thereafter (unless such Thursday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day);

(e) with respect to the ARS Certificates in a 35-day Auction Period and with Auctions generally conducted on (i) Fridays, a period of generally 35 days beginning on a Monday (or the day following the last day of the prior Auction Period if the prior Auction Period does not end on Sunday) and ending on the fifth Sunday thereafter (unless such Sunday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day), (ii) Mondays, a period of generally 35 days beginning on a Tuesday (or the day following the last day of the prior Auction Period if the prior Auction Period does not end on Monday) and ending on the fifth Monday thereafter (unless such Monday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day), (iii) Tuesdays, a period of generally 35 days beginning on a Wednesday (or the day following the last day of the prior Auction Period if the prior Auction Period does not end on Tuesday) and ending on the fifth Wednesday thereafter (unless such Tuesday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day), (iv) Wednesdays, a period of generally 35 days beginning on a Thursday (or the day following the last day of the prior Auction Period if the prior Auction Period does not end on Wednesday) and ending on the fifth Thursday thereafter (unless such Wednesday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day), and (v) Thursdays, a period of generally 35 days beginning on a Friday (or the day following the last day of the prior Auction Period if the prior Auction Period does not end on Thursday) and ending on the fifth Thursday thereafter (unless such Thursday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day);
(f) with respect to the ARS Certificates in a three-month Auction Period, a period of generally three months (or shorter period upon a conversion from another Auction Period) beginning on the day following the last day of the prior Auction Period and ending on the first day of the month that is the third calendar month following the beginning date of such Auction Period (unless such first day of the month is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day); and

(g) with respect to the ARS Certificates in a six-month Auction Period, a period of generally six months (or shorter period upon a conversion from another Auction Period) beginning on the day following the last day of the prior Auction Period and ending on the [next succeeding March 31 or September 30]/last day of the month which is the sixth calendar month following the beginning date of such Auction Period (such six month period to include the month when the six-month Auction Period commenced) and ending on the last day of every sixth month thereafter; provided that no six-month Auction Period for the ARS Certificates may extend beyond the Maturity Date];

provided, however, that:

(a) if there is a conversion of the ARS Certificates with Auctions generally conducted on Fridays (i) from a daily Auction Period to a seven-day Auction Period, the next Auction Period shall begin on the date of the conversion (i.e. the Interest Payment Date for the prior Auction Period) and shall end on the next succeeding Sunday (unless such Sunday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day), (ii) from a daily Auction Period to a 28-day Auction Period, the next Auction Period shall begin on the date of the conversion (i.e. the Interest Payment Date for the prior Auction Period) and shall end on the Sunday (unless such Sunday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day) which is more than 21 days but not more than 28 days from such date of conversion, and (iii) from a daily Auction Period to a 35-day Auction Period, the next Auction Period shall begin on the date of the conversion (i.e. the Interest Payment Date for the prior Auction Period) and shall end on the Sunday (unless such Sunday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day) which is more than 28 days but no more than 35 days from such date of conversion;

(b) if there is a conversion of the ARS Certificates with Auctions generally conducted on Mondays (i) from a daily Auction Period to a seven-day Auction Period, the next Auction Period shall begin on the date of the conversion (i.e. the Interest Payment Date for the prior Auction Period) and shall end on the next succeeding Monday (unless such Monday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day), (ii) from a daily Auction Period to a 28-day Auction Period, the next Auction Period shall begin on the date of the conversion (i.e. the Interest Payment Date for the prior Auction Period) and shall end on the Monday (unless such Monday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day) which is more than 21 days but not more than 28 days from such date of conversion, and (iii) from a daily Auction Period to a 35-day Auction Period, the next Auction Period shall begin on the date of the conversion (i.e. the Interest Payment Date for the prior Auction Period) and shall end on the Monday (unless such Monday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day) which is more than 28 days but no more than 35 days from such date of conversion;
(c) if there is a conversion of the ARS Certificates with Auctions generally conducted on Tuesdays (i) from a daily Auction Period to a seven-day Auction Period, the next Auction Period shall begin on the date of the conversion (i.e. the Interest Payment Date for the prior Auction Period) and shall end on the next succeeding Tuesday (unless such Tuesday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day) (ii) from a daily Auction Period to a 28-day Auction Period, the next Auction Period shall begin on the date of the conversion (i.e. the Interest Payment Date for the prior Auction Period) and shall end on the Tuesday (unless such Tuesday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day) which is more than 21 days but not more than 28 days from such date of conversion, and (iii) from a daily Auction Period to a 35-day Auction Period, the next Auction Period shall begin on the date of the conversion (i.e. the Interest Payment Date for the prior Auction Period) and shall end on Tuesday (unless such Tuesday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day) which is more than 28 days but no more than 35 days from such date of conversion;

d) if there is a conversion of the ARS Certificates with Auctions generally conducted on Wednesdays (i) from a daily Auction Period to a seven-day Auction Period, the next Auction Period shall begin on the date of the conversion (i.e. the Interest Payment Date for the prior Auction Period) and shall end on the next succeeding Wednesday (unless such Wednesday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day) (ii) from a daily Auction Period to a 28-day Auction Period, the next Auction Period shall begin on the date of the conversion (i.e. the Interest Payment Date for the prior Auction Period) and shall end on the Wednesday (unless such Wednesday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day) which is more than 21 days but not more than 28 days from such date of conversion, and (iii) from a daily Auction Period to a 35-day Auction Period, the next Auction Period shall begin on the date of the conversion (i.e. the Interest Payment Date for the prior Auction Period) and shall end on Wednesday (unless such Wednesday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day) which is more than 28 days but no more than 35 days from such date of conversion;

e) if there is a conversion of the ARS Certificates with Auctions generally conducted on Thursdays (i) from a daily Auction Period to a seven-day Auction Period, the next Auction Period shall begin on the date of the conversion (i.e. the Interest Payment Date for the prior Auction Period) and shall end on the next succeeding Thursday (unless such Thursday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day) (ii) from a daily Auction Period to a 28-day Auction Period, the next Auction Period shall begin on the date of the conversion (i.e. the Interest Payment Date for the prior Auction Period) and shall end on the Thursday (unless such Thursday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day) which is more than 21 days but not more than 28 days from such date of conversion, and (iii) from a daily Auction Period to a 35-day Auction Period, the next Auction Period shall begin on the date of the conversion (i.e. the Interest Payment Date for the prior Auction Period) and shall end on Thursday (unless such Thursday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day) which is more than 28 days but no more than 35 days from such date of conversion.
Notwithstanding the foregoing, if an Auction is for an Auction Period of more than seven days and the Auction Rate on such Auction Date is the Maximum Interest Rate because Sufficient Clearing Bids do not exist, the Auction Period shall automatically change to a seven-day Auction Period.

**Auction Procedures** means the procedures for conducting Auctions for the ARS Certificates during an ARS Rate Period set forth in this Appendix.

**Auction Rate** means for the ARS Certificates, the rate of interest to be borne by the ARS Certificates during each Auction Period determined in accordance with Section 2.03 of this Appendix, which: (i) if Sufficient Clearing Bids exist, shall be the Winning Bid Rate, provided, however, if all of the ARS Certificates are the subject of Submitted Hold Orders, such rate shall be the All Hold Rate with respect to the ARS Certificates; and (ii) if Sufficient Clearing Bids do not exist, such rate shall be the Maximum Interest Rate with respect to the ARS Certificates.

**Available Certificates** means for the ARS Certificates on each Auction Date, the aggregate principal amount of ARS Certificates that are not the subject of Submitted Hold Orders.

**Bid** has the meaning specified in subsection (a) of Section 2.01 of this Appendix.

**Bidder** means each Existing Owner and Potential Owner who places an Order.

**Broker-Dealer** means any entity that is permitted by law to perform the function required of a Broker-Dealer described in this Appendix that is a member of, or a direct participant in, the Securities Depository, that has been selected by the Authority and that is a party to a Broker-Dealer Agreement with the Auction Agent.

**Broker-Dealer Agreement** means an agreement approved by the 2006 Certificate Insurer among the Auction Agent, the Authority and a Broker-Dealer pursuant to which such Broker-Dealer agrees to follow the procedures described in this Appendix, as such agreement may from to time be amended or supplemented.

**Broker-Dealer Deadline** means the internal deadline established by each Broker-Dealer after which it will not accept Orders or any change in any Order previously placed with such Broker-Dealer.

**Conversion Date** means the date on which ARS Certificates are converted from an ARS Mode to a Mode other than an ARS Mode and begin to bear interest at a Daily Rate, a Weekly Rate, a Flexible Rate, a Term Rate or a Fixed Rate.

**Existing Owner** means a Person who is listed as the beneficial owner of ARS Certificates in the records of the Auction Agent; provided, however, that for purposes of conducting an Auction, the Auction Agent may consider a Broker-Dealer acting on behalf of its customer as an Existing Owner.

**Hold Order** has the meaning specified in subsection (a) of Section 2.01 of this Appendix.

**Initial Period** means the period from the issue date to but not including ____, 2006 for the ARS Certificates.
Interest Payment Date with respect to the ARS Certificates means 2006 with respect to the Initial Period for the ARS Certificates, and thereafter (a) when used with respect to any Auction Period other than a daily Auction Period or a Special Auction Period, the Business Day immediately following such Auction Period, (b) when used with respect to a daily Auction Period, the first Business Day of the month immediately succeeding such Auction Period, (c) when used with respect to a Special Auction Period of (i) seven or more but fewer than one hundred eighty-three (183) days, the Business Day immediately following such Special Auction Period, or (ii) more than one hundred eighty-two (182) days, each April 1 and October 1 and on the Business Day immediately following such Special Auction Period.

LIBOR means, with respect to ARS Certificates, on any date of determination for an Auction Period for ARS Certificates, the offered rate (rounded up to the next highest one one-thousandth of one percent (0.001%)) for deposits in U.S. dollars for a one-month period which appears on the Telerate Page 3750 at approximately 11:00 a.m., London time, on such date, or if such date is not a date on which dealings in U.S. dollars are transacted in the London interbank market, then on the next preceding day on which such dealings were transacted in such market.

Maximum Interest Rate means the lesser of 12% or the maximum rate permitted by applicable law.

Order means a Hold Order, Bid or Sell Order.

Potential Owner means any Person, including any Existing Owner, who may be interested in acquiring a beneficial interest in ARS Certificates in addition to ARS Certificates currently owned by such Person, if any.

Principal Office means, with respect to the Auction Agent, the office thereof designated in writing to the Authority, the Trustee and each Broker-Dealer.

Sell Order has the meaning specified in subsection (a) of Section 2.01 of this Appendix.

Special Auction Period means, with respect to ARS Certificates, (a) any period of one hundred eighty-two (182) days or less which is divisible by seven and which begins on an Interest Payment Date and ends (i) in the case of ARS Certificates with Auctions generally conducted on Fridays, on a Sunday unless such Sunday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day, (ii) in the case of ARS Certificates with Auctions generally conducted on Mondays, on a Monday unless such Monday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day, (iii) in the case of ARS Certificates with Auctions generally conducted on Tuesdays, on a Tuesday unless such Tuesday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day, (iv) in the case of ARS Certificates with Auctions generally conducted on Wednesdays, on a Wednesday unless such Wednesday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day, and (v) in the case of ARS Certificates with Auctions generally conducted on Thursdays, on a Thursday unless such Thursday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day, or (b) any period which is longer than one hundred eighty-two (182) days, which begins on an Interest Payment Date and ends not later than the final scheduled Maturity Date and, in either case, is not otherwise within the definition of an Auction Period.
Submission Deadline means 1:00 p.m. New York City time on each Auction Date for ARS Certificates not in a daily Auction Period, and 11:00 a.m., New York City time, on each Auction Date for ARS Certificates in a daily Auction Period, or such other time on such date as shall be specified from time to time by the Auction Agent pursuant to the Auction Agreement as the time by which Broker-Dealers are required to submit Orders to the Auction Agent.

Submission Processing Deadline means the earlier of (i) forty (40) minutes after the Submission Deadline and (ii) the time when the Auction Agent begins to disseminate the results of the Auction to the Broker-Dealers.

Submitted Bid has the meaning specified in subsection (b) of Section 2.03 of this Appendix.

Submitted Hold Order has the meaning specified in subsection (b) of Section 2.03 of this Appendix.

Submitted Order has the meaning specified in subsection (b) of Section 2.03 of this Appendix.

Submitted Sell Order has the meaning specified in subsection (b) of Section 2.03 of this Appendix.

Sufficient Clearing Bids means with respect to ARS Certificates, an Auction for which the aggregate principal amount of ARS Certificates that are the subject of Submitted Bids by Potential Owners specifying one or more rates not higher than the Maximum Interest Rate is not less than the aggregate principal amount of ARS Certificates that are the subject of Submitted Sell Orders and of Submitted Bids by Existing Owners specifying rates higher than the Maximum Interest Rate.

Winning Bid Rate means with respect to ARS Certificates, the lowest rate specified in any Submitted Bid, for ARS Certificates which if selected by the Auction Agent as the ARS Rate for ARS Certificates would cause the aggregate principal amount of ARS Certificates that are the subject of Submitted Bids specifying a rate not greater than such rate to be not less than the aggregate principal amount of Available Certificates.

ARTICLE II

AUCTION PROCEDURES

Section 2.01. Orders by Existing Owners and Potential Owners.

(a) Prior to the Submission Deadline on each Auction Date:

(i) each Existing Owner may submit to a Broker-Dealer, in writing or by such other method as shall be reasonably acceptable to such Broker-Dealer, information as to:

(A) the principal amount of the ARS Certificates, if any, held by such Existing Owner, which such Existing Owner commits to continue to hold for the next succeeding Auction Period without regard to the rate determined by the Auction Procedures for such Auction Period;
(B) the principal amount of the affected ARS Certificates, if any, held by such Existing Owner, which such Existing Owner commits to continue to hold for the next succeeding Auction Period if the rate determined by the Auction Procedures for such Auction Period shall not be less than the rate per annum then specified by such Existing Owner (and which such Existing Owner offers to sell on the next succeeding Interest Payment Date (or the same day in the case of a daily Auction Period) if the rate determined by the Auction Procedures for the next succeeding Auction Period shall be less than the rate per annum then specified by such Existing Owner); and/or

(C) the principal amount of the ARS Certificates, if any, held by such Existing Owner which such Existing Owner offers to sell on the next succeeding Interest Payment Date (or on the same day in the case of a daily Auction Period) without regard to the rate determined by the Auction Procedures for the next succeeding Auction Period.

(ii) for the purpose of implementing the Auctions and thereby to achieve the lowest possible interest rate on the ARS Certificates, the Broker-Dealers shall contact Potential Owners, including Persons that are Existing Owners, to determine the principal amount of the ARS Certificates, if any, which each such Potential Owner irrevocably offers to purchase if the rate determined by the Auction Procedures for the next succeeding Auction Period is not less than the rate per annum then specified by such Potential Owner.

For the purposes hereof, an Order containing the information referred to in clause (i)(A) above is herein referred to as a "Hold Order," an Order containing the information referred to in clause (i)(B) or (ii) above is herein referred to as a "Bid," and an Order containing the information referred to in clause (i)(C) above is herein referred to as a "Sell Order."

(b)(i) A Bid by an Existing Owner shall constitute an irrevocable offer to sell:

(A) the principal amount of the ARS Certificates specified in such Bid if the rate determined by the Auction Procedures on such Auction Date shall be less than the rate specified therein; or

(B) such principal amount or a lesser principal amount of the ARS Certificates to be determined as described in subsection (a)(v) of Section 2.04 hereof if the rate determined by the Auction Procedures on such Auction Date shall be equal to such specified rate; or

(C) a lesser principal amount of the ARS Certificates to be determined as described in subsection (b)(iv) of Section 2.04 of this Appendix if such specified rate shall be higher than the Maximum Interest Rate and Sufficient Clearing Bids do not exist.

(ii) A Sell Order by an Existing Owner shall constitute an irrevocable offer to sell:

(A) the principal amount of the ARS Certificates specified in such Sell Order; or

(B) such principal amount or a lesser principal amount of the ARS Certificates as described in subsection (b)(iv) of Section 2.04 of this Appendix if Sufficient Clearing Bids do not exist.

(iii) A Bid by a Potential Owner shall constitute an irrevocable offer to purchase:
(A) the principal amount of the ARS Certificates specified in such Bid if the rate
determined by the Auction Procedures on such Auction Date shall be higher than the rate
specified therein; or

(B) such principal amount or a lesser principal amount of the ARS Certificates as
described in subsection (a)(vi) of Section 2.04 of this Appendix if the rate determined by the
Auction Procedures on such Auction Date shall be equal to such specified rate.

(c) Anything herein to the contrary notwithstanding:

(i) for purposes of any Auction, any Order which specifies the ARS Certificates
to be held, purchased or sold in a principal amount which is not $25,000 or an integral
multiple thereof shall be rounded down to the nearest $25,000, and the Auction Agent shall
conduct the Auction Procedures as if such Order had been submitted in such lower amount;

(ii) for purposes of any Auction other than during a daily Auction Period, any
portion of an Order of an Existing Owner which relates to the ARS Certificates that has been
called for prepayment on or prior to the Interest Payment Date next succeeding such Auction
shall be invalid with respect to such portion and the Auction Agent shall conduct the Auction
Procedures as if such portion of such Order had not been submitted; and

(iii) for purposes of any Auction other than during a daily Auction Period, no
portion of ARS Certificates that has been called for prepayment on or prior to the Interest
Payment Date next succeeding such Auction shall be included in the calculation of Available
Certificates for such Auction.

(iv) for purposes of any Auction, any Order by an Existing Owner or Potential
Owner is revocable until the Broker-Dealer Deadline, and after the Broker-Dealer Deadline
all Orders are irrevocable.

Section 2.02. Submission of Orders by Broker-Dealers to Auction Agent.

