

In the opinion of Sidley Austin LLP, Bond Counsel, based on existing statutes, regulations, rulings and judicial decisions and assuming compliance with certain covenants in the documents pertaining to the Series 2006A Bonds and requirements of the Internal Revenue Code of 1986, as amended, as described herein, interest on the Series 2006A Bonds is not includable in the gross income of the owners of the Series 2006A Bonds for federal income tax purposes. In the further opinion of Bond Counsel, interest on the Series 2006A Bonds is not treated as an item of tax preference in calculating the federal alternative minimum taxable income of individuals and corporations. Interest on the Series 2006A Bonds, 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 Bond Counsel, interest on the Series 2006A Bonds is exempt from personal income taxes imposed by the State of California. See "TAX MATTERS" herein.

\$16,535,000
CITY OF MODESTO, CALIFORNIA
WASTEWATER REVENUE BONDS,
SERIES 2006A

Dated: Date of Delivery**Due: November 1, as shown on the inside front cover hereof**

The Wastewater Revenue Bonds, Series 2006A are being issued by the City of Modesto to provide funds to (i) finance the costs of the planning, design, acquisition, construction and improvement of the City's wastewater treatment and conveyance facilities, (ii) fund a deposit to the Parity Reserve Fund, and (iii) pay the costs of issuance of the Series 2006A Bonds, as more fully described herein. The Series 2006A Bonds are being issued pursuant to Chapter 6 of Title VIII of the Modesto Municipal Code and a Wastewater Revenue Bond Indenture, dated as of April 1, 2005, as supplemented.

Interest on the Series 2006A Bonds is payable on May 1 and November 1 of each year, commencing on May 1, 2007. Principal of the Series 2006A Bonds is payable on the dates set forth on the inside front cover hereof.

The Series 2006A Bonds are being issued in fully registered form and, when issued, 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 of the Series 2006A Bonds. Individual purchases of interests in the Series 2006A Bonds will be made in book-entry form only, in the principal amount of \$5,000 or any integral multiple thereof. Purchasers of such interests will not receive certificates representing their interests in the Series 2006A Bonds. Principal of, redemption premium, if any, and interest on the Series 2006A Bonds are payable directly by The Bank of New York Trust Company, N.A., San Francisco, California, as successor trustee (the "Trustee"), to DTC, which is obligated in turn to remit such principal, redemption premium, if any, and interest to DTC Participants for subsequent disbursement to the Beneficial Owners of the Series 2006A Bonds, as described herein.

The Series 2006A Bonds are subject to optional redemption, mandatory sinking fund redemption and special mandatory redemption prior to their respective maturities as described herein.

THE SERIES 2006A BONDS AND THE INTEREST THEREON ARE PAYABLE SOLELY FROM THE NET REVENUES DERIVED BY THE CITY FROM THE OPERATION OF THE CITY'S WASTEWATER ENTERPRISE. THE PRINCIPAL OF AND INTEREST ON THE SERIES 2006A BONDS, AND ANY PREMIUMS UPON THE REDEMPTION OF ANY THEREOF, ARE NOT A DEBT OF THE CITY, OR A LEGAL OR EQUITABLE PLEDGE, CHARGE, LIEN OR ENCUMBRANCE UPON ANY PROPERTY OF THE CITY OR UPON ANY OF ITS INCOME, RECEIPTS OR REVENUES EXCEPT THE NET REVENUES AND OTHER FUNDS PLEDGED TO THE PAYMENT THEREOF AS PROVIDED IN THE INDENTURE.

The scheduled payment of principal of and interest on the Series 2006A Bonds when due will be guaranteed under an insurance policy to be issued concurrently with the delivery of the Series 2006A Bonds by FINANCIAL SECURITY ASSURANCE INC.



This cover page contains certain information for general reference only. It is not intended to be a summary of the security for or the terms of the Series 2006A Bonds. Investors are advised to read the entire Official Statement to obtain information essential to the making of an informed investment decision. Capitalized terms used on this cover page not otherwise defined shall have the meanings set forth herein.

Maturity Schedule
(See inside cover)

The Series 2006A Bonds will be offered when, as and if issued and received by the Underwriter, subject to the approval of validity by Sidley Austin LLP, San Francisco, California, Bond Counsel. Certain legal matters will be passed upon for the Underwriter by Gibbs & Oliphant LLP Oakland, California; for the City by the City Attorney and by Stradling Yocca Carlson & Rauth, a Professional Corporation, Newport Beach, California, Disclosure Counsel; for the Trustee by its General Counsel; and for the Series 2006A Bond Insurer by its General Counsel. It is anticipated that the Series 2006A Bonds, in book-entry form will be available for delivery to DTC in New York, New York on or about December 14, 2006.

Citigroup

MATURITY SCHEDULE

\$3,765,000 Series 2006A Serial Bonds

<i>Maturity Date (November 1)</i>	<i>Principal Amount</i>	<i>Interest Rate</i>	<i>Yield</i>	<i>CUSIP[†]</i>
2023	\$880,000	4.500%	4.250% ^(c)	607802AX3
2024	920,000	4.500	4.290 ^(c)	607802AY1
2025	960,000	4.200	4.310	607802AZ8
2026	1,005,000	4.250	4.320	607802BA2

\$12,770,000 Series 2006A Term Bonds

\$5,710,000 4.25% Term Bonds Due November 1, 2031 - Yield: 4.39% CUSIP No. 607802BB0[†]
\$7,060,000 4.25% Term Bonds Due November 1, 2036 - Yield: 4.42% CUSIP No. 607802BC8[†]

^(c) Priced to call on November 1, 2011 at par.

[†] CUSIP® is a registered trademark of the American Bankers Association. Copyright© 2006 Standard & Poor's, a Division of the McGraw Hill Companies, Inc. CUSIP® data herein is provided by Standard & Poor's CUSIP Service Bureau. This data is not intended to create a database and does not serve in any way as a substitute for the CUSIP Service Bureau. CUSIP® numbers are provided for convenience of reference only. The City and the Underwriter take no responsibility for the accuracy of such numbers.

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Will O'Bryant, Vice Mayor

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Brad Hawn

Janice Keating

Garrad Marsh

Kristin 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

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San Francisco, California

Financial Advisor

Public Financial Management, Inc.

San Francisco, California

Disclosure Counsel

Stradling Yocca Carlson & Rauth, a Professional Corporation

Newport Beach, California

All the information which the City of Modesto intends to present investors regarding the City and the Series 2006A Bonds 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 Series 2006A Bonds 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 Series 2006A Bond 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 Series 2006A Bond 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 Series 2006A Bonds 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 Series 2006A Bonds. Statements contained in this Official Statement which involve estimates, forecasts or matters of opinion, whether or not expressly so described herein, are intended solely as such and are not to be construed as a representation of facts.

The information set forth herein has been 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 Series 2006A Bond 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.

Financial Security Assurance Inc. has provided the following sentence for inclusion in this Official Statement:

Other than with respect to information concerning Financial Security Assurance Inc. ("Financial Security") contained under the caption "BOND INSURANCE" and Appendix F — "SPECIMEN MUNICIPAL BOND INSURANCE POLICY" herein, none of the information in this Official Statement has been supplied or verified by Financial Security and Financial Security makes no representation or warranty, express or implied, as to (i) the accuracy or completeness of such information; (ii) the validity of the Series 2006A Bonds; or (iii) the tax exempt status of the interest on the Series 2006A Bonds.

**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 Wastewater Enterprise.

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 SERIES 2006A BONDS HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED, IN RELIANCE UPON AN EXEMPTION CONTAINED IN SUCH ACT. THE SERIES 2006A BONDS HAVE NOT BEEN REGISTERED OR QUALIFIED UNDER THE SECURITIES LAWS OF ANY STATE.

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\$16,535,000
CITY OF MODESTO, CALIFORNIA
WASTEWATER REVENUE BONDS
SERIES 2006A

INTRODUCTION

This Introduction is qualified in its entirety by reference to the more detailed information included and referred to elsewhere in this Official Statement. The offering of the Series 2006A Bonds to potential investors is made only by means of the entire Official Statement. Terms used in this Introduction and not otherwise defined shall have the respective meanings assigned to them elsewhere in this Official Statement. See Appendix C — “SUMMARY OF CERTAIN PROVISIONS OF THE INDENTURE — Definitions.”

Purpose

The purpose of this Official Statement, which includes the cover page and appendices hereto, is to set forth certain information concerning the offering by the City of Modesto (the “City”) of its Wastewater Revenue Bonds, Series 2006A (the “Series 2006A Bonds”). Descriptions and summaries of various documents hereinafter set forth do not purport to be comprehensive or definitive, and reference is made to each such document for complete details of all terms and conditions thereof.

The Series 2006A Bonds are being issued by the City to provide funds to (i) finance the costs of the planning, design, acquisition, construction and improvement of its wastewater treatment and conveyance facilities, (ii) fund a deposit to the Parity Reserve Fund, and (iii) pay the costs of issuance of the Series 2006A Bonds, as more fully described herein.

See “ESTIMATED SOURCES AND USES OF FUNDS.”

Authority for Issuance

The Series 2006A Bonds are being issued pursuant to (a) the City of Modesto Wastewater Treatment Facilities Revenue Bond Law, constituting Chapter 6 of Title VIII of the Modesto Municipal Code (the “Bond Law”), which was enacted by the City Council on October 2, 1984, pursuant to its authority under the Charter of the City of Modesto, and the constitution and laws of the State of California and (b) a Wastewater Revenue Bond Indenture, dated as of April 1, 2005, by and between the City and The Bank of New York Trust Company, N.A., as successor trustee (the “Trustee”), as amended and supplemented by the First Supplemental Wastewater Revenue Bond Indenture, dated as of April 1, 2005, providing for the issuance of the City’s Wastewater Revenue Refunding Bonds, Series 2005A (the “Series 2005A Bonds”), the Second Supplemental Wastewater Revenue Bond Indenture, dated as of April 1, 2005, providing for the City’s Wastewater Revenue Refunding Bonds, Series 2005B (Taxable) (the “Series 2005 B Bonds” and, together with the Series 2005A Bonds, the “Series 2005 Bonds”), and the Third Supplemental Wastewater Revenue Bond Indenture, dated as of December 1, 2006, providing for the issuance of the Series 2006A Bonds (collectively, the “Indenture”).

The City

The City, which has a population of approximately 208,107, is the county seat of Stanislaus County and 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 San Francisco. See Appendix A — “CERTAIN INFORMATION REGARDING THE CITY OF MODESTO.”

The Wastewater Enterprise

The City’s wastewater facilities are comprised of the wastewater collection system and the treatment and disposal facilities located at its water quality control facilities. The City’s wastewater collection and treatment system (the “Enterprise”) services the entire City and additionally accepts some sewage flow from parts of the City of Ceres and some unincorporated communities in the County of Stanislaus, including Empire. The service outside the City is described in various individual contracts with the individual agencies. The current population of the area served by the Enterprise is estimated to be 216,000, but the City estimates that it could grow to approximately 355,000 by 2030.

Security and Sources of Payment for the Series 2006A Bonds

The payment of the principal of and redemption premium, if any, and interest on the Series 2006A Bonds is secured equally and ratably, along with the payment of the principal of, redemption premium, if any, and interest on the Series 2005 Bonds, by a first lien on and pledge of the Net Revenues (as defined herein) derived from the operation of the facilities comprising the Enterprise and the moneys and securities held by the Trustee in the funds under the Indenture. The pledge of Net Revenues to the Series 2005 Bonds and the Series 2006A Bonds is on a parity with the pledge of Net Revenues for the benefit of the owners of any additional Bonds or Parity Debt to be issued pursuant to the Indenture. The Series 2005 Bonds, Series 2006A Bonds and any other series of bonds to be issued under the Indenture are sometimes collectively referred to herein as the “Bonds.” See “SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2006A BONDS — Net Revenue Pledge; Parity Debt.”

Bond Insurance

Concurrently with the issuance of the Series 2006A Bonds, Financial Security Assurance Inc. (the “Series 2006A Bond Insurer” or “Financial Security”) will issue its municipal bond financial guaranty insurance policy for the Series 2006A Bonds (the “Bond Insurance Policy”). See “BOND INSURANCE” and Appendix F — “SPECIMEN MUNICIPAL BOND INSURANCE POLICY.”

Parity Debt

The Series 2006A Bonds are being issued on a parity with the Series 2005 Bonds; and the City may at any time issue or incur Parity Debt payable from the Net Revenues and other funds as provided in the Indenture and secured by a lien and charge securing the Bonds, subject to the conditions set forth in the Indenture. See “SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2006A BONDS — Additional Bonds and Parity Debt.”

Rate Covenant

The City covenants under the Indenture that so long as any of the Series 2006A Bonds are outstanding, the City will fix, prescribe, revise and collect rates, fees and charges for the services and facilities furnished by the Enterprise which are sufficient to yield Net Revenues in each Fiscal Year equal to at least 1.25 times the Debt Service on the Bonds and Parity Debt becoming due and payable during such Fiscal Year. See Appendix C — “SUMMARY OF CERTAIN PROVISIONS OF THE INDENTURE.” However, the City’s ability to increase such rates, fees and charges is subject to the limitations imposed by Proposition 218. See “CONSTITUTIONAL LIMITATIONS ON TAXES AND WASTEWATER RATES AND CHARGES — Articles XIIC and XIID of the California Constitution.”

Continuing Disclosure

The City has covenanted for the benefit of the owners and beneficial owners of the Series 2006A Bonds to provide certain financial information and operating data relating to the City by not later than 270 days following the end of the City’s Fiscal Year (presently June 30), commencing with the report for the 2005-06 Fiscal Year, and to provide notices of occurrence of certain enumerated events, if material. See “CONTINUING DISCLOSURE” herein and Appendix E — “FORM OF CONTINUING DISCLOSURE AGREEMENT.”

Other Matters

This Official Statement speaks only as of its date, and the information and expressions of opinion contained 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 since the date hereof. This Official Statement, including any supplement or amendment hereto, is intended to be deposited with one or more repositories.

All references to and summaries of provisions of the Indenture are qualified in their entirety by reference to the full Indenture, copies of which are available for inspection at the offices of the City in Modesto, California or at the corporate trust office of the Trustee in San Francisco, California.

Changes to Preliminary Official Statement

The material under the caption “CONTINUING DISCLOSURE” has been revised to discuss an error in a previous annual report with respect to the City’s wastewater collection and treatment system, and certain corrections have been made to tables appearing under the captions “WASTEWATER SYSTEM FINANCES — Historical Debt Service Coverage” and “— Projected Debt Service Coverage.”

ESTIMATED SOURCES AND USES OF FUNDS

The following table sets forth the estimated sources and uses of funds with respect to the Series 2006A Bonds.

Sources of Funds

Principal Amount of the Series 2006A Bonds	\$ 16,535,000.00
Less: Net Original Issue Discount	(323,866.90)
Less: Underwriter's Discount	<u>(88,247.69)</u>
Total Sources	<u>\$ 16,122,885.41</u>

Uses of Funds

Series 2006A Wastewater Enterprise Project Fund	\$ 15,600,000.00
Parity Reserve Fund ⁽¹⁾	225,608.83
Series 2006A Costs of Issuance ⁽²⁾	<u>297,276.58</u>
Total Uses	<u>\$ 16,122,885.41</u>

⁽¹⁾ The amount necessary, together with the \$3,436,562 currently on deposit therein, to equal the Reserve Fund Requirement upon the issuance of the Series 2006A Bonds.

⁽²⁾ Includes legal and advisory fees, printing costs, rating agency fees, bond insurance premium and other miscellaneous expenses.

THE SERIES 2006A BONDS

General Description

The Series 2006A Bonds are being issued in fully registered form and, when issued, will be registered in the name of Cede & Co., as nominee of The Depository Trust Company ("DTC"). DTC will act as securities depository of the Series 2006A Bonds. Individual purchases of ownership interests in the Series 2006A Bonds will be made in book-entry form only in denominations of \$5,000 or any integral multiple thereof. See Appendix G — "BOOK-ENTRY SYSTEM."

The Series 2006A Bonds will be dated their date of initial delivery, and will bear interest at the rates and mature in the amounts and on the dates set forth on the inside front cover page of this Official Statement. Interest on the Series 2006A Bonds is payable on May 1 and November 1 of each year, commencing May 1, 2007, calculated on the basis of a 360-day year comprised of twelve 30-day months. Principal of and redemption premium, if any, and interest on the Series 2006A Bonds are payable by the Trustee to DTC, which is obligated in turn to remit such principal and interest to DTC Participants for subsequent disbursement to the Beneficial Owners of the Series 2006A Bonds.

Redemption

Optional Redemption. The Series 2006A Bonds maturing on November 1, 2023 and November 1, 2024 shall be subject to redemption prior to their respective stated maturities, at the option of the City, from any source of available funds, as a whole or in part on any date (by such maturities as may be specified by the City and by lot within a maturity), on or after November 1, 2011, at a Redemption Price equal to 100% of the principal amount of such Series 2006A Bonds called for redemption, plus accrued interest to the date fixed for redemption, without premium.

The Series 2006A Bonds maturing on or after November 1, 2025 shall be subject to redemption prior to their respective stated maturities, at the option of the City, from any source of available funds, as a whole or in part on any date (by such maturities as may be specified by the City and by lot within a maturity), on or after November 1, 2016, at a Redemption Price equal to 100% of the principal amount of such Series 2006A Bonds called for redemption, plus accrued interest to the date fixed for redemption, without premium.

Mandatory Sinking Fund Redemption. The Series 2006A Bonds maturing on November 1, 2031 and November 1, 2036 shall also be subject to mandatory redemption prior to their stated maturity, in part, by lot, from Mandatory Sinking Account Payments commencing on November 1, 2027 for the Series 2006A Bonds maturing on November 1, 2031 and commencing on November 1, 2032 for the Series 2006A Bonds maturing on November 1, 2036, and on each November 1 thereafter at a redemption price equal to the principal amount thereof plus accrued interest thereon to the date fixed for redemption, without premium as follows:

BONDS MATURING NOVEMBER 1, 2031

<i>Redemption Dates (November 1)</i>	<i>Principal Amount</i>
2027	\$1,045,000
2028	1,095,000
2029	1,140,000
2030	1,190,000
2031 (maturity)	1,240,000

BONDS MATURING NOVEMBER 1, 2036

<i>Redemption Dates (November 1)</i>	<i>Principal Amount</i>
2032	\$1,295,000
2033	1,350,000
2034	1,410,000
2035	1,470,000
2036 (maturity)	1,535,000

Special Mandatory Redemption From Insurance or Condemnation Proceeds. The Series 2006A Bonds are subject to redemption as a whole or in part on any date, among such maturities as designated by the City and by lot within a maturity, to the extent of hazard insurance proceeds not used to repair or rebuild the Enterprise or condemnation proceeds received with respect to the Enterprise to be used for such purpose pursuant to the Indenture, at a Redemption Price equal to the principal amount of the Series 2006A Bonds plus interest accrued thereon to the date fixed for redemption, without premium. Notwithstanding the foregoing, in the event of a special mandatory redemption of less than all of the Outstanding Series 2006A Bonds pursuant to the provisions of the Indenture described in this paragraph, the designation by the City of the maturities of the Series 2006A Bonds from which such redemption will be made shall be subject to the prior written approval of the bond insurer of the Series 2005 Bonds (the “Series 2005 Bond Insurer”) and the Series 2006A Bond Insurer.

Notice of Redemption

Notice of redemption of any Series 2006A Bonds shall be sent by the Trustee, by approved means, not less than 30 nor more than 60 days prior to the redemption date, (i) to the respective Owners of any Bonds designated for redemption at their addresses appearing on the bond registration books of the Trustee, (ii) to the Securities Depositories, and (iii) to the Information Services. Failure by the Trustee to give notice to any one or more of the Information Services or Securities Depositories or failure of any Owner to receive notice or any defect in any such notice shall not affect the sufficiency of the proceedings for redemption.

Effect of Redemption

Notice of redemption having been duly given as described above, and moneys for payment of the Redemption Price of, together with interest accrued to the redemption date on, the Series 2006A Bonds (or portions thereof) so called for redemption being held by the Trustee, on the redemption date designated in such notice, the Series 2006A Bonds (or portions thereof) so called for redemption shall become due and payable at the Redemption Price specified in such notice, together with interest accrued thereon to the date fixed for redemption, interest on the Series 2006A Bonds so called for redemption shall cease to accrue, said Bonds (or portions thereof) shall cease to be entitled to any benefit or security under the Indenture, and the Owners of said Bonds shall have no rights in respect thereof except to receive payment of said Redemption Price and accrued interest.

SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2006A BONDS

Net Revenue Pledge; Parity Debt

The Series 2006A Bonds are revenue obligations of the City and are payable, as to both principal and interest and any premium upon redemption thereof, exclusively from Net Revenues and from the other funds pledged under the Indenture. All Net Revenues are pledged to secure the payment of the principal of and redemption premium, if any, and interest on the Bonds, including the Series 2005 Bonds and the Series 2006A Bonds, and any Parity Debt in accordance with their terms, subject only to the provisions of the Indenture permitting the application thereof for the purposes and on the terms and conditions set forth in the Indenture. The pledge of Net Revenues to the Series 2005 Bonds and the Series 2006A Bonds is on a parity with the pledge of Net Revenues for the benefit of the owners of any additional Bonds or Parity Debt to be issued pursuant to the Indenture. See “SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2006A BONDS — Additional Bonds and Parity Debt.” The Net Revenues are irrevocably pledged to the punctual payment of the principal of and redemption premium, if any, and interest on the Outstanding Bonds, including the Series 2006A Bonds.

“Net Revenues” is defined under the Indenture to mean, with respect to any period, the amount of the Gross Revenues received during such period less the amount of Operating Expenses becoming payable during such period.

“Gross Revenues” is defined under the Indenture to mean all gross income and revenue received by the City from the ownership and operation of the Enterprise, including (a) all fees and charges received by the City for the services of the Enterprise, (b) all other income and revenue howsoever derived by the City from the ownership and operation of the Enterprise or arising from the Enterprise, and (c) all sums deposited, or required under the Indenture to be deposited, in the

Sewer Enterprise Fund: but excluding (x) the proceeds of any ad valorem property taxes received by the City to pay debt service on any outstanding obligations of the City, (y) any contributed capital (other than connection fees), and (z) any moneys received as a result of litigation arising out of perchloroethylene (PCE) contamination that are to be expended on capital costs of the Enterprise. See “WASTEWATER SYSTEM — PCE Litigation” herein.

“Operating Expenses” is defined under the Indenture to mean the reasonable and necessary costs of maintaining and operating the Enterprise, calculated on the basis of generally accepted accounting principles, including (among other things) the reasonable expenses of management and repair and other expenses necessary to maintain and preserve the Enterprise in good repair and working order, and reasonable amounts for administration, overhead, insurance, taxes (if any) and other similar costs, but excluding (a) depreciation, replacement and obsolescence charges or reserves therefor or other bookkeeping entries of a similar nature, and (b) interest on the Series 2006A Bonds and any Parity Debt.

The Series 2006A Bonds are special, limited obligations of the City. The Series 2006A Bonds shall not be deemed to constitute a debt or liability of the City, the State of California or of any political subdivision thereof within the meaning of any constitutional or statutory provision, or a pledge of the faith and credit of the City, the State of California or of any political subdivision thereof, but shall be payable, except to the extent of certain amounts held under the Indenture pledged therefor, solely from Net Revenues. Neither the faith and credit nor the taxing power of the City, the State of California or of any political subdivision thereof is pledged to the payment of the principal of, premium, if any, or the interest on the Series 2006A Bonds. The issuance of the Series 2006A Bonds shall not directly or indirectly or contingently obligate the City, the State of California or any political subdivision thereof to levy or to pledge any form of taxation whatsoever therefor or to make any appropriation for their payment.

The Indenture provides that all funds and accounts created pursuant to the Indenture constitute trust funds in favor of the Owners of the Outstanding Bonds, until so applied for the purpose set forth in the Indenture.

Flow of Funds

The City has covenanted that all Gross Revenues, when and as received, will be received, deposited and held by the City in the Sewer Enterprise Fund and will be accounted for through and held in trust in the Sewer Enterprise Fund, and the City shall have no beneficial right or interest in any of such moneys except only as provided in the Indenture. The City has covenanted and agreed to maintain the Sewer Enterprise Fund at all times so long as any Bonds shall be Outstanding under the Indenture. All Gross Revenues and Net Revenues, whether held by the City or deposited with the Trustee, all as provided in the Indenture, shall nevertheless be disbursed, allocated, and applied solely to the uses and purposes set forth below.

All amounts in the Sewer Enterprise Fund required to pay Operating Expenses of the Enterprise shall be applied for such purpose from time to time by the City. So long as any Bonds are Outstanding, the City shall transfer the remaining moneys in the Sewer Enterprise Fund to the Trustee as required for deposit into the following respective funds (each of which the Trustee shall establish, maintain and hold in trust for the benefit of the Owners of the Series 2006A Bonds) in the following amounts, in the following order of priority, the requirements of each such fund (including the making up of any deficiencies in any such fund resulting from lack of Net Revenues sufficient to

make any earlier required deposit) at the time of deposit to be satisfied before any deposit is made to any fund subsequent in priority; provided that on a parity with such deposits the Trustee may set aside or transfer amounts with respect to outstanding Parity Debt as provided in the proceedings for such Parity Debt (which shall be proportionate in the event such amounts are insufficient to provide for all deposits required as of any date to be made with respect to the Series 2006A Bonds and such Parity Debt):

Interest Fund. The City shall transfer to the Trustee and the Trustee shall set aside in the Interest Fund on or before the third Business Day prior to each interest payment date therefor an amount equal to the interest becoming due and payable on the Outstanding Bonds (excluding interest for which there are moneys on deposit in the Interest Fund from the proceeds of any Series of Bonds or other source to pay such interest).

Principal Fund; Sinking Accounts. The City shall transfer to the Trustee and the Trustee shall set aside in the Principal Fund on or before the third Business Day prior to each principal or mandatory sinking fund payment date therefor an amount equal to (a) the amount of Bond Obligation becoming due and payable on the Outstanding Serial Bonds, plus (b) the mandatory sinking fund payments to be paid into the respective Sinking Accounts for the Term Bonds; provided that if the City certifies to the Trustee that any principal payments are expected to be refunded on or prior to their respective due dates or paid from excess amounts on deposit in the Parity Reserve Fund or other bond reserve fund upon such payment, no amounts need be set aside towards such principal to be so refunded or paid. All of the aforesaid mandatory sinking fund payments shall be made without priority of any payment into any one such Sinking Account over any other such payment.

Parity Reserve Fund. Upon the occurrence of any deficiency in the Parity Reserve Fund established pursuant to the Indenture, the City shall transfer to the Trustee and the Trustee shall set aside in the Parity Reserve Fund an amount equal to the aggregate amount of each unreplenished prior withdrawal from the Parity Reserve Fund until there is on deposit in the Parity Reserve Fund an amount equal to the Reserve Fund Requirement.

Any Net Revenues remaining in the Sewer Enterprise Fund after the foregoing transfers described above, except as otherwise provided in a Supplemental Indenture, shall be held free and clear of the Indenture by the City and it may use and apply such Net Revenues for any lawful purpose of the City, including the redemption of Bonds upon the terms and conditions set forth in the Supplemental Indenture relating to such Bonds and the purchase of Bonds as and when and at such prices as it may determine.

If on any principal payment date, interest payment date or mandatory sinking fund redemption date the amounts on deposit in the Interest Fund and Principal Fund, including the Sinking Accounts therein, are insufficient to make such payments, the Trustee shall immediately notify the City, by telephone or facsimile machine, of such deficiency and direct that the City transfer the amount of such deficiency to the Trustee on such payment date. The City has covenanted and agreed to transfer to the Trustee from any Net Revenues in its possession the amount of such deficiency on the principal, interest or mandatory redemption date referenced in such notice.

Parity Reserve Fund

The Trustee is required by the Indenture to establish and maintain and hold in trust, so long as Bonds or Parity Debt to be secured thereby remain outstanding, a special fund designated as the "Parity Reserve Fund." Upon the delivery of the Series 2006A Bonds, there will be deposited in the Parity Reserve Fund from the proceeds thereof, the amount necessary, together with the \$3,436,562 currently on deposit therein, to be equal to the Reserve Fund Requirement. Amounts on deposit in the Parity Reserve Fund are pledged to the payment of the Bonds, including the Series 2005 Bonds and the Series 2006A Bonds, and any Parity Debt to be secured by the Parity Reserve Fund and shall be applied only for such purposes as permitted in the Indenture. The Trustee is also required to deposit in the Parity Reserve Fund, upon the direction of the City, such other amounts transferred to the Trustee by the City pursuant to the Indenture. No deposit need be made in the Parity Reserve Fund so long as there shall be on deposit therein a sum equal to at least the amount required by the Indenture to be on deposit therein. Whenever the amount on deposit in the Parity Reserve Fund is less than the Reserve Fund Requirement, notice thereof shall be provided to the Series 2006A Bond Insurer as well as the Series 2005 Bond Insurer; and such amount shall be increased to the Reserve Fund Requirement as provided for in the Indenture not later than twelve months thereafter. Moneys on deposit in the Parity Reserve Fund (including all amounts that may be obtained from letters of credit and surety bonds and insurance policies, as provided below, on deposit in the Parity Reserve Fund) shall be transferred by the Trustee to the Principal Fund and Interest Fund to pay principal of and interest on the Bonds on any interest payment date in the event amounts on deposit therein are insufficient for such purposes.

The Trustee shall also, from such amounts on deposit in the Parity Reserve Fund, transfer or cause to be transferred to any applicable debt service fund for any Parity Debt to be secured by the Parity Reserve Fund, 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 the documents under which any such Parity Debt to be secured by the Parity Reserve Fund is issued or incurred. Amounts on deposit in the Parity Reserve Fund in excess of the Reserve Fund Requirement shall, at the written Request of the City, be withdrawn from the Parity Reserve Fund and transferred to the City.

In lieu of a cash deposit, the City may, with the consent of the Series 2005 Bond Insurer and the Series 2006A Bond Insurer, satisfy the Reserve Fund Requirement by depositing to the Parity Reserve Fund a letter of credit, surety bond, or insurance policy as provided in the Indenture.

"Reserve Fund Requirement" means, as of any date of determination and excluding any Parity Debt for which no reserve fund is to be maintained or for which a separate reserve fund is to be maintained, the lesser of (a) the Maximum Annual Debt Service on all Bonds and Parity Debt to be secured by the Parity Reserve Fund, or (b) one hundred twenty-five percent (125%) of the Average Annual Debt Service on all Bonds and Parity Debt to be secured by the Parity Reserve Fund; provided that in no event shall the deposit to the Parity Reserve Fund with respect to any Series of Bonds or Parity Debt to be secured by the Parity Reserve Fund be an amount greater than ten percent (10%) of the initial offering price to the public of such Series of Bonds or Parity Debt to be secured by the Parity Reserve Fund as determined under the Code, all as computed and determined by the City and specified in writing to the Trustee. On the date of delivery of the Series 2006A Bonds, the Reserve Fund Requirement will be \$3,662,170.83.

See Appendix C — “SUMMARY OF CERTAIN PROVISIONS OF THE INDENTURE.”

