

*Investment Policy.* The City's treasury operations are managed according to the Investment Policy which sets forth permitted investment vehicles, liquidity parameters and maximum maturities. The Investment Policy is reviewed and authorized by the City Council on an annual basis. The City Council approved the Investment Policy for fiscal year ended June 30, 2007 on November 20, 2006.

The Investment Policy establishes three primary objectives, in the following order of priority, for the City's investment activities.

1. Safety of Principal. The City will seek to preserve principal by mitigating credit risk and market risk (by structuring the portfolio so that securities mature at the same time as major cash outflows occur and by prohibiting the taking of short positions).

2. Liquidity. The City will maintain sufficient liquidity in the investment portfolio to enable the City to meet all operating requirements which might be reasonably anticipated and investments will be authorized only in securities that are actively traded in the secondary market. The City operates its own electric and water utility and bills monthly for such services. The utility billing program generates significant cash flow on a daily basis. Historical cash flow trends are compared to current cash flow requirements on an ongoing basis in an effort to ensure that the City's investment portfolio will remain sufficiently liquid to enable the City to meet all reasonably anticipated operating requirements.

3. Return on Investment. The City will design its investment portfolio to attain a "market average rate of return" through economic cycles and, whenever possible, consistent with risk limitations and prudent investment principles, to augment returns above the market average rate of return.

The City's cash management system is designed to accurately monitor and forecast expenditures and revenues, thus enabling the City to invest funds to the fullest extent possible. The City attempts to earn the highest yield obtainable while keeping within the investment criteria established by the Investment Policy for the safety and liquidity of public funds.

To meet its short-term cash flow needs, the City typically maintains an average investment balance of about \$30 million in securities with a maturity of 30 days or less.

*Authorized Investments.* Funds are invested only in those securities authorized by the various sections of the California Government Code and the City's Investment Policy, which include obligations of the United States Treasury, agencies of the United States Government, local and State bond issues, bankers acceptances, commercial paper of prime quality, certificates of deposit (both collateralized and negotiable), repurchase and reverse repurchase agreements, medium-term corporate bonds, shares of beneficial interest in diversified management companies (mutual funds), and asset-backed (including mortgage-related) and pass-through securities.

The City does not invest funds in any security that could result in a zero interest accrual if held to maturity, and has no investments in derivative products such as interest rate swaps, futures, options or reverse purchase agreements in connection with its investments. The City has entered into interest rate swap agreements in connection with certain of its obligations. The City does not have any investments which are reverse repurchase agreements. A reverse repurchase agreement is a transaction in which a holder of securities, such as the City, sells the same to a third party and agrees to repurchase them at a later date. The proceeds received by the seller can in turn be invested in additional securities, thus producing "leverage."

The Government Code stipulates that no investments may be made in securities with maturities in excess of five years without express authority from the City's legislative body. The Government Code and the City's Investment Policy place various other restrictions on investment in and allocation of funds to various investment categories, including the following:

- The value of bankers acceptances, bills of exchange or time drafts drawn on and accepted by commercial banks may not exceed 40% of the City's portfolio book value as measured on the date of purchase and the days to maturity of such investments may not exceed 180 days.
- Commercial paper must be rated P1 and issued by U.S. corporations with assets greater than \$500 million and a long-term debenture rating of A or better. The City is not permitted to purchase commercial paper that exceeds 270 days to maturity nor hold more than 10% of a corporation's outstanding commercial paper. The value of the City's holdings of commercial paper may not exceed 15% of the book value of the City's portfolio as measured on the date of purchase.
- The value of the City's holdings of negotiable certificates of deposits may not exceed 30% of the book value of the City's portfolio as measured on the date of purchase.
- The market value of the securities used as collateral for repurchase agreements may not be permitted to fall below 102% of the value of the repurchase agreement. Execution of a PSA Master Repurchase Agreement is required for all repurchase agreements transacted and the maturity of repurchase agreements may not exceed one year.
- The value of City's reverse repurchase agreement holdings may not exceed 20% of the book value of the City's portfolio as measured on the day of purchase. Reverse repurchase agreements may not exceed 92 days to maturity unless the agreement includes a written guarantee of minimum earnings for the entire period. Term reverse repurchase transactions in excess of 92 days are only permitted if the securities underlying the reverse are matched to the maturities of the reinvestments.
- No more than 25% of the City's investment portfolio may be invested in time deposits.
- Medium-term corporate bonds must be rated in a rating category of "A" or its equivalent or better by a nationally recognized rating service. The value of the City's holdings of medium-term corporate bonds is limited to 30% of the City's portfolio book value as measured on the date of purchase and no more than 5% of the cost value may be invested in bonds held by one corporation.
- The value of the City's mutual fund holdings may not exceed 20% of the City's portfolio book value as measured on the date of purchase.
- Any eligible mortgage pass-through security, collateralized mortgage obligation, mortgage-backed or other pay-through bond, equipment lease-backed certificate, consumer receivable pass-through certificate or consumer receivable-backed bond must be issued by an issuer having an "A" or higher rating for the issuer's debt as provided by a nationally recognized rating service and rated in a rating category of "AA" or its equivalent or better by a nationally recognized rating service. In addition, purchases of such securities may not exceed 20% of all of the City's surplus funds that may be invested in accordance with the foregoing investment guidelines and restrictions.

None of the moneys on deposit in the City's investment portfolio is currently invested in leveraged products or inverse floating rate bonds. The City has no investments in outside investment pools except for State's Local Agency Investment Fund (LAIF). The City does not have a practice of lending its portfolio's securities to others in return for a fee, although it is not prohibited from doing so.

### **General Obligation Debt**

Under the City Charter, the City may not incur indebtedness by general obligation bond which would in the aggregate exceed 15% of the total assessed valuation of all the real and personal property within the City subject to assessment for taxation for municipal purposes. In addition, no bonded indebtedness which will constitute a general obligation of the City may be created unless authorized by the affirmative vote of two-thirds of the electorate voting on such proposition at any election at which the question is submitted. Such bonds are secured by an ad valorem property tax assessed against the property owners of the City.

The City currently has no general obligation debt outstanding.

### **Estimated Direct and Overlapping Bonded Debt**

The estimated direct and overlapping bonded debt of the City as of [May 31], 2008 is set forth in the following table.

[To Come]

## **RISK FACTORS**

The following risk factors associated with investing in 2008C Certificates, along with all other information in this Official Statement, should be considered by potential investors in evaluating an investment in the 2008C Certificates. The following list is not intended to be comprehensive of all risks of investing in the 2008C Certificates and no significance should be associated with the order of presentation of the risk factors.

### **Lease Obligation—No Tax Pledge**

THE OBLIGATION OF THE CITY TO MAKE BASE RENTAL PAYMENTS UNDER THE SUBLEASE DOES NOT CONSTITUTE AN OBLIGATION OF THE CITY FOR WHICH THE CITY IS OBLIGATED TO LEVY OR PLEDGE ANY FORM OF TAXATION OR FOR WHICH THE CITY HAS LEVIED OR PLEDGED ANY FORM OF TAXATION. NEITHER THE 2008C CERTIFICATES NOR THE OBLIGATION OF THE CITY TO MAKE BASE RENTAL PAYMENTS UNDER THE SUBLEASE CONSTITUTES AN INDEBTEDNESS OF THE CITY, THE STATE OR ANY POLITICAL SUBDIVISION THEREOF WITHIN THE MEANING OF ANY CONSTITUTIONAL OR STATUTORY DEBT LIMITATION OR RESTRICTION.