(a) Each Broker-Dealer shall submit to the Auction Agent in writing or by such other
method as shall be reasonably acceptable to the Auction Agent, including such electronic
communication acceptable to the parties, prior to the Submission Deadline (but subject to the
Submission Processing Deadline) on each Auction Date, all Orders obtained by such Broker-Dealer
and, if requested, specifying with respect to each Order:

(i) the name of the Bidder placing such Order;

(ii) the aggregate principal amount of the ARS Certificates, if any, that are the
subject of such Order;

(iii) to the extent that such Bidder is an Existing Owner:

(A) the principal amount of the ARS Certificates, if any, subject to any
Hold Order placed by such Existing Owner;

(B) the principal amount of the ARS Certificates, if any, subject to any
Bid placed by such Existing Owner and the rate specified in such Bid; and
(C) the principal amount of the ARS Certificates, if any, subject to any Sell Order placed by such Existing Owner.

(iv) the extent such Bidder is a Potential Owner, the rate specified in such Bid.

Notwithstanding the foregoing, Broker-Dealers may submit an Order after the Submission Deadline and prior to the Submission Processing Deadline if the Order was (i) received by the Broker-Dealer from Existing Owners or Potential Owners prior to the Submission Deadline or (ii) initiated internally by the Broker-Dealer for its own account prior to the Submission Deadline. Each Order submitted to the Auction Agent after the Submission Deadline and prior to the Submission Processing Deadline shall constitute a representation by the Broker-Dealer that such Order was (i) received from an Existing Owner or Potential Owner prior to the Submission Deadline or (ii) initiated internally by the Broker-Dealer for its own account prior to the Submission Deadline.

(b) If any rate specified in any Bid contains more than three figures to the right of the decimal point, the Auction Agent shall round such rate up to the next highest one thousandth of one percent (0.001%).

(c) If an Order or Orders covering all of the ARS Certificates held by an Existing Owner is not submitted to the Auction Agent prior to the Submission Deadline, the Auction Agent shall deem a Hold Order to have been submitted on behalf of such Existing Owner covering the principal amount of such ARS Certificates held by such Existing Owner and not subject to Orders submitted to the Auction Agent; provided, however, that if there is a conversion of such ARS Certificates from one Auction Period to another Auction Period and Orders have not been submitted to the Auction Agent prior to the Submission Deadline covering the aggregate principal amount of such ARS Certificates to be converted held by such Existing Owner, the Auction Agent shall deem a Sell Order to have been submitted on behalf of such Existing Owner covering the principal amount of such ARS Certificates to be converted held by such Existing Owner not subject to Orders submitted to the Auction Agent.

(d) If one or more Orders covering in the aggregate more than the principal amount of the ARS Certificates held by any Existing Owner are submitted to the Auction Agent, such Orders shall be considered valid as follows:

(i) all Hold Orders shall be considered Hold Orders, but only up to and including in the aggregate the principal amount of such ARS Certificates held by such Existing Owner;

(ii) (A) any Bid of an Existing Owner shall be considered valid as a Bid of an Existing Owner up to and including the excess of the principal amount of such ARS Certificates held by such Existing Owner over the principal amount of the such ARS Certificates subject to Hold Orders referred to in paragraph (i) above;

(B) subject to clause (A) above, all Bids of an Existing Owner with the same rate shall be aggregated and considered a single Bid of an Existing Owner up to and including the excess of the principal amount of such ARS Certificates held by such Existing Owner over the principal amount of such ARS Certificates held by such Existing Owner subject to Hold Orders referred to in paragraph (i) above;
(C) subject to clause (A) above, if more than one Bid with different rates is submitted on behalf of such Existing Owner, such Bids shall be considered Bids of an Existing Owner in the ascending order of their respective rates up to the amount of the excess of the principal amount of such ARS Certificates held by such Existing Owner over the principal amount of such ARS Certificates held by such Existing Owner subject to Hold Orders referred to in paragraph (i) above; and

(D) the principal amount, if any, of such ARS Certificates subject to Bids not considered to be Bids of an Existing Owner under this paragraph (ii) shall be treated as the subject of a Bid by a Potential Owner.

(iii) all Sell Orders shall be considered Sell Orders, but only up to and including a principal amount of the ARS Certificates equal to the excess of the principal amount of such ARS Certificates held by such Existing Owner over the sum of the principal amount of such ARS Certificates considered to be subject to Hold Orders pursuant to paragraph (i) above and the principal amount of such ARS Certificates considered to be subject to Bids of such Existing Owner pursuant to paragraph (ii) above.

(e) If more than one Bid is submitted on behalf of any Potential Owner, each Bid submitted with the same rate shall be aggregated and considered a single Bid and each Bid submitted with a different rate shall be considered a separate Bid with the rate and the principal amount of the ARS Certificates specified therein.

(f) Anything herein to the contrary notwithstanding, for purposes of any Auction, any Order by a Broker-Dealer for its own account is revocable until the Submission Processing Deadline.

(g) Neither the Authority, the Trustee nor the Auction Agent shall be responsible for the failure of any Broker-Dealer to submit an Order to the Auction Agent on behalf of any Existing Owner or Potential Owner.

Section 2.03. Determination of ARS Rate.

(a) Not later than 9:30 a.m., New York City time, on each Auction Date with respect to ARS Certificates, the Auction Agent shall advise the Broker-Dealers and the Trustee by telephone or other electronic communication acceptable to the parties of the All Hold Rate, the Maximum Interest Rate and the ARS Index for ARS Certificates.

(b) Promptly after the Submission Deadline, but subject to the Submission Processing Deadline, on each Auction Date with respect to ARS Certificates, the Auction Agent shall assemble all Orders submitted or deemed submitted to it by the Broker-Dealers (each such Order as submitted or deemed submitted by a Broker-Dealer being hereinafter referred to as a “Submitted Hold Order,” a “Submitted Bid” or a “Submitted Sell Order,” as the case may be, and collectively as a “Submitted Order”) and shall determine (i) the Available Certificates, (ii) whether there are Sufficient Clearing Bids, and (iii) the Auction Rate.

(c) Promptly after the Auction Agent has made the determinations pursuant to subsection (b) above, the Auction Agent shall advise the Trustee by telephone (promptly confirmed in writing), telex or facsimile transmission or other electronic communication acceptable to the
parties of the Auction Rate for the next succeeding Auction Period and the Trustee shall promptly notify the Securities Depository of such Auction Rate.

(d) In the event the Auction Agent shall fail to calculate or, for any reason (including, but not limited to, the lack of a duly appointed Broker-Dealer), fails to provide the Auction Rate for any Auction Period, (i) if the preceding Auction Period was a period of thirty-five (35) days or less, the new Auction Period shall be the same as the preceding Auction Period and the ARS Rate for the new Auction Period shall be the same as the ARS Rate for the preceding Auction Period, and (ii) if the preceding Auction Period was a period of greater than thirty-five (35) days, the preceding Auction Period shall be extended to the next seventh day following the day that would have been the last day of such Auction Period had it not been extended (or if such seventh day is not followed by a Business Day then to the next succeeding day which is followed by a Business Day) and the ARS Rate in effect for the preceding Auction Period will continue in effect for the Auction Period as so extended. In the event an Auction Period is extended as set forth in clause (ii) of the preceding sentence, an Auction shall be held on the last Business Day of the Auction Period as so extended to take effect for an Auction Period beginning on the Business Day immediately following the last day of the Auction Period as extended which Auction Period will end on the date it would otherwise have ended on had the prior Auction Period not been extended. Notwithstanding the foregoing, no ARS Rate shall be extended for more than thirty-five (35) days. If at the end of thirty-five (35) days the Auction Agent fails to calculate or provide the Auction Rate, the ARS Rate shall be the Maximum Interest Rate.

(e) In the event of a failed conversion to another Mode Period with respect to ARS Certificates, or in the event of a failure to change the length of the current Auction Period with respect to ARS Certificates due to the lack of Sufficient Clearing Bids at the Auction on the Auction Date for the first new Auction Period for ARS Certificates, or in the event there shall be no Auction Agent for the ARS Certificates as a result of the termination of the Auction Agreement pursuant to its terms, the Auction Rate for the next Auction Period for the ARS Certificates shall be the Maximum Interest Rate and the Auction Period for the ARS Certificates shall be a seven-day Auction Period. Succeeding Auction Periods shall be seven-day Auction Periods until subsequently changed in accordance with the provisions set forth in this Appendix and the Auction Rate for succeeding Auction Periods shall be determined in accordance with the provisions set forth in this Appendix.

(f) If the ARS Certificates are no longer maintained in Book-Entry-System by the Securities Depository on any Auction Date, then the ARS Rate for the ARS Certificates for the related Auction Period shall be the Maximum Interest Rate and the Auction Period for the ARS Certificates shall be a seven-day Auction Period.

Section 2.04. Allocation of the ARS Certificates.

(a) In the event of Sufficient Clearing Bids for the ARS Certificates, subject to the further provisions of subsections (c) and (d) below, Submitted Orders for the ARS Certificates shall be accepted or rejected as follows in the following order of priority:

(i) the Submitted Hold Order of each Existing Owner shall be accepted, thus requiring each such Existing Owner to continue to hold the ARS Certificates that are the subject of such Submitted Hold Order;

(ii) the Submitted Sell Order of each Existing Owner shall be accepted and the Submitted Bid of each Existing Owner specifying any rate that is higher than the Winning
Bid Rate shall be rejected, thus requiring each such Existing Owner to sell the ARS Certificates that are the subject of such Submitted Sell Order or Submitted Bid;

(iii) the Submitted Bid of each Existing Owner specifying any rate that is lower than the Winning Bid Rate shall be accepted, thus requiring each such Existing Owner to continue to hold the ARS Certificates that are the subject of such Submitted Bid;

(iv) the Submitted Bid of each Potential Owner specifying any rate that is lower than the Winning Bid Rate shall be accepted, thus requiring each such Potential Owner to purchase the ARS Certificates that are the subject of such Submitted Bid;

(v) the Submitted Bid of each Existing Owner specifying a rate that is equal to the Winning Bid Rate shall be accepted, thus requiring each such Existing Owner to continue to hold the ARS Certificates that are the subject of such Submitted Bid, but only up to and including the principal amount of the ARS Certificates obtained by multiplying (A) the aggregate principal amount of Outstanding ARS Certificates that are not the subject of Submitted Hold Orders described in paragraph (i) above or of Submitted Bids described in paragraphs (iii) or (iv) above by (B) a fraction the numerator of which shall be the principal amount of Outstanding ARS Certificates held by such Existing Owner subject to such Submitted Bid and the denominator of which shall be the aggregate principal amount of the Outstanding ARS Certificates subject to such Submitted Bids made by all such Existing Owners that specified a rate equal to the Winning Bid Rate, and the remainder, if any, of such Submitted Bid shall be rejected, thus requiring each such Existing Owner to sell any excess amount of such ARS Certificates;

(vi) the Submitted Bid of each Potential Owner specifying a rate that is equal to the Winning Bid Rate shall be accepted, thus requiring each such Potential Owner to purchase the ARS Certificates that are the subject of such Submitted Bid, but only in an amount equal to the principal amount of the ARS Certificates obtained by multiplying (A) the aggregate principal amount of Outstanding ARS Certificates that are not the subject of Submitted Hold Orders described in paragraph (i) above or of Submitted Bids described in paragraphs (iii), (iv) or (v) above by (B) a fraction the numerator of which shall be the principal amount of Outstanding ARS Certificates subject to such Submitted Bid and the denominator of which shall be the sum of the aggregate principal amount of Outstanding ARS Certificates subject to such Submitted Bids made by all such Potential Owners that specified a rate equal to the Winning Bid Rate, and the remainder of such Submitted Bid shall be rejected; and

(vii) the Submitted Bid of each Potential Owner specifying any rate that is higher than the Winning Bid Rate shall be rejected.

(b) In the event there are not Sufficient Clearing Bids for the ARS Certificates, subject to the further provisions of subsections (c) and (d) below, Submitted Orders, for the ARS Certificates shall be accepted or rejected as follows in the following order of priority:

(i) the Submitted Hold Order of each Existing Owner shall be accepted, thus requiring each such Existing Owner to continue to hold the ARS Certificates that are the subject of such Submitted Hold Order;
(ii) the Submitted Bid of each Existing Owner specifying any rate that is not higher than the Maximum Interest Rate, shall be accepted, thus requiring each such Existing Owner to continue to hold the ARS Certificates that are the subject of such Submitted Bid;

(iii) the Submitted Bid of each Potential Owner specifying any rate that is not higher than the Maximum Interest Rate, shall be accepted, thus requiring each such Potential Owner to purchase the ARS Certificates that are the subject of such Submitted Bid;

(iv) the Submitted Sell Orders of each Existing Owner shall be accepted as Submitted Sell Orders and the Submitted Bids of each Existing Owner specifying any rate that is higher than the Maximum Interest Rate, shall be deemed to be and shall be accepted as Submitted Sell Orders, in both cases only up to and including the principal amount of the ARS Certificates obtained by multiplying (A) the aggregate principal amount of the ARS Certificates subject to Submitted Bids described in paragraph (iii) of this subsection (b) by (B) a fraction the numerator of which shall be the principal amount of Outstanding ARS Certificates held by such Existing Owner subject to such Submitted Sell Order or such Submitted Bid deemed to be a Submitted Sell Order and the denominator of which shall be the principal amount of Outstanding ARS Certificates subject to all such Submitted Sell Orders and such Submitted Bids deemed to be Submitted Sell Orders, and the remainder of each such Submitted Sell Order or Submitted Bid shall be deemed to be and shall be accepted as a Hold Order and each such Existing Owner shall be required to continue to hold such excess amount of the ARS Certificates; and

(v) the Submitted Bid of each Potential Owner specifying any rate that is higher than the Maximum Interest Rate shall be rejected.

(c) If, as a result of the procedures described in subsection (a) or (b) above, any Existing Owner or Potential Owner would be required to purchase or sell an aggregate principal amount of the ARS Certificates that is not an integral multiple of $25,000 on any Auction Date, the Auction Agent shall by lot, in such manner as it shall determine in its sole discretion, round up or down the principal amount of such ARS Certificates to be purchased or sold by any Existing Owner or Potential Owner on such Auction Date so that the aggregate principal amount of such ARS Certificates purchased or sold by each Existing Owner or Potential Owner on such Auction Date shall be an integral multiple of $25,000, even if such allocation results in one or more of such Existing Owners or Potential Owners not purchasing or selling any such ARS Certificates on such Auction Date.

(d) If, as a result of the procedures described in subsection (a) above, any Potential Owner would be required to purchase less than $25,000 in principal amount of the ARS Certificates on any Auction Date, the Auction Agent shall by lot, in such manner as it shall determine in its sole discretion, allocate such ARS Certificates for purchase among Potential Owners so that the principal amount of ARS Certificates purchased on such Auction Date by any Potential Owner shall be an integral multiple of $25,000, even if such allocation results in one or more of such Potential Owners not purchasing such ARS Certificates.

Section 2.05. Notice of ARS Rate.

(a) On each Auction Date, the Auction Agent shall notify by telephone or other telecommunication device or other electronic communication acceptable to the parties or in writing
each Broker-Dealer that participated in the Auction held on such Auction Date of the following with respect to the ARS Certificates for which an Auction was held on such Auction Date:

(i) the ARS Rate determined on such Auction Date for the succeeding Auction Period or, in the case of the ARS Certificates in a daily Auction Period, the Auction Rate on the ARS Certificates fixed for the current Auction Period;

(ii) whether Sufficient Clearing Bids existed for the determination of the Winning Bid Rate;

(iii) if such Broker-Dealer submitted a Bid or a Sell Order on behalf of an Existing Owner with respect to the ARS Certificates, whether such Bid or Sell Order was accepted or rejected, in whole or in part, and the principal amount of the ARS Certificates, if any, to be sold by such Existing Owner;

(iv) if such Broker-Dealer submitted a Bid on behalf of a Potential Owner, whether such Bid was accepted or rejected, in whole or in part, and the principal amount of the ARS Certificates, if any, to be purchased by such Potential Owner;

(v) if the aggregate principal amount of the ARS Certificates to be sold by all Existing Owners on whose behalf such Broker-Dealer submitted Bids or Sell Orders is different from the aggregate principal amount of the ARS Certificates to be purchased by all Potential Owners on whose behalf such Broker-Dealer submitted a Bid, the name or names of one or more Broker-Dealers (and the Agent Member, if any, of each such other Broker Dealer) and the principal amount of the ARS Certificates to be (A) purchased from one or more Existing Owners on whose behalf such other Broker-Dealers submitted Bids or Sell Orders or (B) sold to one or more Potential Owners on whose behalf such Broker-Dealer submitted Bids; and

(vi) the immediately succeeding Auction Date.

(b) On each Auction Date, each Broker-Dealer that submitted an Order on behalf of any Existing Owner or Potential Owner shall: (i) advise each Existing Owner and Potential Owner on whose behalf such Broker-Dealer submitted an Order as to (A) the ARS Rate determined on such Auction Date, (B) whether any Bid or Sell Order submitted on behalf of each such Existing Owner or Potential Owner was accepted or rejected, in whole or in part, and (C) the immediately succeeding Auction Date; (ii) instruct each Potential Owner on whose behalf such Broker-Dealer submitted a Bid that was accepted, in whole or in part, to instruct such Existing Owner’s Agent Member to pay to such Broker-Dealer (or its Agent Member) through the Securities Depository the amount necessary to purchase the principal amount of such ARS Certificates to be purchased pursuant to such Bid (including, with respect to such ARS Certificates in a daily Auction Period, accrued interest if the purchase date is not an Interest Payment Date for such ARS Certificate) against receipt of such ARS Certificates; and (iii) instruct each Existing Owner on whose behalf such Broker-Dealer submitted a Sell Order that was accepted or a Bid that was rejected, in whole or in part, to instruct such Existing Owner’s Agent Member to deliver to such Broker-Dealer (or its Agent Member) through the Securities Depository the principal amount of such ARS Certificates to be sold pursuant to such Bid or Sell Order against payment therefor.

Section 2.06. ARS Index.
(a) For ARS Certificates in an Auction Period of thirty-five (35) days or less, the ARS Index is LIBOR. For ARS Certificate in an Auction Period of more than thirty-five (35) days, the ARS Index is equal to the yield on the United States Treasury security on the date the Auction Period began which has a maturity which most closely matches the last day of the Auction Period.

(b) If for any reason on any Auction Date the ARS Index shall not be determined as hereinabove provided, the ARS Index shall be the ARS Index for the Auction Period ending on such Auction Date.