Rate Covenant

The rates for use of the Enterprise are set by the City Council and are not subject to review by any state or local governmental agency. The City has covenanted that it will fix, prescribe, revise and collect rates, fees and charges for the services and facilities furnished by the Enterprise during each Fiscal Year which (together with other funds accumulated from Gross Revenues and which are lawfully available to the City for payment of any of the following amounts during such Fiscal Year) are at least sufficient to pay all Operating Expenses estimated to become due and payable in such Fiscal Year, Debt Service on the Bonds and any Parity Debt becoming due and payable during such Fiscal Year, all other payments required by the Indenture and any Parity Debt instruments and all payments required to meet any obligations of the City which are charges, liens, encumbrances upon or payable from the Gross Revenues or Net Revenues. In addition, the City has covenanted that it will fix, prescribe, revise and collect rates, fees and charges so as to yield Net Revenues during such Fiscal Year equal to at least 1.25 times the Debt Service coming due and payable in such Fiscal Year on the Bonds and any Parity Debt. The City may make adjustments from time to time in such fees and charges and may make such classification thereof as it deems necessary, but such fees and charges shall not be reduced so as to be insufficient to provide adequate Gross Revenues for such purposes. See “CONSTITUTIONAL LIMITATIONS ON TAXES AND WASTEWATER RATES AND CHARGES — Articles XIIC and XIID of the California Constitution.”

“Parity Debt” is defined in the Indenture as any indebtedness, installment sale obligation, lease obligation or other obligation of the City for borrowed money having an equal lien and charge upon the Net Revenues, therefore payable on a parity with the Bonds (whether or not any Bonds are Outstanding).

Additional Bonds and Parity Debt

The City may at any time issue additional Series of Bonds or Parity Debt payable from the Net Revenues and other funds and secured by a lien and charge securing the Outstanding Bonds on a parity with the Outstanding Series 2005 Bonds and the Series 2006A Bonds, subject to the following conditions precedent, among others: (a) no Event of Default shall have occurred and then be continuing; (b) there shall be deposited in the Parity Reserve Fund an amount of money so as to increase the amount on deposit therein to the Reserve Fund Requirement, if applicable; and (c) the Net Revenues, calculated on sound accounting principles, as shown by the books of the City for the latest Fiscal Year or any more recent 12-month period selected by the City ending not more than 60 days prior to the adoption of the Supplemental Indenture pursuant to which such Series of Bonds are issued or the instrument pursuant to which such Parity Debt is issued, as shown by the books of the City, plus, at the option of the City, any or all of the items designated in (i) and (ii) below, but excluding connection charges, shall at least equal 125% of the Maximum Annual Debt Service on all Bonds and Parity Debt to be Outstanding immediately subsequent to the issuance of such Series of Bonds or Parity Debt. The items any or all of which may be added to such Net Revenues for the purpose of issuing or incurring additional Series of Bonds or Parity Debt under the Indenture are the following:

- (i) An allowance for Net Revenues from any additions to or improvements or extensions, of the Enterprise to be made with the proceeds of such additional Series of Bonds or Parity Debt, and also

for Net Revenues from any such additions, improvements or extensions which have been made from moneys from any source but in any case which, during all or any part of such Fiscal Year or such 12-month period, were not in service, all in an amount equal to 95% of the estimated additional average annual Net Revenues to be derived from such additions, improvements and extensions for the first 36-month period in which each addition, improvement or extension is respectively to be in operation, all as shown by a certificate of the City filed with the Trustee.

- (ii) An allowance for earnings arising from any increase in the charges made for service from the Enterprise which has become effective prior to the incurring of such additional Series of Bonds or Parity Debt but which, during all or any part of such Fiscal Year or such 12-month period, was not in effect, in an amount equal to 95% of the amount by which the Net Revenues would have been increased if such increase in charges had been in effect during the whole of such Fiscal Year or such 12-month period, all as shown by a certificate of the City filed with the Trustee.

In the event additional assets or revenues are included within the definition of “Net Revenues” by a Supplemental Indenture, such additional assets or revenues shall be included in the calculations described above, as appropriate, as if such additional assets or revenues had always been included in Net Revenues.

“Maximum Annual Debt Service” is defined under the Indenture as the greatest amount of principal and interest becoming due and payable on all Bonds and Parity Debt in the Fiscal Year in which the calculation is made or any successive Fiscal Year using the principles and assumptions set forth under the definition of Debt Service.

“Debt Service” is defined under the Indenture to mean, during any period of computation, the amount of principal and interest becoming due and payable on all Bonds and Parity Debt for such period, determined by totaling the following amounts: (a) the Bond Obligation of all Outstanding Serial Bonds and all Parity Debt coming due and payable by their terms in such period; (b) the minimum Bond Obligation of all Outstanding Term Bonds and all Parity Debt scheduled to be redeemed by operation of mandatory sinking fund deposits in such period, together with any premium thereon; and (c) the interest which would be due during such period on the aggregate principal amount of Bonds and Parity Debt which would be Outstanding in such period if the Bonds or Parity Debt are retired as scheduled, but deducting and excluding from such aggregate amount the amount of Bonds or Parity Debt no longer Outstanding; provided that for purposes of determining compliance with the test for the issuance of additional Bonds or Parity Debt and the rate covenant and the amount of the Reserve Fund Requirement, certain provisions shall be applied as described in Appendix C — “SUMMARY OF CERTAIN PROVISIONS OF THE INDENTURE - Definitions.”

Nothing in the Indenture shall prohibit or impair the authority of the City to issue bonds or other obligations which are unsecured or which are secured by a lien on Net Revenues which is subordinate to the lien established under the Indenture, upon such terms and in such principal amount as the City may determine.

Debt Service Requirements

The debt service requirements of the Series 2005 Bonds and the Series 2006A Bonds are shown in the following table on a bond year basis.

<i>Fiscal Year Ending June 30</i>	<i>Series 2005 Total</i>	<i>Series 2006A Principal</i>	<i>Series 2006A Interest</i>	<i>Series 2006 Total</i>	<i>Total Debt Service</i>
2007	\$ 3,436,562.50	--	\$ 268,960.49	\$ 268,960.49	\$ 3,705,522.99
2008	3,432,230.00	--	706,757.50	706,757.50	4,138,987.50
2009	3,323,875.00	--	706,757.50	706,757.50	4,030,632.50
2010	3,323,325.00	--	706,757.50	706,757.50	4,030,082.50
2011	3,308,550.00	--	706,757.50	706,757.50	4,015,307.50
2012	3,308,050.00	--	706,757.50	706,757.50	4,014,807.50
2013	3,312,800.00	--	706,757.50	706,757.50	4,019,557.50
2014	3,307,675.00	--	706,757.50	706,757.50	4,014,432.50
2015	3,312,425.00	--	706,757.50	706,757.50	4,019,182.50
2016	3,311,675.00	--	706,757.50	706,757.50	4,018,432.50
2017	3,322,225.00	--	706,757.50	706,757.50	4,028,982.50
2018	3,309,293.75	--	706,757.50	706,757.50	4,016,051.25
2019	3,315,156.25	--	706,757.50	706,757.50	4,021,913.75
2020	3,317,125.00	--	706,757.50	706,757.50	4,023,882.50
2021	3,311,743.75	--	706,757.50	706,757.50	4,018,501.25
2022	3,315,031.25	--	706,757.50	706,757.50	4,021,788.75
2023	3,314,787.50	--	706,757.50	706,757.50	4,021,545.00
2024	--	\$ 880,000.00	686,957.50	1,566,957.50	1,566,957.50
2025	--	920,000.00	646,457.50	1,566,457.50	1,566,457.50
2026	--	960,000.00	605,597.50	1,565,597.50	1,565,597.50
2027	--	1,005,000.00	564,081.25	1,569,081.25	1,569,081.25
2028	--	1,045,000.00	520,518.75	1,565,518.75	1,565,518.75
2029	--	1,095,000.00	475,043.75	1,570,043.75	1,570,043.75
2030	--	1,140,000.00	427,550.00	1,567,550.00	1,567,550.00
2031	--	1,190,000.00	378,037.50	1,568,037.50	1,568,037.50
2032	--	1,240,000.00	326,400.00	1,566,400.00	1,566,400.00
2033	--	1,295,000.00	272,531.25	1,567,531.25	1,567,531.25
2034	--	1,350,000.00	216,325.00	1,566,325.00	1,566,325.00
2035	--	1,410,000.00	157,675.00	1,567,675.00	1,567,675.00
2036	--	1,470,000.00	96,475.00	1,566,475.00	1,566,475.00
2037	--	1,535,000.00	32,618.75	1,567,618.75	1,567,618.75
Total	\$56,582,530.00	\$ 16,535,000.00	\$ 16,983,349.24	\$ 33,518,349.24	\$ 90,100,879.24

BOND INSURANCE

Bond Insurance Policy

Concurrently with the issuance of the Series 2006A Bonds, Financial Security Assurance Inc. (“Financial Security”) will issue its Municipal Bond Insurance Policy for the Series 2006A Bonds (the “Policy”). The Policy guarantees the scheduled payment of principal of and interest on the Series 2006A Bonds when due as set forth in the form of the Policy included as Appendix F to this Official Statement.

The Policy is not covered by any insurance security or guaranty fund established under New York, California, Connecticut or Florida insurance law.

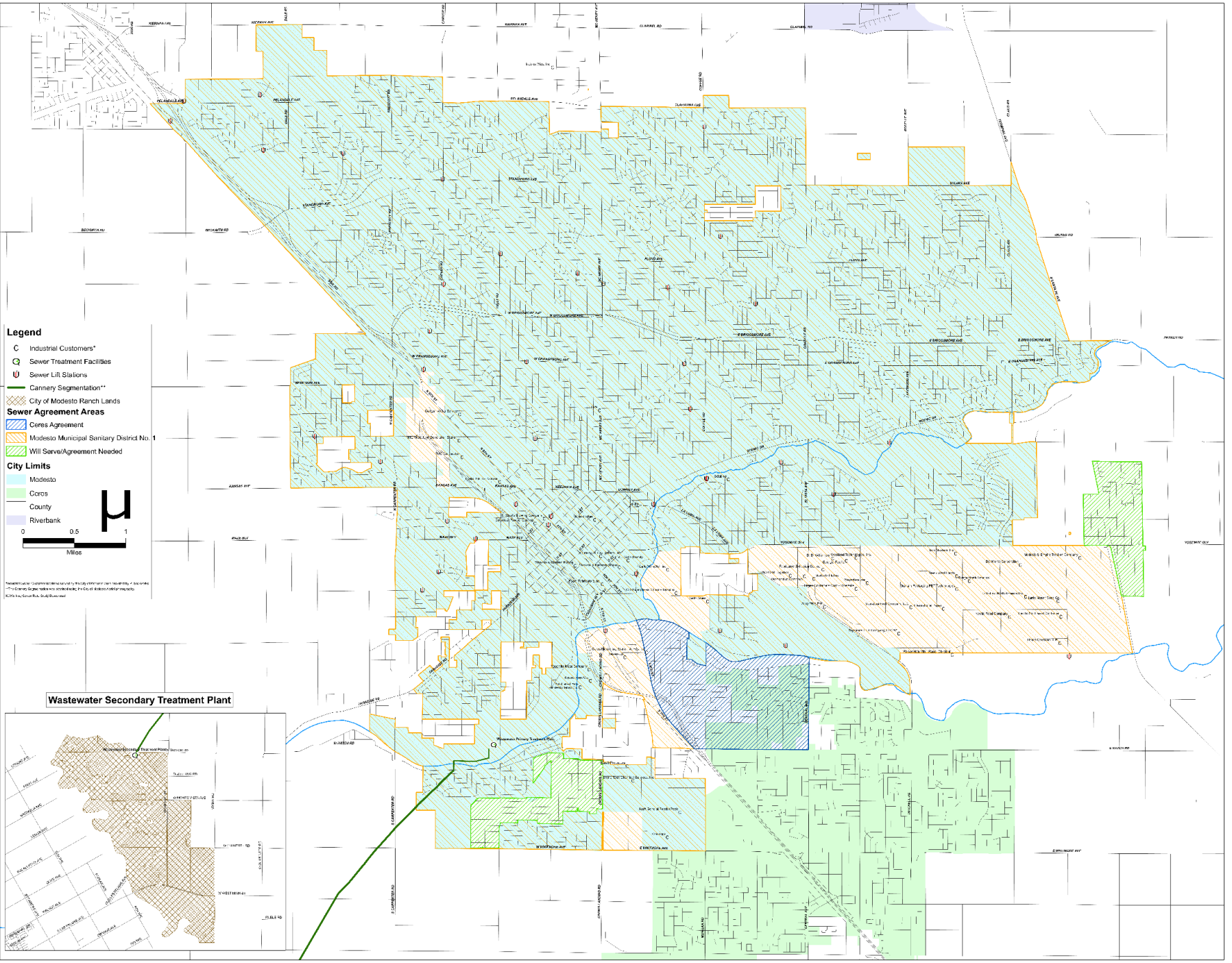
Financial Security Assurance Inc.

Financial Security is a New York domiciled financial guaranty insurance company and a wholly owned subsidiary of Financial Security Assurance Holdings Ltd. (“Holdings”). Holdings is an indirect subsidiary of Dexia, S.A., a publicly held Belgian corporation, and of Dexia Credit Local, a direct wholly-owned subsidiary of Dexia, S.A. Dexia, S.A., through its bank subsidiaries, is primarily engaged in the business of public finance, banking and asset management in France, Belgium and other European countries. No shareholder of Holdings or Financial Security is liable for the obligations of Financial Security.

At September 30, 2006, Financial Security’s combined policyholders’ surplus and contingency reserves were approximately \$2,581,107,000 and its total net unearned premium reserve was approximately \$1,992,163,000 in accordance with statutory accounting principles. At September 30, 2006, Financial Security’s consolidated shareholder’s equity was approximately \$3,058,987,000 and its total net unearned premium reserve was approximately \$1,590,538,000 in accordance with generally accepted accounting principles.

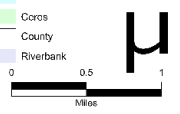
The consolidated financial statements of Financial Security included in, or as exhibits to, the annual and quarterly reports filed after December 31, 2005 by Holdings with the Securities and Exchange Commission are hereby incorporated by reference into this Official Statement. All financial statements of Financial Security included in, or as exhibits to, documents filed by Holdings pursuant to Section 13(a), 13(c), 14 or 15(d) of the Securities Exchange Act of 1934 after the date of this Official Statement and before the termination of the offering of the Bonds shall be deemed incorporated by reference into this Official Statement. Copies of materials incorporated by reference will be provided upon request to Financial Security Assurance Inc.: 31 West 52nd Street, New York, New York 10019, Attention: Communications Department (telephone (212) 826-0100).

The Policy does not protect investors against changes in market value of the Series 2006A Bonds, which market value may be impaired as a result of changes in prevailing interest rates, changes in applicable ratings or other causes. Financial Security makes no representation regarding the Series 2006A Bonds or the advisability of investing in the Series 2006A Bonds. Financial Security makes no representation regarding the Official Statement, nor has it participated in the preparation thereof, except that Financial Security has provided to the Issuer the information presented under this caption for inclusion in the Official Statement.



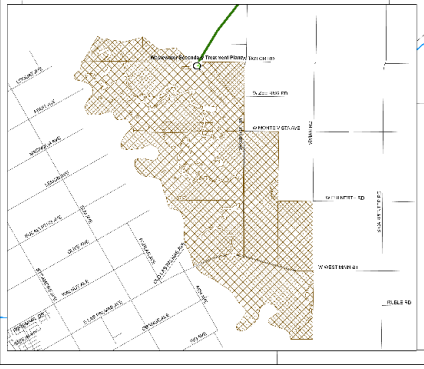
Legend

- C Industrial Customers*
- U Sewer Treatment Facilities
- U Sewer Lift Stations
- City of Modesto Ranch Lands
- Sewer Agreement Areas**
- Ceres Agreement
- Modesto Municipal Sanitary District No. 1
- Will Serve/Agreement Needed
- City Limits**
- Modesto
- Ceres
- County
- Riverbank



*Industrial Customers are shown for information only. The City of Modesto is not responsible for the accuracy of the information provided by these customers. All other information is the property of the City of Modesto.

Wastewater Secondary Treatment Plant



WASTEWATER SYSTEM

Introduction

The City manages, operates, and maintains four utilities. Two of these are wastewater related - water quality control facilities (the “WQC”) and the wastewater collection system (the “WWC”). The Enterprise consists of the WWC and the treatment and disposal facilities located at the WQC.

Service Area

The Enterprise services the entire City and additionally accepts some sewage flow from parts of the City of Ceres and some unincorporated communities in the County of Stanislaus, including Empire. The service outside the City is described in various individual contracts with the individual agencies. The current population of the area of the Enterprise is estimated to be 216,000, but the City estimates that it could grow to approximately 355,000 by 2030. A map showing the service area of the Enterprise appears on page 14.

History

Prior to 1910, wastes from the City were discharged without treatment into the Tuolumne River. From 1910 through the late 1940’s, the City’s wastewater system was comprised of an Imhoff tank with ponds. In 1946, plans were made to take industrial waste into the treatment plant. The City, with a population of 20,000, was faced with constructing a treatment facility to accept wastes equivalent to a contributing population of 400,000 persons during the three-month canning season. Sewer service charges were first collected in the late 1940’s and connection charges were first imposed in 1967. The City continues to be home to a number of food processors, and summer food processing sewer discharges are now equivalent to a contributing population of more than 1,000,000 persons.

System Description

General. The current wastewater system consists of a collection system with approximately 78 miles of trunk sewers (greater than 15”) and approximately 420.4 miles of sanitary sewers. There are 39 wastewater lift stations. Wastewater is treated at the primary treatment plant (the “Primary Treatment Plant”), located at 1221 Sutter Avenue, at the foot of Sutter Street where settleable and floatable material is removed. Residential, commercial, and industrial wastewater is pumped from over 500 miles of underground sewer lines throughout the City, to the Primary Treatment Plant to begin the removal of organic and inorganic constituents from the wastewater.

The Primary Treatment Plant treats over 10.5 billion gallons of wastewater annually and has a treatment capacity of 62.5 million gallons per day (“mgd”). The average processing level for the Primary Treatment Plant during the year is approximately 30 mgd. However, during the three-month canning season the Primary Treatment Plant treats an average of 41 mgd, with the cannery waste being separately piped to the Primary Treatment Plant and then pumped directly to a secondary treatment facility (the “Secondary Site”) located at 7007 Jennings Road (approximately 6.5 miles south of the City) for eventual disposal to the City’s Ranch (as defined below). The wastewater that is treated at the Primary Treatment Plant is then pumped to the Secondary Site. While several miles of farmland separate the Primary Treatment Plant and the Secondary Site, the sites operate as one plant. Biological treatment reduces the organic load so that the treated wastewater -- called

“secondary treated effluent” -- can be used to irrigate fodder crops on approximately 2,500 acres of adjacent City-owned land (the “Ranch”). The biological treatment consists of three fixed film reactors, with two in operation at any given time, several mechanical aerators, 300 acres of oxidation ponds, 100 acres of recirculation channels, and 600 acres of storage ponds.

The Enterprise currently generates approximately 30 mgd of secondary treated effluent. It uses low-capital-intensive irrigation as its primary discharge method. Approximately 3.1 billions gallons of secondary treated wastewater is discharged to the City-owned Ranch annually. The Ranch is managed in a public/private partnership in which the lessee uses the reclaimed water to grow fodder crops. Water that is not used for irrigation is stored, disinfected, and discharged to the San Joaquin River in the months of October through May. Discharge to the San Joaquin River must meet numerous requirements including a flow ratio of river water to effluent of at least 20:1.

The City also maintains a pretreatment program that monitors commercial and industrial facilities to enforce local and federal limits to assure high quality effluent for irrigation and river discharge.

Permitting Issues

The Central Valley Regional Water Quality Control Board (the “RWQCB”) regulates water quality in the Central Valley under the authority of the Federal Clean Water Act and California’s Porter-Cologne Water Control Act. The RWQCB issues wastewater discharge permits through the National Pollutant Discharge Elimination System (“NPDES”). Wastewater treatment plants are required under the State and federal law to meet various requirements for the operation, treatment, monitoring and disposal/discharge of wastewater.

The City received an updated NPDES permit in 2002 (Permit No. CA0079103, the “2002 Permit”), with river discharge limits on various constituents including a cease and desist order on molybdenum, which is a heavy metal in fertilizers. The 2002 Permit expired in May, 2006, but the City is authorized to continue to discharge wastewater thereunder. A draft of a proposed new 5-year NPDES permit to replace the 2002 Permit is currently under review and comment by the City which anticipates approval of the new permit in early 2007. More stringent regulatory requirements will continue to be a concern. The City is directing extensive efforts toward the reduction of molybdenum, approaching it as a source control issue. Numerous studies were mandated in 2002 and resources are being directed towards investment in these studies. The City recognizes, however, that future numerical or total maximum daily load effluent limits may be difficult to reach without significant technological improvements even with diligent source control. NPDES regulates discharge into the San Joaquin River and allows for up to 70 mgd of discharge, depending on river flow, between October and May. However, river flows are generally high enough only from December through April to achieve required dilution rates.

Land discharge is regulated by a separate Waste Discharge Requirement (the “WDR”) permit. Approximately 3.0 billion gallons per year of treated effluent, plus 1 billion gallons of cannery waste, are discharged to land. About 2.2 billion gallons of wastewater are lost each year to evaporation and percolation from within the treatment system and from application to pastureland. The RWQCB has indicated that the City will need to ultimately plan for the implementation of advanced wastewater treatment facilities; and the City anticipates that by 2016 all wastewater system users will need to be upgraded to a tertiary treatment level. (The City is currently the only agency still disposing secondary effluent to the San Joaquin River.) The City is exploring options that

potentially could expand the ability for land discharge. The City is has completed a water reclamation feasibility study to explore possibilities for re-using treated wastewater for landscaping and irrigation purposes. Master Plan studies will identify the need for additional capital improvements to the Enterprise (the “Capital Improvements”). See “Master Plan Update, Capital Improvement Plan and Future Capital Needs” below.

See “RISK FACTORS — Permits and Regulation” herein.

Master Plan Update, Capital Improvement Plan and Future Capital Needs

In 1991, the City recognized that the Enterprise had reached the capacity provided by its last expansion in 1984, which had been funded by a Clean Water Grant. The City commenced a wastewater planning process to determine the most cost-effective approach for the next increment of capacity. Based on considerable input from customers, regulators and the community at large, the City developed the 1995 Wastewater Master Plan (the “1995 Master Plan”). As part of its annual budget process, the City prepares a rolling ten-year capital improvement program for the Enterprise Fund in accordance with the 1995 Master Plan and incorporating current needs which were unknown in 1995. The 1995 Master Plan outlined Capital Improvements to be undertaken over the ensuing 20 to 40 years. These Capital Improvements generally fall into two categories: 1) treatment plant improvements and 2) collection system improvements.

An updated Wastewater Master Plan (the “2006 Master Plan”) initiated in 2004 is being undertaken in two stages, the first of which focuses on the wastewater collection system and the second of which focuses on treatment and disposal. Both documents are currently available for public review as is the Engineer’s Report with respect to the justification and cost allocation for the proposed Master Plan improvements. As part of the Master Plan update effort a long term (30-year) capital program (the “Long Term CIP”) is being developed by Carollo Engineers (the “Engineering Consultant”). The Long Term CIP is expected to include projects for the collection system and a preliminary capital plan for the treatment plant. The Engineering Consultant has also suggested future alternatives for wastewater treatment and discharge. These suggestions include a year-round waste reclamation facility with activated sludge with nutrient removal followed by clarification, filtration, and ultraviolet radiation disinfection prior to San Joaquin River discharge.

The Consulting Engineer has found that, despite long-term water conservation measures enacted by the City, the Enterprise is still facing increasing flow demands. The average annual flow in 2005 was approximately 25.8 mgd. Based upon the City’s estimates with respect to future growth in the service area of the Enterprise, the Consulting Engineer projects that average annual flow in 2030 will be approximately 41.5 mgd. In order to meet this increased demand, the Consulting Engineer has concluded that the City will need to make capital improvements over the next 30 years which are estimated to cost an aggregate of over \$420 million. The City expects that these improvements to the Enterprise will be constructed in phases over time.

In order to address the anticipated near term growth in the population of the service area of the Enterprise, the City commissioned the Consulting Engineer to prepare a capacity study. That study, entitled “Domestic Wastewater Near Term Capacity Study,” was presented to, and its findings and recommendations were adopted by, the City Council on April 4, 2006. The Near Term Capacity Study concluded that adding dissolved air floatation with tertiary treatment for year-round discharge into the San Joaquin River is the most cost effective and the most compatible alternative to reducing the City’s risks of exceeding its regulatory permits and meeting its long-term wastewater treatment

and disposal objectives. The dissolved air floatation system is intended to remove algae from storage pond effluent thereby extending the period of time within which effluent may be discharged to the San Joaquin River and increasing the existing effluent disposal capacity. The Consulting Engineer estimates that this could increase capacity by approximately 3.0 mgd at low levels of water flow in the river. Proceeds from the sale of the Series 2006A Bonds are expected to be used to pay for the construction of the dissolved air floatation facilities and the design of the Phase 1A near term tertiary treatment facilities as well as the design of the Phase 1 long term tertiary treatment facilities. The Phase 1A near term tertiary improvements include the proposed addition of an initial 2.3 mgd of nitrification/tertiary treatment facilities. The City currently expects to fund the construction of the Phase 1A near term tertiary treatment facilities with reserves, new rate/fee revenue and/or the proceeds of bonds to be issued late next year and to fund the construction of the Phase 1 long term tertiary treatment facilities with the proceeds of bonds to be issued in 2008 or 2009.

The present revenue stream of the Enterprise is not expected to be sufficient to meet all of the potential capital needs of the Enterprise. Development fees are currently insufficient to fund the extension of sewers to new development areas, especially if new development projects are not contiguous to then existing developed areas. The City's sphere of influence is currently projected to be built out in 2027. In the nearer term, a cost of service study (the "Cost of Service Study") is presently underway in order to match projected rate increases to the needed Capital Improvements for the existing rate base and for new development. The majority of funding for capital wastewater projects is allocated for critical capacity projects and deferred maintenance projects. The sewer extensions and the construction of dissolved air floatation units and purchase of land at the secondary treatment site to allow for resolution of existing discharge capacity issues are the other priorities. The Cost of Service Study will address funding issues for renewal and replacement of the sewer system and build into the financial plan a recommendation for the projects as well as new reserve targets for repair and replacement funding for the system. See "WASTEWATER SYSTEM FINANCES — Rates."

Management

The Enterprise is operated under the management and control of the City Council. Currently, day-to-day management is provided by Nick Pinhey, Director of Public Works; Richard Ulm, Deputy Director of Public Works/City Engineer; and Dan Wilkowsky, Deputy Director of Public Works – Wastewater Division, under the general supervision of Mr. George W. Britton, City Manager.

Brief resumes of the senior staff of the Enterprise are presented below:

Nick Pinhey, Director of Public Works. Dr. Nick Pinhey has served as Director of Public Works since January, 2006. He has over thirty years in the field of municipal public works and has served as the Director of Public Works for the Cities of Patterson, Merced and Tracy. Dr. Pinhey earned his doctorate from the University of Southern California's School of Policy, Planning and Development, a Masters of Public Administration from the University of Southern California and a masters degree from California State University Stanislaus. He is certified by the State of California as a Water Treatment Plant Operator and a Water Distribution Operator and has served as President of the California Water Environment Association and as a member of the Board of Directors of the Water Environment Federation.

Richard Ulm, Deputy Director of Public Works/City Engineer. Mr. Ulm has been with the City since 1984 and assumed the role of Deputy Director of Public Works in 2000 and City Engineer

in 2005. He is currently responsible for managing the capital improvement program for the Public Works Department. During his tenure with the City, Mr. Ulm has had the opportunity to be involved in the planning and management of dozens of significant capital projects. Prior to joining the City, Mr. Ulm spent approximately six years working as an engineer in the heavy construction industry on major infrastructure projects. He has a BS in Civil Engineering from the University of California, Davis, is a licensed civil engineer and is a member of the American Society of Civil Engineers and the American Public Works Association.

Dan Wilkowsky, Deputy Director of Public Works –Wastewater Division. Mr. Wilkowsky has over 30 years of experience in the management of environmental projects and programs. Prior to joining the City, he was a Senior Environmental Manager for Industrial Design and Construction, a division of CH2M-Hill, the Director of Environmental & Safety Services for National Semiconductor Corporation in Santa Clara and a member of the staff at East Bay Municipal Utility District in Oakland and the California Regional Water Quality Control Board in Los Angeles. Mr. Wilkowsky has a BS in Engineering from Auburn University, an MS in Environmental Engineering from the University of Southern California, and an MBA from San Francisco State University. He is a registered civil engineer in California, a licensed Grade V Wastewater Treatment Plant Operator and a member of the Board of Directors of Union Sanitary District in Union City, California.

Employees

The Public Works Director has primary responsibility for the management of the water control facilities and wastewater collection system as well as for the water system and streets and storm drains. The Enterprise currently has 106 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 Enterprise. The City's net assets available for benefits as of June 30, 2005 (the latest data available) were \$47,334,409 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 may be considered by the City Council during the current Fiscal Year is 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 Enterprise. Coverage thereunder is currently \$10,000,000, but damage resulting from earthquakes is not covered.

Wastewater System Users

The Enterprise’s customer base consists primarily of residential accounts although a substantial portion of revenues comes from industrial customers. The breakdown of accounts by category and percentage of total operating revenues are as follows:

**CITY OF MODESTO
WASTEWATER SYSTEM
Customer Base by Type of Account**

<i>Category</i>	<i>Number of Accounts</i>	<i>Percentage of Total Accounts⁽¹⁾</i>	<i>Percentage of Total Operating Revenues⁽²⁾</i>
Residential	57,301	95.27%	52.60%
Commercial	2,796	4.65	15.80
Industrial	<u>51</u>	<u>0.08</u>	<u>31.60</u>
Total	60,148	100.00%	100.00%

⁽¹⁾ For Fiscal Year 2004-05.

⁽²⁾ For Fiscal Year 2005-06.

Source: City of Modesto Finance Department.

The 10 largest users of the Enterprise accounted for approximately 30.58% of total service charge revenue in Fiscal Year 2005-06. The largest users, in terms of amounts billed to each during the past Fiscal Year, are listed below:

**CITY OF MODESTO
WASTEWATER SYSTEM
Ten Largest Users of Sewer Facilities
As of June 30, 2006**

<i>Users</i>	<i>Sewer Fee Operating Revenue</i>	<i>% of Sewer Fee Operating Revenue</i>
1) Stanislaus Food Products	\$ 1,516,289	6.84%
2) Signature Fruit ⁽¹⁾	1,339,435	6.04
3) Del Monte Foods	1,242,836	5.60
4) E&J Gallo	666,441	3.01
5) Frito-Lay	492,188	2.22
6) City Of Ceres	436,985	1.97
7) Foster Farms	414,412	1.87
8) Modesto Tallow Company ⁽²⁾	396,231	1.79
9) Nestle Food Company	161,893	0.73
10) ConAgra Foods	<u>114,730</u>	<u>0.52</u>
Total (Top Ten Customers) ⁽³⁾	\$ 6,781,440	30.58%
Total (All Customers)	\$22,176,107	

⁽¹⁾ Signature Fruit Co. was acquired by Seneca Foods Corporation in August, 2006. Its Plant 1 in the City was permanently closed on October 30, 2006. However, its Plant 7 in the City has not been closed. In order to maintain its current wastewater capacity allocation Seneca Foods Corporation is required to pay a minimum annual sewer charge based on 80% of that capacity allocation, and it has indicated that it intends to do so.