### **No Pledge of City Funds**

The 2008C Certificates are payable from Base Rental Payments made by the City under the Sublease. While the Base Rental Payments are payable from any legally available funds, the City expects to make Base Rental Payments from amounts in its General Fund to the extent revenues of affiliated entities operating portions of the Leased Property are not available. The City has not pledged any moneys in the General Fund nor any revenue source to secure the obligations represented by the 2008C Certificates. No assurances can be given as to the amount and source of money available to the City at any particular time to make Base Rental Payments. In the event the City's revenue sources are less than its total obligations, the City could fund municipal services and other obligations payable from its General Fund before making Base Rental Payments and other payments due under the Sublease.

### **Sublease Has No Limit on Additional Obligations**

As of June 30, 2007, the City had outstanding \$128,045,109 of pension obligation bonds and, as of March 31, 2008, the City had entered into leasing arrangements with respect to \$395,569,972 of outstanding certificates of participation and lease revenue bonds, all of which are payable from the City's General Fund.

Such leasing arrangements are in addition to the City's obligations under the Sublease with respect to the Prior Certificates. The Sublease does not prohibit the City from incurring additional obligations payable from general revenues on a parity with the Base Rental Payments either as Additional Certificates under the Sublease or under other agreements. See "OUTSTANDING INDEBTEDNESS—Additional Certificates" herein. To the extent that additional obligations are incurred by the City, the funds available to make Base Rental Payments may be decreased. See "CITY FINANCIAL INFORMATION—General Fund Comparative Financial Statements" herein.

## **Rental Abatement**

Under the Sublease, Base Rental Payments will be abated during any period in which, by reason of title defect, damage or destruction, there is substantial interference with the use and occupancy by the City of the Leased Property or any portion thereof to the extent agreed upon by the City and the Authority. See “SOURCE OF PAYMENT FOR THE 2008C CERTIFICATES—Rental Abatement.” If Base Rental Payments are abated, no assurances can be given that moneys held by the Trustee under the Trust Agreement, or the proceeds of rental interruption insurance, will be sufficient to pay the debt service with respect to the 2008C Certificates. In addition, even if such amounts are sufficient to make such payments, moneys remaining in the Certificate Reserve Funds after such payments may be less than the Certificate Reserve Fund Requirement. **If damage, destruction, condemnation or title defect with respect to the Leased Property or any portion thereof results in abatement of Base Rental Payments and the resulting Base Rental Payments, together with moneys in the Certificate Reserve Funds, are insufficient to make all payments with respect to the 2008C Certificates during the period that the Leased Property, or portion thereof, is being restored, then all or a portion of such payments may not be made and no remedy is available to the Owners under the Sublease or Trust Agreement for nonpayment under such circumstances. Failure to pay principal of, premium, if any, or interest represented by the 2008C Certificates as a result of abatement of the City’s obligation to make Base Rental Payments under the Sublease is not an event of default under the Trust Agreement or the Sublease.**

Notwithstanding the provisions of the Sublease specifying that the extent of any Base Rental Payment abatement is to be agreed upon by the City and the Authority, in the event of the City’s failure to have use and possession of the Leased Property, such provisions may be superseded by operation of law, and, in such event, the resulting Base Rental Payments of the City may not be sufficient to pay all or that portion of the remaining principal and interest represented by the 2008C Certificates.

## **Limited Recourse on Default; Reletting of the Leased Property**

The enforcement of any remedies provided for in the Sublease and in the Trust Agreement could prove to be both expensive and time-consuming. Although the Sublease and the Trust Agreement provide that if there is a default by the City, the Trustee, as assignee of the Authority, may take possession of and relet the Leased Property, no assurance can be given that there are prospective tenants who would wish to lease the Leased Property or that the amounts received from any such reletting would be sufficient to pay the Base Rental Payments represented by the 2008C Certificates when due.

## **Limitation on Enforcement of Remedies**

The ability of the Trustee to exercise remedies in the event of a default under the Sublease may be especially difficult because of the essential nature of the Leased Property, its commercial and historical value, as well as the problems associated with taking possession and evicting government operations. Consequently, the Trustee may find it more difficult, time consuming or expensive to exercise its legal remedies than in a lease structure that did not involve governmental services. Consequently, it is likely that the Trustee’s only practical remedy will be to sue the City as rent becomes due and it will be unable to exercise upon the collateral and take possession of, and relet, the Leased Property. If the Trustee is unable to take possession and relet the Leased Property, the Owners of the 2008C Certificates may not receive payment of Base Rental Payments represented by the 2008C Certificates, or such payment may be delayed. See “THE LEASED PROPERTY.”

## **Reserve Funds**

At the time of delivery of the 2008C Certificates, the Certificate Reserve Funds under the Trust Agreement will be funded in an amount equal to the Certificate Reserve Fund Requirement, which as of the date of delivery of the 2008C Certificates will be \$ \_\_\_\_\_. In the event of abatement or default, the amounts on deposit in the Certificate Reserve Funds may be significantly less than the amount of Base Rental Payments due during any period of abatement or default.

## **No Acceleration**

In the event of a default under the Sublease, there is no available remedy of acceleration of the total Base Rental Payments due over the term of the Sublease. The City will only be liable for Base Rental Payments on an annual basis as they come due and the Trustee would be required to seek separate judgments for the annual Base Rental Payments. In addition, any such suit for money damages could be subject to limitations on legal remedies against public agencies in California, including a limitation on enforcement of judgments against funds needed to serve the public welfare and interest.

## **Bankruptcy**

In addition to the limitations on remedies contained in the Sublease and the Trust Agreement, the rights and remedies provided in the Sublease and the Trust Agreement may be limited by, and are subject to, provisions of federal bankruptcy laws, as now or hereafter enacted, and to other laws or equitable principles that may affect the enforcement of creditors' rights.

Under Chapter 9 of the Bankruptcy Code (Title 11, United States Code), which governs the bankruptcy proceedings for public agencies such as the City, there are no involuntary petitions in bankruptcy. If the City were to file a petition under Chapter 9 of the Bankruptcy Code, the Owners and the Trustee would be prohibited from taking any steps to enforce their rights under the Sublease and from taking steps to collect amounts due from the City under the Sublease.

All legal opinions with respect to the 2008C Certificates, the enforceability of the Trust Agreement and the Sublease will be expressly subject to a qualification that such agreements may be limited by bankruptcy, reorganization, insolvency, moratorium or other similar laws affecting creditors' rights and by applicable principles of equity if equitable remedies are sought.

## **Substitution, Addition or Removal of Leased Property**

The Sublease permits the release of portions of the Leased Property or the substitution of other real property for all or a portion of the Leased Property. Although the Sublease requires various certificates designed to ensure that the substitute property has an annual fair rental value upon becoming part of the Leased Property equal to the maximum annual amount of the Base Rental Payments remaining due with respect to the Leased Property being replaced, it does not require that such substitute property have an annual fair rental value equal to the total annual fair rental value at the time of replacement of the Leased Property or portion thereof being replaced. In addition, such replacement property could be located anywhere within the City's boundaries. Therefore, release or substitution of all or a portion of the Leased Property could have an adverse effect on the security for the 2008C Certificates. See "SOURCE OF PAYMENT FOR THE 2008C CERTIFICATES—Substitution, Addition or Removal of Leased Property."