(c) The determination of the ARS Index as provided herein shall be conclusive and binding upon the Authority, the Trustee, the Broker-Dealers, the Auction Agent and the Owners of the ARS Certificates.

Section 2.07. Miscellaneous Provisions Regarding Auctions.

(a) In this Appendix, each reference to the purchase, sale or holding of “ARS Certificates” shall refer to beneficial interests in such ARS Certificates, unless the context clearly requires otherwise.

(b) During an ARS Rate Period with respect to the ARS Certificates, the provisions of the Trust Agreement and the definitions contained therein and described in this Appendix, including without limitation the definitions of Maximum Interest Rate, All Hold Rate, ARS Index, Interest Payment Date, and the ARS Rate, may be amended pursuant to the Trust Agreement, subject to the prior written consent of the 2006 Certificate Insurer, by obtaining the consent of the Owners of all of the ARS Certificates then outstanding as follows.

If on the first Auction Date occurring at least twenty (20) days after the date on which notice of such proposed amendment was given by the Trustee to the Owners of the ARS Certificates Outstanding, such notice to be given by mail to each Owner at its address as it appears on the registration books of the Trustee, (i) the ARS Rate which is determined on such date is the Winning Bid Rate and (ii) there is delivered to the Trustee a Favorable Opinion of Special Counsel the proposed amendment shall be deemed to have been consented to by the Owners of all of the ARS Certificates outstanding bearing interest at an ARS Rate.

(c) If the Securities Depository notifies the Authority that it is unwilling or unable to continue as registered owner of the ARS Certificates or if at any time the Securities Depository shall no longer be registered or in good standing under the Securities Exchange Act of 1934, as amended, or other applicable statute or regulation and a successor to the Securities Depository is not appointed by the Authority within ninety (90) days after the Authority receives notice or becomes aware of such condition, as the case may be, the Authority shall execute and the Trustee shall authenticate and deliver certificates representing the ARS Certificates. Such ARS Certificates shall be registered in such names and Authorized Denominations as the Securities Depository, pursuant to instructions from the Agent Members or otherwise, shall instruct the Authority and the Trustee.

(d) During an ARS Period, so long as the ownership of ARS Certificates is maintained in book-entry form by the Securities Depository, an Existing Owner or a beneficial owner may sell, transfer or otherwise dispose of an ARS Certificate only pursuant to a Bid or Sell Order in accordance with the Auction Procedures or to or through a Broker-Dealer, provided that (i) in the case of all transfers other than pursuant to Auctions, such Existing Owner or its Broker-Dealer or its
Agent Member advises the Auction Agent of such transfer and (ii) a sale, transfer or other disposition of ARS Certificates from a customer of a Broker-Dealer who is listed on the records of that Broker-Dealer as the Owner of such ARS Certificates to that Broker-Dealer or another customer of that Broker-Dealer shall not be deemed to be a sale, transfer or other disposition for purposes of this paragraph if such Broker-Dealer remains the Existing Owner of the ARS Certificates so sold, transferred or disposed of immediately after such sale, transfer or disposition.

Section 2.08. Changes in Auction Period or Auction Date.

(a) Changes in Auction Period. (i) During any ARS Rate Period, the Authority may, from time to time on any Interest Payment Date, change the length of the current Auction Period with respect to all of ARS Certificates among daily, seven-days, 28-days, 35-days, three months, six months and a Special Auction Period in order to accommodate economic and financial factors that may affect or be relevant to the length of the Auction Period and the interest rate borne by the ARS Certificates; provided, however, in the case of a change from a Special Auction Period, the date of such change shall be the Interest Payment Date immediately following the last day of such Special Auction Period. The Authority shall initiate the change in the length of the Auction Period by giving written notice to the Trustee, the 2006 Certificates Insurer, the applicable Auction Agent, the applicable Broker-Dealers and the Securities Depository that the Auction Period shall change if the conditions described herein are satisfied and the proposed effective date of the change, such notice to be provided at least ten (10) Business Days prior to the Auction Date for such Auction Period. Any change in the length of an Auction Period to an Auction Period longer than 35 days shall be subject to the prior written consent of the 2006 Certificate Insurer.

(ii) Any such changed Auction Period shall be for a period of one day, seven-days, 28-days, 35-days, three months, six months or a Special Auction Period and shall apply to all ARS Certificates.

(iii) The change in the length of the Auction Period for any ARS Certificates shall not be allowed unless Sufficient Clearing Bids existed at the Auction immediately preceding the proposed change.

(iv) The change in length of the Auction Period for the ARS Certificates subject to change shall take effect only if Sufficient Clearing Bids exist at the Auction on the Auction Date for such first Auction Period. For purposes of the Auction for such first Auction Period of the new length only, each Existing Owner of an ARS Certificate subject to change shall be deemed to have submitted Sell Orders with respect to all such ARS Certificates owned by it except to the extent such Existing Owner submits an Order with respect to such ARS Certificates. If the condition referred to above is not met, the Auction Rate for the next Auction Period shall be the Maximum Interest Rate, and the Auction Period shall be a seven-day Auction Period.

(v) On the date selected for a change in the length of the Auction Period for the ARS Certificates, any ARS Certificates that are not the subject of a specific Hold Order or Bid shall be deemed to be subject to a Sell Order.

(b) Changes in Auction Date. During any ARS Rate Period, the Auction Agent, with the written consent of the Authority, may specify an earlier Auction Date for the ARS Certificates (but in no event shall such date be more than five (5) Business Days earlier) than the Auction Date that would otherwise be determined in accordance with the definition of “Auction Date” in order to
conform with then current market practice with respect to similar securities or to accommodate
economic and financial factors that may affect or be relevant to the day of the week constituting an
Auction Date and the interest rate borne on the ARS Certificates. The Auction Agent shall provide
notice of its determination to specify an earlier Auction Date for an Auction Period by means of a
written notice delivered at least five (5) Business Days prior to the Auction Date preceding the
proposed changed Auction Date to the Trustee, the Authority, the Broker-Dealers and the Securities
Depository. In the event the Auction Agent specifies an earlier Auction Date, the days of the week
on which an Auction Period begins and ends, the day of the week on which a Special Auction Period
ends and the Interest Payment Date relating to a Special Auction Period shall be adjusted
accordingly.

ARTICLE III

AUCTION AGENT

Section 3.01. Auction Agent.

(a) The Auction Agent for the ARS Certificates shall be appointed by the Trustee, at the
written direction of the Authority, and shall perform the functions specified herein. The Auction
Agent shall designate its Principal Office and signify its acceptance of the duties and obligations
imposed upon it hereunder by a written instrument, delivered to the Authority, the Trustee and each
Broker-Dealer, which written instrument may be in the form of an Auction Agreement.

Notwithstanding that the Auction Agent may be the agent of the Trustee, the Trustee shall not be
liable in any way for any action taken, suffered or omitted, or for any error of judgment made by the
Auction Agent, whether in the performance of its duties under the Auction Agreement or otherwise.

(b) Subject to any applicable governmental restrictions, the Auction Agent may be or
become the owner of or trade in ARS Certificates with the same rights as if such entity were not the
Auction Agent.

Section 3.02. Qualifications of Auction Agent; Resignation; Removal. The Auction
Agent shall be (a) a bank or trust company organized under the laws of the United States or any state
or territory thereof having a combined capital stock, surplus and undivided profits of at least
$50,000,000, or (b) a member of NASD having a capitalization of at least $50,000,000 and, in either
case, authorized by law to perform all the duties imposed upon it by the Trust Agreement and a
member of, or a participant in, the Securities Depository. The Auction Agent may at any time resign
and be discharged of the duties and obligations created by the Trust Agreement by giving at least
ninety (90) days notice to the Authority, the Trustee, the Insurer and the Broker-Dealers. The
Auction Agent may be removed at any time by written notice, delivered by the Trustee, upon the
written direction of the Authority, to the Auction Agent and the 2006 Certificate Insurer.

Upon any such resignation or removal, the Trustee, upon the written direction of the Authority, shall appoint a
successor Auction Agent approved by the 2006 Certificate Insurer meeting the requirements of this
section. In the event of the resignation or removal of the Auction Agent, the Auction Agent shall pay
over, assign and deliver any moneys and any ARS Certificates held by it in such capacity to its
successor. The Auction Agent shall continue to perform its duties hereunder until its successor has
been appointed by the Trustee. In the event that the Auction Agent has not been compensated for its
services, the Auction Agent may terminate the Auction Agreement by giving at least forty-five (45)
days notice to the Authority, the Trustee, the Insurer and the Broker-Dealers, and if it has not
received such compensation by the expiration of such forty-five (45) days, the Auction Agent may resign even if a successor Auction Agent has not been appointed.
APPENDIX D

PROPOSED FORM OF OPINION OF SPECIAL COUNSEL

[Closing Date]

City Council
City of Modesto
Modesto, California

$_____
Water Revenue Certificates of Participation
2006 Series A
Evidencing and Representing Proportionate Interests
of the Owners Thereof in 2006 Payments to be made by the
CITY OF MODESTO
to the
Modesto Public Financing Authority

Ladies and Gentlemen:

We have acted as special counsel to the City of Modesto (the “City”) in connection with the execution and delivery of $____ principal amount of Water Revenue Certificates of Participation, 2006 Series A (the “Certificates”), evidencing and representing proportionate interests of the owners thereof in 2006 Payments (as that term is defined in the Trust Agreement referred to below) to be made by the City under and pursuant to that certain Master Installment Purchase Contract, dated as of November 1, 1997 (the “Master Installment Purchase Contract”), by and between the City and the Modesto Public Financing Authority (the “Authority”), as previously supplemented and as amended and supplemented by that certain 2006 Supplemental Installment Purchase Contract, dated as of November 1, 2006 (the “2006 Supplemental Installment Purchase Contract”), by and between the City and the Authority. The Master Installment Purchase Contract, as previously supplemented and as amended and supplemented by the 2006 Supplemental Installment Purchase Contract, is referred to herein as the “Installment Purchase Contract.” All of the Authority’s rights to receive such 2006 Payments have been assigned by the Authority to ________________, as trustee (the “Trustee”), pursuant to that certain Trust Agreement, dated as of November 1, 2006 (the “Trust Agreement”), by and between the Authority and the Trustee. The Certificates have been executed by the Trustee pursuant to the terms of the Trust Agreement.

In our capacity as special counsel, we have reviewed relevant laws of the State of California, including the City Charter; executed copies of the Installment Purchase Contract and the Trust Agreement; certifications and resolutions of the City, the Authority, the Trustee, and others; opinions of counsel to the City, the Authority and the Trustee; and such other documents, opinions and instruments as we deemed necessary to render the opinions set forth herein. Our services as special counsel were limited to such examination and to rendering the opinions set forth below. We have assumed the genuineness of all documents and signatures presented to us. We have not undertaken to verify independently, and have assumed, the accuracy of the factual matters represented, warranted or certified in the documents. Furthermore, we have assumed compliance with all covenants and agreements contained in the Installment Purchase Contract and the Trust Agreement,
including (without limitation) covenants and agreements compliance with which is necessary to assure that future actions, omissions or events will not cause interest represented by the Certificates to be included in gross income for federal income tax purposes.

Certain requirements and procedures contained or referred to in the Installment Purchase Contract and the Trust Agreement or other relevant documents relating to the Certificates may be changed, and certain actions may be taken (including, without limitation, defeasance of the Certificates), under the circumstances and subject to the terms and conditions set forth in such documents, upon the advice or with the approving opinion of counsel nationally recognized in the area of municipal bonds. We express no opinion as to the exclusion of the interest represented by the Certificates from gross income for federal income tax purposes on and after the date on which any such change occurs or action is taken upon the advice or approval of counsel other than this firm.

With respect to the opinions expressed herein, the enforceability of the Installment Purchase Contract is subject to the limitations on the imposition of certain fees and charges by the City relating to the Water Utility System under Articles XIIIC and XIIID of the California Constitution. In addition, the rights and obligations under the Certificates, the Installment Purchase Contract and the Trust Agreement are subject to bankruptcy, insolvency, reorganization, arrangement, fraudulent conveyance, moratorium and other laws relating to or affecting the enforcement of creditors' rights generally, to the application of equitable principles (regardless of whether such enforceability is considered in equity or at law), to the exercise of judicial discretion in appropriate cases and to the limitations on legal remedies against cities in the State of California. Furthermore, we express no opinion with respect to any indemnification, contribution, penalty, choice of forum or waiver provisions contained in the foregoing documents.

Based on and subject to the foregoing, and in reliance thereon, as of the date hereof, we are of the following opinions:

1. The Master Installment Purchase Contract, the 2006 Supplemental Installment Purchase Contract and the Trust Agreement have been duly authorized, executed and delivered by the Authority; the Master Installment Purchase Contract and the 2006 Supplemental Installment Purchase Contract have been duly authorized, executed and delivered by the City; and, assuming (in the case of the Trust Agreement) due authorization, execution and delivery by the Trustee, such agreements are valid and binding obligations of the Authority and the City (as the case may be), enforceable against the Authority and the City (as the case may be) in accordance with their respective terms.

2. The Certificates, assuming due execution and delivery by the Trustee, are entitled to the benefits of the Trust Agreement.

3. The obligation of the City to make the 2006 Payments under the Installment Purchase Contract is a special obligation of the City payable solely from Gross Revenues (as such term is defined in the Installment Purchase Agreement). The general fund of the City is not liable, and neither the credit nor taxing power of the City is pledged, for the payment of the 2006 Payments under the Installment Purchase Contract.

4. Based on existing statutes, regulations, rulings and judicial decisions and assuming compliance by the City and the Authority with certain covenants in the Trust Agreement and the Installment Purchase Contract and with requirements of the Internal Revenue Code of 1986, as
amended (the “Code”), regarding the use, expenditure and investment of Certificate proceeds and the compliance with certain requirements regarding the rebate of certain investment earnings to the United States Treasury, interest represented by the Certificates is not includable in the gross income of the owners of the Certificates for purposes of federal income taxation. Failure by the Authority or the City to comply with the above covenants and requirements may cause interest represented by the Certificates to be included in gross income retroactive to the date of execution and delivery of the Certificates.

Interest represented by the Certificates will not be treated as an item of tax preference in calculating the federal alternative minimum taxable income of individuals or corporations; however, interest represented by the Certificates will be included as an adjustment in the calculation of the alternative minimum taxable income of corporations and may therefore affect the federal alternative minimum tax liability of corporations. We express no opinion regarding other tax consequences caused by ownership of, or the receipt of interest represented by, the Certificates.

5. Interest represented by the Certificates is exempt from present State of California personal income taxes.

The opinions expressed herein are based on an analysis of existing laws, regulations, rulings and court decisions. Such opinions may be adversely affected by actions taken or events occurring, including a change in law, regulation or ruling (or in the application or official interpretation of any law, regulation or ruling) after the date hereof. We have not undertaken to determine, or to inform any person, whether such actions are taken or such events occur, and we have no obligation to update this opinion in light of such actions or events.

This opinion is limited to the laws of the State of California and the federal laws of the United States. The opinions in this letter are expressed solely as of the date hereof for your benefit and may not be relied upon in any manner for any purposes by any other person.

Respectfully submitted,
APPENDIX E

FORM OF CONTINUING DISCLOSURE AGREEMENT

This Continuing Disclosure Agreement (the “Disclosure Agreement”) is executed and delivered by the City of Modesto (the “City”) and The Bank of New York Trust Company, N.A., as dissemination agent (the “Dissemination Agent”) in connection with the execution and delivery of the City of Modesto Water Revenue Certificates of Participation Series 2006 A (the “2006 Certificates”) evidencing and representing proportionate interests of the owners thereof in certain installment payments to be made by the City. The 2006 Certificates are being executed and delivered pursuant to a 2006 Trust Agreement, dated as of November 1, 2006 (the “2006 Trust Agreement”), by and between the Modesto Public Financing Authority (the “Authority”) and The Bank of New York Trust Company, N.A., as trustee thereunder (the “Trustee”).

The City and the Dissemination Agent covenant and agree as follows:

SECTION 1. Purpose of this Disclosure Agreement. This Disclosure Agreement is being executed and delivered by the City and the Dissemination Agent for the benefit of the Owners and Beneficial Owners of the 2006 Certificates and in order to assist the Participating Underwriter in complying with the Rule.

SECTION 2. Definitions. In addition to the definitions set forth in the 2006 Trust Agreement, which apply to any capitalized term used in this Disclosure Agreement 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 Agreement.

“Beneficial Owner” shall mean any person which (a) has the power, directly or indirectly, to vote or consent with respect to, or to dispose of ownership of, any 2006 Certificate (including a person holding a 2006 Certificate through a nominee, depository or other intermediary), or (b) is treated as the owner of any 2006 Certificate for federal income tax purposes.

“Broker-Dealer” shall mean any entity which is permitted by law to perform the functions required of a broker-dealer as described in Appendix C to the Official Statement, which is a member of, or a direct participant in, the Depository Trust Company, which has been selected to serve as a broker-dealer with respect to the 2006 Certificates and which is a party to a Broker-Dealer Agreement with a Auction Agent for the 2006 Certificates.

“Central Post Office” shall mean the Disclosure USA website maintained by the Municipal Advisory Council of Texas, or any successor thereto, or any other organization or method approved by the staff or members of the Securities and Exchange Commission as an intermediary through which issuers may, in compliance with the Rule, make filings required by this Disclosure Agreement.

“Disclosure Representative” shall mean the City Manager or Finance Director of the City, or their designee, or such other officer or employee as the City shall designate in writing to the Trustee and the Dissemination Agent from time to time.
"Dissemination Agent" shall mean The Bank of New York Trust Company, N.A., acting in the capacity as Dissemination Agent hereunder, or any successor Dissemination Agent designated in writing by the City and which has filed with the Trustee a written acceptance of such designation.

"Fiscal Year" shall mean the one-year period ending on June 30 of each year, or such other one-year period as shall be designated as the City's fiscal year from time to time.

"Installment Purchase Contract" shall mean that certain Master Installment Purchase Contract, dated as of November 1, 1997, by and between the City and the Authority, as supplemented by that certain 2006 Supplemental Installment Purchase Contract, dated as of November 1, 2006, by and between the City and the Authority.