⁽²⁾ Pursuant to an agreement with the San Joaquin Valley Air Pollution Control District, Modest Tallow Company ceased its operations in the City in the summer of 2006.

⁽³⁾ If Signature Fruit Co. and Modesto Tallow Company were not included in this table, it would have included the next two largest customers of the Enterprise in Fiscal Year 2005-06: the City itself and Stanislaus County. Their sewer fee operating revenue payments were \$95,060 and \$92,831, respectively, or 0.43% and 0.42% of the total; and the ten largest customers would have represented 23.60% of the total sewer fee operating revenue. However, Seneca Food Corporation is currently expected to continue operations at its Plant 7 and to pay at least the minimum annual sewer charge described above.

Source: City of Modesto Finance Department.

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 issuance of the Series 2006A Bonds, which is as far as the City believes reasonable forecasting may be done on the cost issue.

WASTEWATER SYSTEM FINANCES

Rate Setting and Budget Process

In accordance with California law, the City Council may, from time to time and at its discretion, fix, alter, change, amend or revise any user fees, connection charges and all other fees related to the Wastewater Enterprise. Proposition 218, passed by the California electorate in 1996 potentially 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 “CONSTITUTIONAL LIMITATIONS ON TAXES AND WASTEWATER RATES AND CHARGES — Articles XIIC and XIID of the California Constitution.”

Proposition 218 Process

In November 1996, citizens of the State of California passed a Constitutional amendment known as Proposition 218. This amendment changed the process for increasing property-related fees within the state. See “CONSTITUTIONAL LIMITATIONS ON TAXES AND WASTEWATER RATES AND CHARGES — Articles XIIC and XIID of the California Constitution” herein. For the City, sewer rates are treated as a property-related fee and, pursuant to Proposition 218, require a protest hearing by the property owners prior to instituting a rate increase. Under the protest hearing process, property owners within the service area are mailed a rate increase notice and protest form detailing the proposed rate increase. To oppose the rate increase, the property owner must return the protest form to the City. To support the rate increase, there is no action required on the part of the property owner. If a significant number of protests are returned to the City no later than the end of the protest hearing, the City may not approve the proposed rate increase. If the protest fails with 50% or less, then the City can approve a rate increase not to exceed the rate increase detailed in the protest form. The rate increases for the services of the Enterprise which took effect in fiscal years 2000-01 through 2003-04 were all approved following the procedures required by Proposition 218.

Rates

The Enterprise collects its sewer service charges on the City's monthly utility bill, which includes water, sewer, storm drain and garbage. If charges are not paid, the City begins the process of initiating a lien on the user's property and may discontinue sewer service to the user. Historically, less than 1% of billed amounts for sewer service charges has been written off as bad debt.

For the average single-family residence, the current monthly sewer charge is \$14.26. A schedule of commercial sewer rates is set forth below:

<i>Commercial Group</i>	<i>Minimum Charge Per 1680 hundred cubic feet (ccf)</i>	<i>Additional Charge Per 1000 Gallons of Waste</i>
Group 1 ⁽¹⁾	\$21.95	\$1.73
Group 2 ⁽²⁾	25.29	2.04
Group 3 ⁽³⁾	31.00	2.47
Group 4 ⁽⁴⁾	37.19	2.98

⁽¹⁾ No food, just toilets or working facilities.

⁽²⁾ Commercial laundromats, service stations, hotels without food.

⁽³⁾ Industrial laundromats, hotels with food.

⁽⁴⁾ Restaurants, bakeries, auto steam, markets.

Source: City of Modesto.

A schedule of industrial sewer rates is set forth below:

Minimum Charge	\$ 10.00
Flow Per Million Gallons	892.23
Excess Biochemical Oxygen Demand (BOD) Per 1,000 Pounds	105.52
Excess Suspended Solids (SS) Per 1000 Pounds	97.14

Source: City of Modesto.

Residential, commercial and industrial rates have increased according to the following approved schedule.

<i>Fiscal Year</i>	<i>Percent Increase</i>
2001/02	5.0%
2002/03	4.0
2003/04	4.0
2004/05	3.0

In 2005, the City Council directed the staff to initiate the Proposition 218 process described above with respect to a possible rate increase for the Enterprise to be effective on July 1, 2007. Pursuant thereto, a cost of service study and engineering report is nearing completion and is expected to be presented to the City Council's Finance Committee in December, 2006 or January, 2007. If the City Council chooses to go forward with the process, the City expects that notice of the proposed rate increases and the opportunity to file protest with respect thereto would be mailed to the rate payers of the Enterprise in April, 2007 and that the protest hearing would be conducted in June, 2007.

Assuming the absence of a majority protest, the City Council would then be in a position to adopt new rates and have them take effect at July 1, 2007.

Comparative Monthly Wastewater Service Charges. The City’s residential charges as of January 1, 2006 are set forth in the table below with a comparison to other Central Valley and Northern California cities.

**CITY OF MODESTO
WASTEWATER SYSTEM
Monthly Sewer Charge Comparison
Residential Service
As of January 1, 2006**

<i>City</i>	<i>Monthly Residential Charge</i>
Modesto	\$14.26
Stockton	19.30
Fresno ⁽¹⁾	20.16
Lodi ⁽²⁾	20.26
Turlock	30.65
Tracy	31.00

⁽¹⁾ Minimum charge.

⁽²⁾ Based upon a three-bedroom residence.

Source: City of Modesto.

Connection Fees. The Enterprise imposes connection fees on a one-time basis to new users of the sewer system and to users that significantly expand their usage. The fees have three components:

- Connection charge: Approximately \$500 per Equivalent Dwelling Unit for residential units and \$2,000/acre for commercial and industrial property.
- Sub-trunk sewer charge: Approximately \$645/acre
- Connection (lateral) charge: \$33 per linear foot of lot frontage adjacent to the sewer line

Connection fees are treated as contributed capital and are used only for capital projects, not for operations.

As described above, the cost of service study and a connection fee study currently being prepared will make new recommendations for new rate structures for the next five years to fund the capital improvement program.

Comparative Connection Fees. The current Connection Fees and a comparison of the City’s Connection Fees to those of other Central Valley and Northern California cities are set forth in the table below.

**CITY OF MODESTO
WASTEWATER SYSTEM
Wastewater Connection Fees Comparison
As of January 1, 2006**

<i>City</i>	<i>Connection Fee</i>
Modesto	\$ 611
Turlock ⁽¹⁾	1,800
Fresno	2,119
Stockton - South of the Calaveras River ⁽²⁾	3,254
Tracy	3,300
Stockton - North of the Calaveras River ⁽³⁾	4,984
Lodi ⁽⁴⁾	6,491

- ⁽¹⁾ Based on local street rate.
⁽²⁾ Represents an average of three fee zones.
⁽³⁾ Represents an average of four fee zones.
⁽⁴⁾ Based upon a three-bedroom residence.
Source: City of Modesto.

Financial Information

The accounts of the City are organized on the basis of funds and account groups, each of which is considered a separate accounting entity. The operations of each fund are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues, and expenditures, or expenses as appropriate. Government resources are allocated to and accounted for in individual funds based upon the purposes for which they are to be spent and the means by which spending activities are controlled. The various funds are grouped into seven generic funds within three broad fund types, and a fourth category of accounting entities, the account groups, as follows:

Governmental Funds.....	General Fund Special Revenue Funds Capital Project Funds
Proprietary Funds.....	Debt Service Funds Enterprise Funds Internal Service Funds
Fiduciary Funds	Agency Funds

Enterprise funds are used to account for operations that are financed in a manner similar to private business enterprises in that the costs of providing goods and services to the general public on a continuing basis are financed or recovered primarily through user charges. The City accounts for the operations of the sewer, storm drain, and water systems, airport, golf, community center, parking, compost, and bus service systems on this basis. Enterprise funds are accounted for using the accrual basis of accounting. Unbilled utility services receivables are recorded at year-end. Property and equipment owned by enterprise funds are stated at historical cost where available and at estimated cost when original cost is not available. Depreciation is charged to operations using the straight-line

method over the estimated useful lives of the assets, which are 30 years for buildings, 20 years for improvements, 10 years for furnishings and equipment and 75 years for pipelines.

Effective for Fiscal Year 2001-02, the City adopted Governmental Accounting Standards Board (GASB) Standard No. 34, Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments, as amended, which establishes a fundamentally new financial reporting model for all state and local governments including management's discussion and analysis of an entity's financial position and results of operations. The City implemented GASB No. 34 in 2002 in accordance with the implementation requirements in the accounting standard. As a result, the basic financial statement presentation set forth in the City's current financial statements was significantly changed, including the addition of management's discussion and analysis of financial activities which is presented in the financial statements as required supplementary information.

See Appendix B — "EXCERPTS FROM THE CITY'S FINANCIAL STATEMENTS."

Historical Debt Service Coverage

The following table shows debt service coverage for the Sewer Enterprise fund for the fiscal years ended June 30, 2002 through June 30, 2006.

**CITY OF MODESTO SEWER ENTERPRISE
HISTORICAL DEBT SERVICE COVERAGE
Fiscal Years Ended June 30, 2002 through June 30, 2006
(In Thousands of Dollars)**

	<i>2002</i>	<i>2003</i>	<i>2004</i>	<i>2005</i>	<i>2006⁽¹⁾</i>
GROSS OPERATING REVENUES:					
Operating Revenue	\$ 20,901.62	\$ 23,556.04	\$ 25,293.00	\$ 24,419.61	\$ 23,057.56 ⁽²⁾
Connection Charges	998.05	759.60	604.08	711.80	751.30
Interest Income	388.29	308.04	226.59	545.73	822.12
Rental Income	0.10	0.10	0.10	24.16	39.18
Miscellaneous Income	0.00	0.00	0.00	0.00	25.72
GROSS OPERATING REVENUES	\$ 22,288.06	\$ 24,623.78	\$ 26,123.77	\$ 25,701.30	\$ 24,695.88
OPERATING EXPENSES:					
Operating Expenditures, Net of Depreciation	\$ 16,056.43	\$ 14,846.14	\$ 15,788.62	\$ 15,494.20	\$ 15,020.70
Allocated Indirect Administration Costs	975.31	731.38	746.01	760.93	760.93
Property Taxes ⁽³⁾	86.18	87.14	153.32	90.12	91.22
Other Uses (Transfers Out)	0.00	0.00	0.00	131.67	171.93
TOTAL OPERATING EXPENSES	\$ 17,117.92	\$ 15,664.66	\$ 16,687.95	\$ 16,476.92	\$ 16,044.78
NET OPERATING REVENUES	\$ 5,170.14	\$ 8,959.12	\$ 9,435.82	\$ 9,224.38	\$ 8,651.10
DEBT SERVICE:					
1993 Bonds	\$ 656.92	\$ 656.72	\$ 660.41	\$ 761.00	--
1996 Bonds	1,024.92	1,022.41	1,022.25	917.00	--
1997 Bonds	1,868.18	1,872.83	1,867.46	1,872.09	--
2005 Refunding Bonds	--	--	--	--	\$ 2,916.46
TOTAL DEBT SERVICE	\$ 3,550.02	\$ 3,551.96	\$ 3,550.12	\$ 3,550.09	\$ 2,916.46
NET REVENUES AFTER DEBT SERVICES	\$ 1,620.12	\$ 5,407.16	\$ 5,885.70	\$ 5,674.29	\$ 5,734.64
DEBT SERVICE COVERAGE (Net Operating Revenues/ Total Debt Service)	1.46	2.52	2.66	2.60	2.97

⁽¹⁾ Reflects estimated, unaudited amounts.

⁽²⁾ Operating revenue declined in Fiscal Year 2006 due in part to a "furloughing" of Plant 1 of Signature Fruit Co. (now Seneca Food Corporation) and the winding down of operations at Modesto Tallow Company's plant in the City.

⁽³⁾ Property taxes paid for property outside of City limits.

Source: City of Modesto Finance Department.

Projected Debt Service Coverage

The following table sets forth projected operating revenues, operating expenses and debt service coverage for the Sewer Enterprise Fund for the fiscal years ending June 30, 2007 through June 30, 2011. The projections of amounts, and timing for receipts and disbursements in the table, are only updated for growth assumptions and at this time do not assume projected rate increases (See “Rate Setting and Budget Process”) which should not be construed as statements of fact. The following projections are based on the City’s current circumstances and currently available information and are believed to be conservative and reasonable. The projections may be affected by various factors and there can be no assurance that they will be achieved and any variation from projected operating results may be material.

CITY OF MODESTO SEWER ENTERPRISE PROJECTED DEBT SERVICE COVERAGE Fiscal Years Ending June 30, 2007 through June 30, 2011 (In Thousands of Dollars)

	2007	2008	2009	2010	2011
GROSS OPERATING REVENUES:					
Operating Revenue	\$ 22,993.55 ⁽¹⁾	\$ 23,711.35	\$ 23,855.94	\$ 24,103.15	\$ 24,353.00
Connection Charges	559.63	661.05	662.66	664.28	665.93
Interest Income	350.00	300.00	300.00	300.00	300.00
Rental Income	--	--	--	--	--
Revenue Adjustments ⁽²⁾	<u>--</u>	<u>(300.00)</u>	<u>(300.00)</u>	<u>(300.00)</u>	<u>(300.00)</u>
GROSS OPERATING REVENUES	<u>\$ 23,903.18</u>	<u>\$ 24,372.40</u>	<u>\$ 24,518.60</u>	<u>\$ 24,767.43</u>	<u>\$ 25,018.93</u>
OPERATING EXPENSES					
Total Operating Expenditures, Net of Depreciation	\$ 16,220.82	\$ 16,545.23	\$ 16,876.14	\$ 17,213.66	\$ 17,557.93
Property Taxes ⁽³⁾	101.32	101.32	101.32	101.32	101.32
Other Uses (Transfers Out)	104.00	104.00	104.00	104.00	104.00
Expense Adjustment ⁽²⁾	<u>500.00</u>	<u>500.00</u>	<u>500.00</u>	<u>500.00</u>	<u>500.00</u>
TOTAL OPERATING EXPENSES	<u>\$ 16,926.14</u>	<u>\$ 17,250.55</u>	<u>\$ 17,581.46</u>	<u>\$ 17,918.98</u>	<u>\$ 18,263.25</u>
NET OPERATING REVENUES	<u>\$ 6,977.04</u>	<u>\$ 7,121.85</u>	<u>\$ 6,937.14</u>	<u>\$ 6,848.45</u>	<u>\$ 6,775.68</u>
DEBT SERVICE					
2005 Refunding Bonds	\$ 3,436.56	\$ 3,432.23	\$ 3,232.88	\$ 3,323.33	\$ 3,308.55
2006 Series A	<u>268.96</u>	<u>706.76</u>	<u>706.76</u>	<u>706.76</u>	<u>706.76</u>
TOTAL DEBT SERVICE	<u>\$ 3,705.52</u>	<u>\$ 4,138.99</u>	<u>\$ 3,939.64</u>	<u>\$ 4,030.09</u>	<u>\$ 4,015.31</u>
NET REVENUES AFTER DEBT SERVICE	<u>\$ 3,271.52</u>	<u>\$ 2,982.86</u>	<u>\$ 2,997.50</u>	<u>\$ 2,818.36</u>	<u>\$ 2,740.37</u>
DEBT SERVICE COVERAGE (Net Operating Revenues/ Total Debt Service)	1.88	1.72	1.76	1.70	1.68

⁽¹⁾ Estimated operating revenue from sewer fees has been reduced from the \$23,057,580 shown for Fiscal Year 2006 in the Historical Debt Service Coverage to reflect the final closings of Signature Fruit Co’s. (now Seneca Food Corporation) Plant 1 and the Modesto Tallow Company’s tallow plant. See “WASTEWATER SYSTEM — Wastewater System Users.”

⁽²⁾ Contingencies to account for unanticipated fluctuations in revenues and expenses.

⁽³⁾ Property taxes paid for property outside of City limits.

Source: City of Modesto Finance Department.

RISK FACTORS

The following section describes certain risk factors affecting the payment of and security for the Series 2006A Bonds. The following discussion of risks is not meant to be an exhaustive list of the risks associated with the purchase of the Series 2006A Bonds and does not necessarily reflect the

relative importance of the various issues. Potential investors are advised to consider the following factors, along with all other information in this Official Statement, in evaluating the Series 2006A Bonds. There can be no assurance that other risk factors will not become material in the future.

General

The payment of principal of and interest on the Series 2006A Bonds is secured solely by a pledge of the Net Revenues and certain funds under the Indenture. The realization of the Net Revenues is subject to, among other things, the capabilities of management of the City, the ability of the City to provide wastewater services to its users, and the ability of the City to establish and maintain wastewater fees and charges sufficient to provide the required debt service coverage as well as pay for Operating Expenses.

Among other matters, drought, general and local economic conditions and changes in law and government regulations (including initiatives and moratoriums on growth) could adversely affect the amount of Net Revenues realized by the City. See “System Demand” below.

Earthquakes, Floods and Other Natural Disasters

Earthquakes, floods or other natural disasters could interrupt operation of the Enterprise and cause increased costs and thereby interrupt the ability of the City to realize Net Revenues. The City is not obligated under the Indenture to have earthquake or flood insurance. According to the California Geological Survey website, the City is not one of the 100 incorporated cities within California on an Earthquake Fault Zone. The Primary Treatment Plant site that was impacted by the 1997 Tuolumne River flooding was upgraded in Fiscal Year 1998-99 with a new Headworks and Cannery Segregation Project. This project mitigated the critical functions of the facility and the impact on those critical process and functional units at the facility from a hundred year flood event.

Natural disasters could also adversely affect the service area of the Enterprise, leading to reduced demand for wastewater service.

System Demand

There can be no assurance that the demand for wastewater services will occur as described in this Official Statement. Reduction in levels of demand could require an increase in rates or charges in order to comply with the covenants to fix rates and charges so as to produce Net Revenues equal to 125% of Debt Service. Moreover, although industrial users account for only 51 of the over 60,000 accounts utilizing the Enterprise, they are responsible for approximately 32% of the sewer fee operating revenues of the Enterprise; and the overwhelming majority of the industrial users are associated with the food or beverage industries. Nine of the ten largest customers of the Enterprise in Fiscal Year 2005-06 are in this category. See “WASTEWATER SYSTEM — Wastewater System Users.” Thus, any changes in these industries and/or the particular customers who utilize the services of the Enterprise which would reduce their wastewater discharge could adversely affect the revenues of the Enterprise.

The City allocates capacity in the Enterprise to major industrial users through the issuance of Wastewater Discharge Permits. Pursuant to Section 5-6.403 of the City’s Municipal Code, whenever the annual flow from a major industrial user for a calendar year falls below 80% of the capacity allocation shown in the applicable Wastewater Discharge Permit, the major industrial user must pay a

minimum sewer service charge for such calendar year based on 80% of such capacity allocation. This requirement is intended to assure that the City will receive at least 80% of the sewer service charges based on the capacity allocated to major industrial users. However, it may limit the ability of the City to reallocate unused allocated capacity in order to maximize the potential sewer fee revenue of the Enterprise.

System Expenses

There can be no assurance that the City's expenses will be consistent with the descriptions in this Official Statement. Increases in expenses could require a significant increase in rates or charges in order to pay for City wastewater projects and comply with the rate covenant. The treatment needs are expected to be affected by growth and tightened regulatory requirements in the future. Preliminary cost estimates for capital improvements required to service build out in the City (currently expected in 2030) are in the range of \$420 million based on current build out and permit requirements assumptions and measured in June 1, 2006 dollars. As stated above, the City is in the process of implementing a plan for capital improvements, including the preparation of a detailed updated Master Plan, which is currently in progress and which will provide a framework for future wastewater discharge permit requirements. See "WASTEWATER SYSTEM — Master Plan Update, Capital Improvement Plan and Future Capital Needs."

Rate Process

The passage of Proposition 218 by the California electorate potentially 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 "CONSTITUTIONAL LIMITATIONS ON TAXES AND WASTEWATER RATES AND CHARGES — Articles XIIC and XIID of the California Constitution."

Permits and Regulation

The wastewater operations of the City are subject to discharge permits from the State Water Resources Control Board. A number of these permits will be modified from time to time to show increased capacity. The major sewer permits are two Waste Discharge Requirements, one centered on river discharge and the other on land discharge. The river discharge permit expired in May, 2006, while the land discharge has a renewal year of 2010. See "WASTEWATER SYSTEM — Permitting Issues."

The City-treated effluent discharge to the San Joaquin River is regulated by the State through a NPDES permit. The renewal process includes specific "effluent limitations" that are typically maximum allowable discharge concentrations for certain constituents. Those constituents that require effluent limitations, and the process for determining the effluent limitation concentration are based on water quality objectives on the San Joaquin River, the implementation of these objectives using the State Implementation Plan (SIP), and observed concentrations in the wastewater treatment facility effluent and the San Joaquin River. The SIP also allows the City to perform additional water quality studies related to permit compliance and effluent limitations. These can be considered during the permit renewal process and can be critical to establishing accurate effluent limitations that are protective of the San Joaquin River and based on the best available science. Each permit-adopted effluent limitation violation is subject to a maximum mandatory penalty.

During the last several years, the City has successfully completed several water quality studies that should be considered in the upcoming permit renewal. The completed study list includes a copper translator study, a dilution/mixing zone study, a dissolved oxygen “far-field” modeling study, a dynamic regulatory compliance model study, and continued water quality monitoring using state-of-the-art analytical methods. To provide the best available science to permit renewal process, the City intends to collect data and perform several additional water quality studies. The City will also increase effluent and San Joaquin River monitoring of key constituents that have been identified as ongoing and new permit issues.

In the event that the federal government, acting through the Environmental Protection Agency, or the State of California, acting through the Department of Health Services, or additional federal or state agencies, should impose stricter water quality standards upon the Enterprise, the City’s expenses could increase accordingly and rates and charges would have to be increased significantly to offset those expenses. It is not possible to predict the direction federal or state regulation will take with respect to water quality standards, although it is likely that, over time, both will impose more stringent standards with attendant higher costs.

See “WASTEWATER SYSTEM — Permitting Issues.”

Limitations on Remedies and Bankruptcy

The ability of the City to increase sewer services charges and to comply with its covenants under the Indenture and to generate Net Revenues sufficient to pay principal of and interest on the Series 2006A Bonds 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 assessments, fees and charges. See “CONSTITUTIONAL LIMITATIONS ON TAXES AND WASTEWATER RATES AND CHARGES — Articles XIIC and XIID of the California Constitution.” Furthermore, any remedies available to the owners of the Series 2006A Bonds upon the occurrence of an event of default under the Indenture are in many respects dependent upon judicial actions which are often subject to discretion and delay and could prove both expensive and time consuming to obtain.

In addition to the limitations on remedies contained in the Indenture, the rights and obligations under the Series 2006A Bonds and the Indenture 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 Series 2006A Bonds will be so qualified. In addition, the opinion to be delivered by Sidley Austin, LLP, Bond Counsel, concurrently with the issuance of the Series 2006A Bonds, will also state that the enforceability of the Indenture is subject to the limitations on the imposition of fees and charges by the City relating to the Enterprise under Article XIIC and XIID of the California Constitution. A complete copy of the proposed form of opinion of Bond Counsel is set forth in Appendix D hereto. In the event the City fails to comply with its covenants under the Indenture or to pay principal of or interest on the Series 2006A Bonds, there can be no assurance that available remedies will be adequate to fully protect the interests of the holders of the Series 2006A Bonds.

The enforcement of the remedies provided in the Indenture could prove both expensive and time consuming. In addition, the rights and remedies provided in the Indenture 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. If the City were to file a petition under Chapter 9 of the Bankruptcy Code (Title 11, United States Code), the Series 2006A Bondholders and the Trustee could be prohibited or severely restricted from taking any steps to enforce their rights under the Indenture.

Limited Obligations

The Series 2006A Bonds are limited obligations of the City and 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 Net Revenues of the Enterprise. The obligation of the City to make debt service payments on the Series 2006A Bonds does not constitute an obligation of the City to levy or pledge any form of taxation or for which the City has levied or pledged any form of taxation.

The City is obligated under the Indenture to make debt service payments on the Series 2006A Bonds solely from Net Revenues. There is no assurance that the City can succeed in operating the Enterprise such that the Net Revenues in the future amounts projected in this Official Statement will be realized.

CONSTITUTIONAL LIMITATIONS ON TAXES AND WASTEWATER RATES AND CHARGES

Article XIII A of the California Constitution

Section 1(a) of Article XIII A of the California Constitution limits the maximum ad valorem tax on real property to 1% of full cash value (as defined in Section 2 of Article XIII A), to be collected by each county and apportioned among the county and other public agencies and funds according to law. Section 1(b) of Article XIII A provides that the 1% limitation does not apply to ad valorem taxes to pay interest or redemption charges on (a) indebtedness approved by the voters prior to July 1, 1978 or (b) any bonded indebtedness for the acquisition or improvement of real property approved on or after July 1, 1978, by two-thirds of the votes cast by the voters voting on the proposition. Section 2 of Article XIII A defines "full cash value" to mean "the County Assessor's valuation of real property as shown on the 1975/76 tax bill under full cash value or, thereafter, the appraised value of real property when purchased, newly constructed, or a change in ownership has occurred after the 1975 assessment." The full cash value may be adjusted annually to reflect inflation at a rate not to exceed 2% per year or to reflect a reduction in the consumer price index or comparable data for the area under the taxing jurisdiction, or reduced in the event of declining property values caused by substantial damage, destruction, or other factors. Legislation enacted by the State Legislature to implement Article XIII A provides that notwithstanding any other law, local agencies may not levy any ad valorem property tax except to pay debt service on indebtedness approved by the voters as described above.

On June 18, 1992, following a number of challenges to the provisions of Article XIII A, the United States Supreme Court upheld the decision in *Nordlinger v. Hahn*, 225 Cal. App. 3d 1259, a case involving residential property taxation decided by the State Court of Appeals. The 8 to 1 majority held that the Article XIII A assessment method serves a rational state interest by providing certainty regarding property taxes to homeowners and therefore does not violate provisions of the Equal Protection Clause codified in the 14th Amendment of the U.S. Constitution.

The effect of Article XIII A on the City's finances, then, has been to restrict ad valorem tax revenues for general purposes to the statutory allocation of the 1% levy while leaving intact the power to levy ad valorem taxes in whatever rate or amount may be required to pay debt service on its general obligation bonds. The City cannot predict whether any further challenges to the State's present system of property tax assessment will be made, or what the outcome of impact on any of the City of any such challenge might be.

Article XIII B of the California Constitution

An initiative amendment to the California Constitution (Article XIII B) was approved by the California electorate on November 6, 1979. This amendment establishes limits on certain annual appropriations of state and local government entities. Initially, the limits are based generally on appropriations for the Fiscal Year 1978-79 with future adjustments permitted for changes in the cost of living, population and certain other factors. The definition of appropriations subject to limitation is stated so as to exclude, among other things, (1) appropriations of proceeds received by a government entity from user fees to the extent such proceeds do not exceed the costs reasonably borne by such entity in providing the product or service, (2) the appropriations of any special district "which did not as of the 1977-78 fiscal year levy an ad valorem tax on property in excess of 12½ cents per \$100 of assessed value", and (3) "appropriations required to pay the cost of interest and redemption charges, including the funding of any reserve or sinking fund required in connection therewith, on indebtedness existing or legally authorized as of January 1, 1979, or a bonded indebtedness thereafter approved . . ." by vote of the electors of the issuing entity. In addition, the amendment provides that nothing in it "will be construed to impair the ability of the State or any local government to meet its obligations with respect to existing or future bonded indebtedness."

The City is of the opinion that its wastewater fees and charges do not exceed the costs they reasonably bear in providing such services and therefore are not subject to the limits of Article XIII B.

Articles XIII C and XIII D of the California Constitution

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 XIII C and Article XIII D 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 XIII D. Article XIII D 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 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 XIII D 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 XIII D requires that any agency imposing or increasing any property-related fee or charge must provide written notice thereof to the record owner of each identified parcel upon which such fee or charge is to be imposed and must conduct a public hearing with respect thereto. The proposed fee or charge may not be imposed or increased if a majority of owners of the identified

parcels file written protests against it. As a result, 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 XIID, 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 connection fees (in that instance, for water) are not property related fees or charges subject to Article XIID while at the same time stating in *dicta* that fees for ongoing service through an existing connection were property related fees and charges. On July 24, 2006, in *Bighorn-Desert View Water Agency v. Verjil*, 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 XIID. Despite the fact that the statement is *dicta*, it does represent the unanimous view of the California Supreme Court as it pertains to charges for water service. The City follows the majority protest procedures set forth in Article XIID in imposing new wastewater fees and charges. See “WASTEWATER SYSTEM FINANCES — Proposition 218 process” herein. Nevertheless, it remains unclear what effect, if any, Article XIID will have on the ability of the City to charge rates to its retail customers greater than those which existed on November 5, 1996, and the potential impact such limitations will have on the City’s Net Revenues.

In addition, Article XIID 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 XIIC. Article XIIC 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 XIIC 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 XIID) are also fees within the meaning of Article XIIC 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 XIIC grants to the voters within the City the power to repeal or reduce rates and charges for the wastewater services 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 Owners of the Series 2006A Bonds. Remedies available to beneficial owners of the Series 2006A Bonds 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.

No assurance may be given that Articles XIIC and XIID will not have a material adverse impact on the City’s Net Revenues.

Other Initiative Measures

Articles XIIA, XIIB, XIIC and XIID were adopted pursuant to California’s constitutional initiative process. From time to time other initiative measures could be adopted by California voters, placing additional limitations on the ability of the City to increase revenues.

TAX MATTERS

In the opinion of Sidley Austin LLP, San Francisco, California, Bond Counsel, based on existing statutes, regulations, rulings and judicial decisions and assuming compliance with certain covenants in the Indenture and the requirements of the Internal Revenue Code of 1986, as amended (the “Code”) regarding the use, expenditure and investment of proceeds of the Series 2006A Bonds and the timely payment of certain investment earnings to the United States, interest on the Series 2006A Bonds is not includable in the gross income of the owners of the Series 2006A Bonds for federal income tax purposes. Failure to comply with such covenants and requirements may cause interest on the Series 2006A Bonds to be included in gross income retroactively to the date of issuance of the Series 2006A Bonds.

In the further opinion of Bond Counsel, interest on the Series 2006A Bonds is not treated as an item of tax preference in calculating the federal alternative minimum taxable income of individuals and corporations. Interest on the Series 2006A Bonds, 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, 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. Bond Counsel expresses no opinion with respect to any collateral tax

consequences and, accordingly, prospective purchasers of the Series 2006A Bonds should consult their tax advisors as to the applicability of any collateral tax consequences.

Certain requirements and procedures contained or referred to in the Indenture and other relevant documents pertaining to the Series 2006A Bonds may be changed, and certain actions may be taken, 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. Bond Counsel expresses no opinion as to the exclusion from gross income for federal income tax purposes of interest on the Series 2006A Bonds on and after the date on which any such change occurs or action is taken upon the advice or approval of counsel other than Bond Counsel.