## **Earthquakes and Natural Disasters**

The City is in a seismically active region of the State. Major fault systems traversing Southern California and affecting the Pasadena area include the San Andreas and Newport-Inglewood fault systems. A major earthquake along these regional systems, a local fault, or as yet unknown faults has the potential to result in seismic-induced ground shaking in the City. Much of the City, including some or all of the Leased Property, overlies sandy, stony or gravelly soil. This soil is more porous and loosely compacted than bedrock and thus subject to greater impacts from seismic ground shaking than bedrock. Some or all of Leased Property lies within four miles of the Sierra Madre fault to the north and within two miles of the Raymond Hill fault to the south. These faults are the only faults considered active within the City. No known faults traverse the Leased Property. A significant earthquake along one or more of these or other faults is probable during the period the 2008C Certificates will be Outstanding.

Earthquake insurance is only required to be provided to the extent such insurance is commercially available from reputable insurance companies. See APPENDIX B – SUMMARY OF PRINCIPAL LEGAL DOCUMENTS – The Sublease.” The City does not carry earthquake insurance for the Leased Property because the City has determined that it is not available at commercially reasonable rates. In the event that a portion or all of the Leased Property is damaged or destroyed by earthquake, the City’s obligation to make Base Rental Payments would be abated. In addition, if a portion or all of the Leased Property were damaged or destroyed in an earthquake, rental interruption insurance would not provide coverage for any abatement of Base Rental Payments and the City would have no obligation to repair such damage. In the event of a serious earthquake affecting the City, it is possible that the Federal Emergency Management Agency (“FEMA”) would provide financing to aid the rebuilding of some or all of the Leased Property; however, there can be no assurance that FEMA or any other entity would provide such aid or that, if provided, it would cover the cost of reconstruction.

The City is also not required under the Sublease to maintain flood insurance on the Leased Property. In the event of damage or destruction to the Leased Property caused by perils for which the City is not required to provide insurance under the Lease, the City will not be obligated to repair, replace or reconstruct the Leased Property. See APPENDIX B – “SUMMARY OF PRINCIPAL LEGAL DOCUMENTS – The Sublease” and “-Rental Abatement” herein.

## **Certain Risks with Respect to the Leased Property**

A portion of the Leased Property includes Pasadena City Hall, the Hale Building and the Civic Center, each an historic building. In the event of a casualty to any of such portions of the Leased Property, the City may not be able to restore or rebuild these buildings in a way that would restore the inherent value of these historic properties. Further, the Civic Center hosts significant celebrity gatherings and awards shows and various community events. Additionally, a significant portion of the Leased Property is located near the route of the Tournament of Roses Rose Parade and the Rose Bowl, both of which attract national attention and sizeable crowds. The City has no way of quantifying the probabilities of a terrorist attack on the Rose Parade, Rose Bowl, the Civic Center or any of the Leased Property, and has not received threats directed to any particular property of the City. The City is not required under the Sublease to carry terrorism risk insurance. In the event of damage or destruction to some or all of the Leased Property caused by a terrorist attack for which the City is not required to provide insurance under the Sublease, the City will not be obligated to repair, replace or reconstruct the Leased Property. See APPENDIX B – “SUMMARY OF PRINCIPAL LEGAL DOCUMENTS—The Sublease” and “-Rental Abatement” herein.

## **Risks Involving the State Budget and Legislation**

The City relies on a number of revenue sources that could be reduced or eliminated by State legislation, including, among others, sales and use taxes (approximately 18% of the City's fiscal year 2008 General Fund revenues), property taxes (approximately 15% of the City's fiscal year 2008 General Fund revenues), utility users tax (approximately 15% of the City's fiscal year 2008 General Fund revenues) and Vehicle License Fee (approximately 5% of the City's fiscal year 2008 General Fund revenues).

The City cannot predict with certainty whether the State's financial condition and budget results will result in the City receiving less in State revenues than currently budgeted. To the extent that the amount of revenues the City actually receives from the State fall short of the budget estimates, the City may experience an overall shortfall in projected revenues under the City's fiscal year 2008-09 budget, depending on the growth or decrease in other revenue sources. Future State Budgets could also be affected by changes in the State economy and other factors over which the City has no control. To the extent that the State budget process results in reduced revenues or increased expenses to the City, the City will be required to make adjustments to the City's fiscal year 2008-09 budget. See "STATE OF CALIFORNIA BUDGET INFORMATION" herein.

## **Hazardous Substances**

The City knows of no existing hazardous substances which require remedial action on or near the Leased Property. However, it is possible that such substances do currently or potentially exist and that the City is not aware of them. The City does not currently carry insurance covering the risk of hazardous substances. Owners and operators of real property may be required by law to remedy conditions of property relating to releases or threatened releases of hazardous substances. The federal Comprehensive Environmental Response, Compensation and Liability Act of 1980, sometimes referred to as "CERCLA" or the "Superfund Act," is the most well known and widely applicable of these laws, but State laws with regard to hazardous substances are also stringent and similar. Under many of these laws, the owner (or operator) is obligated to remedy a hazardous substance condition of property whether or not the owner (or operator) has anything to do with creating or handling the hazardous substance. Further, such liabilities may arise not simply from the existence of a hazardous substance but from the method of handling it. All of these possibilities could significantly and adversely affect the operations and finances of the City and/or the value of the Leased Property.

## **Investment of Funds**

The Certificate Reserve Funds and all other funds held under the Trust Agreement are required to be invested in Permitted Investments as provided under the Trust Agreement. See APPENDIX B – "SUMMARY OF PRINCIPAL LEGAL DOCUMENTS—Definitions of Certain Terms" for a summary of the definition of Permitted Investments. All investments, including the Permitted Investments and those authorized by law from time to time for investments by municipalities, contain a certain degree of risk. Such risks include, but are not limited to, a lower rate of return than expected, decline in market value and loss or delayed receipt of principal. The occurrence of these events with respect to amounts held under the Trust Agreement or the funds and accounts held by the City could have a material adverse affect on the source of payment for the 2008C Certificates and/or the financial condition of the City.

## **Change in Law**

No assurance can be given that the State or the City electorate will not at some future time adopt initiatives or that the State Legislature or the City Council will not enact legislation that will amend the



laws of the State Constitution or the City Charter, respectively, in a manner that could result in a reduction of the City's General Fund revenues and therefore a reduction of the funds legally available to the City to make Base Rental payments. See, for example, "CONSTITUTIONAL AND STATUTORY LIMITS ON TAXES AND APPROPRIATIONS."

## **CONSTITUTIONAL AND STATUTORY LIMITS ON TAXES AND APPROPRIATIONS**

### **Article XIII A of the California Constitution**

Section 1(a) of Article XIII A of the State 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 counties and apportioned according to law. Section 1(b) of Article XIII A provides that the 1% limitation does not apply to (1) ad valorem taxes to pay interest or redemption charges on indebtedness approved by the voters prior to July 1, 1978, or (2) 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, or (3) any bonded indebtedness incurred by a school district, community college district or county office of education for the construction, rehabilitation or replacement of school facilities or the acquisition or lease of real property for school facilities approved after November 8, 2000 by 55% of the voters of the district or county, as appropriate, 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" ("Full Cash Value"). 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 taxing jurisdiction, or may be reduced in the event of declining property value 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.