"Listed Events" shall mean any of the events listed in Section 5(a) of this Disclosure Agreement.


"Owner" means a registered owner of the 2006 Certificates.

"Participating Underwriter" shall mean any of the original underwriters of the 2006 Certificates required to comply with the Rule in connection with offering of the 2006 Certificates.

"Repository" shall mean each National Repository and each State Repository.

"Rule" shall mean Rule 15c2-12(b)(5) adopted by the Securities and Exchange Commission under the Securities Exchange Act of 1934, as the same may be amended from time to time.

"State" shall mean the State of California.

"State Repository" shall mean any public or private repository or entity designated by the State as a state repository for the purpose of the Rule and recognized as such by the Securities and Exchange Commission. As of the date of this Disclosure Agreement, there is no State Repository.

SECTION 3. Provision of Annual Reports.

(a) Not later than 270 days after the end of City's Fiscal Year (commencing with the Fiscal Year ended June 30, 2006) the City shall, or shall cause the Dissemination Agent to, provide to each Repository each Participating Underwriter and each Broker-Dealer an Annual Report relating to such Fiscal Year which is consistent with the requirements of Section 4 of this Disclosure Agreement. 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 Agreement; provided that the audited financial statements of the City may be submitted separately from the balance of the Annual Report and later than the date required above for
the filing of the Annual Report if not available by that date. If the City’s Fiscal Year changes, the City shall give notice of such change in the same manner as for a Listed Event under Section 5(f).

(b) Not later than fifteen (15) Business Days prior to the date specified in subsection (a) for providing the Annual Report to Repositories, the City shall provide the Annual Report to the Dissemination Agent (if other than the City) and the Trustee. The City shall provide a written certification in the form of Exhibit A hereto with each Annual Report furnished to the Dissemination Agent and the Trustee to the effect that such Annual Report constitutes the Annual Report required to be furnished by it hereunder. The Dissemination Agent and Trustee may conclusively rely upon such certification of the City and shall have no duty or obligation to review such Annual Report.

(c) The Dissemination Agent shall:

1. determine each year prior to the date for providing the Annual Report the name and address of each Repository;

2. provide any Annual Report received by it from the City to each Repository;

3. file a report with the City and (if the Dissemination Agent is not the Trustee) the Trustee certifying that the Annual Report has been provided pursuant to this Disclosure Agreement, stating the date it was provided and listing all the Repositories to which it was provided; and

4. if the Dissemination Agent is unable to verify that an Annual Report has been provided to the Repositories by the date required in subsection (a), the Dissemination Agent shall send a notice to each Repository in substantially the form attached as Exhibit B.

(d) Notwithstanding any other provision of this Disclosure Agreement, the City and the Dissemination Agent may make any of the filings of reports required to be filed with Repositories pursuant to this Disclosure Agreement through the Central Post Office.

SECTION 4. Content of Annual Reports. The Annual Report shall contain or incorporate by reference the City’s audited financial statements for the most recent fiscal year of the City and the following:

1. Principal amount of the 2006 Certificates outstanding as of the end of the Fiscal Year to which the Annual Report pertains.

2. Balance in the Parity Reserve Fund and a statement of the Reserve Fund Requirement (as those terms are defined in the Master Contract) as of the end of the Fiscal Year to which the Annual Report pertains.


4. Updated information similar to that contained in the tables entitled “WATER UTILITY SYSTEM — Sale of Water” and “WATER UTILITY SYSTEM — Ten Largest Customers,” appearing under the caption “WATER UTILITY SYSTEM — Service Area and Customers” of the Official Statement.
5. The City’s then current rates and charges for water service.

6. Updated information similar to that contained in the table entitled “WATER UTILITY SYSTEM — Historical Debt Service Coverage” appearing under the caption “WATER UTILITY SYSTEM — Historical Operating Results” of the Official Statement.

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 Authority or the City or related public entities, which have been submitted to each of the Repositories; provided, that if any document included by reference is a final official statement, it must be available from the Municipal Securities Rulemaking Board; and provided further, that the City shall clearly identify each such document so included by reference.

SECTION 5. Reporting of Significant Events.

(a) Pursuant to the provisions of this Section 5, the City shall give, or cause to be given, notice of the occurrence of any of the following events with respect to the 2006 Certificates, if material:

1. principal and interest payment delinquencies,
2. non-payment related defaults,
3. modifications to rights of Beneficial Owners,
4. optional, contingent or unscheduled prepayments of 2006 Certificates,
5. defeasances,
6. rating changes,
7. adverse tax opinions or events affecting the tax-exempt status of the 2006 Certificates,
8. unscheduled draws on the debt service reserves reflecting financial difficulties,
9. unscheduled draws on the credit enhancements reflecting financial difficulties,
10. substitution of the credit or liquidity providers or their failure to perform, and
11. release, substitution or sale of property securing repayment of the 2006 Certificates.

(b) The City shall, within one (1) business day of obtaining actual knowledge of the occurrence of any of the Listed Events contact the Dissemination Agent, inform such the Dissemination Agent of the event and promptly direct the Dissemination Agent in writing whether or not to report the event pursuant to subsection (f).
(c) Whenever the City obtains knowledge of the occurrence of one of the foregoing events, it shall as soon as possible, determine if such event would be material under applicable federal securities laws.

(d) If the City determines that such event would be material under applicable federal securities laws, the City shall promptly notify the Dissemination Agent in writing. Such notice shall instruct the Dissemination Agent to report the occurrence pursuant to subsection (f).

(e) If in response to a request under subsection (b), the City determines that the listed event would not be material under applicable federal securities laws, the City shall so notify the Dissemination Agent in writing and instruct the Dissemination Agent not to report the occurrence pursuant to subsection (f).

(f) If the Dissemination Agent has been instructed by the City to report the occurrence of a listed event, the Dissemination Agent shall file a notice of such occurrence with the Repositories (and may do so through the Central Post Office) with a copy to the City and to each Participating Underwriter and each Broker-Dealer. Notwithstanding the foregoing, notice of Listed Events described in subsections (a)(4) and (5) need not be given under this subsection any earlier than the notice (if any) of the underlying event is given to the Owners of affected Certificates pursuant to the 2006 Trust Agreement.

SECTION 6. Termination of Obligation. The obligation of the City under this Disclosure Agreement shall terminate upon the legal defeasance, prior prepayment or payment in full of all of the 2006 Certificates. If such termination occurs prior to the final maturity of the 2006 Certificates, the City shall give notice of such termination in the same manner as for a Listed Event under Section 5.

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 Agreement, and may discharge any such Dissemination Agent, with or without appointing a successor Dissemination Agent. The Dissemination Agent shall not be responsible in any manner for the content of any notice or report prepared by the City pursuant to this Disclosure Agreement. If at any time there is not any other designated Dissemination Agent, the Trustee shall be the Dissemination Agent. The Dissemination Agent shall be entitled to compensation for its services as Dissemination Agent and reimbursement for its out-of-pocket expenses, attorney’s fees, costs and advances made or incurred in the performance of its duties under this Disclosure Agreement in accordance with its written fee schedule provided to the City, as such fee schedule may be amended from time to time in writing.

SECTION 8. Amendment; Waiver. Notwithstanding any other provision of this Disclosure Agreement, the City and the Dissemination Agent may amend this Disclosure Agreement (and the Dissemination Agent shall agree to any amendment so requested by the City that does not adversely affect the Dissemination Agent’s rights and obligations) and any provision of this Disclosure Agreement may be waived, provided that the following conditions are satisfied:

1. 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 2006 Certificates or the type of business conducted thereby;
2. The undertaking, as amended or taking into 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 execution and delivery of the 2006 Certificates, after taking into account any amendments or interpretations of the Rule, as well as any change in circumstances; and

3. The amendment or waiver either (i) is approved by the Owners of the 2006 Certificates in the same manner as provided in the 2006 Trust Agreement for amendments to the 2006 Trust Agreement with the consent of Owners, or (ii) does not, in the opinion of nationally recognized bond counsel, materially impair the interests of the Owners or Beneficial Owners of the 2006 Certificates.

In the event of any amendment or waiver of a provision of this Disclosure Agreement, 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 Listed Event under Section 5, 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 Agreement shall be deemed to prevent the City from disseminating any other information, using the means of dissemination set forth in this Disclosure Agreement or any other means of communication, or including any other information in any Annual Report or notice of occurrence of a Listed Event, in addition to that which is required by this Disclosure Agreement. If the City chooses to include any information in any Annual Report or notice of occurrence of a Listed Event in addition to that which is specifically required by this Disclosure Agreement, the City shall not have any obligation under this Disclosure Agreement to update such information or include it in any future Annual Report or notice of occurrence of a Listed Event.

SECTION 10. Default. In the event of a failure of the City or the Dissemination Agent to comply with any provision of this Disclosure Agreement, the Dissemination Agent may (and, at the request of any Participating Underwriter or the Owners of at least 25% aggregate principal amount of Outstanding Certificates, shall (to the extent indemnified to its satisfaction)), or any Owner or Beneficial Owner of the 2006 Certificates may, take such actions as may be necessary and appropriate, including seeking mandate or specific performance by court order, to cause the City or the Dissemination Agent, as the case may be, to comply with its obligations under this Disclosure Agreement. A default under this Disclosure Agreement shall not be deemed an Event of Default under the 2006 Trust Agreement or the Installment Purchase Contract, and the sole remedy under this Disclosure Agreement in the event of any failure of the City or the Dissemination Agent to comply with this Disclosure Agreement shall be an action to compel performance.

In accepting the appointment under this Disclosure Agreement, the Dissemination Agent is not acting in a fiduciary capacity to the Owners or Beneficial Owners of the 2006 Certificates, the City, the Participating Underwriter or any other party or person.
No provision of this Disclosure Agreement shall require the Dissemination Agent to risk or advance or expend its own funds or incur any financial liability.

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 Agreement, and the City agrees to indemnify and save the Dissemination Agent, its officers, directors, employees and agents, harmless against any loss, expense and liabilities which it may incur arising out of or in the exercise or performance of its powers and duties hereunder, including the costs and expenses (including attorneys fees) of defending against any claim of liability, but excluding liabilities due to the Dissemination Agent's negligence or willful misconduct. The Dissemination Agent shall have the right to resign from its duties as Dissemination Agent upon thirty (30) days notice to the City and the Trustee. The obligations of the City under this Section shall survive resignation or removal of the Dissemination Agent and payment of the 2006 Certificates.

SECTION 12. Notices. Any notices or communications to or among any of the parties to this Disclosure Agreement may be given as follows:

To the City:
City of Modesto
1010 Tenth Street, Suite 5200
Modesto, California 95353
Attention: Finance Director
Fax: (209) 571-5880
Telephone: (209) 577-5370

To the Dissemination Agent:
The Bank of New York Trust Company
555 Kearney Street, Suite 600
San Francisco, California 94108
Attention: Corporate Trust
Fax: (415) 399-1647
Telephone: (415) 263-2000

Any person may, by written notice to the other persons listed above, designate a different address or telephone number(s) to which subsequent notices or communications should be sent.

SECTION 13. Beneficiaries. This Disclosure Agreement shall inure solely to the benefit of the City, the Dissemination Agent, the Participating Underwriter and Holders and Beneficial Owners from time to time of the 2006 Certificates; and it shall create no rights in any other person or entity.
SECTION 14. Signature. This Disclosure Agreement has been executed by the undersigned on the date hereof, and such signature binds the City and the Dissemination Agent to the undertaking herein provided.

Date: November __, 2006

CITY OF MODESTO

By: ________________________________
Title: ________________________________

THE BANK OF NEW YORK TRUST COMPANY, N.A.

By: ________________________________
Title: ________________________________
EXHIBIT A

WRITTEN CERTIFICATION REGARDING ANNUAL REPORT

To: THE BANK OF NEW YORK TRUST COMPANY, N.A.

Re: CITY OF MODESTO WATER REVENUE CERTIFICATES OF PARTICIPATION
SERIES 2006 A

Pursuant to Section 3(b) of that certain Continuing Disclosure Agreement, dated November __, 2006, between the City of Modesto (the “City”) and The Bank of New York Trust Company, N.A. (the “Dissemination Agent”), the City hereby certifies that the Annual Report attached hereto, which Annual Report has been prepared with respect to the Fiscal Year of the City ended June 30, ____, constitutes the Annual Report required to be furnished by it under the Continuing Disclosure Agreement.

Dated: __________

CITY OF MODESTO

By: __________________________
   Disclosure Representative
EXHIBIT B

NOTICE TO REPOSITORIES OF FAILURE TO FILE ANNUAL REPORT

Name of Obligated Party: CITY OF MODESTO

Name of Issue: CITY OF MODESTO REVENUE CERTIFICATES OF PARTICIPATION SERIES 2006 A

Date of Delivery: November __, 2006

NOTICE IS HEREBY GIVEN that the City of Modesto has not provided an Annual Report with respect to the above-named Certificates as required by the Continuing Disclosure Agreement dated November __, 2006 related to the 2006 Certificates and by Section __ of the 2006 Supplemental Installment Purchase Contract, dated as of November 1, 2006, by and between the City of Modesto and the Modesto Public Financing Authority. [The City anticipates that the Annual Report will be filed by ______________________.] Dated: ____________

The Bank of New York Trust Company, N.A.

By: __________________________
APPENDIX F

INFORMATION CONCERNING DTC

The information in this Appendix concerning DTC and DTC’s book entry only system has been obtained from sources that the Authority and the City believe to be reliable, but neither the Authority nor the City takes any responsibility for the completeness or accuracy thereof. The following description of the procedures and recordkeeping with respect to beneficial ownership in the 2006 Certificates, payment of principal, premium, if any, and interest with respect to the 2006 Certificates to all DTC Participants or to Beneficial Owners, confirmation and transfers of Beneficial Ownership interests in the 2006 Certificates and other related transactions by and between DTC, DTC Participants and Beneficial Owners is based solely on information provided by DTC.

The Depository Trust Company (“DTC”), New York, NY, will act as securities depository for the 2006 Certificates. The 2006 Certificates 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 security certificate will be issued for each maturity of the 2006 Certificates, each in the aggregate principal amount of such maturity, and will be deposited with DTC.

DTC, the world’s largest securities depository, is a limited-purpose trust company organized under the New York Banking Law, a “banking organization” within the meaning of the New York Banking Law, a member of the Federal Reserve System, a “clearing corporation” within the meaning of the New York Uniform Commercial Code, and a “clearing agency” registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for over 2.2 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, in turn, is owned by a number of Direct Participants of DTC and Members of the National Securities Clearing Corporation, Fixed Income Clearing Corporation, and Emerging Markets Clearing Corporation, (NSCC, FICC, and EMCC, also subsidiaries of DTCC), as well as by the New York Stock Exchange, Inc., the American Stock Exchange LLC, and the National Association of Securities Dealers, Inc. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly (“Indirect Participants”). DTC has Standard & Poor’s highest rating: AAA. The DTC Rules applicable to its Participants are on file with the Securities and Exchange Commission.

Purchases of 2006 Certificates under the DTC system must be made by or through Direct Participants, which will receive credit for the 2006 Certificates on DTC’s records. The ownership interest of each actual purchaser of each 2006 Certificate (a “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 purchases. 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 2006 Certificates 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 Certificates, except in the event that use of the book-entry system for the 2006 Certificates is discontinued.
To facilitate subsequent transfers, all 2006 Certificates 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 2006 Certificates 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 2006 Certificates; DTC's records reflect only the identity of the Direct Participants to whose accounts such 2006 Certificates 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 2006 Certificates may wish to take certain steps to augment the transmission to them of notices of significant events with respect to the 2006 Certificates, such as redemptions, tenders, defaults, and proposed amendments to the Bond documents. For example, Beneficial Owners of 2006 Certificates may wish to ascertain that the nominee holding the 2006 Certificates 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.

Prepayment notices shall be sent to DTC. If less than all of the 2006 Certificates within a maturity are being prepaid, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such maturity to be prepaid.

Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to 2006 Certificates unless authorized by a Direct Participant in accordance with DTC's procedures. Under its usual procedures, DTC mails an Omnibus Proxy to the City as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts 2006 Certificates are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Prepayment proceeds, principal and interest payments on the 2006 Certificates will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts upon DTC's receipt of funds and corresponding detail information from the City or the Trustee, on the payable date in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of such Participant and not of DTC, the Trustee or the City, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of prepayment proceeds, principal and interest payments to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the City or the Trustee, disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners will be the responsibility of Direct and Indirect Participants.

DTC may discontinue providing its services as securities depository with respect to the 2006 Certificates at any time by giving reasonable notice to the City or the Trustee. Under such circumstances, in the event that a successor securities depository is not obtained, 2006 Certificates are required to be printed and delivered.