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 issuance of the Series 2006A Bonds will not have an adverse effect on the tax-exempt status of the Series 2006A Bonds. Legislation or regulatory actions and proposals may also affect the economic value of tax exemption or the market price of the Series 2006A Bonds.

The Tax Increase Prevention and Reconciliation Act of 2005, enacted on May 17, 2006, contains a provision under which interest paid on tax-exempt obligations will be subject to information reporting in a manner similar to interest paid on taxable obligations. Although the new reporting requirement does not, in and of itself, affect the excludability of such interest from gross income for federal income tax purposes, the reporting requirement causes the payment of interest on the 2006A Bonds made after March 31, 2007, to be subject to backup withholding if such interest is paid to beneficial owners who (a) are not “exempt recipients,” and (b) either fail to provide certain identifying information (such as the beneficial owner’s taxpayer identification number) in the required manner or have been identified by the Internal Revenue Service (the “IRS”) as having failed to report all interest and dividends required to be shown on their income tax returns. Generally, individuals are not exempt recipients, whereas corporations and certain other entities generally are exempt recipients. Amounts withheld under the backup withholding rules from a payment to a beneficial owner would be allowed as a refund or a credit against such beneficial owner’s federal income tax liability provided the required information is furnished to the IRS.

In the further opinion of Bond Counsel, interest on the Series 2006A Bonds is exempt from personal income taxes imposed by the State of California.

A copy of the proposed form of opinion of Bond Counsel is attached hereto as Appendix D.

Original Issue Discount

The initial public offering price of certain of the Series 2006A Bonds (collectively, the “Discount Bonds”) is less than the principal amount of the Discount Bonds. The difference between the principal amount of a Discount Bond and its initial public offering price is original issue discount. Original issue discount on a Discount Bond accrues over the term of such Discount Bond at a constant interest rate. To the extent it has accrued, original issue discount on a Discount Bond is treated as interest excludable from gross income for federal income tax purposes under the conditions and limitations described above. The amount of original issue discount that accrues on a Discount Bond in each year is not an item of tax preference for purposes of calculating federal alternative minimum taxable income, but 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. Additionally, such accrued original issue discount is taken into account in determining the distribution requirements of certain regulated investment companies and may result in some of the collateral federal tax consequences discussed above. Consequently, owners of Discount Bonds should be aware that the accrual of original issue discount in each year may result in an alternative minimum tax liability, additional distribution requirements or other collateral federal income tax consequences although the owner may not have received cash in such year.

The accrual of original issue discount on a Discount Bond will increase the owner's adjusted basis in such Discount Bond. This will affect the amount of taxable gain or loss realized by the owner of the Discount Bond upon the redemption, sale or other disposition of such Discount Bond. The effect of the accrual of original issue discount on the federal income tax consequences of a redemption, sale or other disposition of a Discount Bond that is not purchased at the initial public offering price may be determined according to rules that differ from those described above. Owners of Discount Bonds should consult their tax advisors with respect to the precise determination for federal income tax purposes of the amount of original issue discount that properly accrues with respect to the Discount Bonds, other federal income tax consequences of owning and disposing of the Discount Bonds and any state and local tax consequences of owning and disposing of the Discount Bonds.

Original Issue Premium

Certain of the Series 2006A Bonds are being purchased in the initial offering for an amount in excess of their principal amount (hereinafter, the "Premium Bonds"). The excess of the tax basis of a purchaser of a Premium Bond (other than a purchaser who holds a Premium Bond as inventory, stock in trade or for sale to customers in the ordinary course of business) over the principal amount of such Premium Bond is "bond premium." Bond premium is amortized for federal income tax purposes over the term of a Premium Bond based on the purchaser's yield to maturity in the Premium Bond, except that in the case of a Premium Bond callable prior to its stated maturity, the amortization period and the yield may be required to be determined on the basis of an earlier call date that results in the lowest yield on such Premium Bond. A purchaser of a Premium Bond is required to decrease his or her adjusted basis in such Premium Bond by the amount of bond premium attributable to each taxable year in which such purchaser holds such Premium Bond. The amount of bond premium attributable to a taxable year is not deductible for federal income tax purposes; however, bond premium is treated as an offset to qualified stated interest on such Premium Bonds. Purchasers of Premium Bonds should consult their tax advisors with respect to the precise determination for federal income tax purposes of the amount of bond premium attributable to each taxable year and the effect of bond premium on the sale or other disposition of a Premium Bond, and with respect to the state and local tax consequences of owning and disposing of a Premium Bond.

ABSENCE OF LITIGATION

There is no action, suit or proceeding known to be pending or threatened, restraining or enjoining the execution or delivery of the Series 2006A Bonds or the Indenture or in any way contesting or affecting the validity of the foregoing or any proceedings of the City taken with respect to any of the foregoing. There is no action, suit or proceeding known to be pending or threatened, restraining or enjoining the City in any way which would have a material adverse effect on the Enterprise or the ability of the City to increase rates.

INDEPENDENT AUDITORS

The basic financial statements of the City as of June 30, 2005, portions of which are included in Appendix B to this Official Statement, have been audited by Maze & Associates (the “Auditor”), independent certified public accountants, as set forth in their report. The Auditor’s consent is not required for the inclusion of the City’s financial statements in this Official Statement, and no such consent has been requested or obtained.

RATINGS

Fitch Ratings (“Fitch”) and Standard & Poor’s Ratings Services (“S&P”) are expected to assign their ratings of “AAA” and “AAA”, respectively, to the Series 2006A Bonds with the understanding that upon delivery of the Series 2006A Bonds, the Bond Insurance Policy will be issued by Financial Security. In addition, both Fitch and S&P have assigned an underlying rating of “A+” to the Series 2006A Bonds. 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 Fitch Ratings, One State Street Plaza, New York, New York 10004 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 Series 2006A Bonds.

UNDERWRITING

The Series 2006A Bonds are being purchased by Citigroup (the “Underwriter”) at a price equal to the principal amount of the Series 2006A Bonds, less a net original issue discount of \$323,866.90, less an underwriting discount of \$88,247.69. The Underwriter will purchase all of the Series 2006A Bonds if any are purchased. The obligation of the Underwriter to make such purchase is subject to certain terms and conditions set forth in the purchase contract related to the Series 2006A Bonds. The purchase contract provides that the fees of the Underwriter’s counsel will be paid by the City and that the aforesaid underwriting discount has been reduced by the fees so paid.

FINANCIAL ADVISOR

The City has retained Public Financial Management, Inc., San Francisco, California, as financial advisor with respect to the issuance of the Series 2006A Bonds. Public Financial Management, Inc. is not obligated to undertake, and has not undertaken to make, an independent verification or to assume responsibility for the accuracy, completeness or fairness of the information contained in this Official Statement. Public Financial Management, Inc. is an independent advisory firm and is not engaged in the business of underwriting, trading or distributing municipal securities or other public securities.

APPROVAL OF LEGAL PROCEEDINGS

The validity of the Series 2006A Bonds and certain other legal matters are subject to the approving opinion of Sidley Austin LLP, San Francisco, California, Bond Counsel. A copy of the proposed form of the opinion of Bond Counsel is attached as Appendix D hereto. Bond Counsel has

undertaken no responsibility for the accuracy, completeness and fairness of this Official Statement. Certain legal matters will be passed upon for the Underwriter by Gibbs & Oliphant LLP, Oakland, California; for the City by the City Attorney and by Stradling Yocca Carlson & Rauth, a Professional Corporation, Newport Beach, California, Disclosure Counsel; for the Trustee by its General Counsel; and for the Series 2006A Bond Insurer by its General Counsel.

CONTINUING DISCLOSURE

The City has covenanted for the benefit of the owners of the Series 2006A Bonds to provide certain financial information and operating data 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. 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 and the Underwriter. 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, in 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 executed by the City in connection with its Refunding Revenue Certificates of Participation (1997), Water Utility System Refinancing Project. The five annual reports in question had not included certain data which the City believes (a) was not literally required to be included therein by the terms of the applicable Continuing Disclosure Agreement, (b) was not material or (c) could be calculated from data the City had included in such annual reports. Notwithstanding the City's beliefs in this regard, it included the data in question in the aforesaid supplements. Moreover, in rechecking its data in connection with the filing of the supplements, the City made certain additional revisions to the original information included in its original annual reports. In addition to the foregoing, the City has determined that its annual report with respect to the Enterprise for Fiscal Year ended June 30, 2005 erroneously included payments received in settlement of certain litigation in "Gross Revenues" for purposes of calculating debt service coverage. The City has indicated that it will correct that mistake with a supplement to the annual report.

MISCELLANEOUS

Reference is made herein to certain documents and reports which are brief summaries thereof which do not purport to be complete or definitive, and reference is made to such documents and complete statement of the contents thereof.

Any statements in this Official Statement involving matters of opinion, whether or not expressly so stated, are intended as such and not as representations of fact. This Official Statement is not to be construed as a contract or agreement between the City and the purchasers or holder of any Bonds.

The execution and delivery of this Official Statement has been duly authorized by the City Council of the City.

CITY OF MODESTO, CALIFORNIA

By: /s/ Wayne Padilla
Finance Director/Treasurer

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APPENDIX A

CERTAIN INFORMATION REGARDING THE CITY OF MODESTO

The following information with respect to the City is presented for information purposes only. The 2006A Bonds 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.

CITY OF MODESTO Population Estimates⁽¹⁾

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

⁽¹⁾ As of January 1.

Source: California State Department of Finance, for Historical City, County and State Population Estimates, 2001-2004 and for Population Estimates for Cities, Counties and State, 2005-2006.

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)

	<i>2005</i>	<i>2004</i>	<i>2003</i>	<i>2002</i>	<i>2001</i>
<u>Civilian Labor Force</u>					
Employment	210,800	204,600	201,500	198,900	196,500
Unemployment	19,000	20,700	22,000	21,200	17,900
Unemployment Rate	8.3%	9.2%	9.8%	9.6%	8.3%
<u>Wage and Salary Employment:</u>					
Total Farm	14,100	13,800	14,000	13,900	14,100
Natural Resources, Mining and Construction	13,300	12,300	11,400	10,700	11,000
Manufacturing	22,300	22,700	23,100	22,500	23,000
Wholesale Trade	6,200	6,000	5,700	5,600	5,400
Retail Trade	22,700	21,500	21,800	21,700	21,100
Transport., Warehousing, Utilities	5,200	4,700	4,600	4,500	4,300
Information	2,500	2,500	2,200	2,100	2,200
Financial Activities	6,200	6,100	6,000	5,600	5,400
Professional and Business Services	14,900	14,200	13,800	15,000	16,800
Educational and Health Services	19,500	19,200	18,900	18,100	17,100
Leisure and Hospitality	14,800	14,200	13,700	13,600	13,000
Other Services	6,100	6,200	6,200	6,200	5,900
Federal Government	1,200	1,200	1,200	1,200	1,200
State Government	1,700	1,700	1,900	1,900	1,800
Local Government	<u>22,700</u>	<u>22,100</u>	<u>21,900</u>	<u>22,200</u>	<u>21,600</u>
Total All Industries	173,300	168,500	166,300	164,600	163,800

Note: Totals may not add up because of rounding.

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

Major Employers

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

COUNTY OF STANISLAUS Twenty Largest Employers

<i>No.</i>	<i>Company Name</i>	<i>No. Employees</i>	<i>No.</i>	<i>Company Name</i>	<i>No. Employees</i>
1.	County of Stanislaus	4,704	11.	City of Modesto	1,660
2.	Modesto City Schools	3,500	12.	Foster Farms	1,592
3.	E&J Gallo Winery	3,280	13.	Emanuel Medical Center	1,329
4.	Memorial Medical Center	2,619	14.	Wal-Mart	1,200
5.	Del Monte Foods	2,600	15.	ConAgra	1,098
6.	Signature Fruit Company	2,321	16.	Save Mart Supermarkets	1,069
7.	Doctors Medical Center	2,312	17.	Ceres Unified School District	1,036
8.	Stanislaus Food Products	2,000	18.	Calif. State Univ. Stanislaus	921
9.	Turlock Unified Schools	1,922	19.	Verizon	900
10.	Modesto Junior College	1,866	20.	Sutter Gould Medical Found.	862

Source: Stanislaus Economic Development and Workforce Alliance, November, 2005.

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**

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

Source: Survey of Buying Power, Sales & Marketing Management Magazine, dated 2000, 2001, 2002, 2003 and 2004.

Commercial Activity

The following table shows the dollar volume of taxable transactions in the City of Modesto from 2001 through 2005.

CITY OF MODESTO
Taxable Transactions
Calendar Years 2001 through 2005
(in Thousands of Dollars)

Retail Outlets	2005	2004	2003	2002	2001
Apparel stores	\$ 168,064	\$ 147,849	\$126,372	\$129,773	\$112,847
General merchandise stores	549,742	539,780	518,024	507,438	499,333
Food stores	168,121	162,515	136,462	119,423	115,743
Eating and drinking places	272,313	259,861	245,609	235,337	219,205
Home furnishing and appliances	169,723	162,749	130,089	131,234	109,395
Bldg. materials and farm implements	316,796	288,841	204,427	188,388	188,459
Auto dealers and supplies	247,795	260,655	259,395	247,861	230,912
Service stations	146,946	126,608	115,317	101,551	106,229
Other retail stores	405,229	394,363	392,650	381,371	364,468
Subtotal	<u>2,444,729</u>	<u>2,343,221</u>	<u>2,128,345</u>	<u>2,042,376</u>	<u>1,946,591</u>
All Other Outlets	<u>309,659</u>	<u>311,646</u>	<u>433,387</u>	<u>372,899</u>	<u>367,760</u>
All Outlets	\$2,754,388	\$2,654,867	\$2,561,732	\$2,415,275	\$2,314,351

Source: State of California, Board of Equalization.

The following table shows the dollar volume of taxable transactions in the County of Stanislaus from 2000 through 2004.

COUNTY OF STANISLAUS
Taxable Transactions
Calendar Years 2000 through 2004
(in Thousands of Dollars)

Retail Outlets	2004	2003	2002	2001	2000
Apparel stores	\$192,858	\$154,867	\$154,083	\$127,711	\$115,339
General merchandise stores	846,742	803,255	784,431	754,247	702,326
Specialty stores	501,694	465,562	432,777	411,996	390,154
Food stores	291,867	282,781	260,781	255,923	237,565
Eating and drinking places	452,120	421,793	403,421	378,985	342,807
Household	198,691	187,214	181,384	153,417	146,043
Building materials	508,825	416,983	368,472	360,337	303,139
Automotive	1,396,277	1,305,986	1,248,936	1,244,939	1,102,803
Other retail stores	<u>331,376</u>	<u>297,729</u>	<u>273,693</u>	<u>249,876</u>	<u>243,819</u>
Subtotal	<u>4,720,450</u>	<u>4,336,170</u>	<u>4,107,978</u>	<u>3,937,431</u>	<u>3,583,995</u>
Business and Personal Services	240,245	224,429	233,862	214,161	208,118
All Other Outlets	<u>\$1,804,973</u>	<u>\$1,614,893</u>	<u>\$1,494,025</u>	<u>\$1,421,077</u>	<u>\$1,402,941</u>
All Outlets	\$6,765,668	\$6,175,492	\$5,825,865	\$5,572,669	\$5,195,054

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. Multi-family 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

	<i>2001</i>	<i>2002</i>	<i>2003</i>	<i>2004</i>	<i>2005</i>
Permit Valuation					
New Single-family	\$246,315,272	\$216,245,472	\$169,003,473	\$69,473,535	\$165,909,336
New Multi-family	3,276,142	1,719,426	6,087,705	20,721,736	1,719,478
Res. Alterations & Additions	7,410,525	9,062,856	9,793,040	15,707,552	17,947,953
Total Residential	\$257,001,939	\$227,027,754	\$184,884,218	\$105,902,823	\$185,576,767
New Commercial	29,067,329	20,306,197	30,255,734	35,298,696	62,592,553
New Industrial	2,967,560	6,580,320	1,183,692	2,003,992	0
New Other	23,022,963	19,899,918	26,649,779	61,628,516	32,919,890
Non-Res. Alterations & Additions	30,662,702	32,507,506	24,933,722	25,524,261	19,914,523
Total Nonresidential	85,720,554	79,293,941	83,022,927	124,455,465	115,426,966
Total All Building	\$342,722,493	\$306,321,695	\$267,907,145	\$230,358,288	\$301,003,773
New Dwelling Units					
Single Family	1,232	1,067	1,105	348	872
Multiple Family	30	21	78	297	9
Total	1,262	1,088	1,183	645	881

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

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

Source: Stanislaus County Department of Agriculture.

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APPENDIX B

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 Wastewater Enterprise.

CITY OF MODESTO
STATEMENT OF NET ASSETS - PROPRIETARY FUNDS
June 30, 2005

	<u>Water</u>	<u>Sewer</u>	<u>Enterprise Other Enterprise</u>	<u>Total Enterprise</u>	<u>Internal Service</u>
ASSETS					
Current assets:					
Cash and cash equivalents	\$ 11,392,092	\$ 18,567,796	\$ 6,616,346	\$ 36,576,234	\$ 42,889,298
Cash and cash equivalents with fiscal agent	263,978	4,010,327	606,895	4,881,200	
Receivables:					
Accounts		167,761	216,481	384,242	346,802
Interest	82,656	174,258	66,590	323,504	149,157
Utilities, net	4,289,320	2,367,136	548,874	7,205,330	
Taxes	3,371		202	3,573	
Due from governments		127,064	1,433,934	1,560,998	
Prepaid expenses	941,175			941,175	
Inventories					375,519
Property held for resale			630,000	630,000	
Advances to other funds					<u>2,000,000</u>
Total current assets	<u>16,972,592</u>	<u>25,414,342</u>	<u>10,119,322</u>	<u>52,506,256</u>	<u>45,760,776</u>
Noncurrent assets:					
Notes receivable, net					3,096
Restricted assets-cash and cash equivalents	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	47,152,054	821,033
Other capital assets, net of accumulated depreciation	<u>66,585,561</u>	<u>106,970,689</u>	<u>61,044,600</u>	<u>234,600,850</u>	<u>17,530,499</u>
Total assets	<u>90,125,605</u>	<u>157,910,675</u>	<u>87,928,600</u>	<u>335,964,880</u>	<u>64,115,404</u>
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					125,000
Interest payable	285,989	344,200	52,568	682,757	
Current portion - compensated absences					2,218,476
Current portion - claims liability					4,831,901
Current portion - long-term debt	931,562	1,057,899	195,000	2,184,461	45,587
Current portion - developer advances	97,533			97,533	
Deferred revenues			<u>2,214,408</u>	<u>2,214,408</u>	
Total current liabilities	<u>1,952,103</u>	<u>2,070,347</u>	<u>3,329,964</u>	<u>7,352,414</u>	<u>8,468,397</u>
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		36,697,428	
Loan payable	2,156,040			2,156,040	
Notes payable					171,034
Obligations under capital leases		222,588		222,588	
Certificates of participation	18,668,167		5,855,000	24,523,167	
Developer advances	<u>2,182,336</u>			<u>2,182,336</u>	
Total liabilities	<u>25,459,905</u>	<u>39,305,595</u>	<u>9,184,964</u>	<u>73,950,464</u>	<u>77,991,160</u>
NET ASSETS					
Invested in capital assets, net of related debt	50,641,533	93,568,409	72,348,208	216,558,150	18,134,911
Restricted for capital projects					
Unrestricted	<u>14,024,167</u>	<u>25,036,671</u>	<u>6,395,428</u>	<u>45,456,266</u>	<u>(32,010,667)</u>
Total net assets	<u>\$ 64,665,700</u>	<u>\$118,605,080</u>	<u>\$ 78,743,636</u>	<u>262,014,416</u>	<u>\$(13,875,756)</u>
Adjustment to reflect the consolidation of internal service fund activities related to enterprise funds.				<u>92,547</u>	
Net assets of business-type activities				<u>\$262,106,963</u>	

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

	Water	Enterprise		Total Enterprise	Internal Service
		Sewer	Other Enterprise		
OPERATING REVENUES:					
Charges for services	\$ 31,315,920	\$ 24,419,607	\$ 11,233,197	\$ 66,968,724	\$ 67,256,696
Sales					3,034,646
Cost of sales					(2,768,263)
Miscellaneous			<u>281,711</u>	<u>281,711</u>	
Total operating revenues	<u>31,315,920</u>	<u>24,419,607</u>	<u>11,514,908</u>	<u>67,250,435</u>	<u>67,523,079</u>
OPERATING EXPENSES:					
Salaries and wages	3,881,015	5,040,630	3,274,602	12,196,247	7,405,247
Contractual services	1,728,962	2,263,834	10,114,453	14,107,24	1,357,225
Utilities	1,599,480	1,022,165	450,616	3,072,261	458,504
Maintenance and supplies	3,400,721	3,673,065	3,077,930	10,151,716	3,728,462
Water purchases	11,751,150			11,751,150	
Insurance	118,168	298,075	172,803	589,046	10,636,951
Claims expense					2,874,266
Employee benefits	1,149,167	1,553,764	890,905	3,593,836	36,793,595
Administration services	2,177,564	1,527,098	1,446,026	5,150,688	1,396,936
Allocated indirect administrative costs	1,049,489	760,932	684,216	2,494,637	264,010
Other	65,796	115,567	172,237	353,600	155,570
Depreciation	<u>2,305,953</u>	<u>5,092,264</u>	<u>3,532,687</u>	<u>10,930,904</u>	<u>2,578,355</u>
Total operating expenses	<u>29,227,465</u>	<u>21,347,394</u>	<u>23,816,475</u>	<u>74,391,334</u>	<u>67,649,121</u>
OPERATING INCOME (LOSS)	<u>2,088,455</u>	<u>3,072,213</u>	<u>(12,301,567)</u>	<u>(7,140,899)</u>	<u>(126,042)</u>
NONOPERATING REVENUES (EXPENSES)					
Operating grants			7,525,367	7,525,367	
Gain (Loss) on disposition of capital assets	(402,627)	(198,137)	(202,180)	(802,944)	(168,965)
Tax revenue			260,064	260,064	
Tax expense	(82,673)	(90,117)	(20,942)	(193,732)	
Interest income	247,831	545,734	221,798	1,015,363	577,126
Net decrease in fair value of investments	24,553	29,961	15,473	69,987	56,239
Rental income	31,785	24,158	678,577	734,520	
Settlements and recoveries	2,960,781	4,435,846		7,396,627	
Interest expense	(1,251,395)	(1,182,467)	(318,612)	(2,752,474)	(15,672)
Amortization of costs of issuance	<u>(13,839)</u>			<u>(13,839)</u>	
Total nonoperating revenues (expenses)	<u>1,514,416</u>	<u>3,564,978</u>	<u>8,159,545</u>	<u>13,238,939</u>	<u>448,728</u>
INCOME (LOSS) BEFORE CAPITAL CONTRIBUTIONS AND TRANSFERS	3,602,871	6,637,191	(4,142,022)	6,098,040	322,686
Capital contributions	2,378,331	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	<u>(898,505)</u>	<u>(1,040,101)</u>		<u>(1,938,606)</u>	
CHANGE IN NET ASSETS	5,381,670	7,432,830	1,150,256	13,964,756	1,404,961
NET ASSETS, July 1	<u>59,284,030</u>	<u>111,172,250</u>	<u>77,593,380</u>		<u>(15,280,717)</u>
NET ASSETS, June 30	<u>\$ 64,665,700</u>	<u>\$118,605,080</u>	<u>\$ 78,743,636</u>		<u>\$ (13,875,756)</u>
Adjustment to reflect the consolidation of internal service fund activities related to enterprise funds.				<u>882,187</u>	
Change in net assets of business-type activities				<u>\$ 14,846,943</u>	

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

	<u>Water</u>	<u>Sewer</u>	<u>Enterprise Other Enterprise</u>	<u>Total Enterprise</u>	<u>Internal Service</u>
CASH FLOWS FROM OPERATING ACTIVITIES:					
Receipts from customers and users	\$ 29,713,475	\$24,682,311	\$ 12,152,712	\$ 66,548,498	\$ 261,741
Receipts from interfund services provided	608,112	111,231	23,607	742,950	67,227,001
Payments to suppliers	(18,484,455)	(6,917,285)	(12,768,257)	(38,169,997)	(16,134,081)
Payment of insurance claims					(5,001,771)
Payments to employees	(5,011,327)	(6,568,579)	(4,150,754)	(15,730,660)	(38,390,175)
Payments for interfund services used	<u>(5,212,937)</u>	<u>(4,221,944)</u>	<u>(3,477,582)</u>	<u>(12,912,463)</u>	<u>(2,164,113)</u>
Net cash provided (used) by operating activities	<u>1,612,868</u>	<u>7,085,734</u>	<u>(8,220,274)</u>	<u>478,328</u>	<u>5,798,602</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:					
Operating grants received			6,564,032	6,564,032	
Taxes received			260,064	260,064	
Settlements and recoveries	2,960,781	4,435,846		7,396,627	
Transfers in	528,000	327,119	846,136	1,701,255	475,000
Transfers out	<u>(229,027)</u>	<u>(134,795)</u>	<u>(30,519)</u>	<u>(394,341)</u>	<u>(99,419)</u>
Net cash provided (used) by noncapital financing activities	<u>3,259,754</u>	<u>4,628,170</u>	<u>7,639,713</u>	<u>15,527,637</u>	<u>375,581</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:					
Acquisition and construction of capital assets	(5,231,056)	(2,669,890)	(2,168,965)	(10,069,911)	(1,527,579)
Proceeds of refunding revenue bonds		39,235,000		39,235,000	
Bond premium		2,300,405		2,300,405	
Payment to refunded bond escrow account		(42,988,215)		(42,988,215)	
Costs of issuance		(559,409)		(559,409)	
Proceeds of capital lease		290,487		290,487	
Principal repayments	(994,636)	(1,265,000)	(185,000)	(2,444,636)	(48,458)
Interest paid	(1,163,784)	(1,157,873)	(320,215)	(2,641,872)	(15,672)
Capital grants received			850,082	850,082	
Connection fees for capital purposes	<u>1,379,725</u>	<u>711,801</u>		<u>2,091,526</u>	
Net cash used by capital and related financing	<u>(6,009,751)</u>	<u>(6,102,694)</u>	<u>(1,824,098)</u>	<u>(13,936,543)</u>	<u>(1,591,709)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:					
Interest received	216,322	495,955	196,088	908,365	527,026
Net increase in the fair value of investments	<u>24,553</u>	<u>29,961</u>	<u>15,474</u>	<u>69,988</u>	<u>56,239</u>
Net cash provided by investing activities	<u>240,875</u>	<u>525,916</u>	<u>211,562</u>	<u>978,353</u>	<u>583,265</u>
Net increase (decrease) in cash and cash equivalents	(896,254)	6,137,126	(2,193,097)	3,047,775	5,145,739
CASH AND CASH EQUIVALENTS, JULY 1	<u>13,053,583</u>	<u>16,756,22</u>	<u>9,416,338</u>	<u>39,226,15</u>	<u>37,743,559</u>
CASH AND CASH EQUIVALENTS, JUNE 30	<u>\$ 12,157,329</u>	<u>\$ 22,893,355</u>	<u>\$ 7,223,241</u>	<u>\$ 42,273,925</u>	<u>\$ 42,889,298</u>
RECONCILIATION TO STATEMENT OF NET ASSETS:					
Cash and cash equivalents	\$ 11,392,092	\$ 18,567,796	\$ 6,616,346	\$ 36,576,234	\$ 42,889,298
Cash and cash equivalents with fiscal agent	263,978	4,010,327	606,895	4,881,200	
Restricted assets-cash and cash equivalents	<u>501,259</u>	<u>315,232</u>		<u>816,491</u>	
TOTAL CASH AND CASH EQUIVALENTS	<u>\$ 12,157,329</u>	<u>\$ 22,893,355</u>	<u>\$ 7,223,241</u>	<u>\$ 42,273,925</u>	<u>\$ 42,889,298</u>

(continued)

	<u>Water</u>	Enterprise <u>Sewer</u>	<u>Other Enterprise</u>	<u>Total Enterprise</u>	<u>Internal Service</u>
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES:					
Operating income (loss)	\$ 2,088,455	\$ 3,072,213	\$ (12,301,567)	\$ (7,140,899)	\$ (126,042)
Adjustments to reconcile operating income (loss) to net cash provided (used) by operating activities:					
Depreciation	2,305,953	5,092,264	3,532,687	10,930,904	2,578,355
Rental income	31,785	24,158	678,577	734,520	
Taxes paid	(82,673)	(90,117)	(19,252)	(192,042)	
Special item	(898,505)	(1,040,101)		(1,938,606)	
Change in assets and liabilities:					
(Increase) in accounts receivable	963	403,291	(75,154)	329,100	(34,495)
(Increase) in utilities receivable	(1,024,978)	(63,690)	(71,992)	(1,160,660)	
(Increase) in taxes receivable	(1,391)			(1,391)	
Decrease in notes receivable					28,863
(Increase) in prepaid expenses	(544,385)			(544,385)	
(Increase) in inventories					(44,404)
(Decrease) in accounts payable and accrued expenses	(280,499)	(348,275)	(106,616)	(735,390)	(255,974)
Increase in accrued salaries and benefits	18,855	25,815	14,753	59,423	19,221
Increase in compensated absences					5,760,583
(Decrease) in claims liability					(2,127,505)
Increase in deferred revenues			128,290	128,290	
Increase (decrease) in refundable deposits	(712)	10,176		9,464	
Total adjustments	<u>(475,587)</u>	<u>4,013,521</u>	<u>4,081,293</u>	<u>7,619,227</u>	<u>5,924,644</u>
Net cash provided (used) by operating activities	<u>\$ 1,612,868</u>	<u>\$ 7,085,734</u>	<u>\$ (8,220,274)</u>	<u>\$ 478,328</u>	<u>\$ 5,798,602</u>
NONCASH INVESTING, CAPITAL AND FINANCING ACTIVITIES:					
Capital asset additions accrued at year end	\$ 20,700		\$ 5,521	\$ 26,221	
Capital assets transferred in		\$ 39,851	3,140,901	3,180,752	\$ 706,694
Developer infrastructure contributions	998,606	891,764	673,936	2,564,306	

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

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APPENDIX C

SUMMARY OF CERTAIN PROVISIONS OF THE INDENTURE

The following is a brief summary of certain provisions of the Indenture. This summary does not purport to be complete or definitive and is qualified in its entirety by reference to the full terms of the Indenture. Reference is directed to the Indenture for the complete text thereof. Copies of the Indenture are available from the City Clerk/Auditor of the City of Modesto.

Definitions

“Accreted Value” means, with respect to any Capital Appreciation Indebtedness, the principal amount thereof plus the interest accrued thereon, compounded at the interest rate thereon on each date as specified therein.

“Annual Debt Service” means, for any Fiscal Year, the aggregate amount of principal and interest on all Bonds and Parity Debt becoming due and payable during such Fiscal Year calculated using the principles and assumptions set forth under the definition of Debt Service.

“Average Annual Debt Service” means, as of any date of calculation, an amount equal to (i) the Annual Debt Service remaining to be paid on all Bonds and Parity Debt on the date of calculation, divided by (ii) the number of Fiscal Years (or partial years) commencing with the Fiscal Year of the date of calculation to and including the Fiscal Year which includes the first date on which none of such Bonds or Parity Debt remains Outstanding. Such interest and principal will be calculated on the assumption that no Bonds or Parity Debt at the date of calculation will cease to be Outstanding except by reason of the payment when due of each principal installment (including mandatory sinking account payments).