The voters of the State subsequently approved various measures that further amended Article XIII A. One such amendment generally provides that the purchase or transfer of (i) real property between spouses or (ii) the principal residence and the first \$1,000,000 of the Full Cash Value of other real property between parents and children, do not constitute a "purchase" or "change of ownership" triggering reappraisal under Article XIII A. Another amendment permitted the State Legislature to allow a person over the age of 55 who meets certain criteria, or a "severely disabled homeowner," who sells his or her residence and buys or builds another of equal or lesser value within two years in the same county, to transfer the old residence's assessed value to the new residence. Another amendment permitted the State Legislature to allow a person who is either 55 years of age or older, or who is "severely disabled," to transfer the old residence's assessed value to his or her new residence located in either the same or a different county and acquired or newly constructed within two years of the sale of the old residence.

Another amendment permitted the State Legislature to exclude from the definition of "new construction" certain additions and improvements, including seismic retrofitting improvements and improvements utilizing earthquake hazard mitigation technologies, constructed or installed in existing buildings after November 6, 1990.

Article XIII A has also been amended to provide that there would be no increase in the Full Cash Value in the event of reconstruction of property damaged or destroyed in a disaster.

Section 4 of Article XIII A provides that cities, counties and special districts cannot, without a two-thirds vote of the qualified electors, impose special taxes, which has been interpreted to include special fees in excess of the cost of providing the services or facility for which the fee is charged, or fees levied for general revenue purposes.

### **Article XIII B of the California Constitution**

State and local government agencies in California are each subject to annual “appropriations limits” imposed by Article XIII B of the State Constitution (“Article XIII B”). Article XIII B prohibits government agencies and the State from spending “appropriations subject to limitation” in excess of the appropriations limit imposed. “Appropriations subject to limitation” are generally authorizations to spend “proceeds of taxes,” which include all tax revenues, and the proceeds to the entity from (i) regulatory licenses, user charges and other user fees to the extent that such proceeds exceed “the cost reasonably borne by that entity in providing the regulation, product, or service” (ii) the investment of tax revenues, and (iii) certain subventions received from the State. No limit is imposed on appropriations for debt service on indebtedness existing prior to the passage of Article XIII B, thereafter authorized by the voters, required to comply with certain mandates of courts or the federal government, or appropriations of revenue from other certain limited sources.

As amended at the June 5, 1990 election by Proposition 111, Article XIII B provides that, in general terms, a city’s annual appropriations limit is based on the appropriations limit for the prior year adjusted annually to reflect changes in cost of living, population and, when appropriate, transfer of financial responsibility of providing services from one governmental unit to another or to a private entity. It may also be adjusted in the event an emergency is determined by the legislative body. If city revenues during any two consecutive fiscal years exceed the combined appropriations limits for those two years, the excess must be returned by a revision of tax rates or fee schedules within the two subsequent fiscal years.

Section 7900, et seq. of the California Government Code defines certain terms used in Article XIII B and sets forth the methods for determining the appropriations limits for local jurisdictions. The City’s appropriation limit for fiscal year 2007-08 is \$199,851,168. It has been determined that \$127,310,326 of the City’s fiscal year 2007-08 budgeted appropriations is subject to the limitation.

### **Article XIII C and Article XIII D of the California Constitution**

On November 5, 1996, the voters of the State approved Proposition 218, the “Right to Vote on Taxes Act.” Proposition 218 added Articles XIII C and XIII D to the State Constitution, which contain a number of provisions affecting the ability of the City to levy and collect both existing and future taxes, assessments, fees and charges.

Article XIII C requires that all new local taxes be submitted to the electorate before they become effective. Taxes for general governmental purposes of the City require a majority vote and taxes for specific purposes, even if deposited in the general fund, require a two-thirds vote. The voter approval requirements of Article XIII C reduce the flexibility of the City Council to deal with fiscal problems by raising revenue through new or extended or increased taxes, and no assurance can be given that the City will be able to raise taxes in the future to meet increased expenditure requirements.

Article XIII D contains several new provisions making it generally more difficult for local agencies to levy and maintain “assessments” for municipal services and programs. “Assessment” is defined to mean any levy or charge upon real property for a special benefit conferred upon the real

property. This definition applies to landscape and maintenance assessments for open space areas, street medians, street lights and parks.

Article XIID also contains several new provisions affecting a “fee” or “charge,” defined for purposes of Article XIID to mean “any levy other than an ad valorem tax, a special tax, or an assessment, imposed by a local government upon a parcel or upon a person as an incident of property ownership, including user fees or charges for a property related service.” All new and existing property related fees and charges must conform to requirements prohibiting, among other things, fees and charges which (i) generate revenues exceeding the funds required to provide the property related service, (ii) are used for any purpose other than those for which the fees and charges are imposed, (iii) with respect to any parcel or person, exceed the proportional cost of the service attributable to the parcel, (iv) are for a service not actually used by, or immediately available to, the owner of the property in question, or (v) are used for general governmental services, including police, fire or library services, where the service is available to the public at large in substantially the same manner as it is to property owners. Further, before any property related fee or charge may be imposed or increased, written notice must be given to the record owner of each parcel of land affected by such fee or charge. The City must then hold a hearing upon the proposed imposition or increase, and if written protests against the proposal are presented by a majority of the owners of the identified parcels, the City may not impose or increase the fee or charge. Moreover, except for fees or charges for sewer, water and refuse collection services (or fees for electrical and gas service, which are not treated as “property related” for purposes of Article XIID), no property related fee or charge may be imposed or increased without majority approval by the property owners subject to the fee or charge or, at the option of the local agency, two-thirds voter approval by the electorate residing in the affected area.

In addition to the provisions described above, Article XIIC removes prohibitions and limitations on the initiative power in matters of any “local tax, assessment, fee or charge.” Consequently, the voters of the City could, by future initiative, repeal, reduce or place limitations on the ability of the City to increase any local tax, assessment, fee or charge. “Fees” and “charges,” are not defined in Article XIIC, and it is not clear whether the definitions of these terms in Article XIID (which are generally property-related as described above) would limit the scope of the initiative power set forth in Article XIIC. If the Article XIID definitions are not held to limit the scope of Article XIIC initiative powers, then the Article XIIC initiative power may apply to a broader category of fees and charges than the property-related fees and charges governed by Article XIID that currently constitute a substantial portion of general fund revenues. No assurance can be given that the voters of the City will not, in the future, approve initiatives that repeal, reduce or place limitations on the ability of the City to increase local taxes, assessments, fees or charges.

The interpretation and application of Proposition 218 will ultimately be determined by the courts with respect to a number of the matters discussed above, and it is not possible at this time to predict with certainty the outcome of such determination. The City imposes some taxes, assessments, fees and charges that could be affected by Proposition 218. To date, Proposition 218 has not impacted the revenues that are available to the City to make the Base Rental Payments required pursuant to the Sublease.

### **Proposition 1A**

As part of Governor Schwarzenegger’s agreement with local jurisdictions, Senate Constitutional Amendment No. 4 was enacted by the Legislature and subsequently approved by the voters as Proposition 1A (“Proposition 1A”) at the November 2004 election. Proposition 1A amended the State Constitution to, among other things, reduce the Legislature’s authority over local government revenue sources by placing restrictions on the State’s access to local governments’ property, sales, and vehicle license fee revenues as of November 3, 2004. Beginning with fiscal year 2008–09, the State will be able

to borrow up to 8 percent of local property tax revenues, but only if the Governor proclaims such action is necessary due to a severe State fiscal hardship and two-thirds of both houses of the Legislature approves the borrowing. The amount borrowed is required to be paid back within three years. The State also will not be able to borrow from local property tax revenues for more than 2 fiscal years within a period of 10 fiscal years. In addition, the State cannot reduce the local sales tax rate or restrict the authority of local governments to impose or change the distribution of the statewide local sales tax.