The Authority may decide to discontinue use of the system of book-entry transfers through DTC (or a successor securities depository). In that event, 2006 Certificates will be printed and delivered.
APPENDIX G

SPECIMEN CERTIFICATE INSURANCE POLICY

FINANCIAL GUARANTY INSURANCE POLICY

MBIA Insurance Corporation
Armonk, New York 10504

Policy No. [NUMBER]

MBIA Insurance Corporation (the "Insurer"), in consideration of the payment of the premium and subject to the terms of this policy, hereby unconditionally and irrevocably guarantees to any owner, as hereinafter defined, of the following described obligations, the full and complete payment required to be made by or on behalf of the Issuer to [PAYING AGENT/TRUSTEE] or its successor (the "Paying Agent") of an amount equal to (i) the principal of (either at the stated maturity or by any advancement of maturity pursuant to a mandatory sinking fund payment) and interest on, the Obligations (as that term is defined below) as such payments shall become due but shall not be so paid (except that in the event of any acceleration of the due date of such principal by reason of mandatory or optional redemption or acceleration resulting from default or otherwise, other than any advancement of maturity pursuant to a mandatory sinking fund payment, the payments guaranteed hereby shall be made in such amounts and at such times as such payments of principal would have been due had there not been any such acceleration, unless the Insurer elects in its sole discretion, to pay in whole or in part any principal due by reason of such acceleration); and (ii) the reimbursement of such payment which is subsequently recovered from any owner pursuant to a final judgment by a court of competent jurisdiction that such payment constitutes an avoidable preference to such owner within the meaning of any applicable bankruptcy law. The amounts referred to in clauses (i) and (ii) of the preceding sentence shall be referred to herein collectively as the "Insured Amounts." "Obligations" shall mean:

[PAR]

[LEGAL NAME OF ISSUE]

Upon receipt of telephonic or telegraphic notice, such notice subsequently confirmed in writing by registered or certified mail, or upon receipt of written notice by registered or certified mail, by the Insurer from the Paying Agent or any owner of an Obligation the payment of an Insured Amount for which is then due, that such required payment has not been made, the Insurer on the due date of such payment or within one business day after receipt of notice of such nonpayment, whichever is later, will make a deposit of funds, in an account with U.S. Bank Trust National Association, in New York, New York, New York, or its successor, sufficient for the payment of any such Insured Amounts which are then due. Upon presentment and surrender of such Obligations or presentment of such other proof of ownership of the Obligations, together with any appropriate instruments of assignment to evidence the assignment of the Insured Amounts due on the Obligations as are paid by the Insurer, and appropriate instruments to effect the appointment of the Insurer as agent for such owners of the Obligations in any legal proceeding related to payment of Insured Amounts on the Obligations, such instruments being in a form satisfactory to U.S. Bank Trust National Association, U.S. Bank Trust National Association shall disburse to such owners, or the Paying Agent payment of the Insured Amounts due on such Obligations, less any amount held by the Paying Agent for the payment of such Insured Amounts and legally available therefor. This policy does not insure against loss of any prepayment premium which may at any time be payable with respect to any Obligation.

As used herein, the term "owner" shall mean the registered owner of any Obligation as indicated in the books maintained by the Paying Agent, the Issuer, or any designee of the Issuer for such purpose. The term owner shall not include the Issuer or any party whose agreement with the Issuer constitutes the underlying security for the Obligations.

Any service of process on the Insurer may be made to the Insurer at its offices located at 113 King Street, Armonk, New York 10504 and such service of process shall be valid and binding.

This policy is non-cancellable for any reason. The premium on this policy is not refundable for any reason including the payment prior to maturity of the Obligations.

In the event the Insurer were to become insolvent, any claims arising under a policy of financial guaranty insurance are excluded from coverage by the California Insurance Guaranty Association, established pursuant to Article 14.2 (commencing with Section 1063) of Chapter 1 of Part 2 of Division 1 of the California Insurance Code.

IN WITNESS WHEREOF, the Insurer has caused this policy to be executed in facsimile on its behalf by its duly authorized officers, this [DAY] day of [MONTH, YEAR].

MBIA Insurance Corporation

President

Attest:

Assistant Secretary

STD-R-CA-7
01/05

DOCSOC/1183217v10/024586-0005

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APPENDIX H

CERTAIN INFORMATION REGARDING THE CITY OF MODESTO

The following information with respect to the City is presented for information purposes only. The 2006 Certificates do not constitute an indebtedness of the City within the meaning of any constitutional, statutory or charter limitations and the City is not obligated to levy any ad valorem taxes therefor or to use any other funds of the City to pay the 2006 Payments or the interest thereon (other than Gross Revenues of the Water Utility System).

General Description

The City, which is the county seat of Stanislaus County, was incorporated in 1884. It covers approximately 36 square miles. The City operates under a council-manager form of government pursuant to a charter adopted in 1963. The City is located in central California approximately 93 miles east of the City and County of San Francisco.

The City Council (the “Council”) appoints the City Clerk and Auditor, the City Attorney, and the City Manager. The City Manager heads the executive branch of government, implements Council directives and policies, and manages the administrative and operational functions through the various department heads who are appointed by the City Manager.

The City provides the full range of services normally associated with a municipality, including public safety (police and fire), highways and streets, sanitation, health and social services, culture-recreation, public improvements, planning and zoning and general administrative services. The City also provides parking and airport facilities and water, sewer and bus service. The school districts in the City are separate governmental entities which receive no funding from the City.

Population

The following table represents historical population statistics for the City, the County and the State.

<table>
<thead>
<tr>
<th>Calendar Year</th>
<th>City of Modesto</th>
<th>Stanislaus County</th>
<th>State of California</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006</td>
<td>208,107</td>
<td>514,370</td>
<td>37,172,015</td>
</tr>
<tr>
<td>2005</td>
<td>207,987</td>
<td>510,858</td>
<td>36,728,196</td>
</tr>
<tr>
<td>2004</td>
<td>207,543</td>
<td>490,127</td>
<td>36,144,000</td>
</tr>
<tr>
<td>2003</td>
<td>204,185</td>
<td>479,000</td>
<td>35,612,000</td>
</tr>
<tr>
<td>2002</td>
<td>199,623</td>
<td>479,193</td>
<td>35,049,000</td>
</tr>
<tr>
<td>2001</td>
<td>193,691</td>
<td>466,442</td>
<td>34,431,000</td>
</tr>
</tbody>
</table>

(1) As of January 1.

Employment

The following table summarizes the civilian labor force, employment and unemployment in the County for the calendar years 2001 through 2005. These figures are county-wide statistics and may not necessarily accurately reflect employment trends in the City.

MODESTO METROPOLITAN STATISTICAL AREA
Industry Employment and Labor Force
(Annual Averages)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Civilian Labor Force</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Employment</td>
<td>210,800</td>
<td>204,600</td>
<td>201,500</td>
<td>198,900</td>
<td>196,500</td>
</tr>
<tr>
<td>Unemployment</td>
<td>19,000</td>
<td>20,700</td>
<td>22,000</td>
<td>21,200</td>
<td>17,900</td>
</tr>
<tr>
<td>Unemployment Rate</td>
<td>8.3%</td>
<td>9.2%</td>
<td>9.8%</td>
<td>9.6%</td>
<td>8.3%</td>
</tr>
<tr>
<td>Wage and Salary Employment:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Farm</td>
<td>14,100</td>
<td>13,800</td>
<td>14,000</td>
<td>13,900</td>
<td>14,100</td>
</tr>
<tr>
<td>Natural Resources, Mining and Construction</td>
<td>13,300</td>
<td>12,300</td>
<td>11,400</td>
<td>10,700</td>
<td>11,000</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>22,300</td>
<td>22,700</td>
<td>23,100</td>
<td>22,500</td>
<td>23,000</td>
</tr>
<tr>
<td>Wholesale Trade</td>
<td>6,200</td>
<td>6,000</td>
<td>5,700</td>
<td>5,600</td>
<td>5,400</td>
</tr>
<tr>
<td>Retail Trade</td>
<td>22,700</td>
<td>21,500</td>
<td>21,800</td>
<td>21,700</td>
<td>21,100</td>
</tr>
<tr>
<td>Transport, Warehousing, Utilities</td>
<td>5,200</td>
<td>4,700</td>
<td>4,600</td>
<td>4,500</td>
<td>4,300</td>
</tr>
<tr>
<td>Information</td>
<td>2,500</td>
<td>2,500</td>
<td>2,200</td>
<td>2,100</td>
<td>2,200</td>
</tr>
<tr>
<td>Financial Activities</td>
<td>6,200</td>
<td>6,100</td>
<td>6,000</td>
<td>5,600</td>
<td>5,400</td>
</tr>
<tr>
<td>Professional and Business Services</td>
<td>14,900</td>
<td>14,200</td>
<td>13,800</td>
<td>15,000</td>
<td>16,800</td>
</tr>
<tr>
<td>Educational and Health Services</td>
<td>19,500</td>
<td>19,200</td>
<td>18,900</td>
<td>18,100</td>
<td>17,100</td>
</tr>
<tr>
<td>Leisure and Hospitality</td>
<td>14,800</td>
<td>14,200</td>
<td>13,700</td>
<td>13,600</td>
<td>13,000</td>
</tr>
<tr>
<td>Other Services</td>
<td>6,100</td>
<td>6,200</td>
<td>6,200</td>
<td>6,200</td>
<td>5,900</td>
</tr>
<tr>
<td>Federal Government</td>
<td>1,200</td>
<td>1,200</td>
<td>1,200</td>
<td>1,200</td>
<td>1,200</td>
</tr>
<tr>
<td>State Government</td>
<td>1,700</td>
<td>1,700</td>
<td>1,900</td>
<td>1,900</td>
<td>1,800</td>
</tr>
<tr>
<td>Local Government</td>
<td>22,700</td>
<td>22,100</td>
<td>21,900</td>
<td>22,200</td>
<td>21,600</td>
</tr>
<tr>
<td>Total All Industries</td>
<td>173,300</td>
<td>168,500</td>
<td>166,300</td>
<td>164,600</td>
<td>163,800</td>
</tr>
</tbody>
</table>

(1) Latest available information.

Note: Totals may not add up because of rounding.

Source: Labor Division of the California State Employment Development Department.

Effective Buying Income

"Effective Buying Income" is defined as money income less personal tax and non-tax payments, a number often referred to as "disposable" or "after-tax" income. Money income is the aggregate of wages and salaries, net farm and non-farm self-employment income, interest, dividends, net rental and royalty income, Social Security and railroad retirement income, other retirement and disability income, public assistance income, unemployment compensation, Veterans Administration payments, alimony and child support, military family allotments, net winnings from gambling and other periodic income. Deducted from this total money income are personal income taxes (federal,
state and local), personal contributions to social insurance (Social Security and federal retirement payroll deductions), and taxes on owner-occupied non-business real estate.

The following table summarizes the total effective buying income for the County and the State for the period from 2000 through 2004.

**CITY OF MODESTO, STANISLAUS COUNTY AND THE STATE OF CALIFORNIA**

**Total Effective Buying Income and Median Household Effective Buying Income**

2000 through 2004

<table>
<thead>
<tr>
<th>Year</th>
<th>Area</th>
<th>Total Effective Buying Income (000's Omitted)</th>
<th>Median Household Effective Buying Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004</td>
<td>City of Modesto</td>
<td>$3,274,173</td>
<td>$37,874</td>
</tr>
<tr>
<td></td>
<td>Stanislaus County</td>
<td>7,416,705</td>
<td>37,815</td>
</tr>
<tr>
<td></td>
<td>California</td>
<td>705,108,410</td>
<td>43,915</td>
</tr>
<tr>
<td>2003</td>
<td>City of Modesto</td>
<td>3,165,245</td>
<td>36,774</td>
</tr>
<tr>
<td></td>
<td>Stanislaus County</td>
<td>7,078,408</td>
<td>36,670</td>
</tr>
<tr>
<td></td>
<td>California</td>
<td>647,879,427</td>
<td>42,484</td>
</tr>
<tr>
<td>2002</td>
<td>City of Modesto</td>
<td>2,957,668</td>
<td>36,573</td>
</tr>
<tr>
<td></td>
<td>Stanislaus County</td>
<td>6,679,400</td>
<td>36,331</td>
</tr>
<tr>
<td></td>
<td>California</td>
<td>650,521,407</td>
<td>43,532</td>
</tr>
<tr>
<td>2001</td>
<td>City of Modesto</td>
<td>2,903,037</td>
<td>37,705</td>
</tr>
<tr>
<td></td>
<td>Stanislaus County</td>
<td>6,517,967</td>
<td>36,180</td>
</tr>
<tr>
<td></td>
<td>California</td>
<td>652,190,282</td>
<td>44,464</td>
</tr>
<tr>
<td>2000</td>
<td>City of Modesto</td>
<td>2,845,198</td>
<td>37,597</td>
</tr>
<tr>
<td></td>
<td>Stanislaus County</td>
<td>6,611,580</td>
<td>36,022</td>
</tr>
<tr>
<td></td>
<td>California</td>
<td>590,376,663</td>
<td>39,492</td>
</tr>
</tbody>
</table>

Major Employers

The following table summarizes the largest employers in the County of Stanislaus.

COUNTY OF STANISLAUS
Twenty Largest Employers

<table>
<thead>
<tr>
<th>No.</th>
<th>Company Name</th>
<th>Employees</th>
<th>No.</th>
<th>Company Name</th>
<th>Employees</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>County of Stanislaus</td>
<td>4,747</td>
<td>11.</td>
<td>Foster Poultry Farms</td>
<td>1,813</td>
</tr>
<tr>
<td>2.</td>
<td>Signature Fruit Company</td>
<td>4,100</td>
<td>12.</td>
<td>City of Modesto</td>
<td>1,691</td>
</tr>
<tr>
<td>3.</td>
<td>Modesto City Schools</td>
<td>4,000</td>
<td>13.</td>
<td>ConAgra</td>
<td>1,400</td>
</tr>
<tr>
<td>4.</td>
<td>E&amp;J Gallo Winery</td>
<td>3,425</td>
<td>14.</td>
<td>Emanuel Medical Center</td>
<td>1,329</td>
</tr>
<tr>
<td>5.</td>
<td>Memorial Medical Center</td>
<td>2,600</td>
<td>15.</td>
<td>Wal-Mart</td>
<td>1,173</td>
</tr>
<tr>
<td>6.</td>
<td>Del Monte Foods</td>
<td>2,600</td>
<td>16.</td>
<td>Save Mart</td>
<td>1,167</td>
</tr>
<tr>
<td>7.</td>
<td>Doctors Medical Center</td>
<td>2,300</td>
<td>17.</td>
<td>Ceres Unified School District</td>
<td>1,000</td>
</tr>
<tr>
<td>8.</td>
<td>Stanislaus Food Products</td>
<td>2,000</td>
<td>18.</td>
<td>Calif. State Univ. Stanislaus</td>
<td>971</td>
</tr>
<tr>
<td>9.</td>
<td>Modesto Junior College</td>
<td>1,866</td>
<td>19.</td>
<td>Sutter Gould Medical Found.</td>
<td>819</td>
</tr>
</tbody>
</table>

Source: Stanislaus Economic Development and Workforce Alliance.

Commercial Activity

The following two tables show the dollar volume of taxable transactions in the City of Modesto and County of Stanislaus from 1999 through 2004.

CITY OF MODESTO
Taxable Transactions
Calendar Years 2000 through 2004
(in Thousands of Dollars)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Apparel stores</td>
<td>$148,097</td>
<td>$126,372</td>
<td>$129,773</td>
<td>$112,847</td>
<td>$101,835</td>
</tr>
<tr>
<td>General merchandise stores</td>
<td>538,323</td>
<td>518,024</td>
<td>507,438</td>
<td>499,333</td>
<td>475,171</td>
</tr>
<tr>
<td>Food stores</td>
<td>133,058</td>
<td>136,462</td>
<td>119,423</td>
<td>115,743</td>
<td>111,684</td>
</tr>
<tr>
<td>Eating and drinking places</td>
<td>258,357</td>
<td>245,609</td>
<td>235,337</td>
<td>219,205</td>
<td>198,766</td>
</tr>
<tr>
<td>Home furnishing and appliances</td>
<td>258,357</td>
<td>130,089</td>
<td>131,234</td>
<td>109,395</td>
<td>105,010</td>
</tr>
<tr>
<td>Bldg. materials and farm implements</td>
<td>233,124</td>
<td>204,427</td>
<td>188,388</td>
<td>188,459</td>
<td>162,696</td>
</tr>
<tr>
<td>Auto dealers and supplies</td>
<td>253,170</td>
<td>259,395</td>
<td>247,861</td>
<td>230,912</td>
<td>212,069</td>
</tr>
<tr>
<td>Service stations</td>
<td>131,695</td>
<td>115,317</td>
<td>101,551</td>
<td>106,229</td>
<td>110,618</td>
</tr>
<tr>
<td>Other retail stores</td>
<td>418,822</td>
<td>392,650</td>
<td>381,371</td>
<td>364,468</td>
<td>343,021</td>
</tr>
<tr>
<td>Subtotal</td>
<td>$2,250,789</td>
<td>2,128,345</td>
<td>2,042,376</td>
<td>1,946,591</td>
<td>1,820,870</td>
</tr>
<tr>
<td>All Other Outlets</td>
<td>414,841</td>
<td>433,387</td>
<td>372,899</td>
<td>367,760</td>
<td>356,567</td>
</tr>
<tr>
<td>All Outlets</td>
<td>$2,665,630</td>
<td>$2,561,732</td>
<td>$2,415,275</td>
<td>$2,314,351</td>
<td>$2,177,437</td>
</tr>
</tbody>
</table>

Source: State of California, Board of Equalization.

DOCSOC/1183217v10/024586-0005
COUNTY OF STANISLAUS  
Taxable Transactions  
Calendar Years 2000 through 2004  
(in Thousands of Dollars)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Apparel stores</td>
<td>$192,858</td>
<td>$154,867</td>
<td>$154,083</td>
<td>$127,711</td>
<td>$115,339</td>
</tr>
<tr>
<td>General merchandise stores</td>
<td>846,742</td>
<td>803,255</td>
<td>784,431</td>
<td>754,247</td>
<td>702,326</td>
</tr>
<tr>
<td>Specialty stores</td>
<td>501,694</td>
<td>465,562</td>
<td>432,777</td>
<td>411,996</td>
<td>390,154</td>
</tr>
<tr>
<td>Food stores</td>
<td>291,867</td>
<td>282,781</td>
<td>260,781</td>
<td>255,923</td>
<td>237,565</td>
</tr>
<tr>
<td>Eating and drinking places</td>
<td>452,120</td>
<td>421,793</td>
<td>403,421</td>
<td>378,985</td>
<td>342,807</td>
</tr>
<tr>
<td>Household</td>
<td>198,691</td>
<td>187,214</td>
<td>181,384</td>
<td>153,417</td>
<td>146,043</td>
</tr>
<tr>
<td>Building materials</td>
<td>508,825</td>
<td>416,983</td>
<td>368,472</td>
<td>360,337</td>
<td>303,139</td>
</tr>
<tr>
<td>Automotive</td>
<td>1,396,277</td>
<td>1,305,986</td>
<td>1,248,936</td>
<td>1,244,939</td>
<td>1,102,803</td>
</tr>
<tr>
<td>Other retail stores</td>
<td>331,376</td>
<td>297,729</td>
<td>273,693</td>
<td>249,876</td>
<td>243,819</td>
</tr>
<tr>
<td><strong>Subtotal</strong></td>
<td>4,720,450</td>
<td>4,336,170</td>
<td>4,107,978</td>
<td>3,937,431</td>
<td>3,583,995</td>
</tr>
<tr>
<td>Business and Personal Services</td>
<td>240,245</td>
<td>224,429</td>
<td>233,862</td>
<td>214,161</td>
<td>208,118</td>
</tr>
<tr>
<td>All Other Outlets</td>
<td>$1,804,973</td>
<td>$1,614,893</td>
<td>$1,494,025</td>
<td>$1,421,077</td>
<td>$1,402,941</td>
</tr>
<tr>
<td>All Outlets</td>
<td>$6,765,668</td>
<td>$6,175,492</td>
<td>$5,825,865</td>
<td>$5,572,669</td>
<td>$5,195,054</td>
</tr>
</tbody>
</table>

Source: State of California, Board of Equalization.