“Balloon Indebtedness” means any Series of Bonds or Parity Debt 50% or more of the principal of which matures or is payable on the same date and which is not required by the instrument pursuant to which such Bonds or Parity Debt were issued to be amortized by payment or redemption prior to such date.

“Bond Obligation” means, as of any given date of calculation, (1) with respect to any Current Interest Indebtedness, the principal amount thereof, and (2) with respect to any Capital Appreciation Indebtedness, the Accreted Value thereof.

“Bonds” means the City of Modesto, California Wastewater Revenue Bonds authorized by, and at any time Outstanding pursuant to, the Indenture.

“Business Day” means any day other than (1) a Saturday, Sunday, or a day on which banking institutions in the State or the State of New York are authorized or obligated by law or executive order to be closed, and (2) for purposes of payments and other actions relating to Bonds secured by a letter of credit, a day upon which commercial banks in the city in which is located the office of the issuing bank at which demands for payment under the letter of credit are to be presented are authorized or obligated by law or executive order to be closed.

“Capital Appreciation Indebtedness” means Bonds and Parity Debt on which interest is compounded and paid less frequently than annually.

“**Certificate,**” “**Statement,**” “**Request,**” “**Requisition**” or “**Order**” of the City mean, respectively, a written certificate, statement, request, requisition or order signed in the name of the City by its City Manager, Finance Director or any other person authorized by the City Manager or Finance Director to execute such instruments. Any such instrument and supporting opinions or representations, if any, may, but need not, be combined in a single instrument with any other instrument, opinion or representation, and the two or more so combined will be read and construed as a single instrument. If and to the extent required by the Indenture, certificates and opinions will include the statements provided for in the Indenture.

“**City**” means the City of Modesto, California.

“**City Council**” means the City Council of the City or any other legislative body of the City hereafter provided for pursuant to law.

“**Code**” means the Internal Revenue Code of 1986, and the regulations issued thereunder, as the same may be amended from time to time, and any successor provisions of law. Reference to a particular section of the Code will be deemed to be a reference to any successor to any such section.

“**Continuing Disclosure Agreement**” means any Continuing Disclosure Agreement executed and delivered by the City relating to any Series of Bonds.

“**Corporate Trust Office**” or “**corporate trust office**” means the corporate trust office of the Trustee at One California Street, Suite 2550, San Francisco, California 94111, Attention: Corporate Trust Services, or such other or additional offices as may be designated by the Trustee.

“**Current Interest Indebtedness**” means Bonds and Parity Debt on which interest is paid at least annually.

“**Debt Service**” means, during any period of computation, the amount of principal and interest becoming due and payable on all Bonds and Parity Debt for such period, determined by totaling the following amounts:

(a) The Bond Obligation of all Outstanding Serial Bonds and all Parity Debt coming due and payable by their terms in such period;

(b) The minimum Bond Obligation of all Outstanding Term Bonds and all Parity Debt scheduled to be redeemed by operation of mandatory sinking fund deposits in such period, together with any premium thereon; and

(c) The interest which would be due during such period on the aggregate principal amount of Bonds and Parity Debt which would be Outstanding in such period if the Bonds or Parity Debt are retired as scheduled, but deducting and excluding from such aggregate amount the amount of Bonds or Parity Debt no longer Outstanding;

provided, that for the purposes of determining compliance with the requirements for issuance of additional Bonds or Parity Debt, the rate covenant contained in the Indenture and the amount of the Reserve Fund Requirement, the following provisions apply:

(i) Generally. Except as otherwise provided in subparagraph (ii) below with respect to Variable Interest Rate Indebtedness, in subparagraph (iii) below with

respect to Bonds or Parity Debt with respect to which a Public Finance Contract is in force, and in subparagraph (iv) below with respect to Balloon Indebtedness, interest on any Bond or Parity Debt will be calculated based on the actual amount of interest that is payable under such Bond or Parity Debt;

(ii) Interest on Variable Interest Rate Indebtedness. Interest deemed to be payable on any Variable Interest Rate Indebtedness for periods when the actual interest rate can be determined will be the actual Variable Interest Rates and for periods when the actual interest rate cannot yet be determined will be calculated on the assumption that the interest rate on such Variable Interest Rate Indebtedness would be equal to (a) the average rate that accrued on such Variable Interest Rate Indebtedness over the preceding twelve (12) months, or (b) if the Variable Interest Rate Indebtedness has not been accruing interest at a variable rate for twelve (12) months, the average interest rate that accrued on any outstanding Variable Interest Rate Indebtedness for which interest is computed on substantially the same basis during the preceding twelve (12) month period, or (c) if no such comparable Variable Interest Rate Indebtedness was outstanding during the twelve (12) months preceding the date of calculation, then (x) if the interest on such Variable Interest Rate Indebtedness is excluded from gross income for purposes of Federal income taxation, 90% of the average rate of interest for The Bond Buyer Revenue Bond Index over the preceding twelve (12) months, or, if that index is no longer published, an interest rate equal to 80% of the yield for outstanding United States Treasury bonds having an equivalent maturity as the Variable Rate Interest Indebtedness, or if there are no such Treasury Bonds having equivalent maturities, 80% of the lowest prevailing prime rate of any of the five largest commercial banks in the United States, ranked by assets, and (y) if interest on such Variable Interest Rate Indebtedness is not excluded from gross income for purposes of Federal income taxation, 110% of the yield for outstanding United States Treasury bonds having an equivalent maturity as the Variable Rate Interest Indebtedness, or if there are no such United States Treasury Bonds having equivalent maturities, 110% of the lowest prevailing prime rate of any of the five largest commercial banks in the United States, ranked by assets;

(iii) Interest on Bonds or Parity Debt with respect to which a Public Finance Contract is in force. Interest deemed to be payable on any Bonds or Parity Debt with respect to which a Public Finance Contract is in force will be based on the net economic effect on the City expected to be produced by the terms of such Bonds or Parity Debt and such Public Finance Contract, including but not limited to the effects that (a) such Bonds or Parity Debt would, but for such Public Finance Contract, be treated as an obligation bearing interest at a Variable Interest Rate instead will be treated as an obligation bearing interest at a fixed interest rate, and (b) such Bonds or Parity Debt would, but for such Public Finance Contract, be treated as an obligation bearing interest at a fixed interest rate instead will be treated as an obligation bearing interest at a Variable Interest Rate; and accordingly, the amount of interest deemed to be payable on any Bonds or Parity Debt with respect to which a Public Finance Contract is in force will be an amount equal to the amount of interest that would be payable at the rate or rates stated in such Bonds or Parity Debt plus the Public Finance Contract Payments minus the Public Finance Contract Receipts, and for the purpose of calculating as nearly as practicable the Public Finance Contract

Receipts and the Public Finance Contract Payments under such Bonds or Parity Debt, the following assumptions will be made:

(1) City Obligated to Pay Net Variable Payments. If a Public Finance Contract has been entered into by the City with respect to Bonds or Parity Debt resulting in the payment of a net variable interest rate with respect to such Bonds or Parity Debt and Public Finance Contract by the City, the interest rate on such Bonds or Parity Debt for future periods when the actual interest rate cannot yet be determined will be assumed (but only during the period the Public Finance Contract is in effect) to be equal to the sum of (x) the fixed rate or rates stated in such Bonds or Parity Debt, minus (y) the fixed rate paid by the Qualified Counterparty to the City, plus (z) the lesser of (A) the interest rate cap, if any, provided by a Qualified Counterparty with respect to such Public Finance Contract (but only during the period that such interest rate cap is in effect) and (B) the applicable Variable Interest Rate calculated in accordance with subparagraph (ii) above; and

(2) City Obligated to Pay Net Fixed Payments. If a Public Finance Contract has been entered into by the City with respect to Bonds or Parity Debt resulting in the payment of a net fixed interest rate with respect to such Bonds or Parity Debt and Public Finance Contract by the City, the interest on such Bonds or Parity Debt will be included in the calculation of Debt Service (but only during the period the Public Finance Contract is in effect) by including for each Fiscal Year or twelve (12) calendar month period an amount equal to the amount of interest payable at the fixed interest rate pursuant to such Public Finance Contract;

(iv) Interest on Balloon Indebtedness. If any outstanding Bonds or Parity Debt constitute Balloon Indebtedness (and such Bonds or Parity Debt do not constitute Short Term Indebtedness excluded from the calculation of the Debt Service pursuant to clause (v), below) or if Bonds or Parity Debt proposed to be incurred would constitute Balloon Indebtedness (and such Bonds or Parity Debt would not constitute Short Term Indebtedness excluded from the calculation of the Debt Service pursuant to clause (v), below), then such Balloon Indebtedness will be treated as if the principal amount of such Bonds or Parity Debt were amortized from the date originally incurred in substantially equal installments of principal and interest over a term of thirty (30) years; provided, however, that the full principal amount of such Balloon Indebtedness will be included in making such calculation if such principal amount is due within ninety (90) days of the date such calculation is being made); and, if interest accrues under such Balloon Indebtedness at other than a fixed rate, the interest rate used for such computation will be (x) if the interest on such Bonds or Parity Debt is excluded from gross income for purposes of Federal income taxation, 90% of the average rate of interest for The Bond Buyer Revenue Bond Index over the preceding twelve (12) months, or if that index is no longer published, an interest rate equal to 80% of the yield for outstanding United States Treasury bonds having an equivalent maturity as the Bonds or Parity Debt on the date incurred, or if there are no such United States Treasury bonds having equivalent maturities, 80% of the lowest prevailing prime rate of any of the five largest commercial banks in the United States, ranked by assets, and (y) if the interest on such Bonds or Parity Debt is not

excluded from gross income for purposes of Federal income taxation, the rate equal to 110% of the yield for outstanding United States Treasury bonds having an equivalent maturity as the Balloon Indebtedness, or, if there are no such United States Treasury Bonds having equivalent maturities, 110% of the lowest prevailing prime rate of any of the five largest commercial banks in the United States, ranked by assets;

(v) Exclusion of Certain Short-Term Indebtedness. If any outstanding Bonds or Parity Debt constitute Short Term Indebtedness or if the Bonds or Parity Debt proposed to be issued would constitute Short Term Indebtedness, and such Short Term Indebtedness are or will be payable only out of Net Revenues of the Fiscal Year in which such Short Term Indebtedness are incurred, then such Short Term Indebtedness will be disregarded and not included in calculating Debt Service;

(vi) Credit for Accrued and Capitalized Interest. If amounts constituting accrued interest or capitalized interest have been deposited with a trustee for such Bonds or Parity Debt, then the interest payable from such amounts with respect to such Bonds or Parity Debt will be disregarded and not included in calculating Debt Service.

“Defeasance Securities” means any of the following:

(i) any bonds or other obligations which as to principal and interest constitute direct obligations of the United States of America;

(ii) any certificates, receipts, securities or other obligations evidencing ownership of, or the right to receive, a specified portion of one or more interest payments or principal payments, or any combination thereof, to be made on any bond, note, or other obligation described above in clause (i) held by a bank or trust company as custodian, under which the owner thereof is the real party in interest and has the right to proceed directly and individually against the obligor and the underlying bonds or other obligations which as to principal and interest constitute direct obligations of the United States of America are not available to any person claiming through the custodian or to whom the custodian may be obligated; or

(iii) any bonds or other obligations of any state of the United States of America or any political subdivision thereof (a) which are not callable prior to maturity or as to which irrevocable instructions have been given to the trustee of such bonds or other obligations by the obligor to give due notice of redemption and to call such bonds for redemption on the date or dates specified in such instructions, (b) which are secured as to principal and interest and redemption premium, if any, by a fund consisting only of cash or bonds or other obligations of the character described above in clause (i) or (ii) which fund may be applied only to the payment of such principal of and interest and redemption premium, if any, on such bonds or other obligations on the interest payment dates and the maturity date or dates thereof or the specified redemption date or dates pursuant to such irrevocable instructions, as appropriate, (c) as to which the principal of and interest on the bonds and obligations of the character described above in clause (i) or (ii) which have been deposited in such fund along with any cash on deposit in such fund are sufficient to pay the principal of and interest and redemption premium, if any, on the bonds or other obligations described in this clause (iii) on

the interest payment dates and the maturity date or dates thereof or on the redemption date or dates specified in the irrevocable instructions referred to in subclause (a) of this clause (iii), as appropriate, and (d) which have been rated “AAA” by Standard & Poor’s and “Aaa” by Moody’s or which are eligible to be rated “AAA” by Standard & Poor’s under the then existing defeasance criteria of Standard & Poor’s;

“**Enterprise**” means any and all facilities of the City for the disposal or reuse of wastewater, including sewage treatment plants, intercepting and collecting sewers, outfall sewers, force mains, pumping stations, ejector stations, pipes, valves, machinery and all other appurtenances necessary, useful or convenient for the collection, treatment, purification or disposal of sewage and any necessary lands, rights of way and other real or personal property useful in connection therewith. The term “Enterprise” does not include, however, facilities relating to the production, distribution and use of methane gas.

“**Event of Default**” means any of the events specified as such in the Indenture as described under the caption “Events of Default” below.

“**Fiscal Year**” means the period beginning on July 1 of each year and ending on the next succeeding June 30, or any other twelve-month period hereafter selected and designated as the official fiscal year period of the City which designation will be provided to the Trustee in a Certificate of the City.

“**Gross Revenues**” means all gross income and revenue received by the City from the ownership and operation of the Enterprise, including (a) all fees and charges received by the City for the services of the Enterprise, (b) all other income and revenue howsoever derived by the City from the ownership and operation of the Enterprise or arising from the Enterprise, and (c) all sums deposited, or required under the Indenture to be deposited, in the Sewer Enterprise Fund; but excluding (x) the proceeds of any ad valorem property taxes received by the City to pay debt service on any outstanding obligations of the City, (y) any contributed capital (other than connection fees), and (z) any moneys received by the City as a result of litigation arising out of perchloroethylene (PCE) contamination that are to be expended on capital costs of the Enterprise.

“**Indenture**” means the Wastewater Revenue Bond Indenture, dated as of April 1, 2005, by and between the City and the Trustee, as originally executed and as it may from time to time be supplemented or amended by any Supplemental Indenture delivered pursuant to the provisions of the Indenture.

“**Independent Accountant**” means any accountant or firm of such accountants appointed and paid by the City, and who, or each of whom-

- (a) is in fact independent and not under domination of the City;
- (b) does not have any substantial interest, direct or indirect, with the City; and
- (c) is not connected with the City as an officer or employee of the City, but who may be regularly retained to make annual or other audits of the books of or reports to the City.

“**Interest Fund**” means the fund by that name established with the Trustee pursuant to the Indenture.

“**Investment Securities**” means the following:

(i) any bonds or other obligations which as to principal and interest constitute direct obligations of, or are unconditionally guaranteed by, the United States of America, including obligations of any of the federal agencies and federally sponsored entities set forth in clause (iii) below to the extent unconditionally guaranteed by the United States of America;

(ii) any certificates, receipts, securities or other obligations evidencing ownership of, or the right to receive, a specified portion of one or more interest payments or principal payments, or any combination thereof, to be made on any bond, note, or other obligation described above in clause (i);

(iii) obligations of the Federal National Mortgage Association, the Government National Mortgage Association, Federal Home Loan Banks, and Federal Home Loan Mortgage Corporation;

(iv) obligations of any state, territory or commonwealth of the United States of America or any political subdivision thereof or any agency or department of the foregoing; provided that at the time of their purchase such obligations are rated not lower than their respective ratings on the Bonds by Moody’s (if Moody’s is then rating the Bonds) and Standard & Poor’s (if Standard & Poor’s is then rating the Bonds);

(v) any bonds or other obligations of any state of the United States of America or any political subdivision thereof (a) which are not callable prior to maturity or as to which irrevocable instructions have been given to the trustee of such bonds or other obligations by the obligor to give due notice of redemption and to call such bonds for redemption on the date or dates specified in such instructions, (b) which are secured as to principal and interest and redemption premium, if any, by a fund consisting only of cash or bonds or other obligations of the character described above in clause (i), (ii) or (iii) which fund may be applied only to the payment of such principal of and interest and redemption premium, if any, on such bonds or other obligations on the interest payment dates and the maturity date or dates thereof or the specified redemption date or dates pursuant to such irrevocable instructions, as appropriate, (c) as to which the principal of and interest on the bonds and obligations of the character described above in clause (i), (ii) or (iii) which have been deposited in such fund along with any cash on deposit in such fund are sufficient to pay the principal of and interest and redemption premium, if any, on the bonds or other obligations described in this clause (v) on the interest payment dates and the maturity date or dates thereof or on the redemption date or dates specified in the irrevocable instructions referred to in subclause (a) of this clause (v), as appropriate, and (d) which have been rated not lower than their respective ratings on the Bonds by Moody’s (if Moody’s is then rating the Bonds) and Standard & Poor’s (if Standard & Poor’s is then rating the Bonds);

(vi) bonds, notes, debentures or other evidences of indebtedness issued or guaranteed by any corporation which are, at the time of purchase, rated by Moody’s (if Moody’s is then rating the Bonds) and Standard & Poor’s (if Standard & Poor’s is then rating

the Bonds) in their respective highest short-term Rating Categories, or, if the term of such indebtedness is longer than three (3) years, rated not lower than their respective ratings on the Bonds by Moody's (if Moody's is then rating the Bonds) and Standard & Poor's (if Standard & Poor's is then rating the Bonds);

(vii) demand or time deposits or certificates of deposit, whether negotiable or nonnegotiable, issued by any bank or trust company organized under the laws of any state of the United States of America or any national banking association (including the Trustee), provided that such certificates of deposit will be purchased directly from such a bank, trust company or national banking association and will be either (1) continuously and fully insured by the Federal Deposit Insurance Corporation, or (2) continuously and fully secured by such securities and obligations as are described above in clauses (i) through (iv), inclusive, which will have a market value (exclusive of accrued interest) at all times at least equal to the principal amount of such certificates of deposit and will be lodged with the Trustee, as custodian, by the bank, trust company or national banking association issuing such certificates of deposit, and the bank, trust company or national banking association issuing each such certificate of deposit required to be so secured will furnish the Trustee with an undertaking satisfactory to it that the aggregate market value of all such obligations securing each such certificate of deposit will at all times be an amount equal to the principal amount of each such certificate of deposit and the Trustee will be entitled to rely on each such undertaking;

(viii) taxable commercial paper or tax-exempt commercial paper, rated in their respective highest Rating Categories by Moody's (if Moody's is then rating the Bonds) and Standard & Poor's (if Standard & Poor's is then rating the Bonds);

(ix) variable rate obligations required to be redeemed or purchased by the obligor or its agent or designee upon demand of the holder thereof secured as to such redemption or purchase requirement by a liquidity agreement with a corporation and as to the payment of interest and principal either upon maturity or redemption (other than upon demand by the holder thereof) thereof by an unconditional credit facility of a corporation provided that the variable rate obligations themselves are rated in their respective highest Rating Categories for its short-term rating, if any, and not lower than their respective ratings on the Bonds for its long-term rating, if any, by Moody's (if Moody's is then rating the Bonds) and Standard & Poor's (if Standard & Poor's is then rating the Bonds), and that the corporations providing the liquidity agreement and credit facility have, at the date of acquisition of the variable rate obligation by the Trustee, an outstanding issue of unsecured, uninsured and unguaranteed debt obligations rated not lower than their respective ratings on the Bonds by Moody's (if Moody's is then rating the Bonds) and Standard & Poor's (if Standard & Poor's is then rating the Bonds);

(x) any repurchase agreement with any bank or trust company organized under the laws of any state of the United States or any national banking association (including the Trustee) having a minimum permanent capital of one hundred million dollars (\$100,000,000) and with short-term debt rated by Moody's (if Moody's is then rating the Bonds) and Standard & Poor's (if Standard & Poor's is then rating the Bonds) in their respective four highest short-term rating categories or with government bond dealer reporting to, trading with, and recognized as a primary dealer by the Federal Reserve Bank of New York, which agreement is secured by any one or more of the securities and obligations described in

clauses (i), (ii) or (iii) above, which will have a market value (exclusive of accrued interest and valued at least monthly) at least equal to the principal amount of such investment and will be lodged with the Trustee or other fiduciary, as custodian for the Trustee, by the bank, trust company, national banking association or bond dealer executing such repurchase agreement, and the entity executing each such repurchase agreement required to be so secured will furnish the Trustee with an undertaking satisfactory to it that the aggregate market value of all such obligations securing each such repurchase agreement (as valued at least monthly) will be an amount equal to the principal amount of each such repurchase agreement and the Trustee will be entitled to rely on each such undertaking;

(xi) any cash sweep or similar account arrangement of or available to the Trustee, the investments of which are limited to investments described in clauses (i), (ii), (iii), (iv) and (x) of the definition of Investment Securities and any money market fund, the entire investments of which are limited to investments described in clauses (i), (ii), (iii), (iv) and (x) of the definition of Investment Securities and which money market fund is rated in their respective highest Rating Categories by Moody's (if Moody's is then rating the Bonds) and Standard & Poor's (if Standard & Poor's is then rating the Bonds); provided that as used in this clause (xi) and clause (xii) investments will be deemed to satisfy the requirements of clause (x) if they meet the requirements set forth in clause (x) ending with the words "clauses (i), (ii) or (iii) above" and without regard to the remainder of such clause (x);

(xii) investment agreements with a domestic or foreign bank or corporation (other than a life or property casualty insurance company) the long-term debt of which, or, in the case of a guaranteed corporation the long-term debt, or, in the case of a monoline financial guaranty insurance company, claims paying ability, of the guarantor is rated at least "AA" by Standard & Poor's and "Aa" by Moody's; provided that the terms of the investment agreement will be approved in writing by each insurer of the Bonds, if any;

(xiii) shares of beneficial interest in diversified management companies investing exclusively in securities and obligations described in clauses (i) through (xii) of the definition of Investment Securities and which companies are rated in their respective highest Rating Categories by Moody's (if Moody's is then rating the Bonds) and Standard & Poor's (if Standard & Poor's is then rating the Bonds) or have an investment advisor registered with the Securities and Exchange Commission with not less than 5 years experience investing in such securities and obligations and with assets under management in excess of \$500,000,000;

(xiv) the California Asset Management Program (CAMP);

(xv) forward purchase and sale agreements for underlying securities otherwise authorized under this definition of "Investment Securities" with providers acceptable to each insurer of the Bonds, if any; and

(xvi) any other investment approved by the City Council.

"Maximum Annual Debt Service" means the greatest amount of principal and interest becoming due and payable on all Bonds and Parity Debt in the Fiscal Year in which the calculation is made or any subsequent Fiscal Year using the principles and assumptions set forth under the definition of Debt Service.

“**Moody’s**” means Moody’s Investors Service, a corporation duly organized and existing under and by virtue of the laws of the State of Delaware, and its successors and assigns, except that if such corporation will be dissolved or liquidated or will no longer perform the functions of a securities rating agency, then the term “Moody’s” will be deemed to refer to any other nationally recognized securities rating agency selected by the City.

“**Net Revenues**” means, with respect to any period, the amount of the Gross Revenues received during such period less the amount of Operating Expenses becoming payable during such period.

“**Operating Expenses**” means the reasonable and necessary costs of maintaining and operating the Enterprise, calculated on the basis of generally accepted accounting principles, including (among other things) the reasonable expenses of management and repair and other expenses necessary to maintain and preserve the Enterprise in good repair and working order, and reasonable amounts for administration, overhead, insurance, taxes (if any) and other similar costs, but excluding (a) depreciation, replacement and obsolescence charges or reserves therefor or other bookkeeping entries of a similar nature, and (b) interest on the Bonds and any Parity Debt.

“**Opinion of Bond Counsel**” means a written opinion of a law firm of national standing in the field of public finance selected by the City.

“**Outstanding**,” when used as of any particular time with reference to Bonds, means (subject to the provisions of the Indenture) all Bonds theretofore, or thereupon being, authenticated and delivered by the Trustee under the Indenture except (1) Bonds theretofore cancelled by the Trustee or surrendered to the Trustee for cancellation; (2) Bonds with respect to which all liability of the City will have been discharged in accordance with the Indenture, including Bonds (or portions of Bonds) for which money has been set aside for the payment of the interest, principal or Redemption Price due as provided in the Indenture; and (3) Bonds for the transfer or exchange of or in lieu of or in substitution for which other Bonds will have been authenticated and delivered by the Trustee pursuant to the Indenture.

“**Owner**” or “**Bondholder**” or “**Bondowner**,” whenever used in the Indenture with respect to a Bond, means the person in whose name such Bond is registered.

“**Parity Debt**” means any indebtedness, installment sale obligation, lease obligation or other obligation of the City for borrowed money having an equal lien and charge upon the Net Revenues, therefore payable on a parity with the Bonds (whether or not any Bonds are Outstanding).

“**Parity Reserve Fund**” means the fund by that name established with the Trustee pursuant to the Indenture.

“**Principal Fund**” means the fund by that name established with the Trustee pursuant to the Indenture.

“**Public Finance Contract**” means a written agreement for the purpose of managing or reducing the City’s exposure to fluctuations in interest rates or for any other interest rate, investment, asset or liability managing purposes, entered into either on a current or forward basis by the City and a Qualified Counterparty as authorized under any applicable laws of the State in connection with, or incidental to, the issuance of Bonds or Parity Debt, that provides for an exchange of payments based

on interest rates, ceilings or floors on such payments, options on such payments or any combination thereof, or any similar device.

“Public Finance Contract Payments” means the amounts periodically required to be paid by the City to all Qualified Counterparties under all Public Finance Contracts.

“Public Finance Contract Receipts” means the amounts periodically required to be paid by all Qualified Counterparties to the City under all Public Finance Contracts.

“Qualified Counterparty” means a party (other than the City or a party related to the City) who is the other party to a Public Finance Contract and (1) (A) who is rated at least “A2” from Moody’s and “A” from Standard & Poor’s, or (B) whose senior debt obligations are rated at least “A2” from Moody’s and “A” from Standard & Poor’s, or guaranteed by an entity so rated, or (C) whose obligations under the Public Finance Contract are guaranteed for the entire term of the Public Finance Contract by a bond insurer or other institution which has been assigned a credit rating at least equal to “A2” from Moody’s and “A” from Standard & Poor’s, or (D) whose obligations under the Public Finance Contract are collateralized in such a manner as to obtain a rating at least equal to the ratings assigned by each of the Rating Agencies to the Bonds or Parity Debt to which such Public Finance Contract relates, and (2) who is otherwise qualified to act as the other party to a Public Finance Contract under all applicable laws of the State.

“Rating Category” means (i) with respect to any long-term rating category, all ratings designated by a particular letter or combination of letters, without regard to any numerical modifier, plus or minus sign or other modifier and (ii) with respect to any short-term or commercial paper rating category, all ratings designated by a particular letter or combination of letters and taking into account any numerical modifier, but not any plus or minus sign or other modifier.

“Rebate Fund” means the fund by that name established with the Trustee pursuant to the Indenture.

“Rebate Requirement” means the Rebate Requirement defined in the Tax Certificate.

“Redemption Fund” means the fund by that name established with the Trustee pursuant to the Indenture.

“Redemption Price” means, with respect to any Bond (or portion thereof) the Bond Obligation of such Bond (or portion thereof) plus the applicable premium, if any, payable upon redemption thereof pursuant to the provisions of such Bond and the Indenture.

“Reserve Fund Requirement” means, as of any date of determination and excluding any Parity Debt for which no reserve fund is to be maintained or for which a separate reserve fund is to be maintained, the lesser of (a) the Maximum Annual Debt Service on all Bonds and Parity Debt to be secured by the Parity Reserve Fund, or (b) one hundred twenty-five percent (125%) of the Average Annual Debt Service on all Bonds and Parity Debt to be secured by the Parity Reserve Fund; provided that in no event will the deposit to the Parity Reserve Fund with respect to any Series of Bonds or Parity Debt to be secured by the Parity Reserve Fund be an amount greater than ten percent (10%) of the initial offering price to the public of each Series of Bonds and any Parity Debt to be secured by the Parity Reserve Fund as determined under the Code, all as computed and determined by the City and specified in writing to the Trustee.

“**Serial Bonds**” means Bonds, maturing in specified years, for which no mandatory sinking fund payments are provided.

“**Series**,” whenever used in the Indenture with respect to Bonds, means all of the Bonds designated as being of the same series, authenticated and delivered in a simultaneous transaction, regardless of variations in maturity, interest rate, redemption and other provisions, and any Bonds thereafter authenticated and delivered upon transfer or exchange or in lieu of or in substitution for (but not to refund) such Bonds as provided in the Indenture.

“**Sewer Enterprise Fund**” means the existing fund by that name established and held by the City with respect to the Enterprise.

“**Short-Term Indebtedness**” means Bonds or Parity Debt having an original maturity of less than or equal to one year and which are not renewable at the option of the City for a term greater than one year beyond the date of original incurrence.

“**Standard & Poor’s**” means Standard & Poor’s, a corporation duly organized and existing under and by virtue of the laws of the State of New York, and its successors and assigns, except that if such corporation will be dissolved or liquidated or will no longer perform the functions of a securities rating agency, then the term “Standard & Poor’s” will be deemed to refer to any other nationally recognized securities rating agency selected by the City.

“**State**” means the State of California.

“**Supplemental Indenture**” means any indenture hereafter duly executed and delivered, supplementing, modifying or amending the Indenture, but only if and to the extent that such Supplemental Indenture is specifically authorized under the Indenture.

“**Tax Certificate**” means the Tax Certificate delivered by the City at the time of the issuance and delivery of any Series of Bonds, as the same may be amended or supplemented in accordance with its terms.

“**Term Bonds**” means Bonds payable at or before their specified maturity date or dates from mandatory sinking fund payments established for that purpose and calculated to retire such Bonds on or before their specified maturity date or dates.

“**Trustee**” means U.S. Bank National Association, acting as trustee under the Indenture, or its successor, as Trustee as provided in the Indenture.

“**Variable Interest Rate**” means any variable interest rate or rates to be paid under any Bonds or Parity Debt, the method of computing which variable interest rate will be as specified in the Supplemental Indenture providing for the issuance of the applicable Bonds or the instrument providing for the issuance of the Parity Debt, which Supplemental Indenture or other instrument will also specify either (i) the payment period or periods or time or manner of determining such period or periods or time for which each value of such variable interest rate will remain in effect, and (ii) the time or times based upon which any change in such variable interest rate will become effective, and which variable interest rate may, without limitation, be based on the interest rate on certain bonds or may be based on interest rate, currency, commodity or other indices.

“Variable Interest Rate Indebtedness” means, for any period of time, any Bonds or Parity Debt that bear a Variable Interest Rate during such period, except that no Bonds or Parity Debt will be treated as a Variable Interest Rate Indebtedness if the net economic effect of a Public Finance Contract with respect to any particular Bonds or Parity Debt is to produce obligations that bear interest at a fixed interest rate, and any Bonds or Parity Debt with respect to which a Public Finance Contract is in force will be treated as a Variable Interest Rate Indebtedness if the net economic effect of the Public Finance Contract is to produce obligations that bear interest at a Variable Interest Rate.