Proposition 1A also prohibits the State from mandating activities on cities, counties or special districts without providing for the funding needed to comply with the mandates. Beginning in fiscal year 2005–06, if the State does not provide funding for the mandated activity, the requirement on cities, counties or special districts to abide by the mandate would be suspended. In addition, Proposition 1A expanded the definition of what constitutes a mandate on local governments to encompass State action that transfers to cities, counties and special districts financial responsibility for a required program for which the State previously had partial or complete responsibility. The State mandate provisions of Proposition 1A do not apply to schools or community colleges or to mandates relating to employee rights.

### **Proposition 62**

A statutory initiative (“Proposition 62”) was adopted by State voters at the November 4, 1986 General Election, which (1) requires that any tax for general governmental purposes imposed by local governmental entities be approved by resolution or ordinance adopted by two-thirds vote of the governmental agency’s legislative body and by a majority of the electorate of the governmental entity voting in such election, (2) requires that any special tax (defined as taxes levied for other than general governmental purposes) imposed by a local governmental entity be approved by a two-thirds vote of the voters within that jurisdiction voting in such election, (3) restricts the use of revenues from a special tax to the purpose or for the service for which the special tax was imposed, (4) prohibits the imposition of ad valorem taxes on real property by local governmental entities except as permitted by Article XIII A, (5) prohibits the imposition of transaction taxes and sales taxes on the sale of real property by local governmental entities and (6) requires that any tax imposed by a local governmental entity on or after August 1, 1985 be ratified by a majority vote of the electorate voting in such election within two years of the adoption of the initiative or be terminated by November 15, 1988. Proposition 62 requirements are generally not applicable to general taxes and special taxes levied prior to its November 4, 1986 effective date.

On September 28, 1995, the California Supreme Court filed its decision in *Santa Clara County Local Transportation Authority v. Carl Guardino*, 11 Cal. 4th 220 (1995) (the “Santa Clara decision”), which upheld a Court of Appeal decision invalidating a 1/2-cent countywide sales tax for transportation purposes levied by a local transportation authority. The California Supreme Court based its decision on the failure of the authority to obtain a two-thirds vote of the electorate for the levy of a “special tax,” as required by Proposition 62. The Santa Clara decision did not address the question of whether or not it should be applied retroactively.

On December 15, 1997, the Court of Appeals for the State of California, Fourth Appellate District, in *McBrearty v. City of Brawley*, a presently published opinion, determined that (i) Guardino is to be applied retroactively to require voter approval of previously enacted taxes, and (ii) the three-year statute of limitations applicable to such taxes runs from the date of the Guardino decision (September 28, 1995).

In deciding the *Santa Clara* case on Proposition 62 grounds, the Court disapproved the decision in *City of Woodlake v. Logan*, 230 Cal. App. 3d 1058 (1991) (“*Woodlake*”), where the Court of Appeal had held portions of Proposition 62 unconstitutional as a referendum on taxes prohibited by the California

Constitution. The California Supreme Court determined that the voter approval requirement of Proposition 62 is a condition precedent to the enactment of each tax statute to which it applies, while referendum refers to a process invoked only after a statute has been enacted. Numerous taxes to which Proposition 62 would apply were imposed or increased without voter approval in reliance on *Woodlake*. The Court notes as apparently distinguishable, but did not confirm, the decision in *City of Westminster v. County of Orange*, 204 Cal. App. 3d 623 (1988), which held unconstitutional the provision of Proposition 62 requiring voter approval of taxes imposed during the “window period” of August 1, 1985 until November 5, 1986.

Following the *Guardino* decision upholding Proposition 62, several actions were filed challenging taxes imposed by public agencies since the adoption of Proposition 62. On June 4, 2001, the California Supreme Court released its decision in one of these cases, *Howard Jarvis Taxpayers Association v. City of La Habra, et al.* (“*La Habra*”). In this case, the court held that a public agency’s continued imposition and collection of a tax is an ongoing violation upon which the statute of limitations period begins anew with each collection. The court also held that, unless another statute or constitutional rule provided differently, the statute of limitations for challenges to taxes subject to Proposition 62 is three years. Accordingly, a challenge to a tax subject to Proposition 62 may only be made for those taxes received within three years of the date the action is brought.

Proposition 62 as an initiative statute does not have the same level of authority as a constitutional initiative, but is analogous to legislation adopted by the State Legislature, except that it may be amended only by a vote of the State’s electorate. Since the passage of Proposition 218, however, certain provisions of Proposition 62 (e.g., voter approval of taxes) are governed by the State Constitution. In the view of the City Attorney, Proposition 62 does not apply to charter cities such as the City.

#### **Future Initiatives**

Article XIII A, Article XIII B, Proposition 218, Proposition 111 and Proposition 62 were each adopted as measures that qualified for the ballot pursuant to the State’s initiative process. From time to time, other initiative measures could be adopted, further affecting City General Fund revenues or the City’s ability to expend revenues. The nature and impact of these measures cannot be anticipated by the City. The State Supreme Court has held that an initiative can repeal a tax ordinance and prohibit the imposition of further such taxes, and that the Constitutional prohibition against referenda on tax levies does not apply to initiatives.

#### **STATE OF CALIFORNIA BUDGET INFORMATION**

The following information concerning the State of California (the “State”) has been obtained from publicly available information which the City believes to be reliable; however, the City takes no responsibility as to the accuracy or completeness thereof and has not independently verified such information. Information about the State budget is regularly available at various State-maintained websites. Text of the State budget may be found at the Department of Finance website, [www.dof.ca.gov](http://www.dof.ca.gov), under the heading “California Budget.” An impartial analysis of the State budget is posted by the Office of the Legislative Analyst (the “LAO”) at [www.lao.ca.gov](http://www.lao.ca.gov). In addition, various State of California official statements, many of which contain a summary of the current and past State budgets, may be found at the website of the State Treasurer, [www.treasurer.ca.gov](http://www.treasurer.ca.gov). The information referred to is prepared by the respective State agency maintaining each website and not by the City and the City takes no responsibility for the continued accuracy of the internet addresses or for the accuracy or timeliness of information posted there, and such information is not incorporated herein by these references.

## 2008 Budget Act

On August 24, 2007 the Governor signed the State Budget Act for Fiscal Year 2007-08 (the "2008 Budget Act"). The 2008 Budget Act assumes a carryover balance from fiscal year 2006-07 of \$4.8 billion. The 2008 Budget Act projects \$102.3 billion in revenues for fiscal year 2007-08 and authorizes the expenditure of an equal amount, leaving the State General Fund with a year-end reserve of \$4.1 billion. Even though the expenditures authorized under the 2008 Budget Act do not exceed the projected revenues for fiscal year 2007-08, the State will still face operating shortfalls in both fiscal years 2008-09 and 2009-10. According to the LAO, the shortfall in future years is due to the fact that many of the State's solutions enacted in the 2008 Budget Act are one-time in nature. For example, the State assumes \$1 billion in one-time revenues from the sale of EdFund, the State's nonprofit student loan guaranty agency, \$293 million in General Fund revenues from amended tribal gaming compacts and \$600 million in General Fund revenues due to the transfer from the State's tobacco securitization fund, which transfer was originally scheduled for fiscal years 2008-09 and 2009-10. In addition, due to the fluctuation in estimates of State revenues in fiscal year 2006-07, the 2008 Budget Act assumes no additional Proposition 98 funding for fiscal year 2006-07. If, however, the finalized revenue figures for fiscal year 2006-07 are higher than expected, the State will automatically owe a settle-up payment of approximately \$411 million for fiscal year 2006-07 Proposition 98 funding, which will be paid out of the State's reserve. The 2008 Budget Act also uses \$567 million of one-time and special fund monies to support fiscal year 2007-08 K-12 costs, which results in the State entering fiscal year 2008-09 with a large ongoing shortfall for K-12 education.