**Construction Trends**

"Single Family Housing," includes detached, semi-detached, rowhouse and townhouse units. Rowhouses and townhouses are included when each unit is separated from the adjacent unit by an unbroken ground-to-roof party or fire wall. Condominiums are included in single-family when they are of zero-lot-line or zero-property-line construction; when units are separated by an air space; or, when units are separated by an unbroken ground-to-roof party or fire wall. "Multi-Family Housing," includes duplexes, 3-4-unit structures and apartment-type structures with five units or more. Multifamily housing also includes condominium units in structures of more than one living unit that do not meet the above single-family housing definition. "Residential Alterations and Additions," means alterations, additions, and conversions to residential structures, excluding special installation permits for electrical, plumbing, heating, air-conditioning, or similar mechanical work, or installation of fire escapes, elevators, signs, etc.

"New Commercial," includes new hotels and motels, office and bank buildings, stores and other mercantile buildings, parking garages, service stations, and amusement and recreational buildings. "New Industrial," includes manufacturing plants and affiliated buildings. "Other New Nonresidential," includes churches and religious buildings, hospitals and institutional buildings, schools and educational buildings, residential garages, public works and utilities buildings, and miscellaneous nonresidential structures. "Nonresidential Alterations and Additions," means alterations, additions, and conversions to nonresidential structures, excluding special installation permits for electrical, plumbing, heating, air-conditioning, or similar mechanical work, or installation of fire escapes, elevators and signs, etc.
Provided below are the building permits and valuations for the City of Modesto for calendar years 2001 through 2005.

**CITY OF MODESTO**

Residential and Nonresidential Building Permit Valuations and Total Residential Building Permits

<table>
<thead>
<tr>
<th>Permit Valuation</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>New Multi-family</td>
<td>3,276,142</td>
<td>1,719,426</td>
<td>6,087,705</td>
<td>20,721,736</td>
<td>1,719,478</td>
</tr>
<tr>
<td>Res. Alterations &amp; Additions</td>
<td>7,410,525</td>
<td>9,062,856</td>
<td>9,793,040</td>
<td>15,707,552</td>
<td>17,947,953</td>
</tr>
<tr>
<td>Total Residential</td>
<td>$257,001,939</td>
<td>$227,027,754</td>
<td>$184,884,218</td>
<td>$105,902,823</td>
<td>$185,576,767</td>
</tr>
<tr>
<td>New Industrial</td>
<td>2,967,560</td>
<td>6,580,320</td>
<td>1,183,692</td>
<td>2,003,992</td>
<td>0</td>
</tr>
<tr>
<td>New Other</td>
<td>23,022,963</td>
<td>19,899,918</td>
<td>26,649,779</td>
<td>61,628,516</td>
<td>32,919,890</td>
</tr>
<tr>
<td>Non-Res. Alterations &amp; Additions</td>
<td>30,662,702</td>
<td>32,507,506</td>
<td>24,933,722</td>
<td>25,524,261</td>
<td>19,914,523</td>
</tr>
<tr>
<td>Total Nonresidential</td>
<td>85,720,554</td>
<td>79,293,941</td>
<td>83,022,927</td>
<td>124,455,465</td>
<td>115426966</td>
</tr>
<tr>
<td>Total All Building</td>
<td>$342,722,493</td>
<td>$306,321,695</td>
<td>$267,907,145</td>
<td>$230,358,288</td>
<td>$301,003,773</td>
</tr>
</tbody>
</table>

New Dwelling Units

<table>
<thead>
<tr>
<th></th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Single Family</td>
<td>1,232</td>
<td>1,067</td>
<td>1,105</td>
<td>348</td>
<td>872</td>
</tr>
<tr>
<td>Multiple Family</td>
<td>30</td>
<td>21</td>
<td>78</td>
<td>297</td>
<td>9</td>
</tr>
<tr>
<td>Total</td>
<td>1,262</td>
<td>1,088</td>
<td>1,183</td>
<td>645</td>
<td>881</td>
</tr>
</tbody>
</table>

Note: Totals may not add up because of rounding.
Source: Building Permit Summary, Construction Industry Research Board and City of Modesto.

**Agriculture**

The following table summarizes historical agricultural production within the County for calendar years 2001 through 2005.

**STANISLAUS COUNTY**

Agricultural Production
2001-2005

<table>
<thead>
<tr>
<th>Commodity</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fruit and Nut Crops</td>
<td>$311,735,000</td>
<td>$393,520,000</td>
<td>$431,642,000</td>
<td>$616,452,000</td>
<td>$686,897,000</td>
</tr>
<tr>
<td>Vegetable Crops</td>
<td>100,153,000</td>
<td>105,508,000</td>
<td>105,667,000</td>
<td>125,903,000</td>
<td>91,454,000</td>
</tr>
<tr>
<td>Field Crops</td>
<td>139,898,000</td>
<td>132,418,000</td>
<td>127,329,000</td>
<td>137,871,000</td>
<td>147,744,000</td>
</tr>
<tr>
<td>Seed Crops</td>
<td>797,000</td>
<td>561,000</td>
<td>533,000</td>
<td>401,000</td>
<td>810,000</td>
</tr>
<tr>
<td>Apiary</td>
<td>7,389,000</td>
<td>7,323,000</td>
<td>7,565,000</td>
<td>8,865,000</td>
<td>12,045,000</td>
</tr>
<tr>
<td>Nursery Crops</td>
<td>68,960,000</td>
<td>85,889,000</td>
<td>99,164,000</td>
<td>111,272,000</td>
<td>71,240,000</td>
</tr>
<tr>
<td>Livestock &amp; Poultry</td>
<td>233,237,000</td>
<td>242,677,000</td>
<td>239,990,000</td>
<td>403,205,000</td>
<td>401,244,000</td>
</tr>
<tr>
<td>Livestock &amp; Poultry Products</td>
<td>491,131,000</td>
<td>400,075,000</td>
<td>443,042,000</td>
<td>574,465,000</td>
<td>566,161,000</td>
</tr>
<tr>
<td>TOTALS</td>
<td>$1,353,300,000</td>
<td>$1,367,971,000</td>
<td>$1,454,932,000</td>
<td>$1,978,434,000</td>
<td>$1,977,595,000</td>
</tr>
</tbody>
</table>

Source: Stanislaus County Department of Agriculture.
APPENDIX E

FORM OF CONTINUING DISCLOSURE AGREEMENT

This Continuing Disclosure Agreement (the “Disclosure Agreement”) is executed and delivered by the City of Modesto (the “City”) and The Bank of New York Trust Company, N.A., as dissemination agent (the “Dissemination Agent”) in connection with the execution and delivery of the City of Modesto Water Revenue Certificates of Participation Series 2006 A (the “2006 Certificates”) evidencing and representing proportionate interests of the owners thereof in certain installment payments to be made by the City. The 2006 Certificates are being executed and delivered pursuant to a 2006 Trust Agreement, dated as of November 1, 2006 (the “2006 Trust Agreement”), by and between the Modesto Public Financing Authority (the “Authority”) and The Bank of New York Trust Company, N.A., as trustee thereunder (the “Trustee”).

The City and the Dissemination Agent covenant and agree as follows:

SECTION 1. Purpose of this Disclosure Agreement. This Disclosure Agreement is being executed and delivered by the City and the Dissemination Agent for the benefit of the Owners and Beneficial Owners of the 2006 Certificates and in order to assist the Participating Underwriter in complying with the Rule.

SECTION 2. Definitions. In addition to the definitions set forth in the 2006 Trust Agreement, which apply to any capitalized term used in this Disclosure Agreement 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 Agreement.

“Beneficial Owner” shall mean any person which (a) has the power, directly or indirectly, to vote or consent with respect to, or to dispose of ownership of, any 2006 Certificate (including a person holding a 2006 Certificate through a nominee, depository or other intermediary), or (b) is treated as the owner of any 2006 Certificate for federal income tax purposes.

“Broker-Dealer” shall mean any entity which is permitted by law to perform the functions required of a broker-dealer as described in Appendix C to the Official Statement, which is a member of, or a direct participant in, the Depository Trust Company, which has been selected to serve as a broker-dealer with respect to the 2006 Certificates and which is a party to a Broker-Dealer Agreement with a Auction Agent for the 2006 Certificates.

“Central Post Office” shall mean the Disclosure USA website maintained by the Municipal Advisory Council of Texas, or any successor thereto, or any other organization or method approved by the staff or members of the Securities and Exchange Commission as an intermediary through which issuers may, in compliance with the rule, make filings required by this Disclosure Agreement.
“Disclosure Representative” shall mean the City Manager or Finance Director of the City, or their designee, or such other officer or employee as the City shall designate in writing to the Trustee and the Dissemination Agent from time to time.

“Dissemination Agent” shall mean The Bank of New York Trust Company, N.A., acting in the capacity as Dissemination Agent hereunder, or any successor Dissemination Agent designated in writing by the City and which has filed with the Trustee a written acceptance of such designation.

“Fiscal Year” shall mean the one-year period ending on June 30 of each year, or such other one-year period as shall be designated as the City’s fiscal year from time to time.

“Installment Purchase Contract” shall mean that certain Master Installment Purchase Contract, dated as of November 1, 1997, by and between the City and the Authority, as supplemented by that certain 2006 Supplemental Installment Purchase Contract, dated as of _______ 1, 2006, by and between the City and the Authority.

“Listed Events” shall mean any of the events listed in Section 5(a) of this Disclosure Certificate.


“Owner” means a registered owner of the 2006 Certificates.

“Participating Underwriter” shall mean any of the original underwriters of the 2006 Certificates required to comply with the Rule in connection with offering of the 2006 Certificates.

“Repository” shall mean each National Repository and each State Repository.

“Rule” shall mean Rule 15c2-12 adopted by the Securities and Exchange Commission under the Securities Exchange Act of 1934, as the same may be amended from time to time.

“State” shall mean the State of California.

“State Repository” shall mean any public or private repository or entity designated by the State as a state repository for the purpose of the Rule and recognized as such by the Securities and Exchange Commission. As of the date of this Disclosure Agreement, there is no State Repository.
SECTION 3. Provision of Annual Reports.

(a) Not later than 270 days after the end of City’s Fiscal Year (commencing with the Fiscal Year ended June 30, 2006) the City shall, or shall cause the Dissemination Agent to, provide to each Repository each Participating Underwriter and each Broker-Dealer an Annual Report relating to such Fiscal Year which is consistent with the requirements of Section 4 of this Disclosure Agreement. 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 Agreement; provided that the audited financial statements of the City may be submitted separately from the balance of the Annual Report and later than the date required above for the filing of the Annual Report if not available by that date. If the City’s fiscal year changes, the City shall give notice of such change in the same manner as for a Listed Event under Section 5(f).

(b) Not later than fifteen (15) Business Days prior to the date specified in subsection (a) for providing the Annual Report to Repositories, the City shall provide the Annual Report to the Dissemination Agent (if other than the City) and the Trustee. The City shall provide a written certification in the form of Exhibit A hereto with each Annual Report furnished to the Dissemination Agent and the Trustee to the effect that such Annual Report constitutes the Annual Report required to be furnished by it hereunder. The Dissemination Agent and Trustee may conclusively rely upon such certification of the City and shall have no duty or obligation to review such Annual Report.

(c) The Dissemination Agent shall:

1. determine each year prior to the date for providing the Annual Report the name and address of each Repository;

2. provide any Annual Report received by it from the City to each Repository;

3. file a report with the City and (if the Dissemination Agent is not the Trustee) the Trustee certifying that the Annual Report has been provided pursuant to this Disclosure Agreement, stating the date it was provided and listing all the Repositories to which it was provided; and

4. if the Dissemination Agent is unable to verify that an Annual Report has been provided to the Repositories by the date required in subsection (a), the Dissemination Agent shall send a notice to each Repository in substantially the form attached as Exhibit B.

(d) Notwithstanding any other provision of this Disclosure Agreement, the City and the Dissemination Agent may make any of the filings of reports required to be filed with Repositories pursuant to this Disclosure Agreement through the Central Post Office.

SECTION 4. Content of Annual Reports. The Annual Report shall contain or incorporate by reference the City’s audited financial statements for the most recent fiscal year of the City and the following:
1. Principal amount of the 2006 Certificates outstanding as of the end of the Fiscal Year to which the Annual Report pertains.

2. Balance in the Parity Reserve Fund and a statement of the Reserve Fund Requirement (as those terms are defined in the Master Contract) as of the end of the Fiscal Year to which the Annual Report pertains.


4. Updated information similar to that contained in the tables entitled “WATER UTILITY SYSTEM — Sale of Water” and “WATER UTILITY SYSTEM — Ten Largest Customers,” appearing under the caption “WATER UTILITY SYSTEM — Service Area and Customers” of the Official Statement.

5. The City’s then current rates and charges for water service.

6. Updated information similar to that contained in the table entitled “WATER UTILITY SYSTEM — Historical Debt Service Coverage” appearing under the caption “WATER UTILITY SYSTEM — Historical Operating Results” of the Official Statement.

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 Authority or the City or related public entities, which have been submitted to each of the Repositories; provided, that if any document included by reference is a final official statement, it must be available from the Municipal Securities Rulemaking Board; and provided further, that the City shall clearly identify each such document so included by reference.

SECTION 5. Reporting of Significant Events.

(a) Pursuant to the provisions of this Section 5, the City shall give, or cause to be given, notice of the occurrence of any of the following events with respect to the 2006 Certificates, if material:

1. principal and interest payment delinquencies,
2. non-payment related defaults,
3. modifications to rights of Beneficial Owners,
4. optional, contingent or unscheduled prepayments of 2006 Certificates,
5. defeasances,
6. rating changes,
7. adverse tax opinions or events affecting the tax-exempt status of the 2006 Certificates,
8. unscheduled draws on the debt service reserves reflecting financial difficulties,
9. unscheduled draws on the credit enhancements reflecting financial difficulties,
10. substitution of the credit or liquidity providers or their failure to perform, and
11. release, substitution or sale of property securing repayment of the 2006 Certificates.

(b) The City shall, within one (1) business day of obtaining actual knowledge of the occurrence of any of the Listed Events contact the Dissemination Agent, inform such the Dissemination Agent of the event and promptly direct the Dissemination Agent in writing whether or not to report the event pursuant to subsection (f).

(c) Whenever the City obtains knowledge of the occurrence of one of the foregoing events, it shall as soon as possible, determine if such event would be material under applicable federal securities laws.

(d) If the City determines that such event would be material under applicable federal securities laws, the City shall promptly notify the Dissemination Agent in writing. Such notice shall instruct the Dissemination Agent to report the occurrence pursuant to subsection (f).

(e) If in response to a request under subsection (b), the City determines that the listed event would not be material under applicable federal securities laws, the City shall so notify the Dissemination Agent in writing and instruct the Dissemination Agent not to report the occurrence pursuant to subsection (f).

(f) If the Dissemination Agent has been instructed by the City to report the occurrence of a listed event, the Dissemination Agent shall file a notice of such occurrence with the Repositories (and may do so through the Central Post Office) with a copy to the City and to each Participating Underwriter and each Broker-Dealer. Notwithstanding the foregoing, notice of Listed Events described in subsections (a)(4) and (5) need not be given under this subsection any earlier than the notice (if any) of the underlying event is given to the Owners of affected Certificates pursuant to the 2006 Trust Agreement.

SECTION 6. Termination of Obligation. The obligation of the City under this Disclosure Agreement shall terminate upon the legal defeasance, prior prepayment or payment in full of all of the 2006 Certificates. If such termination occurs prior to the final maturity of the 2006 Certificates, the City shall give notice of such termination in the same manner as for a Listed Event under Section 5.

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 Agreement, and may discharge any such Dissemination Agent, with or without appointing a successor Dissemination Agent. The Dissemination Agent shall not be responsible in any
manner for the content of any notice or report prepared by the City pursuant to this Disclosure Agreement. If at any time there is not any other designated Dissemination Agent, the Trustee shall be the Dissemination Agent. The Dissemination Agent shall be entitled to compensation for its services as Dissemination Agent and reimbursement for its out-of-pocket expenses, attorney's fees, costs and advances made or incurred in the performance of its duties under this Disclosure Agreement in accordance with its written fee schedule provided to the City, as such fee schedule may be amended from time to time in writing.

SECTION 8. Amendment; Waiver. Notwithstanding any other provision of this Disclosure Agreement, the City and the Dissemination Agent may amend this Disclosure Agreement (and the Dissemination Agent shall agree to any amendment so requested by the City that does not adversely affect the Dissemination Agent's rights and obligations) and any provision of this Disclosure Agreement may be waived, provided that the following conditions are satisfied:

1. 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 2006 Certificates or the type of business conducted thereby;

2. The undertaking, as amended or taking into 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 execution and delivery of the 2006 Certificates, after taking into account any amendments or interpretations of the Rule, as well as any change in circumstances; and

3. The amendment or waiver either (i) is approved by the Owners of the 2006 Certificates in the same manner as provided in the 2006 Trust Agreement for amendments to the 2006 Trust Agreement with the consent of Owners, or (ii) does not, in the opinion of nationally recognized bond counsel, materially impair the interests of the Owners or Beneficial Owners of the 2006 Certificates.