Issuance of Bonds and Parity Debt

Issuance of Bonds. The City may by Supplemental Indenture establish one or more Series of Bonds payable from Net Revenues and secured by the pledge made under the Indenture equally and ratably with Bonds previously issued, and the City may issue, and the Trustee may authenticate and deliver to the purchasers thereof, Bonds of any Series so established, in such principal amount as will be determined by the City, but only, with respect to each Series of Bonds, upon compliance by the City with the provisions of the Indenture (except any Series of Bonds delivered under a Supplemental Indenture of even date with the Indenture may be issued upon compliance by the City with the requirements of the Indenture described under subparagraph (c) under “Proceedings for Issuance of Additional Series of Bonds” below and without further condition) and any additional requirements set forth in said Supplemental Indenture and subject to the following specific conditions, which are made conditions precedent to the issuance of any such additional Series of Bonds:

- (a) no Event of Default shall have occurred and then be continuing;
- (b) the aggregate principal amount of Bonds issued under the Indenture will not exceed any limitation imposed by law or otherwise;
- (c) there will be deposited in the Parity Reserve Fund an amount of money so as to increase the amount on deposit therein to the Reserve Fund Requirement; and
- (d) The Net Revenues, calculated on sound accounting principles, as shown by the books of the City for the latest Fiscal Year or any more recent twelve (12) month period selected by the City ending not more than sixty (60) days prior to the adoption of the Supplemental Indenture pursuant to which such Series of Bonds are issued or the instrument pursuant to which such Parity Debt is issued, as shown by the books of the City, plus, at the option of the City, any or all of the items designated in (i) and (ii) below, but excluding connection charges, will at least equal one hundred twenty-five percent (125%) of the Maximum Annual Debt Service on all Bonds and Parity Debt to be Outstanding immediately subsequent to the issuance of such Series of Bonds or Parity Debt. The items any or all of which may be added to such Net Revenues for the purpose of issuing or incurring additional Series of Bonds or Parity Debt under the Indenture are the following:
 - (i) An allowance for Net Revenues from any additions to or improvements or extensions of the Enterprise to be made with the proceeds of such additional Series of Bonds or Parity Debt, and also for Net Revenues from any such additions, improvements or extensions which have been made from moneys from any source but in any case which, during all or any part of such Fiscal Year or such twelve (12) month period, were not in service, all in an amount equal to ninety-five percent (95%) of the estimated additional average annual Net Revenues to be derived

from such additions, improvements and extensions for the first thirty-six (36) month period in which each addition, improvement or extension is respectively to be in operation, all as shown by a Certificate of the City filed with the Trustee.

(ii) An allowance for earnings arising from any increase in the charges made for service from the Enterprise which has become effective prior to the incurring of such additional Series of Bonds or Parity Debt but which, during all or any part of such Fiscal Year or such twelve (12) month period, was not in effect, in an amount equal to ninety-five percent (95%) of the amount by which the Net Revenues would have been increased if such increase in charges had been in effect during the whole of such Fiscal Year or such twelve (12) month period, all as shown by a Certificate of the City filed with the Trustee.

In the event additional assets or revenues are included within the definition of “Net Revenues” by a Supplemental Indenture, such additional assets or revenues will be included in the calculations in (d) above, as appropriate, as if such additional assets or revenues had always been included in Net Revenues.

Proceedings for Issuance of Additional Series of Bonds. Whenever the City determines to issue a Series of Bonds pursuant to the Indenture, the City will authorize the execution of a Supplemental Indenture specifying the principal amount, and prescribing the form or forms of Bonds of such additional Series and providing the terms, conditions, distinctive designation, denominations, date, maturity date or dates, interest rate or rates (or the manner of determining the same), redemption provisions and place or places of payment of principal or Redemption Price, if any, of and interest on such Bonds, and any other provisions respecting the Bonds of such Series not inconsistent with the terms of the Indenture.

Before such additional Series of Bonds is issued and delivered, the City will file the following documents with the Trustee (upon which documents the Trustee may conclusively rely in determining whether the conditions precedent to the issuance of such Series of Bonds have been satisfied):

- (a) an executed copy of the Supplemental Indenture authorizing such Series;
- (b) a Certificate of the City stating that no Event of Default has occurred and is then continuing;
- (c) an Opinion of Bond Counsel to the effect that the execution of the Supplemental Indenture has been duly authorized by the City in accordance with the Indenture; that such Series, when duly executed by the City and authenticated and delivered by the Trustee, will be valid and binding limited obligations of the City, and that upon the delivery of such Series the aggregate principal amount of Bonds then Outstanding will not exceed the amount permitted by law or otherwise;
- (d) the Certificate of the City required by the Indenture; and
- (e) a Certificate of the City or of an independent certified public accountant that upon delivery of such Bonds, the aggregate principal amount of Bonds then Outstanding will not exceed the amount permitted under the Indenture.

Issuance of Refunding Bonds. Notwithstanding any provisions in the Indenture, there will be no limitation on the ability of the City to issue any Bonds at any time to refund any outstanding Bonds or Parity Debt; provided, however, that the Maximum Annual Debt Service with respect to any such refunding Bonds will not exceed 1.10 times the Maximum Annual Debt Service with respect to the Bonds or Parity Debt being refunded.

Limitations on the Issuance of Obligations. The City will not, so long as any of the Bonds are Outstanding, issue any obligations or securities, howsoever denominated, payable in whole or in part from Net Revenues, except the following:

(a) Bonds of any Series authorized pursuant to the Indenture as described under the captions “Issuance of Bonds” and “Proceedings for Issuance of Additional Series of Bonds” above;

(b) refunding Bonds authorized pursuant to the Indenture as described under “Issuance of Refunding Bonds” above.

(c) Parity Debt payable on a parity with the Bonds and which will have, when issued, an equal lien and charge upon the Net Revenues, provided that the following conditions to the issuance of such Parity Debt are satisfied:

(1) such Parity Debt has been duly and legally authorized for any lawful purpose;

(2) no Event of Default shall have occurred and then be continuing, as evidenced in a Certificate of the City filed with the Trustee;

(3) unless such Parity Debt is for the refunding purposes specified in the Indenture, the City will have obtained and placed on file with the Trustee a Certificate of the City that (on the basis of calculations as of the date of delivery of such Parity Debt) the requirements of the Indenture with respect to additional Bonds have been met with respect to such Parity Debt;

(4) the City will have filed with the Trustee an Opinion of Bond Counsel to the effect that such Parity Debt has been duly authorized in accordance with law and constitutes a valid and binding obligation of the City payable from Net Revenues on a parity with the Bonds; and

(5) the Trustee will be designated as paying agent or trustee for such Parity Debt and the City will deliver to the Trustee a transcript of the proceedings providing for the issuance of such Parity Debt (but the Trustee will not be responsible for the validity or sufficiency of such proceedings or such Parity Debt); or

(d) Obligations which are junior and subordinate to the payment of the principal, premium, interest and reserve fund requirements for the Bonds and all Parity Debt and which subordinated obligations are payable as to principal, premium, interest and reserve fund requirements, if any, only out of Net Revenues, after the prior payment of all amounts then required to be paid under the Indenture from Net Revenues, for principal, premium, interest

and reserve fund requirements for the Bonds and all Parity Debt, as the same become due and payable and at the times and in the manner as required in the Indenture.

Pledge of Net Revenues; Sewer Enterprise Fund; Trustee Funds and Accounts

Pledge of Net Revenues. The Bonds are revenue obligations of the City and are payable as to both principal and interest, and any premium upon redemption thereof, exclusively from Net Revenues and from the other funds pledged under the Indenture. All Net Revenues are pledged to secure the payment of the principal of and redemption premium, if any, and interest on the Bonds and any Parity Debt in accordance with their terms, subject only to the provisions of the Indenture permitting the application thereof for the purposes and on the terms and conditions set forth in the Indenture. There are pledged to secure the payment of the principal of and redemption premium, if any, and interest on the Bonds in accordance with their terms all amounts (including proceeds of the Bonds) held by the Trustee under the Indenture (except for amounts held in the Rebate Fund), subject only to the provisions of the Indenture permitting the application thereof for the purposes and on the terms and conditions set forth in the Indenture. Said pledge will constitute a first lien on the Net Revenues and amounts in such funds and will be valid and binding from and after delivery by the Trustee of the Bonds or Parity Debt, without any physical delivery thereof or further act.

The Net Revenues are pledged to the payment of Bonds and Parity Debt without priority or distinction of one over the other and the Net Revenues constitute a trust fund for the security and payment of the Bonds and Parity Debt; but nevertheless out of Net Revenues, certain amounts may be applied for other purposes as provided in the Indenture.

Out of Net Revenues, there will be applied as set forth in the Indenture all sums required for the payment of the principal of (including any premium thereon) and interest on the Bonds and all Parity Debt, together with any reserve fund requirements with respect thereto. All remaining Net Revenues, after making the foregoing allocation, will be available to the City for all lawful City purposes. The pledge of Net Revenues in the Indenture made will be irrevocable until all of the Bonds and all Parity Debt are no longer outstanding.

Sewer Enterprise Fund. In order to carry out and effectuate the obligation of the City contained in the Indenture to pay the Bonds, so long as any Bonds are Outstanding, the City covenants and agrees that all Gross Revenues, when and as received, will be received, deposited and held by the City in the Sewer Enterprise Fund and will be accounted for through and held in trust in the Sewer Enterprise Fund, and the City will have no beneficial right or interest in any of such moneys except only as provided in the Indenture. The City covenants and agrees to maintain the Sewer Enterprise Fund at all times so long as any Bonds will be Outstanding under the Indenture. All Gross Revenues and Net Revenues, whether held by the City or deposited with the Trustee, all as provided in the Indenture, will nevertheless be disbursed, allocated, and applied solely to the uses and purposes set forth in the Indenture.

All amounts in the Sewer Enterprise Fund required to pay Operating Expenses of the Enterprise will be applied for such purpose from time to time by the City. So long as any Bonds are Outstanding, the City will transfer the remaining moneys in the Sewer Enterprise Fund to the Trustee as required for deposit into the following respective funds (each of which the Trustee will establish, maintain and hold in trust for the benefit of the Owners of the Bonds) in the following amounts, in the following order of priority, the requirements of each such fund (including the making up of any deficiencies in any such fund resulting from lack of Net Revenues sufficient to make any earlier

required deposit) at the time of deposit to be satisfied before any deposit is made to any fund subsequent in priority; provided that on a parity with such deposits the Trustee may set aside or transfer amounts with respect to outstanding Parity Debt as provided in the proceedings for such Parity Debt (which will be proportionate in the event such amounts are insufficient to provide for all deposits required as of any date to be made with respect to the Bonds and such Parity Debt):

(1) Interest Fund. The City will transfer to the Trustee and the Trustee will set aside in the Interest Fund on or before the third Business Day prior to each interest payment date therefor an amount equal to the interest becoming due and payable on the Outstanding Bonds (excluding interest for which there are moneys on deposit in the Interest Fund from the proceeds of any Series of Bonds or other source to pay such interest).

(2) Principal Fund; Sinking Accounts. The City will transfer to the Trustee and the Trustee will set aside in the Principal Fund on or before the third Business Day prior to each principal or mandatory sinking fund payment date therefor an amount equal to (a) the amount of Bond Obligation becoming due and payable on the Outstanding Serial Bonds, plus (b) the mandatory sinking fund payments to be paid into the respective Sinking Accounts for the Term Bonds; provided that if the City certifies to the Trustee that any principal payments are expected to be refunded on or prior to their respective due dates or paid from excess amounts on deposit in the Parity Reserve Fund or other bond reserve fund upon such payment, no amounts need be set aside towards such principal to be so refunded or paid. All of the aforesaid mandatory sinking fund payments will be made without priority of any payment into any one such Sinking Account over any other such payment.

(3) Parity Reserve Fund. Upon the occurrence of any deficiency in the Parity Reserve Fund established pursuant to the Indenture, the City will transfer to the Trustee and the Trustee will set aside in the Parity Reserve Fund an amount equal to the aggregate amount of each unreplenished prior withdrawal from the Parity Reserve Fund until there is on deposit in the Parity Reserve Fund an amount equal to the Reserve Fund Requirement.

Any Net Revenues remaining in the Sewer Enterprise Fund after the transfers described above, except as otherwise provided in a Supplemental Indenture, will be held free and clear of the Indenture by the City and it may use and apply such Net Revenues for any lawful purpose of the City, including the redemption of Bonds upon the terms and conditions set forth in the Supplemental Indenture relating to such Bonds and the purchase of Bonds as and when and at such prices as it may determine.

If on any principal payment date, interest payment date or mandatory sinking fund redemption date the amounts on deposit in the Interest Fund and Principal Fund, including the Sinking Accounts therein, are insufficient to make such payments, the Trustee will immediately notify the City, by telephone or facsimile machine, of such deficiency and direct that the City transfer the amount of such deficiency to the Trustee on such payment date. The City covenants and agrees to transfer to the Trustee from any Net Revenues in its possession the amount of such deficiency on the principal, interest or mandatory redemption date referenced in such notice.

Application of Interest Fund. All amounts in the Interest Fund will be used and withdrawn by the Trustee solely for the purpose of paying interest on the Bonds as it will become due and payable (including accrued interest on any Bonds purchased or redeemed prior to maturity pursuant to the Indenture). In addition if so directed by the City, the Trustee may deposit into the Interest

Fund, Public Finance Contract Receipts of the City and may pay from the Interest Fund, Public Finance Contract Payments on behalf of the City.

Application of Principal Fund. All amounts in the Principal Fund will be used and withdrawn by the Trustee solely for the purposes of paying the Bond Obligation of the Bonds when due and payable, except that all amounts in the Sinking Accounts will be used and withdrawn by the Trustee solely to purchase or redeem or pay at maturity Term Bonds, as provided in the Indenture.

The Trustee will establish and maintain within the Principal Fund a separate sinking account for the Term Bonds of each Series and maturity. On or before the Business Day prior to any date upon which a mandatory sinking fund payment is due, the Trustee will transfer the amount of such mandatory sinking fund payment (being the principal thereof, in the case of Current Interest Bonds and the Accreted Value, in the case of Capital Appreciation Bonds from the Principal Fund to the applicable Sinking Account. With respect to each Sinking Account, on each mandatory sinking fund payment date established for such Sinking Account, the Trustee will apply the mandatory sinking fund payment required on that date to the redemption of Term Bonds of such Series and maturity for which such Sinking Account was established, in the manner provided in the Supplemental Indenture pursuant to which such Series of Bonds was created; provided that, at any time prior to giving such notice of such redemption, the Trustee will, upon receipt of a Request of the City, apply moneys in such Sinking Account to the purchase of Term Bonds of such Series and maturity at public or private sale, as and when and at such prices (including brokerage and other charges, but excluding accrued interest, which is payable from the Interest Fund) as is directed by the City, except that the purchase price (excluding accrued interest, in the case of Current Interest Bonds) will not exceed the principal amount or Accreted Value thereof. If the Trustee has purchased Term Bonds of such Series and maturity with moneys in such Sinking Account, or purchased or redeemed Term Bonds of such Series and maturity at any time from the Redemption Fund and allocable to said mandatory sinking fund payment, or if the City has purchased or otherwise acquired Term Bonds and deposited such Term Bonds with the Trustee, such Term Bonds so purchased or deposited or redeemed by the Trustee or the City will be applied, to the extent of the full principal amount thereof, to reduce said mandatory sinking fund payment. All Term Bonds so purchased or deposited as described under this caption, "Application of Principal Fund" will be cancelled and destroyed by the Trustee. Any amounts remaining in a Sinking Account when all of the Term Bonds for which such account was established are no longer Outstanding will be withdrawn by the Trustee and transferred to the City to be deposited in the Sewer Enterprise Fund. All Term Bonds so purchased will be allocated first to the next succeeding mandatory sinking fund payment for such Series and maturity of Term Bonds, then as a credit against such future mandatory sinking fund payment for such Series and maturity of Term Bonds as may be specified in a Request of the City. All Term Bonds redeemed from the Redemption Fund will be credited to such future mandatory sinking fund payment for such Series and maturity of Term Bonds as may be specified in a Request of the City.

Application of Redemption Fund. The Trustee will establish, maintain and hold in trust a special fund designated as the "Redemption Fund" when required. All moneys deposited by the City with the Trustee for the purpose of redeeming Bonds of any Series pursuant to optional redemption or special mandatory redemption provisions applicable to such Series of Bonds will, unless otherwise directed by the City, be deposited in the Redemption Fund. All amounts deposited in the Redemption Fund will be used and withdrawn by the Trustee solely for the purpose of redeeming Bonds of such Series, in the manner, at the times and upon the terms and conditions specified in the Supplemental Indenture pursuant to which such Series of Bonds was created; provided that, at any time prior to giving notice of such redemption, the Trustee will, upon receipt of a Request of the

City, apply such amounts to the purchase of Bonds of such Series at public or private sale, as and when and at such prices (including brokerage and other charges, but excluding, in the case of Current Interest Bonds, accrued interest, which is payable from the Interest Account) as is directed by the City, except that the purchase price (exclusive of such accrued interest) may not exceed the Redemption Price then applicable to such Bonds. All Term Bonds purchased or redeemed from the Redemption Fund will be allocated to mandatory sinking fund payments applicable to such Series and maturity of Term Bonds as may be specified in a Request of the City.

Parity Reserve Fund. The Trustee will establish and maintain and hold in trust so long as Bonds or Parity Debt to be secured thereby remain outstanding, a special fund designated as the "Parity Reserve Fund." Amounts on deposit in the Parity Reserve Fund are pledged to the payment of the Bonds and any Parity Debt to be secured by the Parity Reserve Fund and will be applied only for such purposes as permitted in the Indenture. The Trustee will deposit in the Parity Reserve Fund, upon the direction of the City, the Reserve Fund Requirement and such other amounts transferred to the Trustee by the City pursuant to the Indenture. No deposit need be made in the Parity Reserve Fund so long as there will be on deposit therein a sum equal to at least the amount required to be on deposit therein as described in this paragraph. Whenever the amount on deposit in the Parity Reserve Fund is less than the Reserve Fund Requirement, notice thereof will be provided to the insurer of the Bonds, if any, and such amount will be increased to the Reserve Fund Requirement as described in this paragraph not later than twelve months thereafter. Moneys on deposit in the Parity Reserve Fund (including all amounts that may be obtained from letters of credit and surety bonds and insurance policies, as provided below, on deposit in the Parity Reserve Fund) will be transferred by the Trustee to the Principal Fund and Interest Fund to pay principal of and interest on the Bonds on any interest payment date in the event amounts on deposit therein 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 for any Parity Debt to be secured by the Parity Reserve Fund, 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 the documents under which any such Parity Debt to be secured by the Parity Reserve Fund is issued or incurred. Amounts on deposit in the Parity Reserve Fund in excess of the Reserve Fund Requirement will, at the written Request of the City, be withdrawn from the Parity Reserve Fund and transferred to the City.

The City may provide for all or any part of the Reserve Fund Requirement by delivering to the Trustee an irrevocable letter of credit issued by a financial institution having unsecured debt obligations rated in one of the two highest Rating Categories of Moody's and Standard & Poor's, securing an amount, together with moneys, Investment Securities or surety bonds or insurance policies (as described in the immediately succeeding paragraph under this caption "Pledge of Net Revenues; Sewer Enterprise Fund; Trustee Funds and Accounts-Parity Reserve Fund" on deposit in the Parity Reserve Fund, equal to the Reserve Fund Requirement. Such letter of credit will have an original term of no less than three (3) years or, if less, the final maturity of the Bonds and such letter of credit will provide by its terms that it may be drawn upon as provided in the Indenture. At least one year prior to the stated expiration of such letter of credit, the City will either (i) deliver a replacement letter of credit, (ii) deliver an extension of the letter of credit for at least an additional year or, if less, the maturity of the Bonds or (iii) deliver to the Trustee a surety bond or an insurance policy satisfying the requirements described in the immediately succeeding paragraph under this caption "Pledge of Net Revenues; Sewer Enterprise Fund; Trustee Funds and Accounts-Parity Reserve Fund." Upon delivery of such replacement letter of credit, extended letter of credit, or

surety bond or insurance policy, the Trustee will deliver the then effective letter of credit to or upon the order of the City. If the City fails to deposit a replacement letter of credit, extended letter of credit, surety bond or insurance policy with the Trustee, the City will immediately commence to make monthly deposits with the Trustee so that an amount equal to the Reserve Fund Requirement will be on deposit in the Parity Reserve Fund no later than the stated expiration date of the letter of credit. If an amount equal to the Reserve Fund Requirement, as of the date following the expiration of the letter of credit, is not on deposit in the Parity Reserve Fund one week prior to the stated expiration date of the letter of credit (excluding from such determination the letter of credit), the Trustee will draw on the letter of credit to fund the amount of any such deficiency in the Parity Reserve Fund.

The City may also provide for all or any part of the Parity Reserve Fund by delivering to the Trustee a surety bond or an insurance policy securing an amount, together with moneys, Investment Securities or letters of credit on deposit in the Parity Reserve Fund, equal to the Reserve Fund Requirement. Such surety bond or insurance policy will be issued by an insurance company whose unsecured debt obligations (or obligations secured by such insurance company's insurance policies) are rated in one of the two highest Rating Categories of Moody's and Standard & Poor's. Such surety bond or insurance policy will have a term of no less than the final maturity of the Bonds. In the event that such surety bond or insurance policy for any reason lapses or expires, the City will immediately implement the actions described in clause (i) or (iii) of the immediately preceding paragraph under this caption "Pledge of Net Revenues; Sewer Enterprise Fund; Trustee Funds and Accounts-Parity Reserve Fund" above or make the required deposits to the Parity Reserve Fund. Repayment of any draw under any such surety bond or insurance policy, and any expenses and accrued interest related to such draw (collectively the "Policy Costs") will commence in the first month following each such draw, and will be paid at the time specified in the first paragraph under this caption "Pledge of Net Revenues; Sewer Enterprise Fund; Trustee Funds and Accounts-Parity Reserve Fund" above in an amount not less than one-twelfth (1/12th) of the aggregate of the Policy Costs related to such draw. If and to the extent that cash has also been deposited in the Parity Reserve Fund, all such cash will be used (including investments purchased with such cash, which will be liquidated and the proceeds thereof applied as required under the Indenture) prior to any drawing under surety bond or insurance policy, and repayment of any Policy Costs will be made prior to any replenishment of any such cash amounts. If the City fails to repay any Policy Costs in accordance with the Indenture, the insurance company issuing such surety bond or insurance policy will be entitled to exercise any and all remedies available at law or under the Indenture other than (i) an acceleration of the interest on or principal of the Bonds as provided in the Indenture or (ii) any other remedy that would adversely affect Bondholders. The Trustee will ascertain the necessity for a claim upon any surety bond or insurance policy provided pursuant to the provisions of the Indenture described under this caption "Pledge of Net Revenues; Sewer Enterprise Fund; Trustee Funds and Accounts-Parity Reserve Fund" and provide notice to the insurance company issuing such bond or policy in accordance with the terms and conditions of such bond or insurance policy not less than two (2) Business Days prior to any interest payment date upon which such a claim should be paid.

In the event of any deficiency in the Principal Fund or Interest Fund for the payment of principal and interest payments for the Bonds pursuant to clause (A) above, the Trustee will, after first applying all cash and Investment Securities held in the Parity Reserve Fund to pay the Bond Obligation of, any mandatory sinking fund payments with respect to, and interest on, the Bonds when due, on a pro rata basis with respect to the portion of the Parity Reserve Fund held in the form of letters of credit and amounts held in the form of surety bonds and insurance policies (calculated by reference to the maximum amounts of such letters of credit and surety bonds and insurance policies),

draw under each letter of credit or surety bond or insurance policy issued with respect to the Parity Reserve Fund, in a timely manner and pursuant to the terms of such letter of credit or surety bond or insurance policy to the extent necessary in order to obtain sufficient funds on or prior to the date such funds are needed to pay the Bond Obligation of, any mandatory sinking fund payments with respect to, and interest on, the Bonds when due. In the event that the Trustee has written notice from the City or any Bondholder that any payment of principal of, or interest on, a Bond has been recovered from a Bondholder pursuant to the United States Bankruptcy Code by a trustee in bankruptcy in accordance with the final, nonappealable order of a court having competent jurisdiction, the Trustee, pursuant to and provided that the terms of the letter of credit or surety bond or insurance policy, if any, credited to the Parity Reserve Fund so provide, will so notify the issuer thereof and draw on such letter of credit or surety bond or insurance policy to the lesser of the extent required or the maximum amount of such letter of credit or surety bond or insurance policy in order to pay to such Bondholder the principal of and interest so recovered. All amounts in the Parity Reserve Fund (other than amounts that may be obtained from letters of credit and surety bonds and insurance policies on deposit in the Parity Reserve Fund) may be used and withdrawn by the Trustee, if so directed by the City, for the payment or redemption of all Bonds then Outstanding, or for the payment of the final principal and interest payments of the Bonds.

Investment of Moneys in Funds and Accounts

All moneys in any of the funds and accounts held by the Trustee and established pursuant to the Indenture will be invested, as directed by the City, solely in Investment Securities; provided, however, that Investment Securities (other than those described in clauses (x), (xii), (xv) or (xvi) of the definition thereof) purchased with moneys held by the Trustee in the Parity Reserve Fund will have an average weighted term to maturity not greater than five years. All Investment Securities will, as directed by the City in writing or by telephone, promptly confirmed in writing, be acquired subject to the limitations as to maturities set forth in the Indenture and such additional limitations or requirements consistent with the foregoing as may be established by Request of the City. The Trustee may conclusively rely upon any investment direction from the City as a certification to the Trustee that such investment constitutes an Investment Security. If and to the extent the Trustee does not receive investment instructions from the City with respect to the moneys in the funds and accounts held by the Trustee pursuant to the Indenture, such moneys will be invested in Investment Securities described in clause (xi) of the definition thereof and the Trustee will thereupon request investment instructions from the City for such moneys.

Unless otherwise provided in the Indenture or in a Supplemental Indenture, all interest, profits and other income received from the investment of moneys in any fund or account, other than the Rebate Fund, will be transferred by the Trustee to the City for deposit in the Sewer Enterprise Fund when received. All interest, profits and other income received from the investment of moneys in the Rebate Fund will be deposited in the Rebate Fund, except as otherwise provided in the Indenture. Notwithstanding anything to the contrary contained in the Indenture, an amount of interest received with respect to any Investment Security equal to the amount of accrued interest, if any, paid as part of the purchase price of such Investment Security will be credited to the fund or account from which such accrued interest was paid.

The Trustee may commingle any of the funds or accounts established pursuant to the Indenture into a separate fund or funds for investment purposes only, provided that all funds or accounts held by the Trustee under the Indenture will be accounted for separately as required by the Indenture. The Trustee may act as principal or agent in the making or disposing of any investment

and, with the prior written consent of the City, may impose its customary charge therefor. The Trustee may sell or present for redemption, any Investment Securities so purchased whenever it will be necessary to provide moneys to meet any required payment, transfer, withdrawal or disbursement from the fund or account to which such Investment Security is credited, and the Trustee will not be liable or responsible for any loss resulting from such investment.

The Trustee and the City will each keep proper books of record and accounts containing complete and correct entries of all transactions made by it relating to the receipt, investment, disbursement, allocation and application of the moneys related to the Bonds, including moneys derived from, pledged to, or to be used to make payments on the Bonds. Such records will specify the account or fund to which each investment (or portion thereof) is to be allocated and will set forth, in the case of each investment security, (a) its purchase price, (b) identifying information, including par amount, coupon rate, and payment dates, (c) the amount received at maturity or its sale price, as the case may be, including accrued interest, (d) the amounts and dates of any payments made with respect thereto, and (e) the dates of acquisition and disposition or maturity.

The City acknowledges that to the extent regulations of the Comptroller of the Currency or other applicable regulatory entity grant the City the right to receive brokerage confirmations of security transactions as they occur, the City will not receive such confirmations to the extent permitted by law. The Trustee will furnish the City periodic cash transaction statements which include detail for all investment transactions made by the Trustee under the Indenture.

The Trustee may make any investments under the Indenture through its own bond or investment department or trust investment department, or those of its parent or any affiliate.

The Trustee or any of its affiliates may act as sponsor, advisor or manager in connection with any investments made by the Trustee under the Indenture.

The Trustee will also provide to the City in accordance with a Request of the City, with respect to each Investment Security such documentation as is reasonably available to the Trustee and specified by the City to the Trustee in writing and is required by the Code or other applicable law to be obtained by the City as evidence to establish that each investment had been acquired and disposed of on an established market in an arm's-length transaction at a price equal to its fair market value and with no amounts having been paid to reduce the yield on the investments, or will be United States Treasury Obligations-State and Local Government Series as set forth in the Tax Certificate.

Covenants

Pursuant to the Indenture, the City has covenanted as follows:

Punctual Payment. The City will punctually pay or cause to be paid the principal or Redemption Price of and interest on all the Bonds, in strict conformity with the terms of the Bonds and of the Indenture, according to the true intent and meaning thereof, and will punctually pay or cause to be paid all mandatory sinking fund payments, but in each case only out of Net Revenues, as provided in the Indenture.

Operation of Enterprise in Efficient and Economical Manner. The City covenants and agrees to operate the Enterprise in an efficient and economical manner and to operate, maintain and preserve the Enterprise in good repair and working order.

Waiver of Laws. The City will not at any time insist upon or plead in any manner whatsoever, or claim or take the benefit or advantage of, any stay or extension law now or at any time hereafter in force that may affect the covenants and agreements contained in the Indenture or in the Bonds, and all benefit or advantage of any such law or laws is expressly waived by the City to the extent permitted by law.

Further Assurances. The City will make, execute and deliver any and all such instruments and assurances as may be reasonably necessary or proper to carry out the intention or to facilitate the performance of the Indenture and for the better assuring and confirming unto the Owners of the Bonds of the rights and benefits provided in the Indenture.

Discharge of Claims. The City covenants that in order to fully preserve and protect the priority and security of the Bonds, the City will pay from the Gross Revenues and discharge all lawful claims for labor, materials and supplies furnished for or in connection with Enterprise which, if unpaid, may become a lien or charge upon the Gross Revenues or the Net Revenues prior or superior to the lien of the Bonds and impair the security of the Bonds. The City will also pay from the Gross Revenues all taxes and assessments or other governmental charges lawfully levied or assessed upon or in respect of the Enterprise or upon any part thereof or upon any of the Gross Revenues or the Net Revenues therefrom.

Against Sale, Eminent Domain. Except as provided in the Indenture, the City covenants that the property, facilities and improvements of the Enterprise will not be mortgaged or otherwise encumbered, sold, leased, pledged, any charge placed thereon, or disposed of as a whole or substantially as a whole unless: (a) the City will cause to be filed with the Trustee written evidence from each Rating Agency that such sale or other disposition will not cause a reduction or withdrawal of the rating then assigned to the Bonds by each such Rating Agency; (b) such sale or other disposition will be so arranged as to provide for a continuance of payments into the Sewer Enterprise Fund sufficient in amount to permit payment therefrom of the principal of and interest on and premiums, if any, due upon the call and redemption. thereof, of the Outstanding Bonds, and also to provide for such payments into the funds as are required under the terms of the Indenture and any Supplemental Indenture; and (c) the City will have filed with the Trustee an opinion of nationally-recognized bond counsel to the effect that such sale or other disposition will not adversely affect the exemption from federal income taxation of interest on the Bonds. The City further covenants that the Net Revenues or any other funds pledged or otherwise made available to secure payment of the principal of and interest on the Outstanding Bonds will not be mortgaged, encumbered, sold, leased, pledged, any charge placed thereon, or disposed of or used except as authorized by the terms of the Indenture. The City further covenants that it will not enter into any agreement which impairs the operation of the Enterprise or any part of it necessary to secure adequate Net Revenues to pay the principal and interest of the Bonds or which otherwise would impair the rights of the Bond Owners with respect to the Net Revenues. If any substantial part of the Enterprise is sold the payment therefor will either be used for the acquisition and/or construction of improvements and extensions of the Enterprise or will be deposited with the Trustee and will be used to redeem the Outstanding Bonds and Parity Debt in respective amounts and on the respective dates identified by the City in writing.