Certain of the features of the 2008 Budget Act affecting cities include the following:

1. The 2008 Budget Act suspends funding for California Work Opportunity Responsibility to Kids cost-of-living adjustments for one year and permanently delays for five months the annual State Supplemental Security Income/State Supplementary Program cost-of-living adjustments. The 2008 Budget Act also provides \$35.7 million for county-operated housing assistance programs for emancipated foster youth, of which \$10.5 million is available for reimbursement to counties for costs incurred in fiscal year 2006-07.
2. The 2008 Budget Act provides approximately \$14.3 billion from the General Fund for Medi-Cal expenditures. Approximately \$50.8 million (\$25.4 million from the General Fund) will be provided to county administrations to fund the costs incurred in connection with the implementation of new federal regulations under the Deficit Reduction Act of 2005.
3. Pursuant to Proposition 1A, the State is required to repay local agencies for previously unreimbursed State mandates. The 2008 Budget Act includes only reimbursements for mandates performed in fiscal year 2006-07 and delays the reimbursements for mandates to be performed in fiscal year 2007-08 until fiscal year 2008-09.
4. The 2008 Budget Act appropriates approximately \$4.2 billion for transportation programs, \$950 million of which will be allocated to cities and counties for local streets and roads.

Complete text of the 2007 Budget Act may be found at the website of the Department of Finance ([www.dof.ca.gov](http://www.dof.ca.gov)), under the heading "California Budget." Information on the website is not incorporated herein by reference.

## **Proposed 2008-09 Governor's Budget**

The 2008-09 Governor's Budget, released on January 10, 2008 projects to end fiscal year 2008-09 with a \$2.8 billion total reserve. General Fund revenues and transfers for fiscal year 2008-09 are projected at \$102.9 billion, an increase of \$1.7 billion compared with revised estimates for fiscal year 2007-08. General Fund expenditures for fiscal year 2008-09 are projected at \$101.0 billion, a decrease of \$2.4 billion, or 2.0 percent compared with the revised estimates for 2007-08.

The 2008-09 Governor's Budget has the following major components which might affect cities:

1. **Budget Balancing Reductions** — The 2008-09 Governor's Budget proposes budget-balancing reductions of \$216.6 million in 2007-08 and \$9.1 billion in 2008-09 to close the \$14.5 billion budget gap. The 10 percent across-the-board reductions applies to all General Fund departments and programs, Boards, Commissions, and elected offices including the legislative and judicial branches except where such a reduction is in conflict with the State constitution or impractical. Many of the reductions require implementation as early as March 1, 2008 in order to achieve a full 10 percent reduction in 2008-09.

2. **Cash Flow Management** — The deterioration of the budget reserve in the current year has resulted in a projected cash shortage in July and August 2008. In order to manage cash flow for current and budget years and ensure timely payments of the State's debts, the 2008-09 Governor's Budget proposes cash management solutions totaling \$8.7 billion (\$4.2 billion in 2007-08 and \$4.5 billion in 2008-09). These include selling \$3.313 billion of Economic Recovery Bonds by the end of February 2008 to help current year cash flow (which bonds were issued on February 14, 2008) and, among other solutions, delaying disbursement of deferred apportionments for K-12 schools and community colleges to achieve \$1.3 billion savings.

3. **Health and Human Services** — The 2008-09 Governor's Budget includes \$29.3 billion General Fund for Health and Human Service Programs after budget-balancing reductions, which is a decrease of \$279 million or 1.0 percent below the revised 2007-08 estimate. The 2008-09 Governor's Budget includes \$27.1 million in General Fund expenditure increases in Health and Human Services programs due to policy adjustments.

4. **Transportation Funding** - The 2008-09 Governor's Budget includes \$1.485 billion to fully fund Proposition 42 in 2008-09. Proposition 1A was passed in November 2006 and provides for the repayment of any remaining Proposition 42 debt by the year 2015-16. Pursuant to Proposition 1A, the 2008-09 Governor's Budget repays \$83 million from the 2003-04 and 2004-05 Proposition 42 suspensions. Because the issuance of tribal gaming bonds continues to be delayed, the Governor's Budget proposes to use the \$100 million in tribal gaming compact revenues that will be received in 2007-08 and 2008-09 until the bonds are sold, to repay past loans made from the State Highway Account, the Traffic Congestion Relief Fund, and the Public Transportation Account ("PTA"). Proposition 1B was also passed in November 2006, providing \$19.925 billion in bonding authority for a total of 16 programs intended to address a broad range of transportation priorities including rehabilitation and expansion of highways, transit and transit security, port security, and air quality. The authority for the use of any bond funds must be provided for in the Budget Act. The Governor's Budget proposes to appropriate \$4.7 billion in Proposition 1B funding.

***Department of Finance Reports Show Continuous Weakening in State Economy.*** Since the release of the 2008-09 Governor's Budget, monthly finance bulletins issued by the Department of Finance (available at [www.dof.ca.gov](http://www.dof.ca.gov)) have shown continuing weak economic performance in early 2008, including continued job losses in the State and further weakening of the housing markets. These reports

have also disclosed General Fund revenues falling below the forecasts made in the 2008-09 Governor's Budget, with the weakest performance among the three major tax sources in sales and use tax receipts. The Department of Finance's April 2008 report on receipts for the month of March reflects continued weakness in performance in corporate tax revenues, and that actual General Fund revenues through March are \$1.184 billion below those forecasted in the 2008-09 Governor's Budget. Continuing revenue declines will exacerbate the fiscal challenges facing the State, and depending on their severity, could increase the projected shortfall by the end of fiscal year 2008-09 by multiple billions of dollars.

***LAO Assessment of the 2008-09 Governor's Budget.*** The LAO has released several reports which include their estimates and assessments of State budget acts and associated fiscal and economic projections. These include a report titled "Analysis of the 2008-09 Budget Bill: Perspectives and Issues" dated February 20, 2008. In the report, the LAO makes the following statements in "The State's Fiscal Picture" section:

"Primarily due to the continued deterioration of the State's revenue outlook, we project that the State's budget shortfall (prior to any corrective actions) has increased to about \$16 billion. Consequently, the reserve at the end of 2008-09 under the Governor's budget policies would be \$1.1 billion—\$1.6 billion less than forecasted by the administration. Despite achieving a positive reserve, we conclude that the administration's budget-balancing approach is fundamentally flawed. Its across-the-board reductions reflect little effort to prioritize and determine which state programs provide essential services or are most critical to California's future. In the absence of a credible plan that prioritizes state spending and revenues, we offer an alternative approach for the Legislature's consideration. By making more targeted reductions and adding ongoing revenue solutions, we believe this approach offers the Legislature a better foundation to begin crafting a 2008-09 budget that focuses on essential services."

***May Revision to the 2008-09 Governor's Budget.*** On May 14, 2008, the Governor released the May Revision to the 2008-09 Governor's Budget (the "May Revision"). The May Revision projects a current budget gap of \$17.2 billion, approximately \$3.0 billion more than the \$14.5 billion budget gap reflected in the 2008-09 Governor's Budget. The May Revision attributes the difference to a lower than expected gross domestic product growth, weaker State job growth, and smaller gains in State personal income in calendar years 2008 and 2009.