In the event of any amendment or waiver of a provision of this Disclosure Agreement, 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 Listed Event under Section 5, 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 Agreement shall be deemed to prevent the City from disseminating any other information, using the means of dissemination set forth in this Disclosure Agreement or any other means of communication, or including any other information in any Annual Report or notice of occurrence of a Listed
Event, in addition to that which is required by this Disclosure Agreement. If the City chooses to include any information in any Annual Report or notice of occurrence of a Listed Event in addition to that which is specifically required by this Disclosure Agreement, the City shall not have any obligation under this Disclosure Agreement to update such information or include it in any future Annual Report or notice of occurrence of a Listed Event.

SECTION 10. Default. In the event of a failure of the City or the Dissemination Agent to comply with any provision of this Disclosure Agreement, the Dissemination Agent may (and, at the request of any Participating Underwriter or the Owners of at least 25% aggregate principal amount of Outstanding Certificates, shall (to the extent indemnified to its satisfaction)), or any Owner or Beneficial Owner of the 2006 Certificates may, take such actions as may be necessary and appropriate, including seeking mandate or specific performance by court order, to cause the City or the Dissemination Agent, as the case may be, to comply with its obligations under this Disclosure Agreement. A default under this Disclosure Agreement shall not be deemed an Event of Default under the 2006 Trust Agreement or the Installment Purchase Contract, and the sole remedy under this Disclosure Agreement in the event of any failure of the City or the Dissemination Agent to comply with this Disclosure Agreement shall be an action to compel performance.

In accepting the appointment under this Disclosure Agreement, the Dissemination Agent is not acting in a fiduciary capacity to the Owners or Beneficial Owners of the 2006 Certificates, the City, the Participating Underwriter or any other party or person.

No provision of this Disclosure Agreement shall require the Dissemination Agent to risk or advance or expend its own funds or incur any financial liability.

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 Agreement, and the City agrees to indemnify and save the Dissemination Agent, its officers, directors, employees and agents, harmless against any loss, expense and liabilities which it may incur arising out of or in the exercise or performance of its powers and duties hereunder, including the costs and expenses (including attorneys fees) of defending against any claim of liability, but excluding liabilities due to the Dissemination Agent’s negligence or willful misconduct. The Dissemination Agent shall have the right to resign from its duties as Dissemination Agent upon thirty (30) days notice to the City and the Trustee. The obligations of the City under this Section shall survive resignation or removal of the Dissemination Agent and payment of the 2006 Certificates.

SECTION 12. Notices. Any notices or communications to or among any of the parties to this Disclosure Agreement may be given as follows:

To the City: City of Modesto
1012 “I” Street, 2nd Floor
Modesto, California 95353
Attention: Finance Director
Fax: (209) 521-4801
Telephone: (209) 577-5370

To the Dissemination Agent: The Bank of New York Trust Company
Any person may, by written notice to the other persons listed above, designate a different address or telephone number(s) to which subsequent notices or communications should be sent.

SECTION 13. Beneficiaries. This Disclosure Agreement shall inure solely to the benefit of the City, the Dissemination Agent, the Participating Underwriter and Holders and Beneficial Owners from time to time of the 2006 Certificates; and it shall create no rights in any other person or entity.

SECTION 14. Signature. This Disclosure Agreement has been executed by the undersigned on the date hereof, and such signature binds the City and the Dissemination Agent to the undertaking herein provided.

Date: November __, 2006

CITY OF MODESTO

By: ________________________________
Title: ________________________________

THE BANK OF NEW YORK TRUST COMPANY, N.A.

By: ________________________________
Title: ________________________________
EXHIBIT A

WRITTEN CERTIFICATION REGARDING ANNUAL REPORT

To: THE BANK OF NEW YORK TRUST COMPANY, N.A.

Re: CITY OF MODESTO WATER REVENUE CERTIFICATES OF PARTICIPATION SERIES 2006 A

Pursuant to Section 3(b) of that certain Continuing Disclosure Agreement, dated November __, 2006, between the City of Modesto (the "City") and The Bank of New York Trust Company, N.A. (the "Dissemination Agent"), the City hereby certifies that the Annual Report attached hereto, which Annual Report has been prepared with respect to the Fiscal Year of the City ended June 30, ____, constitutes the Annual Report required to be furnished by it under the Continuing Disclosure Agreement.

Dated: ______________

CITY OF MODESTO

By: ____________________________
    Disclosure Representative
EXHIBIT B

NOTICE TO REPOSITORIES OF FAILURE TO FILE ANNUAL REPORT

Name of Obligated Party: CITY OF MODESTO
Name of Issue: CITY OF MODESTO REVENUE CERTIFICATES OF PARTICIPATION SERIES 2006 A
Date of Delivery: November __, 2006

NOTICE IS HEREBY GIVEN that the City of Modesto has not provided an Annual Report with respect to the above-named Certificates as required by the Continuing Disclosure Agreement dated November __, 2006 related to the 2006 Certificates and by Section ___ of the 2006 Supplemental Installment Purchase Contract, dated as of November 1, 2006, by and between the City of Modesto and the Modesto Public Financing Authority. [The City anticipates that the Annual Report will be filed by _______________________.]

Dated: __________

The Bank of New York Trust Company, N.A.

By: ________________________________
INSURANCE AND REIMBURSEMENT AGREEMENT
among
THE CITY OF MODESTO, CALIFORNIA
THE BANK OF NEW YORK TRUST COMPANY, N.A.,
and
MBIA INSURANCE CORPORATION
regarding
City of Modesto, California
Water Revenue Certificates of Participation
2006 Series A
Evidencing and Representing a Proportionate Interest of the Owners Thereof
in 2006 Payments to be made by the City of Modesto
to the Modesto Public Financing Authority
AND
[Confirmation] bearing [Ref. No.: _______]
Dated September _____, 2006, governed by the
Master Agreement and the Schedule thereto dated
As of September ___, 2006, by and between
Bank of America, N.A. and City of Modesto, California

Dated as of November [1], 2006
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INSURANCE AND REIMBURSEMENT AGREEMENT

THIS INSURANCE AND REIMBURSEMENT AGREEMENT (this “Agreement”) dated as of November [__], 2006 is entered into by and among the THE CITY OF MODESTO, CALIFORNIA (the “City”), THE BANK OF NEW YORK TRUST COMPANY, N.A., as trustee (the “Trustee”), and MBIA INSURANCE CORPORATION, a stock insurance corporation, duly organized and existing under the laws of the State of New York (“MBIA”). Capitalized terms not otherwise defined shall have the meanings ascribed thereto in Article I of this Agreement.

RECITALS:

1. The Authority is a joint exercise of powers authority duly organized and existing under and pursuant to the Joint Exercise of Powers Act (being Sections 6500 et seq. of the Government Code of the State of California (the “Act”) and a Joint Exercise of Powers Agreement dated as of December 1, 1989, by and between the City of Modesto and the Industrial Development Authority of the City of Modesto;

2. The Authority is has entered into a Master Installment Purchase Contract, dated as of November 1, 1997 (the “Master Contract”), as supplemented by the 1997 Supplemental Installment Purchase Contract, dated as of November 1, 1997, and as supplemented by a 2006 Supplemental Installment Purchase Contract, dated as of November 1, 2006 (the "2006 Supplemental Contract"), each by and between the Authority and the City, for the purpose of assisting the City by financing certain additions, betterments, extensions and improvements to the water utility system of the City (the "2006 Project");

3. In order to assist the City in financing the 2006 Project, the Authority has entered into the Trust Agreement, dated as of November 1, 2006 ("Trust Agreement"), with the Trustee, pursuant to which the Authority has assigned to the Trustee certain rights under the 2006 Supplemental Contract, including the right to receive 2006 payments made by the City thereunder certificates of participation evidencing and representing a proportionate interest of the Owners Thereof in 2006 payments to be made by the City to the Authority (the "2006 Certificates");

4. The 2006 Certificates will be delivered by the Trustee as variable rate certificates under the Trust Agreement and MBIA has issued a Commitment to provide a financial guaranty insurance policy (the “Policy”) insuring certain payments of principal and interest due with respect to the 2006 Certificates without regard to any acceleration of the time of payment of the 2006 Certificates;

5. The City wishes to hedge a portion of its Certificates and has determined that the Swap Agreement and related arrangements are designed to enhance the relationship between risk and return with respect to its program of investment and to that end has asked the Swap Provider to execute the Swap Agreement;

6. The Swap Provider, as a condition of providing the Swap Agreement required that MBIA issue an interest rate swap insurance policy (the “Swap Policy”) contemporaneously with
the delivery of the 2006 Certificates, insuring certain of the amounts which may be due from the City to the Swap Provider under the Swap Agreement;

7. MBIA has agreed to issue the Swap Policy contemporaneously with the delivery of the Certificates, insuring certain of the amounts which may be due from the City to the Swap Provider under the Swap Agreement;

8. MBIA has agreed, pursuant to the terms of the MBIA Commitment, to deliver the Swap Policy to the Swap Provider and the Policy to the Trustee, but has required that the City undertake certain obligations hereunder in connection therewith; and

9. This Agreement is entered into in order to set forth certain representations, warranties, covenants and other agreements of the City and the Trustee and to evidence and secure the City’s obligation (a) to reimburse MBIA for any payment made by MBIA under the Policy and the Swap Policy and as provided herein and (b) to indemnify or reimburse MBIA for certain amounts as more fully set forth herein.

In consideration of the premises and the mutual promises set forth below, MBIA, the Trustee, the City agree as follows:

ARTICLE I

DEFINITIONS

Unless the context otherwise requires, the terms defined in this Article I shall, for all purposes of this Agreement, have the meanings herein specified, to be equally applicable to both the singular and plural forms of any of the terms herein defined. Capitalized terms not otherwise defined herein shall have the meanings ascribed thereto in the Trust Agreement.

“Agreement” means this Insurance and Reimbursement Agreement dated as of November [____], 2006, including any amendments or any supplements hereto as herein permitted.

“Auction Agreement” means the Auction Agreement dated as of November 1, 2006 between the Trustee and The Bank of New York, as Auction Agent.

“Authority” means the Modesto Public Financing Authority.

“Authorized Officer,” with respect to the City, means the [______], the [______], the [______], and any other individual authorized by [the City’s organizational documents] to perform the act or sign the document in question.

“Broker Dealer Agreement” means the Broker-Dealer Agreement dated as of November 1, 2006 among the Auction Agent, Banc of America Securities LLC and the Authority.

“Business Day” means any day other than (a) a Saturday or Sunday, (b) a State legal holiday or (c) any day which shall be in the city in which the Trustee or MBIA is located, a legal holiday or a day on which banks in any of such cities are required or authorized by law or other government action to close.
“2006 Certificates” means the City of Modesto, California Water Revenue Certificates of Participation, 2006 Series A, Evidencing and Representing a Proportionate Interest of the Owners Thereof in 2006 Payments to be made by the City to the Authority.

“Certificate Purchase Agreement” means [_______].

“Counsel” means nationally recognized municipal bond counsel acceptable to MBIA.

“Financial Statements” means the audit report, including the financial statements and other documents required to be filed by the City with the Trustee pursuant to the Master Contract.

“Issuance Date” means the date upon which the Policy is issued.

“MBIA” means MBIA Insurance Corporation, a New York stock insurance corporation.

“MBIA Commitment” means the MBIA Insurance Corporation Commitment dated September 11, 2006, relating to the delivery of the Policy and the Swap Policy.


“Parity Obligations” shall have the meaning ascribed thereto in the Master Contract.

“Policy” means the Financial Guaranty Insurance Policy No. [______], including any endorsements thereto, issued by MBIA in connection with the 2006 Certificates.

“Prime Rate” means for any date of determination, the rate of interest as it is publicly announced by Citibank, N.A. at its principal office in New York, New York as its prime lending rate for unsecured commercial loans within the United States (any change in such prime rate of interest to be effective on the date such change is announced by Citibank, N.A.); provided, however, that if Citibank, N.A. ceases to announce a prime lending rate for unsecured commercial loans within the United States, then “Prime Rate” shall mean the average of the prime lending rates for unsecured commercial loans within the United States as announced by three leading commercial banks selected by MBIA from time-to-time.

“Reimbursement Rate” means for any date of determination, the Prime Rate plus 3%. The Reimbursement Rate shall be computed on the basis of a year of 365 days calculating the actual number of days elapsed. In no event shall the Reimbursement Rate exceed the maximum rate permissible under any applicable law limiting interest rates.

“Related Documents” means the Certificates, the Trust Agreement, each Supplemental Trust Agreement, including without limitation the Supplemental Trust Agreement relating to the 2006 Certificates, The Master Contract, the Auction Agent Agreement, the Broker Dealer Agreement, the Standby Bond Purchase Agreement, the Swap Agreement, any liquidity facility and any other transaction document or agreement contemplated by the 2006 Certificates or this Agreement.

“State” means the State of California.
“Swap Agreement” means the Master Agreement dated as of [ ], 2006 between the Borrower and the Swap Provider, the Schedule thereto, and the Insured Transaction bearing Admin No: [ ] dated [ ], 2006, which is the subject of the Swap Policy.

“Swap Policy” means the Interest Rate Swap Insurance Policy No. [ ] issued by MBIA, including any endorsements thereto.

“Swap Provider” means the Bank of America N.A.

“Trust Agreement” means the Trust Agreement dated as of November 1, 2006, between the Authority and the Trustee, including any Supplemental Trust Agreements.

ARTICLE II

REPRESENTATIONS, WARRANTIES AND COVENANTS
OF THE CITY AND THE TRUSTEE

Section 2.01. Representations, Warranties and Covenants of the City. The City represents and warrants to, and covenants with, MBIA that:

(a) The City is organized and is duly established and existing under the laws of the State.

(b) The City has the full power and authority under its Charter and Constitution to execute and deliver this Agreement and to enter into the transactions contemplated by this Agreement and the Related Documents. The execution and delivery of this Agreement and each of the Related Documents to which it is a party has been duly authorized by the City, and all necessary approvals for the execution, delivery and performance by the City of this Agreement and the Related Documents have been obtained.

(c) The execution and delivery of this Agreement and each of the Related Documents, the consummation of the transactions contemplated hereby and thereby and the fulfillment of or compliance with the terms and conditions of this Agreement and each Related Document by the City do not conflict with or result in any material breach or violation of any of the terms, conditions or provisions of any applicable laws, including regulations, or any material agreement or instrument to which the City is now a party or by which it is bound, or constitute a default under any of the foregoing which default would materially and adversely affect the consummation of the transactions contemplated hereby and by the terms of the Related Documents.

(d) This Agreement and each Related Document to which the City is a party, when executed and delivered by the City, assuming the due authorization, execution and delivery by the other parties thereto, will constitute the legal, valid and binding obligations of the City, enforceable against the City in accordance with their terms, except as such enforceability may be limited by bankruptcy, insolvency, reorganization,
moratorium or other similar laws affecting creditors' rights generally and general equitable principles.

(e) The 2006 Supplemental Contract and the payment obligations of the City under this Agreement constitute Parity Obligations within the meaning of the Master Contract.

(f) The City shall provide or cause to be provided to MBIA at or prior to the disbursement of the proceeds of the Certificates (i) conformed copies of this Agreement and the Related Documents and (ii) such opinions of legal counsel and certified resolutions of the City evidencing necessary or appropriate corporate action by the City, and other documents as may reasonably be requested by MBIA, including documents evidencing any required approvals of the transactions contemplated to be undertaken by the City under this Agreement and the Related Documents.

(g) The City hereby makes to MBIA the same representations, warranties and the same covenants made by the City, as are set forth in each of the Related Documents which representations, warranties and covenants, as well as the related defined terms contained therein, are incorporated herein by this reference with the same effect as if each and every such representation, warranty and covenant and defined term were set forth herein in its entirety. Any amendment to such representations, warranties and covenants or defined terms in any of the Related Documents and any termination, defeasance, discharge or replacement of any of the Related Documents shall be effective to amend, terminate, replace or discharge such representations, warranties, covenants and defined terms of the specified documents if adopted in accordance with their respective requirements, but shall not be effective to amend this Agreement without the prior written consent of MBIA if such amendment, termination, replacement or discharge shall materially adversely affect the rights of MBIA hereunder.

(h) The City will deliver to MBIA:

(i) simultaneously upon execution thereof, copies of the Master Contract and all amendments relating to the Related Documents; and

(i) The City agrees to permit MBIA to examine and inspect, at any reasonable time, upon reasonable notice, the books of record and account of the City relating to its transactions pursuant to the Master Contract, and all other records relating to its transactions pursuant to the Trust Agreement and the Master Contract, the 2006 Certificates and Parity Obligations relating to the 2006 Certificates. The City further agrees to promptly notify MBIA in writing of the happening of any event resulting in the loss of the tax-exempt status of the 2006 Certificates or placing the same in jeopardy with respect to the 2006 Certificates.

(j) Notwithstanding anything to the contrary in the Master Contract or any other Related Document, the City hereby agrees that there shall be no acceleration of the 2006 Payments without the prior written consent of MBIA.
(k) The City hereby agrees not to use MBIA’s name in any public document (other than the Official Statement) including, without limitation, a press release or presentation, announcement or forum without MBIA’s prior consent. In the event that the City is advised by counsel that the City has a legal obligation to disclose MBIA’s name in any press release, public announcement or other public document, the City shall provide MBIA with at least three business days prior written notice of the City’s intent to use MBIA’s name together with a copy of the proposed use of MBIA’s name and of any description of a transaction with MBIA and shall obtain MBIA’s prior consent as to the form and substance of the proposed use of MBIA’s name and any such description.

(l) The City shall not enter into any agreement nor shall it consent to or participate in any arrangement pursuant to which Certificates are tendered or purchased for any purpose other than the redemption and cancellation or legal defeasance of such Certificates without the prior written consent of MBIA.

Section 2.02. Representations, Warranties and Covenants of the Trustee. The Trustee represents and warrants to, and covenants with, MBIA that:

(a) The Trustee is a [ ] and has been duly organized, and is validly existing in good standing under the laws of the State of New York. The Trustee is duly authorized to do business, is in good standing and has obtained all licenses, permits, charters, registrations and approvals (together, “approvals”) necessary for the conduct of its business as currently conducted and the performance of its obligations under this Agreement and each Related Document to which it is a party.

(b) The execution, delivery and performance by the Trustee of this Agreement and the Related Documents to which it is a party have been duly authorized by all necessary corporate action and do not require any additional approvals or consents, or other action by or any notice to or filing with any Person, including, without limitation, any governmental entity.