The City covenants that any amounts received as awards as a result of the taking of all or any part of the Enterprise by the lawful exercise of eminent domain, if and to the extent that such right can be exercised against such property of the City, will either (a) be used for the acquisition and or construction of improvements and extension of the Enterprise, or (b) be deposited with the Trustee

(in an amount required to redeem the maximum amount of Outstanding Bonds and Parity Debt) to be used to pay or redeem the Outstanding Bonds and Parity Debt in respective amounts and on the respective dates identified by the City in writing.

Insurance. The City covenants that it will at all times maintain with responsible insurers all such insurance on the Enterprise as is customarily maintained with respect to works and properties of like character against accident to, loss of or damage to such works or properties. If any useful part of the Enterprise is damaged or destroyed, such part will be restored to use. The money collected from insurance against accident to or destruction of the physical Enterprise will either (a) be used for repairing or rebuilding the damaged or destroyed Enterprise, and to the extent not so applied will be deposited with the Trustee (in an amount required to redeem the maximum amount of Outstanding Bonds and Parity Debt) to be used to pay or redeem the Outstanding Bonds and Parity Debt in respective amounts and on the respective dates identified by the City in writing.

Any such insurance will be in the form of policies or contracts for insurance with insurers of good standing and will be payable to the City, or may in the form of self-insurance by the City. The City will establish such fund or funds or reserves as are necessary to provide for its share of any such self-insurance. The City will file or cause to be filed with the Trustee, annually within one hundred twenty (120) days after the close of each Fiscal Year, a Certificate of the City (a) stating that the City is then in compliance with the requirements of the Indenture described under this caption "Covenants–Insurance," and (b) stating whether during the preceding Fiscal Year any loss has been incurred with respect to the Enterprise and, if so, the amount of insurance proceeds, including the proceeds of any self-insurance fund covering such loss and specifying the reasonable and necessary costs of repair, reconstruction or replacement thereof.

Records and Accounts. The City covenants that it will keep proper books of record and accounts of the Enterprise, separate from all other records and accounts, in which complete and correct entries will be made of all transactions relating to the Enterprise. Said books will, upon reasonable request, be subject to the inspection of the Owners of not less than ten percent (10%) of the Outstanding Bonds or their representatives authorized in writing.

The City covenants that it will cause the books and accounts of the Enterprise to be audited annually by an Independent Accountant and will make available for inspection by the Bond Owners at the Trust Office of the Trustee, upon reasonable request, a copy of the report of such Independent Accountant.

Rates and Charges. The City will fix, prescribe, revise and collect rates, fees and charges for the services and facilities furnished by the Enterprise during each Fiscal Year which (together with other funds accumulated from Gross Revenues and which are lawfully available to the City for payment of any of the following amounts during such Fiscal Year) are at least sufficient, after making allowances for contingencies and error in the estimates, to pay the following amounts in the following order:

- (a) all Operating Expenses estimated by the City to become due and payable in such Fiscal Year;
- (b) the Debt Service on the Outstanding Bonds and Parity Debt becoming due and payable during such Fiscal Year;

(c) all other payments required for compliance with the Indenture and the instruments pursuant to which any Parity Debt will have been issued; and

(d) all payments required to meet any other obligations of the City which are charges, liens, encumbrances upon or payable from the Gross Revenues or the Net Revenues.

In addition, the City will fix, prescribe, revise and collect rates, fees and charges for the services and facilities furnished by the Enterprise during each Fiscal Year which are sufficient to yield Net Revenues during such Fiscal Year equal to at least 1.25 times the amount determined pursuant to the (b) above. The City may make adjustments from time to time in such fees and charges and may make such classification thereof as it deems necessary, but will not reduce such fees and charges below those then in effect unless the Gross Revenues from such reduced fees and charges will at all times be sufficient to meet the requirements of the Indenture described in this caption "Covenants Rates and Charges."

No Priority for Additional Obligations. The City covenants that no additional bonds, notes or other indebtedness will be issued or incurred having any priority in payment of principal or interest out of the Net Revenues over the Bonds. Nothing in the Indenture will prohibit or impair the authority of the City to issue bonds or other obligations which are unsecured or which are secured by a lien on Net Revenues which is subordinate to the lien established under the Indenture, upon such terms and in such principal amount as the City may determine.

Tax Covenants. The City covenants that it will not take any action, or fail to take any action, if any such action or failure to take action would adversely affect the exclusion from gross income of the interest on the Bonds under Section 103 of the Code; provided that, prior to the issuance of any Series of Bonds, the City may exclude the application of the tax covenants contained in the Indenture to such Series of Bonds. The City will not directly or indirectly use or permit the use of any proceeds of the Bonds or any other funds of the City, or take or omit to take any action that would cause the Bonds to be arbitrage bonds within the meaning of Section 148(a) of the Code. To that end, the City will comply with all requirements of Section 148 of the Code to the extent applicable to the Bonds. In the event that at any time the City is of the opinion that for purposes of the tax covenants contained in the Indenture it is necessary to restrict or limit the yield on the investment of any moneys held by the Trustee under the Indenture, the City will so instruct the Trustee in writing, and the Trustee will take such action as may be necessary in accordance with such instructions.

Without limiting the generality of the foregoing, the City agrees that there will be paid from time to time all amounts required to be rebated to the federal government of the United States of America pursuant to Section 148(f) of the Code and any temporary, proposed or final Treasury Regulations as may be applicable to the Bonds from time to time. The City specifically covenants to pay or cause to be paid to the federal government of the United States of America the Rebate Requirement at the times and in the amounts determined under and as described in the Tax Certificate.

Notwithstanding any of the tax covenants contained in the Indenture, if the City will receive an Opinion of Bond Counsel to the effect that any action required by the tax covenants contained in the Indenture is no longer required, or to the effect that some further action is required, to maintain the exclusion from gross income of the interest on the Bonds pursuant to Section 103 of the Code, the City and the Trustee may rely conclusively on such opinion in complying with the provisions of the Indenture, and the covenants under the Indenture will be deemed to be modified to that extent.

Continuing Disclosure Agreement. The City will comply with and carry out all of its obligations under any Continuing Disclosure Agreement executed in connection with a Series of Bonds. Upon the failure of the City to comply with the Continuing Disclosure Agreement relating to any Series of Bonds, the Trustee (at the written request of any Participating Underwriter (as defined in the Continuing Disclosure Agreement) or the Owners of at least 25% in aggregate Bond Obligation of the related Series of Bonds, will, but only to the extent indemnified to its satisfaction from any liability or expense, including, without limitation, fees and expenses of its attorneys) or any Owner or Beneficial Owner may take such actions as may be necessary and appropriate, including seeking mandate or specific performance by court order, to cause the City, to comply with its obligations under this paragraph. For purposes of the covenant described in this paragraph, “Beneficial Owner” will have the meaning prescribed thereto in the respective Continuing Disclosure Agreement relating to such Series of Bonds.

Events of Default and Remedies

Events of Default. The following events will be Events of Default under the Indenture:

(a) default in the due and punctual payment of the principal or Redemption Price of any Bond when and as the same shall become due and payable, whether at maturity as therein expressed, by proceedings for redemption, by declaration or otherwise in the amounts and at the times provided therefor;

(b) default in the due and punctual payment of any installment of interest on any Bond when and as such interest installment shall become due and payable;

(c) failure by the City to observe or perform any covenant, condition, agreement or provision in the Indenture on its part to be observed or performed, other than as referred to in (a) or (b) under this caption “Events of Default,” for a period of thirty (30) days after written notice, specifying such failure and requesting that it be remedied, has been given to the City by the Trustee; except that, if such failure can be remedied but not within such thirty (30) day period and if the City has taken all action reasonably possible to remedy such failure within such thirty (30) day period, such failure shall not become an Event of Default for so long as the City shall diligently proceed to remedy the same in accordance with and subject to any directions or limitations of time established by the Trustee or any insurer of the Bonds;

(d) default by the City under any agreement governing any Parity Debt and the continuance of such default beyond the therein stated grace period, if any, with respect to such default;

(e) the filing by the City of a petition in voluntary bankruptcy for the composition of its affairs or for its corporate reorganization under any state or federal bankruptcy or insolvency law, or an assignment by the City for the benefit of creditors, or the admission by the City in writing to its insolvency or inability to pay debts as they mature, or the consent by the City in writing to the appointment of a trustee or receiver for itself;

(f) the entering by a court of competent jurisdiction of an order, judgment or decree declaring the City insolvent, or adjudging it bankrupt, or appointing a trustee or receiver of the City, or approving a petition filed against the City seeking reorganization of the City under any applicable law or statute of the United States of America or any state

thereof, and such order, judgment or decree shall not be vacated or set aside or stayed within sixty (60) days from the date of the entry thereof; or

(g) the assumption, under the provisions of any other law for the relief or aid of debtors, by any court of competent jurisdiction of custody or control of the City or of the Net Revenues and such custody or control shall not be terminated within sixty (60) days from the date of assumption of such custody or control.

Application of Net Revenues and Other Funds After Default; Acceleration. If an Event of Default shall occur and be continuing, the City shall immediately transfer to the Trustee all Net Revenues held by it and received thereafter and the Trustee shall apply all Net Revenues and any other funds then held or thereafter received by the Trustee under any of the provisions of the Indenture (except as otherwise provided in the Indenture) as follows and in the following order:

(1) To the payment of any expenses necessary in the opinion of the Trustee to protect the interests of the Owners of the Bonds and Parity Debt, including the costs and expenses of the Trustee and the Bondholders in declaring such Event of Default, and payment of reasonable fees and expenses of the Trustee (including reasonable fees and disbursements of its counsel and other agents) incurred in and about the performance of its powers and duties under the Indenture;

(2) To the payment of the whole amount of Bond Obligation then due on the Bonds and Parity Debt (upon presentation of the Bonds and Parity Debt to be paid, and stamping thereon of the payment if only partially paid, or surrender thereof if fully paid) subject to the provisions of the Indenture, with interest on such Bond Obligation at the rate or rates of interest borne by the respective Bonds and Parity Debt, to the payment to the persons entitled thereto of all installments of interest then due and the unpaid principal or Redemption Price of any Bonds and Parity Debt which shall have become due, whether at maturity or by call for redemption, in the order of their due dates, with interest on the overdue Bond Obligation and Parity Debt at the rate borne by the respective Bonds and Parity Debt, and, if the amount available shall not be sufficient to pay in full all the Bonds and Parity Debt due on any date, together with such interest, then to the payment thereof ratably, according to the amounts of principal or interest or Accreted Value (plus accrued interest) due on such date to the persons entitled thereto, without any discrimination or preference.

In each and every such case during the continuance of such Event of Default (and subject to any rights granted to any insurer of the Bonds with respect to the enforcement of remedies upon an Event of Default pursuant to a Supplemental Indenture), the Owners of not less than a majority in aggregate amount of Bond Obligation of the Bonds at the time Outstanding shall be entitled, upon notice in writing to the City, to declare the principal of all of the Bonds then Outstanding, and the interest accrued thereon, to be due and payable immediately, and upon any such declaration the same shall become and shall be immediately due and payable, anything in the Indenture or in the Bonds contained to the contrary notwithstanding.

This provision, however, is subject to the condition that if, at any time after the principal of the Bonds shall have been so declared due and payable, the City shall pay to or shall deposit with the Trustee a sum sufficient to pay all principal on such Bonds matured prior to such declaration and all matured installments of interest (if any) upon all the Bonds, and the reasonable fees and expenses of the Trustee, and any and all other defaults known to the Trustee (other than in the payment of

principal of and interest on the Bonds due and payable solely by reason of such declaration) shall have been made good or cured to the satisfaction of the Trustee, or provision deemed by the Trustee to be adequate shall have been made therefor, then, and in every such case, the Owners of not less than a majority in aggregate amount of Bond Obligation of the Bonds at the time Outstanding, by written notice to the City and to the Trustee, may, on behalf of the Owners of all the Bonds, rescind and annul such declaration and its consequences; but no such rescission and annulment shall extend to or shall affect any subsequent default, or shall impair or exhaust any right or power consequent thereon.

Trustee to Represent Bondholders. The Trustee is irrevocably appointed (and the successive respective Owners of the Bonds, by taking and holding the same, shall be conclusively deemed to have so appointed the Trustee) as trustee and true and lawful attorney-in-fact of the Owners of the Bonds for the purpose of exercising and prosecuting on their behalf such rights and remedies as may be available to such Owners under the provisions of the Bonds, the Indenture and applicable provisions of any other law. Upon the occurrence and continuance of an Event of Default or other occasion giving rise to a right in the Trustee to represent the Bondholders, the Trustee in its discretion may, and upon the written request of the Owners of not less than twenty-five percent (25%) in aggregate amount of Bond Obligation of the Bonds then Outstanding, and upon being indemnified to its satisfaction therefor, shall, proceed to protect or enforce its rights or the rights of such Owners by such appropriate action, suit, mandamus or other proceedings as it shall deem most effectual to protect and enforce any such right, at law or in equity, either for the specific performance of any covenant or agreement contained in the Indenture, or in aid of the execution of any power in the Indenture granted, or for the enforcement of any other appropriate legal or equitable right or remedy vested in the Trustee or in such Owners under the Indenture or any other law; and upon instituting such proceeding, the Trustee shall be entitled, as a matter of right, to the appointment of a receiver of the Net Revenues, and other assets pledged under the Indenture, pending such proceedings. All rights of action under the Indenture or the Bonds or otherwise may be prosecuted and enforced by the Trustee without the possession of any of the Bonds or the production thereof in any proceeding relating thereto, and any such suit, action or proceeding instituted by the Trustee shall be brought in the name of the Trustee for the benefit and protection of all the Owners of such Bonds, subject to the provisions of the Indenture.

Bondholders' Direction of Proceedings. Anything in the Indenture to the contrary notwithstanding, the Owners of a majority in aggregate amount of Bond Obligation of the Bonds then Outstanding shall have the right, by an instrument or concurrent instruments in writing executed and delivered to the Trustee and upon furnishing the Trustee with indemnification satisfactory to it, to direct the method of conducting all remedial proceedings taken by the Trustee under the Indenture, provided that such direction shall not be otherwise than in accordance with law and the provisions of the Indenture, that the Trustee may take any other action deemed proper by the Trustee which is not inconsistent with such direction, and that the Trustee shall have the right to decline to follow any such direction which in the opinion of the Trustee would be unjustly prejudicial to Bondholders or holders of Parity Debt not parties to such direction.

Limitation on Bondholders' Right to Sue. No Owner of any Bond shall have the right to institute any suit, action or proceeding at law or in equity, for the protection or enforcement of any right or remedy under the Indenture or any other applicable law with respect to such Bond, unless (1) such Owner shall have given to the Trustee written notice of the occurrence of an Event of Default; (2) the Owners of not less than twenty-five percent (25%) in aggregate amount of Bond Obligation of the Bonds then Outstanding shall have made written request upon the Trustee to exercise the powers

hereinbefore granted or to institute such suit, action or proceeding in its own name; (3) such Owner or said Owners shall have tendered to the Trustee reasonable indemnity against the costs, expenses and liabilities to be incurred in compliance with such request; (4) the Trustee shall have refused or omitted to comply with such request for a period of sixty (60) days after such written request shall have been received by, and said tender of indemnity shall have been made to, the Trustee; and (5) the Trustee shall not have received contrary directions from the Owners of a majority in aggregate amount of Bond Obligation of the Bonds then Outstanding.

Such notification, request, tender of indemnity and refusal or omission are declared, in every case, to be conditions precedent to the exercise by any Owner of Bonds of any remedy under the Indenture or under law; it being understood and intended that no one or more Owners of Bonds shall have any right in any manner whatever by his or their action to affect, disturb or prejudice the security of the Indenture or the rights of any other Owners of Bonds, or to enforce any right under the Indenture or other applicable law with respect to the Bonds, except in the manner provided in the Indenture, and that all proceedings at law or in equity to enforce any such right shall be instituted, had and maintained in the manner provided in the Indenture and for the benefit and protection of all Owners of the Outstanding Bonds, subject to the provisions of the Indenture.

Absolute Obligation of the City. Nothing in any other provision of the Indenture or in the Bonds contained shall affect or impair the obligation of the City, which is absolute and unconditional, to pay the principal or Redemption Price of and interest on the Bonds to the respective Owners of the Bonds at their respective due dates therefor or upon call for redemption, as provided in the Indenture, but only out of the Net Revenues and other assets pledged in the Indenture therefor, or affect or impair the right of such Owners, which is also absolute and unconditional, to enforce such payment by virtue of the contract embodied in the Bonds.

Termination of Proceedings. In case any proceedings taken by the Trustee or any one or more Bondholders on account of any Event of Default shall have been discontinued or abandoned for any reason or shall have been determined adversely to the Trustee or the Bondholders, then in every such case the City, the Trustee and the Bondholders, subject to any determination in such proceedings, shall be restored to their former positions and rights under the Indenture, severally and respectively, and all rights, remedies, powers and duties of the City, the Trustee and the Bondholders shall continue as though no such proceedings had been taken.

Remedies Not Exclusive. No remedy conferred in the Indenture upon or reserved to the Trustee or to the Owners of the Bonds is intended to be exclusive of any other remedy or remedies, and each and every such remedy, to the extent permitted by law, shall be cumulative and in addition to any other remedy given under the Indenture or now or hereafter existing at law or in equity or otherwise.

No Waiver of Default. No delay or omission of the Trustee or of any Owner of the Bonds to exercise any right or power arising upon the occurrence of any default shall impair any such right or power or shall be construed to be a waiver of any such default or an acquiescence therein; and every power and remedy given by the Indenture to the Trustee or to the Owners of the Bonds may be exercised from time to time and as often as may be deemed expedient.

The Trustee

Appointment; Duties, Immunities and Liabilities of Trustee. The Bank of New York Trust Company, N.A. serves as successor Trustee under the Indenture and accepts the trust imposed upon it as Trustee under the Indenture and to perform all the functions and duties of the Trustee under the Indenture, subject to the terms and conditions set forth in the Indenture. The Trustee shall, prior to an Event of Default, and after the curing or waiver of all Events of Default which may have occurred, perform such duties and only such duties as are specifically set forth in the Indenture and no implied covenants shall be read into the Indenture against the Trustee. The Trustee shall, during the existence of any Event of Default (which has not been cured or waived), exercise such of the rights and powers vested in it by the Indenture and use the same degree of care and skill in their exercise as a prudent person would exercise or use under the circumstances in the conduct of his or her own affairs.

The City may remove the Trustee at any time unless an Event of Default shall have occurred and then be continuing, and shall remove the Trustee if at any time requested to do so by an instrument or concurrent instruments in writing signed by the Owners of not less than a majority in aggregate amount of Bond Obligation of the Bonds then Outstanding (or their attorneys duly authorized in writing) or if at any time the Trustee will cease to be eligible in accordance with the requirements of the Indenture, or will become incapable of acting, or will be adjudged a bankrupt or insolvent, or a receiver of the Trustee or its property will be appointed, or any public officer will take control or charge of the Trustee or of its property or affairs for the purpose of rehabilitation, conservation or liquidation, in each case by giving written notice of such removal to the Trustee, and thereupon will appoint a successor Trustee by an instrument in writing.

The Trustee may at any time resign by giving written notice of such resignation to the City and by giving the Bondholders notice of such resignation by mail at the addresses shown on the registration books maintained by the Trustee. Upon receiving such notice of resignation, the City will promptly appoint a successor Trustee by an instrument in writing.

Any removal or resignation of the Trustee and appointment of a successor Trustee will become effective upon acceptance of appointment by the successor Trustee. If no successor Trustee has been appointed and have accepted appointment within forty-five (45) days of giving notice of removal or notice of resignation as aforesaid, the resigning Trustee or any Bondholder (on behalf of himself and all other Bondholders) may petition any court of competent jurisdiction for the appointment of a successor Trustee, and such court may thereupon, after such notice (if any) as it may deem proper, appoint such successor Trustee. Any successor Trustee appointed under the Indenture, will signify its acceptance of such appointment by executing and delivering to the City and to its predecessor Trustee a written acceptance thereof, and thereupon such successor Trustee, without any further act, deed or conveyance, will become vested with all the moneys, estates, properties, rights, powers, trusts, duties and obligations of such predecessor Trustee, with like effect as if originally named Trustee in the Indenture; but, nevertheless at the Request of the City or the request of the successor Trustee, such predecessor Trustee will execute and deliver any and all instruments of conveyance or further assurance and do such other things as may reasonably be required for more fully and certainly vesting in and confirming to such successor Trustee all the right, title and interest of such predecessor Trustee in and to any property held by it under the Indenture and will pay over, transfer, assign and deliver to the successor Trustee any money or other property subject to the trusts and conditions set forth in the Indenture. Upon request of the successor Trustee, the City will execute and deliver any and all instruments as may be reasonably required for

more fully and certainly vesting in and confirming to such successor Trustee all such moneys, estates, properties, rights, powers, trusts, duties and obligations. Upon acceptance of appointment by a successor Trustee as described under this caption "The Trustee," the City will give notice of the succession of such Trustee to the trusts under the Indenture by mail to the Bondholders at the addresses shown on the registration books maintained by the Trustee. If the City fails to mail such notice within fifteen (15) days after acceptance of appointment by the successor Trustee, the successor Trustee will cause such notice to be mailed at the expense of the City.

Any Trustee appointed under the provisions of the Indenture in succession to the Trustee will be a trust company or bank having the powers of a trust company having a corporate trust office in the State, having a combined capital and surplus of at least fifty million dollars (\$50,000,000) and subject to supervision or examination by federal or state authority. If such bank or trust company publishes a report of condition at least annually, pursuant to law or to the requirements of any supervising or examining authority above referred to, then for the purpose of the Indenture described in this paragraph, the combined capital and surplus of such bank or trust company will be deemed to be its combined capital and surplus as set forth in its most recent report of condition so published. In case at any time the Trustee will cease to be eligible in accordance with the provisions of the Indenture described in this paragraph, the Trustee will resign immediately in the manner and with the effect described under this caption "The Trustee."

If, by reason of the judgment of any court, the Trustee or any successor Trustee is rendered unable to perform its duties under the Indenture, and if no successor Trustee be then appointed, all such duties and all of the rights and powers of the Trustee under the Indenture will be assumed by and vest in the Treasurer of the City in trust for the benefit of the Bondowners.

Merger or Consolidation. Any company into which the Trustee may be merged or converted or with which it may be consolidated or any company resulting from any merger, conversion or consolidation to which it is a party or any company to which the Trustee may sell or transfer all or substantially all of its corporate trust business, provided such company will be eligible under the Indenture, will be the successor to such Trustee without the execution or filing of any paper or any further act, anything in the Indenture to the contrary notwithstanding.

Liability of Trustee. The recitals of facts in the Indenture and in the Bonds contained will be taken as statements of the City, and the Trustee assumes no responsibility for the correctness of the same (other than the certificate of authentication of the Trustee on each Bond), and makes no representations as to the validity or sufficiency of the Indenture or of the Bonds or of any Investment Security, as to the sufficiency of the Net Revenues, or the priority of the lien of the Indenture thereon, or as to the financial or technical feasibility of the Enterprise and will not incur any responsibility in respect of any such matter, other than in connection with the duties or obligations expressly in the Indenture or in the Bonds assigned to or imposed upon it. The Trustee will, however, be responsible for its representations contained in its certificate of authentication on the Bonds. The Trustee will not be liable in connection with the performance of its duties under the Indenture, except for its own negligence, willful misconduct or breach of the express terms and conditions of the Indenture. The Trustee and its directors, officers, employees or agents may in good faith buy, sell, own, hold and deal in any of the Bonds and may join in any action which any Owner of a Bond may be entitled to take, with like effect as if the Trustee was not the Trustee under the Indenture. The Trustee may in good faith hold any other form of indebtedness of the City, own, accept or negotiate any drafts, bills of exchange, acceptances or obligations of the City and make

disbursements for the City and enter into any commercial or business arrangement therewith, without limitation.

The Trustee will not be liable for any error of judgment made in good faith by a responsible officer unless it is proved that the Trustee was negligent in ascertaining the pertinent facts. The Trustee may execute any of the trusts or powers of the Indenture and perform the duties required of it under the Indenture by or through attorneys, agents, or receivers, and will be entitled to advice of counsel concerning all matters of trust and its duty under the Indenture, but the Trustee will be answerable for the negligence or misconduct of any such attorney, agent, or receiver selected by it; provided, however, that the Trustee will not be answerable for the negligence or misconduct of any attorney or certified public accountant selected by it with due care.

The Trustee will not be liable with respect to any action taken or omitted to be taken by it in good faith in accordance with the direction of the Owners of not less than twenty-five percent (25%) in aggregate amount of Bond Obligation of the Bonds at the time Outstanding relating to the time, method and place of conducting any proceeding for any remedy available to the Trustee or exercising any trust or power conferred upon the Trustee under the Indenture.

The Trustee is under no obligation to exercise any of the rights or powers vested in it by the Indenture at the request, order or direction of any of the Bondholders pursuant to the provisions of the Indenture, including, without limitation, the provisions of the Indenture, unless such Bondholders has offered to the Trustee security or indemnity satisfactory to it against the costs, expenses and liabilities which may be incurred therein or thereby.

No provision of the Indenture will require the Trustee to expend or risk its own funds or otherwise incur any financial liability in the performance or exercise of any of its duties under the Indenture.

The Trustee shall not be deemed to have knowledge of and shall not be required to take any action with respect to, any Event of Default (other than an Event of Default described under (a) or (b) under the caption "Events of Default" above) or event which would, with the giving of notice, the passage of time or both, constitute an Event of Default, unless the Trustee shall have actual knowledge of such event or shall have been notified of such event by the City or the Owners of twenty-five percent (25%) in aggregate amount of Bond Obligation of the Bonds at the time Outstanding. Without limiting the generality of the foregoing, the Trustee shall not be required to ascertain, monitor or inquire as to the performance or observance by the City of the terms, conditions, covenants or agreements set forth in the Indenture (including, without limitation, the covenants of the City set forth in the Indenture relating to insurance and records and accounts), other than the covenants of the City to make payments with respect to the Bonds when due as set forth in the Indenture and to file with the Trustee when due, such reports and certifications as the City is required to file with the Trustee under the Indenture.

No permissive power, right or remedy conferred upon the Trustee under the Indenture will be construed to impose a duty to exercise such power, right or remedy.

The Trustee will not be bound to make any investigation into the facts or matters stated in any resolution, certificate, statement, instrument, opinion, report, notice, request, direction, consent, order, bond, debenture, coupon or other paper or document but the Trustee, in its discretion, may make such further inquiry or investigation into such facts or matters as it may see fit, and, if the

Trustee will determine to make such further inquiry or investigation, it will be entitled to examine the books, records and premises of the City, personally or by agent or attorney.

The Trustee will not be responsible for:

(1) the application or handling by the City of any Net Revenues or other moneys transferred to or pursuant to any Requisition or Request of the City in accordance with the terms and conditions of the Indenture;

(2) the application and handling by the City of any other fund or account designated to be held by the City under the Indenture;

(3) any error or omission by the City in making any computation or giving any instruction pursuant to the covenant provisions of the Indenture relating to insurance and records and accounts and may rely conclusively on any computations or instructions furnished to it by the City in connection with the requirements of the Indenture and the Tax Certificate; or

(4) the construction, operation or maintenance of the Enterprise by the City.

Whether or not therein expressly so provided, every provision of the Indenture relating to the conduct or affecting the liability of or affording protection to the Trustee will be subject to the provisions of the Indenture described under this caption "The Trustee."

The Trustee will have no responsibility with respect to any information, statement or recital in any official statement, offering memorandum or any other disclosure material prepared or distributed with respect to the Bonds.

Amendments

Amendments Permitted with Consent. The Indenture and the rights and obligations of the City, the Owners of the Bonds and the Trustee may be modified or amended from time to time and at any time by a Supplemental Indenture, which the City and the Trustee may enter into with the written consent of the Owners of a majority in aggregate amount of Bond Obligation of the Bonds (or, if such Supplemental Indenture is only applicable to a Series of Bonds, such Series of Bonds) then Outstanding has been filed with the Trustee; provided that if such modification or amendment will, by its terms, not take effect so long as any Bonds of any particular maturity remain Outstanding, the consent of the Owners of such Bonds will not be required and such Bonds will not be deemed to be Outstanding for the purpose of any calculation of Bonds Outstanding described under this under this caption "Amendments."

For any Series of Bonds for which there is a letter of credit or policy of bond insurance in place securing such Series of Bonds, the written consents of each provider of a letter of credit or a policy of bond insurance for such Series of Bonds filed with the Trustee shall be accepted in lieu of consent of the Owners of such Series of Bonds and shall be deemed to be the consent of all of the Owners of such Series of Bonds for purposes of satisfying the requirements described in the preceding paragraph, provided that at the time such consent is given, the payment of all the principal of and interest on all Outstanding Bonds of such Series will be insured by a policy or policies of municipal bond insurance or payable under a letter of credit the provider of which will be a financial institution

or association having unsecured debt obligations rated, or insuring or securing other debt obligations rated on the basis of such insurance or letters of credit, in one of the two highest Rating Categories of Moody's or Standard & Poor's.

No such modification or amendment will (a) extend the fixed maturity of any Bond, or reduce the amount of principal thereof, or extend the time of payment or reduce the amount of any mandatory sinking fund payment provided for the payment of any Bond, or reduce the rate of interest thereon, or extend the time of payment of interest thereon, or reduce any premium payable upon the redemption thereof exclusively, without the consent of the Owner of each Bond so affected, or (b) reduce the aforesaid percentage of Bond Obligation the consent of the Owners of which is required to effect any such modification or amendment, or permit the creation of any lien on the Net Revenues and other assets pledged under the Indenture prior to or on a parity with the lien created by the Indenture, or deprive the Owners of the Bonds of the lien created by the Indenture on such Net Revenues and other assets (in each case, except as expressly provided in the Indenture), without the consent of the Owners of all of the Bonds then Outstanding. It will not be necessary for the consent of the Bondholders to approve the particular form of any Supplemental Indenture, but it will be sufficient if such consent will approve the substance thereof. Promptly after the execution and delivery by the Trustee and the City of any Supplemental Indenture under the provisions of the Indenture described under this caption "Amendments Permitted With Consent," the Trustee will mail a notice, setting forth in general terms the substance of such Supplemental Indenture to the Owners of the Bonds at the addresses shown on the registration books of the Trustee. Any failure to give such notice, or any defect therein, will not, however, in any way impair or affect the validity of any such Supplemental Indenture.

A copy of each Supplemental Indenture entered into by the City and the Trustee pursuant to the provisions described under this caption "Amendments Permitted with Consent" will be sent by the City to Moody's and Standard & Poor's.