The May Revision proposes a combination of spending reductions and revenue solutions to address the State budget gap and to provide for reserves of approximately \$2.0 billion. The May Revision fully funds the Proposition 98 guarantee and abandons earlier proposals by the Governor to close over 40 State parks and to release certain California prison inmates early. The Governor also proposes in the May Revision \$12.6 billion in expenditure reductions across State government and \$627 million in additional reductions to health and human service programs.

The May Revision includes the Governor's plan to address the State's current and ongoing budget problem, which plan focuses on four elements: (1) the Budget Stabilization Act, a constitutional amendment that seeks to address the cyclical nature of the State's revenues by establishing a Revenue Stabilization Fund (the "RSF") in which General Fund revenues above a certain cap would be deposited in the RSF, with certain amounts set aside in an educational subaccount, (2) the sale of bonds backed by the securitization of a portion of State lottery revenues, with the expectation that such securitization will generate \$5.1 billion for the RSF in fiscal year 2008-09 and a total of \$15 billion by fiscal year 2010-11, (3) a temporary 1% sales tax increase as a fail-safe mechanism in the event that the ballot measure authorizing the securitization of lottery revenues is not approved by voters, and (4) the creation of a Tax Modernization Commission to conduct a comprehensive examination of California's tax laws.



## **Impact of the State Budget on the City**

The City cannot predict what actions will be taken in future years by the State Legislature and the Governor to address future State budget deficits. Future State budgets will be affected by national and state economic conditions and other factors over which the City has no control. To the extent that the State budget process results in reduced revenues to the City, the City will be required to make adjustments to its budget.

The Governor's 10% across the board cuts for the current and next fiscal years will have the greatest impact on the City's health department. For the current year, the City will transfer additional funds from the General Fund to offset these cuts. For next year, the City may need to reduce services or continue General Fund support, or some combination thereof. The current year budget for the City's health department is approximately \$13 million.

## **FINANCIAL STATEMENTS**

The audited basic financial statements (the "Financial Statements") of the City for the year ended June 30, 2007, included in APPENDIX A – "EXCERPTS FROM AUDITED BASIC FINANCIAL STATEMENTS OF THE CITY OF PASADENA FOR FISCAL YEAR ENDED JUNE 30, 2007," have been examined by Mayer Hoffman McCann P.C., Certified Public Accountants (the "Auditor"), to the extent and for the period indicated in its report (the "Report"), which also appears in APPENDIX A. The Financial Statements and the Report should be read in their entirety.

The Financial Statements and Report for the year ended June 30, 2007 and for prior years are on file for public inspection with the City Clerk. The City has not requested nor received the consent of the Auditor to the reproduction of its Report in APPENDIX A – "EXCERPTS FROM AUDITED BASIC FINANCIAL STATEMENTS OF THE CITY OF PASADENA FOR FISCAL YEAR ENDED JUNE 30, 2007." The Auditor has not reviewed or expressed any opinion regarding any portion of this Official Statement other than the Financial Statements as stated in the Report.

## **TAX MATTERS**

In the opinion of Special Counsel, based on existing statutes, regulations, rulings and judicial decisions and assuming compliance with certain covenants in the Trust Agreement, the Sublease and other documents relating to the 2008C Certificates and requirements of the Internal Revenue Code of 1986, as amended, regarding the use, expenditure and investment of proceeds of the 2008C Certificates and the timely payment of certain investment earnings to the United States, the portion of each Base Rental Payment due under the Sublease designated as and comprising interest with respect to the 2008C Certificates is not includable in the gross income of the Owners of the 2008C Certificates for federal income tax purposes. Failure to comply with such covenants and requirements may cause the portion of each Base Rental Payment due under the Sublease designated as and comprising interest with respect to the 2008C Certificates to be included in gross income retroactively to the date of execution and delivery of the 2008C Certificates.

In the further opinion of Special Counsel, the portion of each Base Rental Payment due under the Sublease designated as and comprising interest with respect to the 2008C Certificates is not treated as an item of tax preference in calculating the federal alternative minimum taxable income of individuals and corporations. Such portion of each Base Rental Payment, however, is included as an adjustment in the calculation of federal corporate alternative minimum taxable income and may therefore affect a corporation's alternative minimum tax liability.

Ownership of, or the receipt of interest on or with respect to, tax-exempt obligations may result in collateral tax consequences to certain taxpayers, including, without limitation, financial institutions, property and casualty insurance companies, certain foreign corporations doing business in the United States, certain S corporations with excess passive income, individual recipients of Social Security or Railroad Retirement benefits, taxpayers that may be deemed to have incurred or continued indebtedness to purchase or carry tax-exempt obligations and taxpayers who may be eligible for the earned income tax credit. Special Counsel expresses no opinion with respect to any collateral tax consequences and, accordingly, prospective purchasers of the 2008C Certificates should consult their tax advisors as to the applicability of any collateral tax consequences.

Certain requirements and procedures contained or referred to in the Trust Agreement, the Sublease or other documents pertaining to the 2008C Certificates 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. Special Counsel expresses no opinion as to the exclusion from gross income for federal income tax purposes of the portion of each Base Rental Payment due under the Sublease designated as and comprising interest with respect to the 2008C Certificates on and after the date on which any such change occurs or action is taken upon the advice or approval of counsel other than Special Counsel.

Legislation affecting municipal securities is constantly being considered by the United States Congress. There can be no assurance that legislation enacted after the date of execution and delivery of the 2008C Certificates will not have an adverse effect on the tax-exempt status of the 2008C Certificates. Legislative or regulatory actions and proposals may also affect the economic value of tax exemption or the market prices of the 2008C Certificates.

In the further opinion of Special Counsel, the portion of each Base Rental Payment due under the Sublease designated as and comprising interest with respect to the 2008C Certificates is exempt from personal income taxes imposed by the State.

### **Original Issue Discount**

The excess, if any, of the amount payable at maturity of any maturity of the 2008C Certificates purchased as part of the initial public offering over the issue price thereof constitutes original issue discount. The amount of original issue discount that has accrued and is properly allocable to an owner of any maturity of 2008C Certificates with original issue discount (a, the "Discount Certificate") is excluded from gross income for federal, State and City income tax purposes to the same extent as interest on the 2008C Certificates. In general, the issue price of a maturity of 2008C Certificates is the first price at which a substantial amount of 2008C Certificates of that maturity was sold (excluding sales to bond houses, brokers or similar persons or organizations acting in the capacity of underwriters, placement agents, or wholesalers), and the amount of original issue discount accrues in accordance with a constant yield method based on the compounding of interest. A purchaser's adjusted basis in a Discount Certificate is increased by the amount of such accruing discount for purposes of determining taxable gain or loss on the sale or other disposition of such Discount Certificate for federal income tax purposes. A portion of the original issue discount that accrues in each year to an owner of a Discount Certificate that is a corporation is included in the calculation of the corporation's federal alternative minimum tax liability. In addition, original issue discount that accrues in each year to an owner of a Discount Certificate is included in the calculation of the distribution requirements of certain regulated investment companies and may result in some of the collateral federal income tax consequences discussed above. Consequently, owners of a Discount Certificate 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 of such Discount Certificate has not received cash attributable to such original issue discount in such year.