(c) Neither the execution and delivery by the Trustee of this Agreement or the Related Documents to which it is a party nor the consummation of the transactions contemplated hereby or thereby conflicts with or results in any breach or violation of any provision of the organizational documents of the Trustee or any law, rule, regulation or order currently in effect having applicability to the banking or trust powers of the Trustee, including regulations issued by an administrative agency or other governmental authority having supervisory powers over the Trustee.

(d) This Agreement and each Related Document to which the Trustee is a party, when executed and delivered by the Trustee, assuming the due authorization, execution and delivery by the other parties thereto, will constitute the legal, valid and binding obligations of the Trustee, enforceable against the Trustee in accordance with their terms, except as such enforceability may be limited by bankruptcy, insolvency, reorganization, moratorium or other similar laws affecting creditors’ rights generally and general equitable principles.
(e) The Trustee hereby remakes for the benefit of MBIA all of its representations and warranties and covenants set forth in each of the Related Documents.

(f) The Trustee acknowledges that both the Certificates and all amounts which may become due under this Agreement will be secured by the Revenues on a parity with the 2006 Certificates and other Parity Obligations. All amounts which may become due under this Agreement shall constitute Parity Obligations of the Authority under the Trust Agreement.

(g) The Trustee shall comply in all material respects with the terms and conditions of the Related Documents to which it is a party.

(h) The Trustee acknowledges that, notwithstanding anything to the contrary in the Trust Agreement or any other Related Document, there shall be no acceleration of the Certificates without the prior written consent of MBIA; provided however, MBIA may provide funds to the Trustee with respect to any payment date in accordance with Section 4.02 hereof.

(i) The Trustee hereby agrees not to use MBIA’s name in any public document (other than the Official Statement) including, without limitation, a press release or presentation, announcement or forum without MBIA’s prior consent. In the event that the Trustee is advised by counsel that the Trustee has a legal obligation to disclose MBIA’s name in any press release, public announcement or other public document, the Trustee shall provide MBIA with at least three business days prior written notice of the Trustee’s intent to use MBIA’s name together with a copy of the proposed use of MBIA’s name and of any description of a transaction with MBIA and shall obtain MBIA’s prior consent as to the form and substance of the proposed use of MBIA’s name and any such description.

ARTICLE III

[AGREEMENT TO INDEMNIFY]

To the extent not prohibited by law, the City shall indemnify MBIA against any and all liability, claims, loss, costs, damages, fees of attorneys and other expenses which MBIA may sustain or incur by reason of or in consequence of:

(a) the failure of the Authority or the City to perform or comply with the covenants or conditions of this Agreement or any of the Related Documents;

(b) enforcing any covenants, conditions or legal obligations with respect to the Certificates or the transactions contemplated thereby, or under the Related Documents or this Agreement that are required to be complied with by the Trustee, or the City;

(c) any action, proceeding (administrative, regulatory or legal) or suit threatened or brought in connection with the 2006 Certificates, the Related Documents, this Agreement or with respect to the Authority’s rights or obligations under the Trust Agreement, including all litigation or potential litigation, costs of defense and/or
settlement by MBIA of any such threatened or pending action, proceeding, suit or judgment; or

(d) recovering or attempting to recover losses or expenses paid or incurred in connection with the 2006 Certificates, the Related Documents, the Policy, the Swap Policy, this Agreement or the transactions contemplated hereby and thereby.

Costs and expenses shall include a reasonable allocation of compensation and overhead attributable to the time of employees of MBIA spent in connection with the actions described in clauses (b), (c) and (d) above. The City agrees to reimburse MBIA immediately and unconditionally upon demand, to the extent permitted by law, for all reasonable expenses, including attorneys’ fees and expenses, incurred by MBIA in connection with (i) the enforcement by MBIA of the City’s obligations, or the preservation or defense of any rights of MBIA, under the Related Documents and any other document executed in connection with the issuance of the 2006 Certificates and (ii) any consent, amendment, waiver or other action with respect to any Related Document, whether or not granted or approved, together with interest on all such expenses from and including the date incurred to the date of payment at the Reimbursement Rate. In addition, MBIA reserves the right to charge a fee in connection with its review of any such consent, amendment or waiver, whether or not granted or approved.

An itemized statement of costs incurred by MBIA for any of the purposes specified in this Article III shall be prima facie evidence of the liability of the City and, the City fails to reimburse MBIA within ten business days of receipt of such statement of payments, interest shall be computed on such amount from the date of the payment made by MBIA at the Reimbursement Rate.

ARTICLE IV

PAYMENT, REIMBURSEMENT AND OTHER RIGHTS OF MBIA

Section 4.01. Payment and Reimbursement Rights of MBIA. The City agrees to make the following payments to MBIA:

(a) On or prior to the Issuance Date, the premium, as required to be paid pursuant to paragraph [1] of the MBIA Commitment. Such premium shall be nonrefundable without regard to (i) whether MBIA makes any payment under either the Policy, or the Swap Policy, (ii) any other circumstances relating to the 2006 Certificates or (iii) provision being made for payment of the 2006 Certificates prior to maturity;

(b) The reimbursement of all payments made by MBIA under the terms of the Policy, the Swap Policy or this Agreement;

(c) All other amounts required to be paid to MBIA by the City pursuant to the terms of this Agreement or in connection with the transactions contemplated by the 2006 Certificates, the Related Documents, this Agreement, the Policy and the Swap Policy upon written notice from MBIA of the amounts so owed;
(d) Any and all charges, fees, costs and expenses which MBIA may pay or incur in connection with (i) the administration, enforcement, defense or preservation of any rights or security in this Agreement or any of the Related Documents, (ii) the pursuit of any remedies thereunder or otherwise afforded by law or equity, (iii) any amendment, waiver or other action with respect thereto, or related thereto, whether or not executed or completed, (iv) the violation by the Authority of any law, rule or regulation, or any judgment, order or decree applicable to it in connection with, or affecting, this Agreement, any of the Related Documents or any of the obligations hereunder or thereunder or (v) any litigation or other dispute in connection with this Agreement or any of the Related Documents or the transactions contemplated hereby or thereby upon written notice from MBIA of the amounts so owed; and

(e) Interest on the amounts owed in clauses (a), (b), (c) or (d) of this Article IV from the date of any payment due or paid as described in clauses (a), (b) or (c), and from the date of receipt of written notice from MBIA, as provided in clauses (d), in each case at the Reimbursement Rate. If the interest provisions of this clause (i) shall result in an effective rate of interest which, for any period, exceeds the limit of the usury or any other laws applicable to the indebtedness created herein, then all sums in excess of those lawfully collectible as interest for the period in question shall, without further agreement or notice between or by any party hereto, be applied as additional interest for any later periods of time when amounts are outstanding hereunder to the extent that interest otherwise due hereunder for such periods plus such additional interest would not exceed the limit of the usury or such other laws, and any excess shall be applied upon principal immediately upon receipt of such moneys by MBIA, with the same force and effect as if the Authority had specifically designated such extra sums to be so applied and MBIA had agreed to accept such extra payment(s) as additional interest for such later periods. In no event shall any agreed-to or actual exaction as consideration for the indebtedness created herein exceed the limits imposed or provided by the law applicable to this transaction for the use or detention of money or for forbearance in seeking its collection.

Section 4.02. Optional Deposits by MBIA. MBIA shall at any time, and from time to time, with respect to a payment date on the Certificates, have the option to deliver amounts to the Trustee for deposit into the bond payment account for either of the following purposes: (i) to provide funds in respect of the payment of fees or expenses of any provider of services to the Trustee or (ii) to provide monies with respect to any payment date on the 2006 Certificates to the extent that without such provision of funds, a claim would be required to be made on the Policy or the Swap Policy. Any such amounts provided by MBIA shall be reimbursable amounts as due hereunder.

ARTICLE V

SUBROGATION RIGHTS AND SECURITY OF MBIA

Section 5.01. Subrogation Rights. To the extent of payments made and expenses incurred by MBIA in connection with the Policy, the Swap Policy and this Agreement, MBIA shall be fully subrogated to the 2006 Certificateholders rights under the Trust Agreement and the
Swap Provider’s rights under the Swap Agreement to seek payment of amounts owed by the Authority or the City, as the case may be. The City acknowledges and agrees, that upon payment of a claim under the Policy, or the Swap Policy, MBIA will be subrogated to the rights of the 2006 Certificateholders or the Swap Provider, as the case may be. The City will at any time, and from time to time, at the request of MBIA execute any instrument, document or agreement, and take any other action, that MBIA may consider necessary or desirable to effect these rights of subrogation.

Section 5.02. Security. The Authority hereby grants MBIA a security interest in the Gross Revenues of the Water Utility System to secure all amounts which may become due under this Agreement which security interest shall be on a parity with that granted any Parity Obligations. The City and the Trustee severally agree that each will, from time to time, execute, acknowledge and deliver, or cause to be executed, acknowledged and delivered, any and all financing statements, if applicable, and all other further instruments as may be required by law or as shall reasonably be requested by MBIA for the perfection of the security interest granted under this Article V and for the preservation and protection of all rights of MBIA under this Article V. The parties hereto agree that the pledge and covenants contained herein shall survive the payment of the 2006 Certificates and the defeasance of the Trust Agreement.

ARTICLE VI

EVENTS OF DEFAULT

Section 6.01. Events of Default Described. The happening of any one or more of the following events shall constitute an “Event of Default” and, upon the occurrence of any such Event of Default, MBIA may exercise the remedies specified herein:

(a) Failure by the City to make any payment required by Article III or IV hereof;

(b) The dissolution or liquidation of the City, or the voluntary initiation by the City of any proceeding under any federal or state law relating to bankruptcy, insolvency, arrangement, reorganization, readjustment of debt or any other form of debtor relief, or the initiation against the Authority of any such proceeding, which remains undischarged or unstayed for 90 days, or failure by the City to promptly have discharged any execution, garnishment or attachment of such consequence as would materially impair the ability of the Authority to carry on its operations, or assignment by the City for the benefit of creditors, or the entry by the City into an agreement of composition with creditors or the failure generally by the City to pay its debts as they become due;

(c) Any representation of or warranty by the City made in this Agreement or the Related Documents is untrue in any material respect;

(d) Except as otherwise provided in Section 6.01(a) above, the failure of the City to observe or perform in any material respect any covenant, condition or provision of this Agreement, if such failure shall not have been remedied or cured within 30 days after the City’s receipt of written notice thereof by MBIA;
(e) The occurrence and continuation of an event of default (however defined but excluding any event described in subparagraphs (a), (b), (c), (f) or (g) of this Section 6.01) under any of the Related Documents, if such event of default shall not have been cured or otherwise remedied within any related cure period set forth in the applicable Related Document;

(f) Any acceleration of the 2006 Payments or any Parity Obligation without the prior written consent of MBIA or the occurrence of any event which causes a termination payment to be due by the City with respect to any Parity Obligation;

(g) Any material provision of this Agreement or the Related Documents to which the Authority is a party shall at any time for any reason cease to be valid and binding, unless by their terms they cease to be valid and binding, on the Authority or shall be declared to be null and void by a final, nonappealable order of a court having competent jurisdiction, or the validity or enforceability of any thereof shall be contested by the Authority or any governmental agency or authority, or if the City shall deny that it has any further liability or obligation under this Agreement or the Related Documents to which it is a party; or

Section 6.02. Remedies. Whenever an Event of Default referred to in Section 6.01 hereof shall have happened and be continuing, MBIA may take any one or more of the following remedial steps:

(a) Exercise its rights of subrogation pursuant to the Trust Agreement;

(b) Exercise any rights of subrogation it may have under the Policy or the Swap Policy;

(c) Take whatever other action at law or in equity as may appear necessary or desirable to collect the amounts then due and thereafter to become due under this Agreement or to enforce performance and observance of any obligation, agreement or covenant of the Authority or the City under this Agreement or under any Related Document;

(d) Accelerate any or all amounts due under this Agreement to the extent acceleration is a permitted remedy with respect to the 2006 Certificates or any other Parity Obligation; or

(e) Pursue any remedy it may have under any of the Related Documents or the Trust Agreement.

Section 6.03. No Remedy Exclusive. Unless otherwise expressly provided, no remedy herein conferred or reserved is intended to be exclusive of any other available remedy, but each remedy shall be cumulative and shall be in addition to other remedies given under this Agreement or under any Related Document or existing at law or in equity. No delay or omission to exercise any right or power accruing under this Agreement or under any Related Document upon the happening of any Event of Default set forth in Section 6.01 hereof shall impair any such right or power or shall be construed to be a waiver thereof, but any such right and power may be
exercised from time to time and as often as may be deemed expedient. In order to entitle MBIA to exercise any remedy reserved to it in this Article VI, it shall not be necessary to give any notice, other than such notice as may be required in this Article VI.

ARTICLE VII

SETTLEMENT

MBIA shall have the exclusive right to decide and determine whether any claim, liability, suit or judgment made or brought on the Policy or the SWAP Policy shall or shall not be paid, compromised, resisted, defended, tried or appealed, and MBIA’s decision thereon, if made in good faith, shall be final and binding upon the Authority and the City.

ARTICLE VIII

OBLIGATIONS OF THE CITY ABSOLUTE

The obligations of the City to make payments under this Agreement shall be absolute, unconditional and irrevocable and shall be paid strictly in accordance with the terms of this Agreement under all circumstances whatsoever, including, without limitation, the following circumstances:

(a) any lack of validity or enforceability of any of the Related Documents;

(b) any amendment or waiver of or any consent to departure from all or any of the Related Documents;

(c) the existence of any claim, setoff, defense or other right which the Authority or the City may have at any time against the Trustee or any other person or entity other than MBIA, whether in connection with this Agreement, the transactions contemplated herein or in the Related Documents or any unrelated transactions;

(d) any statement or any other document presented under or in connection with the Policy, the Swap Policy or the MBIA Commitment proving to be forged, fraudulent, invalid or insufficient in any respect or any statement therein being untrue or inaccurate in any respect whatsoever; or

(e) payment by MBIA under the Policy or the Swap Policy under circumstances which do not comply with the terms of the Policy or the Swap Policy, provided, however, that such payments shall not have resulted from gross negligence or willful misconduct on the part of MBIA.
ARTICLE IX

MISCELLANEOUS PROVISIONS

Section 9.01. Amendments, Changes and Modifications. This Agreement may be amended, changed, modified, altered or terminated only with the prior written approval of MBIA, the Trustee and the City.

Section 9.02. Governing Law. This Agreement shall be construed in accordance with the substantive laws of the State of California, and the obligations, rights and remedies of the parties hereunder shall be determined in accordance with such laws.

Section 9.03. Notices. All notices hereunder shall be sufficiently given and shall be deemed given when delivered or mailed by certified or registered mail, postage prepaid, return receipt requested, addressed as follows:

MBIA: MBIA Insurance Corporation
113 King Street
Armonk, NY 10504
Attention: Insured Portfolio Management—[______]
Telephone: (914) 273-4545
Facsimile: (914) 765-3799

Authority: Modesto Public Financing Authority
c/o City of Modesto, California
City Hall, Suite 5200
1010 Tenth Street
Modesto, CA 95353
Attention: Wayne Padilla, Director of Finance
Telephone: (209) 577-5371
Facsimile: (209) 571-5880

City: City of Modesto, California
City Hall
1010 Tenth Street
Suite 5200
Modesto, CA 95353
Attention: [______]
Telephone: [______]
Facsimile: [______]
Trustee: The Bank of New York Trust Company, N.A.

[ ]
[ ]
[ ]

Attention: [__________]
Telephone: [__________]
Facsimile: [__________]

Any party may, by notice given hereunder, designate any further or different addresses to which subsequent notices, certificates or other communications shall be sent.

Section 9.04. Third-party Beneficiary. MBIA shall be deemed a third-party beneficiary of each of the Related Documents and entitled to enforce the terms thereof as if a signatory thereto.

Section 9.05. Severability. In the event any provision of this Agreement shall be held invalid or unenforceable by any court of competent jurisdiction, such holding shall not invalidate or render unenforceable any other provision hereof.

Section 9.06. Counterparts. This Agreement may be executed in several counterparts, each of which shall be an original and all of which together shall constitute but one and the same instrument.

Section 9.07. Primary Obligation. Payment of amounts due by the Authority under this Agreement is a primary obligation of the City and such obligation is absolute and unconditional, irrespective of any illegality, invalidity or unenforceability of or defect in any provision of the 2006 Certificates or of any obligations of the City.

Section 9.08. Further Assurances and Corrective Instruments. To the extent permitted by law, the Trustee and the City agree that they will, from time to time, execute, acknowledge and deliver, or cause to be executed, acknowledged and delivered, such supplements hereto and such further instruments as may reasonably be required for carrying out the intention of or facilitating the performance of this Agreement.

Section 9.09. No Rights Conferred on Others. Nothing in this Agreement shall confer any right upon any person other than MBIA, the Trustee and the City.

Section 9.10. Term. The term of this Agreement shall commence on the date hereof and shall end on the date the 2006 Certificates and the interest thereon, and all amounts due and owing to MBIA under this Agreement and all Related Documents and pursuant to any rights of subrogation MBIA may have under this Agreement, the Policy, the Swap Policy and the Trust Agreement, are paid in full.

Section 9.11. Payment Procedure. All payments to be made to MBIA under this Agreement shall be made to MBIA in lawful currency of the United States of America in immediately available funds at the notice address for MBIA as set forth in this Agreement on the date when due.
Section 9.12. Successor Trustees. All provisions of this Agreement relating to the Trustee shall apply to any successor Trustee without the execution or filing of any paper or the performance of any further act.

[The remainder of this page is intentionally left blank]
IN WITNESS WHEREOF, each of the parties hereto has caused this Insurance and Reimbursement Agreement to be executed in its respective name by its duly authorized officer, all as of the date first above written.

MBIA INSURANCE CORPORATION

By __________________________________________
Title __________________________________________

CITY OF MODESTO, as City

By __________________________________________
Title __________________________________________

THE BANK OF NEW YORK TRUST COMPANY, N.A., as Trustee

By __________________________________________
Title __________________________________________