Amendments Not Requiring Consent. The Indenture and the rights and obligations of the City, of the Trustee and of the Owners of the Bonds may also be modified or amended from time to time and at any time by a Supplemental Indenture, which the City may adopt without the consent of any Bondholders but only to the extent permitted by law and only for any one or more of the following purposes:

(1) to add to the covenants and agreements of the City in the Indenture contained other covenants and agreements thereafter to be observed, to pledge or assign additional security for the Bonds (or any portion thereof), or to surrender any right or power reserved in the Indenture to or conferred upon the City;

(2) to make such provisions for the purpose of curing any ambiguity, inconsistency or omission, or of curing or correcting any defective provision, contained in the Indenture, or in regard to matters or questions arising under the Indenture, as the City may deem necessary or desirable, and which will not materially and adversely affect the interests of the Owners of the Bonds;

(3) to modify, amend or supplement the Indenture in such manner as to permit the qualification of the Indenture under the Trust Indenture Act of 1939, as amended, or any similar federal statute hereafter in effect, and to add such other terms, conditions and

provisions as may be permitted by said Act or similar federal statute, and which will not materially and adversely affect the interests of the Owners of the Bonds;

(4) to make modifications or adjustments necessary, appropriate or desirable to provide for the issuance of Variable Rate Indebtedness, Capital Appreciation Indebtedness or Parity Debt with such interest rate, payment, maturity and other terms as the City may deem desirable; subject to the provisions of the Indenture;

(5) to provide for the issuance of Bonds in book-entry form or bearer form, provided that no such provision will materially and adversely affect the interests of the Owners of the Bonds;

(6) if the City agrees in a Supplemental Indenture to maintain the exclusion of interest on a Series of Bonds from gross income for purposes of federal income taxation, to make such provisions as are necessary or appropriate to ensure such exclusion;

(7) to provide for the issuance of an additional Series of Bonds pursuant to provisions of the Indenture; and

(8) for any other purpose that does not materially and adversely affect the interests of the Owners of the Bonds.

Defeasance

Discharge of Indenture. Bonds of any Series or a portion thereof may be paid by the City in any of the following ways:

(a) by paying or causing to be paid the Bond Obligation of and interest on such Outstanding Bonds, as and when the same become due and payable;

(b) by depositing with the Trustee, an escrow agent or other fiduciary, in trust, at or before maturity, money or securities in the necessary amount and subject to the conditions as described under "Deposit of Moneys or Securities with Trustee" to pay or redeem such Outstanding Bonds; or

(c) by delivering to the Trustee, for cancellation by it, such Outstanding Bonds.

If the City pays all Series for which any Bonds are Outstanding and also pay or cause to be paid all other sums payable under the Indenture by the City, then and in that case (but subject to any additional requirements in connection therewith as may be imposed by any insurer of the Bonds and set forth in a Supplemental Indenture), at the election of the City (evidenced by a Certificate of the City filed with the Trustee signifying the intention of the City to discharge all such indebtedness and the Indenture), and notwithstanding that any Bonds have not been surrendered for payment, the Indenture and the pledge of Net Revenues and other assets made under the Indenture and all covenants, agreements and other obligations of the City under the Indenture will cease, terminate, become void and be completely discharged and satisfied. In such event, upon Request of the City, the Trustee will cause an accounting for such period or periods as may be requested by the City to be prepared and filed with the City and will execute and deliver to the City all such instruments as may be necessary or desirable to evidence such discharge and satisfaction, and the Trustee will pay over, transfer, assign or deliver to the City all moneys or securities or other property held by it pursuant to

the Indenture which, as evidenced by a verification report, upon which the Trustee may conclusively rely, from a firm of certified public accountants, are not required for the payment or redemption of Bonds not theretofore surrendered for such payment or redemption.

Discharge of Liability on Bonds. Upon the deposit with the Trustee, escrow agent or other fiduciary, in trust, at or before maturity, of money or securities in the necessary amount and subject to the conditions as described under “Deposit of Moneys or Securities with Trustee” to pay or redeem any Outstanding Bond (whether upon or prior to its maturity or the redemption date of such Bond), provided that, if such Bond is to be redeemed prior to maturity, notice of such redemption has been given as in the Indenture provided or provision satisfactory to the Trustee have been made for the giving of such notice, then (but subject to any additional requirements with respect thereto as may be imposed by any insurer of the Bonds and set forth in a Supplemental Indenture) all liability of the City in respect of such Bond will cease, terminate and be completely discharged, provided that the Owner thereof will thereafter be entitled to the payment of the principal of and premium, if any, and interest on the Bonds, and the City will remain liable for such payment, but only out of such money or securities deposited with the Trustee as aforesaid for their payment, subject, however, to the provisions of the Indenture and the continuing duties of the Trustee under the Indenture.

The City may at any time surrender to the Trustee for cancellation by it any Bonds previously issued and delivered, which the City may have acquired in any manner whatsoever, and such Bonds, upon such surrender and cancellation, will be deemed to be paid and retired.

Deposit of Money or Securities with Trustee. Whenever in the Indenture it is provided or permitted that there be deposited with or held in trust by the Trustee money or securities in the necessary amount to pay or redeem any Bonds, the money or securities so to be deposited or held may include money or securities held by the Trustee in the funds and accounts established pursuant to the Indenture and will be:

(a) lawful money of the United States of America in an amount equal to the principal amount of such Bonds and all unpaid interest thereon to maturity, except that, in the case of Bonds which are to be redeemed prior to maturity and in respect of which notice of such redemption has been given as in the Indenture provided or provision satisfactory to the Trustee has been made for the giving of such notice, the amount to be deposited or held will be the principal amount or Redemption Price of such Bonds and all unpaid interest thereon to the redemption date; or

(b) Defeasance Securities, the principal of and interest on which when due will, in the opinion of an independent certified public accountant delivered to the Trustee (upon which opinion the Trustee may conclusively rely), provide money sufficient to pay the principal or Redemption Price of and all unpaid interest to maturity, or to the redemption date, as the case may be, on the Bonds to be paid or redeemed, as such principal or Redemption Price and interest become due, provided that, in the case of Bonds which are to be redeemed prior to the maturity thereof, notice of such redemption has been given as in the Indenture provided or provision satisfactory to the Trustee has been made for the giving of such notice;

provided, in each case, that the Trustee has been irrevocably instructed (by the terms of the Indenture or by Request of the City) to apply such money to the payment of such principal or Redemption Price and interest with respect to such Bonds.

Liability of City Limited to Net Revenues

Notwithstanding anything in the Indenture or in the Bonds contained, the City will not be required to advance any moneys derived from any source other than the Net Revenues and other assets pledged under the Indenture for any of the purposes in the Indenture mentioned, whether for the payment of the principal or Redemption Price of or interest on the Bonds or for any other purpose of the Indenture.

The Bonds are special, limited obligations of the City. The Bonds will not be deemed to constitute a debt or liability of the City, the State of California or of any political subdivision thereof within the meaning of any constitutional or statutory provision, or a pledge of the faith and credit of the City, the State of California or of any political subdivision thereof, but will be payable, except to the extent of certain amounts held under the Indenture pledged therefor, solely from Net Revenues. Neither the faith and credit nor the taxing power of the City, the State of California or of any political subdivision thereof is pledged to the payment of the principal of, premium, if any, or the interest on the Bonds. The issuance of the Bonds will not directly or indirectly or contingently obligate the City, the State of California or any political subdivision thereof to levy or to pledge any form of taxation whatsoever therefor or to make any appropriation for their payment.

Special Insurance Provisions

So long as the payment of principal of and interest on any Series 2006A Bonds is insured by a municipal bond insurance policy issued simultaneously with the delivery of the Series 2006A Bonds, anything in the Indenture to the contrary notwithstanding, the bond insurer shall be deemed to be the sole Owner of the Series 2006A Bonds for the purpose of exercising any voting right or privilege or giving any consent or direction or taking any other action that the Owners of the Series 2006A Bonds are entitled to take pursuant to the Indenture upon the occurrence and continuance of an Event of Default and shall be entitled to control and direct the enforcement of all rights and remedies granted to the Owners of the Series 2006A Bonds (or to the Trustee for the benefit of the Owners of the Series 2006A Bonds insured by the bond insurer under the Indenture as if (and to the extent that) the bond insurer were the Owner of all of the Series 2006A Bonds insured by the bond insurer then Outstanding, including, without limitation, (i) the right to pursue any available remedy at law or in equity to enforce the payment of the principal and interest and premium, if any, (including the right to accelerate the principal of the Series 2006A Bonds as described in the Indenture) on the Series 2006A Bonds and (ii) the right to waive any Event of Default with respect to the Series 2006A Bonds (including the right to rescind and annul any declaration of acceleration of the Series 2006A Bonds as described in the Indenture) insured by the bond insurer.

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APPENDIX D

PROPOSED FORM OF OPINION OF BOND COUNSEL

[Closing Date]

City of Modesto
Modesto, California

Re:

\$16,535,000
City of Modesto, California
Wastewater Revenue Bonds,
Series 2006A

Ladies and Gentlemen:

We have acted as bond counsel to the City of Modesto, California (the “City”) in connection with the issuance by the City of its Wastewater Revenue Bonds, Series 2006A in the aggregate principal amount of \$16,535,000 (the “Series 2006A Bonds”). The Bonds are being issued pursuant to Section 200 of the City Charter and the City of Modesto Wastewater Treatment Facilities Revenue Bond Law, constituting Chapter 6 of Title VIII of the Modesto Municipal Code (the “Bond Law”) and a Wastewater Revenue Bond Indenture, dated as of April 1, 2005 (the “Master Indenture”), as previously supplemented and as supplemented by the Third Supplemental Wastewater Revenue Bond Indenture, dated as of December 1, 2006 (the “Third Supplement”), providing for the issuance of the Series 2006A Bonds, each by and between the City and The Bank of New York Trust Company, N.A., as successor trustee (the “Trustee”). The Master Indenture as so supplemented is hereinafter referred to as the “Indenture”. Capitalized terms not otherwise defined herein shall have the meanings ascribed thereto in the Indenture.

In our capacity as bond counsel, we have reviewed the Bond Law, the Indenture, certifications of the City, the Trustee, and others, opinions of counsel to the City and the Trustee, and such other documents, opinions and instruments as we deemed necessary to render the opinions set forth herein. Our services as bond 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. 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 Indenture, including (without limitation) covenants and agreements compliance with which is necessary to assure that future actions, omissions or events will not cause interest on the Series 2006A Bonds to be included in gross income for federal income tax purposes.

Certain requirements and procedures contained or referred to in the Indenture or other relevant documents relating to the Series 2006A Bonds may be changed, and certain actions may be taken (including, without limitation, defeasance of the Series 2006A Bonds) 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 municipal bonds. We

express no opinion as to the exclusion of the interest on the Series 2006A Bonds from gross income for federal income tax purposes 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 this firm.

With respect to the opinions expressed herein, the enforceability of the Indenture is subject to the limitations on the imposition of certain fees and charges by the City relating to the Enterprise under Articles XIII C and XIII D of the California Constitution. In addition, the rights and obligations under the Series 2006A Bonds and the Indenture 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, under existing law, we are of the following opinions:

1. The Bonds constitute the valid and binding special limited obligations of the City.
2. The Bonds are payable exclusively from and are secured by a pledge of Net Revenues of the Enterprise and certain amounts pledged under the Indenture. Neither the faith and credit nor the taxing power of the City, the State of California or of any political subdivision thereof is pledged to the payment of the principal of, premium, if any, or the interest on the Bonds.
3. The Indenture has been duly authorized, executed and delivered by, and constitutes the valid and binding obligation of, the City. The Indenture creates a valid pledge, to secure the payment of the principal of and interest on the Series 2006A Bonds, of the Net Revenues of the Enterprise, and certain other amounts held by the Trustee under the Indenture, as and to the extent set forth in the Indenture and subject to the provisions of the Indenture permitting the application thereof for the purposes and on the terms and conditions set forth therein.
4. Additional bonds and other Parity Debt of the City have been and may from time to time hereafter be issued under the Indenture which are payable from Net Revenues on a parity basis with the Series 2006A Bonds.
5. Assuming continuing compliance by the City with certain covenants in the Indenture and requirements of the Internal Revenue Code of 1986, as amended, regarding the use, expenditure and investment of bond proceeds and the timely payment of certain investment earnings to the United States, interest on the Series 2006A Bonds is not includable in the gross income of the owners of the Series 2006A Bonds for purposes of federal income taxation.

Interest on the Series 2006A Bonds is not treated as an item of tax preference in calculating the federal alternative minimum taxable income of individuals and corporations. Interest on the Series 2006A Bonds, however, is included as an adjustment in the calculation of federal corporate alternative minimum taxable income and may therefore affect a corporation's federal alternative minimum tax liability.

6. Interest on the Series 2006A Bonds is exempt from personal income tax imposed by the State of California.

Other than as described herein, we have neither addressed nor are we opining on the tax consequences to any person of the investment in, or the receipt of interest on, the Series 2006A Bonds.

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 any 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,

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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., in its capacity as Dissemination Agent (the “Dissemination Agent”), in connection with the issuance by the City of its \$16,535,000 Wastewater Revenue Bonds, Series 2006A (the “Bonds”). The Bonds are being issued pursuant to a Wastewater Revenue Bond Indenture, dated as of April 1, 2005, by and between the City and The Bank of New York Trust Company, N.A., San Francisco, California, as successor trustee (the “Trustee”), as supplemented by a First Supplemental Wastewater Revenue Bond Indenture and a Second Supplemental Wastewater Revenue Bond Indenture, each dated as of April 1, 2005, each by and between the City and the Trustee, and a Third Supplemental Wastewater Revenue Bond Indenture, dated as of December 1, 2006, by and between the City and the Trustee (as so supplemented, the “Indenture”). The City and the Dissemination Agent covenant and agree as follows:

SECTION 1. Purpose of the Disclosure Agreement. This Disclosure Agreement is being executed and delivered by the City and the Dissemination Agent for the benefit of the Holders and Beneficial Owners of the Bonds and in order to assist the Participating Underwriters in complying with Securities and Exchange Commission Rule 15c2-12(b)(5).

SECTION 2. Definitions. In addition to the definitions set forth in the Indenture, which apply to any capitalized term used in this Disclosure Agreement unless otherwise defined in this Section 2, the following 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 Bonds (including persons holding Bonds through nominees, depositories or other intermediaries), or (b) is treated as the owner of any Bonds for federal income tax purposes.

“Central Post Office” means the DisclosureUSA 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 period beginning on July 1 of each year and ending on the next succeeding June 30, or any twelve month or fifty-two week period hereafter selected by the City, with notice of such selection or change in fiscal year to be provided as set forth herein.

“Holders” shall mean either the registered owners of the Bonds, or, if the Bonds are registered in the name of The Depository Trust Company or another recognized depository, any applicable participant in such depository system.

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

“National Repository” shall mean any Nationally Recognized Municipal Securities Information Repository for purposes of the Rule. The Nationally Recognized Municipal Securities Information Repositories for purposes of the Rule are identified in the Securities and Exchange Commission website located at www.sec.gov/consumer/nrmsir.htm.

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

“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) The City shall, or shall cause the Dissemination Agent to, not later than 270 days after the end of the City’s Fiscal Year (presently March 31 of the subsequent year following the end of the City’s Fiscal Year), commencing with the report for the end of the 2005-06 Fiscal Year, prepare an Annual Report 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. If by fifteen (15) Business Days prior to such date, the Dissemination Agent has not received a copy of the Annual Report from the City, the Dissemination Agent shall contact the City to determine if the City is in compliance with subsection (a). The City reserves the right to make this filing through the Central Post Office.

(c) If the Dissemination Agent is unable to verify that an Annual Report of the City 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 hereto as Exhibit A.

(d) The Dissemination Agent shall:

- (i) determine each year prior to the date for providing the Annual Report the name and address of each National Repository and the State Repository, if any; and;
- (ii) to the extent the City has provided the Dissemination Agent with the Annual Report, 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. The Dissemination Agent shall have no responsibility for the content of any Annual Report.

SECTION 4. Content of Annual Reports. The Annual Report of the City shall contain or include by reference the following:

- (i) the Annual Budget of the City;
- (ii) the Comprehensive Annual Financial Report of the City and, to the extent not contained in said Report or if said Report is no longer being prepared, the audited financial statements of the City's wastewater system Enterprise for the prior Fiscal Year, prepared in accordance with generally accepted accounting principles as promulgated to apply to governmental entities from time to time by the Government Accounting Standards Board. If the audited financial statements of the City's wastewater system Enterprise are not available by the time the Annual Report is required to be filed pursuant to Section 3(a), the Annual Report shall contain unaudited financial statements, and the audited financial statements shall be filed in the same manner as the Annual Report when they become available;
- (iii) the principal amount of the Bonds and any other Parity Debt outstanding,
- (iv) to the extent not included in the City's audited financial statements, an update for the prior Fiscal Year of the financial information and operating data with respect to the City and the Enterprise of the following type (or information and data comparable thereto) included in the Official Statement relating to the Bonds, dated November 28, 2006 (the "Official Statement"):
 - (a) the table on page 20 of the Official Statement entitled "City of Modesto Wastewater System Customer Base by Type of Account;"
 - (b) the table on page 21 of the Official Statement entitled "City of Modesto Wastewater System Ten Largest Users of Sewer Facilities;"
 - (c) the information in the tables on page 23 under the caption "Rates" and in the table on page 25 under the subcaption "Connection Fees;" and

- (d) the table on page 26 of the Official Statement entitled “City of Modesto Sewer Enterprise Historical Debt Service Coverage.”

Any or all of the items listed in (iv) above may be included by specific reference to other documents, including official statements of debt issues of the City or related public entities, which have been submitted to each of the Repositories or the Securities and Exchange Commission. If the document included by reference is a final official statement, it must be available from the Municipal Securities Rulemaking Board. The City shall clearly identify each such other document so included by reference.

SECTION 5. Reporting of Significant Events.

(a) Pursuant to the provisions of this Section 5, the City shall give, or cause to be given, notice of the occurrence of any of the following events with respect to the Bonds, if the City determines that such event is material under federal securities law:

1. principal and interest payment delinquencies;
2. non-payment related defaults;
3. modifications to rights of Bondholders;
4. optional, contingent or unscheduled bond calls;
5. defeasances;
6. rating changes;
7. adverse tax opinions or events adversely affecting the tax-exempt status of the Bonds;
8. unscheduled draws on credit enhancements reflecting financial difficulties;
9. unscheduled draws on the insurance policies reflecting financial difficulties;
10. substitution of the provider of any municipal bond insurance, or any failure by any insurer to perform on any municipal bond insurance policy; and
11. release, substitution or sale of property securing repayment of the Bonds.

(b) Whenever the City obtains knowledge of the occurrence of a Listed Event, the City shall as soon as possible determine if such event would be material under applicable federal securities laws.

(c) If the City determines that knowledge of the occurrence of a Listed Event would be material under applicable federal securities laws, the City shall promptly notify the Dissemination Agent in writing. Such notice shall instruct the Dissemination Agent to report the occurrence pursuant to subsection (e).

(d) If 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 (e).

(e) 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 Municipal

Securities Rulemaking Board or the Repositories with a copy to the City. 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 Holders of affected Bonds pursuant to the Indenture.

(f) The City reserves the right to make such notice of significant event filings through the Central Post Office.

SECTION 6. Termination of Reporting Obligation. The obligations of the City under this Disclosure Agreement shall terminate upon the defeasance, prior redemption or payment in full of all of the Bonds.

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 initial Dissemination Agent shall be The Bank of New York Trust Company, N.A. 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:

- (i) If the amendment or waiver relates to the provisions of Sections 3(a), 4 or 5(a), it may only be made in connection with a change in circumstances that arises from a change in legal requirements, change in law, or change in the identity, nature or status of an obligated person with respect to the Bonds or the type of business conducted;
- (ii) 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 original issuance of the Bonds, after taking into account any amendments or interpretations of the Rule, as well as any change in circumstances; and
- (iii) The amendment or waiver either (i) is approved by the Holders of the Bonds in the same manner as provided in the Indenture for amendments to the Indenture with the consent of Holders, or (ii) does not, in the opinion of nationally recognized bond counsel, materially impair the interests of the Holders or Beneficial Owners of the Bonds.

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 Holders of at least 25% aggregate principal amount of Outstanding Bonds, shall (to the extent indemnified to its satisfaction)) or any Holder or Beneficial Owner of the Bonds may, take such actions as may be necessary and appropriate, including seeking mandate or specific performance by court order, to cause the City 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 Indenture, 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 Holders or Beneficial Owners of the Bonds, the City, the Participating Underwriters 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 Bonds.

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 10th Street, Suite 5200
Modesto, California 95353
Attention: Finance Director
Telephone: (209) 577-5371
Facsimile: (209) 571-5880

To the Dissemination Agent: The Bank of New York Trust Company, N.A.
555 Kearny 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 Bonds, and 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.

Dated: December 14, 2006

CITY OF MODESTO

By: _____
Director of Finance

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

By: _____
Authorized Officer

EXHIBIT A

NOTICE TO REPOSITORIES OF FAILURE TO FILE ANNUAL REPORT

Name of Obligated Party: City of Modesto
Name of Issue: Wastewater Revenue Bonds, Series 2006A
Date of Delivery: December 14, 2006

NOTICE IS HEREBY GIVEN that the City has not provided an Annual Report with respect to the above-named Bonds as required by Section 3 of the Continuing Disclosure Agreement, dated December 1, 2006, between the City and The Bank of New York Trust Company, N.A., as Dissemination Agent. The City has informed the undersigned that it anticipates that the Annual Report will be filed by _____.

Dated: _____

The Bank of New York Trust Company, N.A.,
as Dissemination Agent

By: _____
Authorized Officer

cc: City of Modesto

APPENDIX F

SPECIMEN MUNICIPAL BOND INSURANCE POLICY



**MUNICIPAL BOND
INSURANCE POLICY**

ISSUER:

BONDS: \$ in aggregate principal amount of

Policy No.: -N

Effective Date:

Premium: \$

FINANCIAL SECURITY ASSURANCE INC. ("Financial Security"), for consideration received, hereby UNCONDITIONALLY AND IRREVOCABLY agrees to pay to the trustee (the "Trustee") or paying agent (the "Paying Agent") (as set forth in the documentation providing for the issuance of and securing the Bonds) for the Bonds, for the benefit of the Owners or, at the election of Financial Security, directly to each Owner, subject only to the terms of this Policy (which includes each endorsement hereto), that portion of the principal of and interest on the Bonds that shall become Due for Payment but shall be unpaid by reason of Nonpayment by the Issuer.

On the later of the day on which such principal and interest becomes Due for Payment or the Business Day next following the Business Day on which Financial Security shall have received Notice of Nonpayment, Financial Security will disburse to or for the benefit of each Owner of a Bond the face amount of principal of and interest on the Bond that is then Due for Payment but is then unpaid by reason of Nonpayment by the Issuer, but only upon receipt by Financial Security, in a form reasonably satisfactory to it, of (a) evidence of the Owner's right to receive payment of the principal or interest then Due for Payment and (b) evidence, including any appropriate instruments of assignment, that all of the Owner's rights with respect to payment of such principal or interest that is Due for Payment shall thereupon vest in Financial Security. A Notice of Nonpayment will be deemed received on a given Business Day if it is received prior to 1:00 p.m. (New York time) on such Business Day; otherwise, it will be deemed received on the next Business Day. If any Notice of Nonpayment received by Financial Security is incomplete, it shall be deemed not to have been received by Financial Security for purposes of the preceding sentence and Financial Security shall promptly so advise the Trustee, Paying Agent or Owner, as appropriate, who may submit an amended Notice of Nonpayment. Upon disbursement in respect of a Bond, Financial Security shall become the owner of the Bond, any appurtenant coupon to the Bond or right to receipt of payment of principal of or interest on the Bond and shall be fully subrogated to the rights of the Owner, including the Owner's right to receive payments under the Bond, to the extent of any payment by Financial Security hereunder. Payment by Financial Security to the Trustee or Paying Agent for the benefit of the Owners shall, to the extent thereof, discharge the obligation of Financial Security under this Policy.

Except to the extent expressly modified by an endorsement hereto, the following terms shall have the meanings specified for all purposes of this Policy. "Business Day" means any day other than (a) a Saturday or Sunday or (b) a day on which banking institutions in the State of New York or the Insurer's Fiscal Agent are authorized or required by law or executive order to remain closed. "Due for Payment" means (a) when referring to the principal of a Bond, payable on the stated maturity date thereof or the date on which the same shall have been duly called for mandatory sinking fund redemption and does not refer to any earlier date on which payment is due by reason of call for redemption (other than by mandatory sinking fund redemption), acceleration or other advancement of maturity unless Financial Security shall elect, in its sole discretion, to pay such principal due upon such acceleration together with any accrued interest to the date of acceleration and (b) when referring to interest on a Bond, payable on the stated date for payment of interest. "Nonpayment" means, in respect of a Bond, the failure of the Issuer to have provided sufficient funds to the Trustee or, if there is no Trustee, to the Paying Agent for payment in full of all principal and interest that is Due for Payment on such Bond. "Nonpayment" shall also include, in respect of a Bond, any payment of principal or interest that is Due for Payment made to an Owner by or on behalf of the Issuer 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. "Notice" means telephonic or telecopied notice, subsequently confirmed in a signed writing, or written notice by registered or certified mail, from an Owner, the Trustee or the Paying Agent to Financial Security which notice shall specify (a) the person or entity making the claim, (b) the Policy Number, (c) the claimed amount and (d) the date such claimed amount became Due for Payment. "Owner" means, in respect of a Bond, the person or entity who, at the time of Nonpayment, is entitled under the terms of such Bond to payment thereof, except that "Owner" shall not include the Issuer or any person or entity whose direct or indirect obligation constitutes the underlying security for the Bonds.

Financial Security may appoint a fiscal agent (the "Insurer's Fiscal Agent") for purposes of this Policy by giving written notice to the Trustee and the Paying Agent specifying the name and notice address of the Insurer's Fiscal Agent. From and after the date of receipt of such notice by the Trustee and the Paying Agent, (a) copies of all notices required to be delivered to Financial Security pursuant to this Policy shall be simultaneously delivered to the Insurer's Fiscal Agent and to Financial Security and shall not be deemed received until received by both and (b) all payments required to be made by Financial Security under this Policy may be made directly by Financial Security or by the Insurer's Fiscal Agent on behalf of Financial Security. The Insurer's Fiscal Agent is the agent of Financial Security only and the Insurer's Fiscal Agent shall in no event be liable to any Owner for any act of the Insurer's Fiscal Agent or any failure of Financial Security to deposit or cause to be deposited sufficient funds to make payments due under this Policy.

To the fullest extent permitted by applicable law, Financial Security agrees not to assert, and hereby waives, only for the benefit of each Owner, all rights (whether by counterclaim, setoff or otherwise) and defenses (including, without limitation, the defense of fraud), whether acquired by subrogation, assignment or otherwise, to the extent that such rights and defenses may be available to Financial Security to avoid payment of its obligations under this Policy in accordance with the express provisions of this Policy.

This Policy sets forth in full the undertaking of Financial Security, and shall not be modified, altered or affected by any other agreement or instrument, including any modification or amendment thereto. Except to the extent expressly modified by an endorsement hereto, (a) any premium paid in respect of this Policy is nonrefundable for any reason whatsoever, including payment, or provision being made for payment, of the Bonds prior to maturity and (b) this Policy may not be canceled or revoked. THIS POLICY IS NOT COVERED BY THE PROPERTY/CASUALTY INSURANCE SECURITY FUND SPECIFIED IN ARTICLE 76 OF THE NEW YORK INSURANCE LAW.

In witness whereof, FINANCIAL SECURITY ASSURANCE INC. has caused this Policy to be executed on its behalf by its Authorized Officer.

[Countersignature]

FINANCIAL SECURITY ASSURANCE INC.

By _____

By _____
Authorized Officer

A subsidiary of Financial Security Assurance Holdings Ltd.
350 Park Avenue, New York, N.Y. 10022-6022

(212) 826-0100

Form 500NY (5/90)



**FINANCIAL
SECURITY
ASSURANCE®**

**ENDORSEMENT NO. 1 TO
MUNICIPAL BOND
INSURANCE POLICY
(California Insurance
Guaranty Association)**

ISSUER:

Policy No.:

BONDS:

Effective Date:

Notwithstanding the terms and provisions contained in this Policy, it is further understood that the insurance provided by this Policy is not covered 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.

Nothing herein shall be construed to waive, alter, reduce or amend coverage in any other section of the Policy. If found contrary to the Policy language, the terms of this Endorsement supersede the Policy language.

In witness whereof, FINANCIAL SECURITY ASSURANCE INC. has caused this Endorsement to be executed on its behalf by its Authorized Officer.

FINANCIAL SECURITY ASSURANCE INC.

By: _____
Authorized Officer

A subsidiary of Financial Security Assurance Holdings Ltd.
350 Park Avenue, New York, N.Y. 10022-6022

(212) 826-0100

Form 560NY (CA 1/91)

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APPENDIX G

BOOK ENTRY SYSTEM

The information in this Appendix concerning DTC and DTC's book entry only system has been obtained from sources that the City believes to be reliable, but 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 Series 2006A Bonds, payment of principal, premium, if any, and interest with respect to the Series 2006A Bonds to all DTC Participants or to Beneficial Owners, confirmation and transfers of Beneficial Ownership interests in the Series 2006A Bonds 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 Series 2006A Bonds. The Series 2006A Bonds will be issued as fully-registered securities registered in the name of Cede & Co. (DTC’s partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully-registered security certificate will be issued for each maturity of the Series 2006A Bonds, each in the aggregate principal amount of such maturity, and will be deposited with DTC.

DTC, the world’s largest securities depository, is a limited-purpose trust company organized under the New York Banking Law, a “banking organization” within the meaning of the New York Banking Law, a member of the Federal Reserve System, a “clearing corporation” within the meaning of the New York Uniform Commercial Code, and a “clearing agency” registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for over 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 Series 2006A Bonds under the DTC system must be made by or through Direct Participants, which will receive credit for the Series 2006A Bonds 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 Series 2006A Bonds are to be accomplished by entries made on the books of Direct and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in Certificates, except in the event that use of the book-entry system for the Series 2006A Bonds is discontinued.

To facilitate subsequent transfers, all Series 2006A Bonds deposited by Direct Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co, or such other name as may be requested by an authorized representative of DTC. The deposit of Series 2006A Bonds with DTC and their registration in the name of Cede & Co. or such other DTC nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Series 2006A Bonds; DTC's records reflect only the identity of the Direct Participants to whose accounts such Series 2006A Bonds are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. Beneficial Owners of Series 2006A Bonds may wish to take certain steps to augment the transmission to them of notices of significant events with respect to the Series 2006A Bonds, such as redemptions, tenders, defaults, and proposed amendments to the Bond documents. For example, Beneficial Owners of Series 2006A Bonds may wish to ascertain that the nominee holding the Series 2006A Bonds for their benefit has agreed to obtain and transmit notices to Beneficial Owners. In the alternative, Beneficial Owners may wish to provide their names and addresses to the registrar and request that copies of notices be provided directly to them.

Prepayment notices shall be sent to DTC. If less than all of the Series 2006A Bonds 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 Series 2006A Bonds 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 Series 2006A Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Prepayment proceeds, principal and interest payments on the Series 2006A Bonds will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts upon DTC's receipt of funds and corresponding detail information from the 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 Series 2006A Bonds 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, Series 2006A Bonds are required to be printed and delivered.

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

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