The accrual of original issue discount and its effect on the redemption, sale or other disposition of a Discount Certificate that is not purchased in the initial public offering at the first price at which a substantial amount of such substantially identical 2008C Certificates is sold to the public may be determined according to rules that differ from those described above. An owner of a Discount Certificate should consult his or her tax advisor with respect to the determination for federal income tax purposes of the amount of original issue discount with respect to such Discount Certificate and with respect to state and local tax consequences of owning and disposing of such Discount Certificate.

### **Original Issue Premium**

Certain of the 2008C Certificates may be purchased in the initial offering for an amount in excess of their principal amount (the "Premium Certificates"). The excess of the tax basis of a purchaser of a Premium Certificate (other than a purchaser who holds a Premium Certificate as inventory, stock in trade or for sale to customers in the ordinary course of business) over the principal amount of such Premium Certificate is "certificate premium." Certificate premium is amortized for federal income tax purposes over the term of a Premium Certificate based on the purchaser's yield to maturity in the Premium Certificate, except that in the case of a Premium Certificate 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 Certificate. Owners of a Premium Certificate is required to decrease his or her adjusted basis in such Premium Certificate by the amount of certificate premium attributable to each taxable year in which such purchaser holds such Premium Certificate. The amount of certificate premium attributable to a taxable year is not deductible for federal income tax purposes; however, certificate premium is treated as an offset to qualified stated interest received on a Premium Certificate. Purchasers of Premium Certificate should consult their tax advisors with respect to the precise determination for federal income tax purposes of the amount of certificate premium attributable to each taxable year and the effect of certificate premium on the sale or other disposition of a Premium Certificate, and with respect to the state and local tax consequences of owning and disposing of a Premium Certificate.

### **Information Reporting and Backup Withholding**

Interest paid on tax-exempt obligations is subject to information reporting in a manner similar to interest paid on taxable obligations. While this reporting requirement does not, by itself, affect the excludability of interest from gross income for federal income tax purposes, the reporting requirement causes the payment of interest with respect to the 2008C Certificates to be subject to backup withholding if such interest is paid to beneficial owners that (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 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 are exempt recipients. Amounts withheld under the backup withholding rules from a payment to a beneficial owner are allowed as a refund or credit against such beneficial owner's federal income tax liability so long as the required information is furnished to the IRS.

### **Future Developments**

Future legislative proposals, if enacted into law, regulations, rulings or court decisions may cause interest on the 2008C Certificates to be subject, directly or indirectly, to federal income taxation or to

State or local income taxation, or otherwise prevent beneficial owners from realizing the full current benefit of the tax status of such interest. Prospective purchasers of the 2008C Certificates should consult their own tax advisors regarding any pending or proposed federal or State tax legislation, regulations, rulings or litigation as to which Special Counsel expresses no opinion.

A copy of the proposed form of opinion of Special Counsel is attached hereto as APPENDIX C – “PROPOSED FORM OF OPINION OF SPECIAL COUNSEL.”

### **APPROVAL OF LEGALITY**

Legal matters incident to the execution and delivery of the 2008C Certificates are subject to the approving opinion of Sidley Austin LLP, San Francisco, California, Special Counsel. A form of such opinion is attached hereto in APPENDIX C – “PROPOSED FORM OF OPINION OF SPECIAL COUNSEL,” and copies of such opinion with respect to the 2008C Certificates will be available at the time of delivery of the 2008C Certificates. Certain legal matters will be passed upon for the City and the Authority by the City Attorney and by Sidley Austin LLP, San Francisco, California, as Disclosure Counsel.

### **LITIGATION**

There is no action, suit, proceeding or investigation at law or in equity before or by any court, public board or body, pending or, to the best knowledge of the City, threatened against or affecting the City: (i) which would materially and adversely impact the City’s ability to complete the transactions described in or contemplated by this Official Statement; (ii) to restrain or enjoin the delivery of any of the 2008C Certificates or the payments to be made by the City pursuant to the Sublease; (iii) in any way contesting or affecting the validity of the Trust Agreement, the Sublease, any of the 2008C Certificates or the transactions relating to the Leased Property as described in “THE LEASED PROPERTY,” or contesting in any way the completeness or accuracy of this Official Statement; or (iv) wherein an unfavorable decision, ruling or finding would materially and adversely affect the City or the validity or enforceability of the Trust Agreement, the Sublease or the 2008C Certificates.

A number of suits and claims are pending against the City and related entities. In the opinion of the City, the results of such legal activities will not have a material adverse effect on the financial position or results of operations of the City or such entities.

### **CONTINUING DISCLOSURE**

Pursuant to a Continuing Disclosure Agreement to be entered into simultaneously with the delivery of the 2008C Certificates (the “Continuing Disclosure Agreement”), between the City and the Dissemination Agent, the City has covenanted for the benefit of the holders and beneficial owners of the 2008C Certificates to provide certain financial information and operating data relating to the City by not later than 185 days following the end of the City’s fiscal year (which fiscal year presently ends on June 30) (the “Annual Report”), commencing with the report for Fiscal Year 2007-2008, and to provide notices of the occurrence of certain enumerated events, if material. The Annual Report will be filed by the City with each Nationally Recognized Municipal Securities Information Repository. The notices of material events will be filed by the City with the Municipal Securities Rulemaking Board or the Nationally Recognized Municipal Securities Information Repositories. The specific nature of the information to be contained in the Annual Report and the notice of material events is set forth in APPENDIX E – “FORM OF CONTINUING DISCLOSURE AGREEMENT” herein. These covenants have been made in order to assist the Underwriters in complying with S.E.C. Rule 15c2-12(b)(5) (the

“Rule”). The City has never failed to comply in all material respects with any previous undertakings with regard to the Rule to provide annual reports or notices of material events.

### **RATING**

Standard & Poor’s, a Division of The McGraw–Hill Companies, Inc. (“S&P”) has assigned the 2008C Certificates the rating of “\_\_\_\_\_” and Fitch Ratings (“Fitch”) has assigned the rating of “\_\_\_\_\_.” An explanation of the significance of the rating may be obtained from Standard & Poor’s at 55 Water Street, New York, New York 10004.

Such rating expresses only the views of S&P and are not a recommendation to buy, sell or hold the 2008C Certificates. There is no assurance that such rating will continue for any given period of time or that they will not be revised, either downward or upward, or withdrawn entirely by S&P, if in the judgment of S&P, circumstances so warrant. Any such downward revision or withdrawal may have an adverse effect on the market price of the 2008C Certificates.

### **UNDERWRITING**

The 2008C Certificates are being purchased for reoffering by De La Rosa & Co. and Wedbush Morgan Securities, Inc. (collectively, the “Underwriters”). The Underwriters have agreed to purchase the 2008C Certificates at a purchase price of \$\_\_\_\_\_ (representing the principal amount of the 2008C Certificates of \$\_\_\_\_\_, [plus/minus] a net original [premium/discount] of \$\_\_\_\_\_ and less an Underwriters’ discount of \$\_\_\_\_\_). The Underwriters will purchase all of the 2008C Certificates if any are purchased. The obligation of the Underwriters to make such purchase is subject to certain terms and conditions set forth in the contract of purchase relating to the 2008C Certificates.

**EXECUTION AND DELIVERY**

The preparation, execution and distribution of this Official Statement have been authorized by the City.

CITY OF PASADENA

By: \_\_\_\_\_

Steven B. Mermell  
Acting Director of Finance

**APPENDIX A**

**EXCERPTS FROM AUDITED BASIC FINANCIAL STATEMENTS OF  
THE CITY OF PASADENA FOR FISCAL YEAR ENDED JUNE 30, 2007**