

Raymond Basin Surface Water. The principal streams in the service area include the Arroyo Seco, Eaton Wash and the Santa Anita Wash. According to the Judgment, PWP is entitled to divert an instantaneous capacity of up to 25.00 cfs of surface water in the Arroyo Seco (including Millard Canyon) and up to 8.90 cfs of surface water in Eaton Canyon. The Arroyo Seco source accounts for less than 5% of the City's total water supply, depending on rainfall in a particular year. Surface water diversions from the Arroyo Seco have historically been used in two ways: (1) water has been treated for direct supply into PWP's distribution system, and (2) water has been diverted by PWP to the spreading grounds owned by PWP and operated until 1998 by the Los Angeles County Department of Public Works ("LACDPW") in exchange for groundwater pumping credits. In 1970, PWP constructed the 5-million gallons per day John L. Behner Water Treatment Plant ("Behner Water Treatment Plant"), which is located directly east of Jet Propulsion Laboratories ("JPL") in the Arroyo Seco Canyon. The treatment plant was shut down in June 1993 as a result of water quality regulations imposed pursuant to the Surface Water Treatment Rule. See "– Environmental Regulation" below. The feasibility of upgrading this plant was evaluated in a June 1995 study funded by the American Water Works Association Research Foundation, PWP and other local surface water purveyors. However, no attempt to bring the Behner Water Treatment Plant back on-line has been made.

Until June 1993, a portion of the Arroyo Seco water that was diverted by PWP was treated at the Behner Water Treatment Plant, while the remainder of the diverted water was sent to spreading grounds. Since July 1993, all water that has been diverted by PWP in the Arroyo Seco has been sent to the spreading grounds. The Arroyo Seco spreading basins consist of 14 basins that have an approximate gross area of 24 acres, and a wetted area of 13.5 acres. The spreading basins were constructed in approximately 1948 on City-owned land that was leased to LACDPW. LACDPW operated and maintained the spreading basins on behalf of all Raymond Basin members. However, in 1998, PWP assumed the responsibility of operating and maintaining these spreading basins. Due to past precedence established by LACDPW, which spread surface water for the benefit of the Raymond Basin, the Raymond Basin Management Board mandated that PWP could no longer receive full credit for spreading surface water in the Arroyo Seco, even though PWP absorbs all costs to maintain and operate the spreading basins. As a result of this mandate, a spreading methodology was developed in which the amount of water that is determined to be "spread" by PWP in the Arroyo Seco is approximately 60% of the water diverted.

In Eaton Canyon, PWP measures the water flowing down the canyon, which is spread naturally in the streambed behind the dam. This water, up to 8.90 cfs, is reported to the Raymond Basin Management Board as water that is diverted by PWP. PWP gets 80% credit for the amount of water "spread" as per the Judgment. Under current operations, PWP spreads all of its surface water diversions to receive spreading credits. No surface water directly supplies the PWP distribution system.

Surface water supply is highly variable, as it is entirely dependent on the amount of rainfall during the year.

Raymond Basin Management Board. The City obtains its groundwater from the Raymond Basin. Under the Judgment, a court of law determined the parties who have the right to extract water and the timing and amount of such pumping based on a "safe yield" concept. There are fifteen entities that are allowed to pump from the Raymond Basin. PWP has the largest entitlement, with up to 42% of the total adjudicated rights. As a party holding a "decreed right" of 1,000 acre-feet/year or more, PWP appoints one member to the eleven-member Raymond Basin Management Board. All costs of enforcing the Judgment are assumed by all water users in the Raymond Basin in proportion to their respective "decreed right."

PWP has taken an active role in securing greater local control of the management of the Raymond Basin. Prior to 1984, the administration of the Raymond Basin was under the authority of the State Department of Water Resources as Watermaster. During that time, the Raymond Basin Management Board (the "Management Board") only acted in an advisory capacity to the Watermaster. In 1984, the Judgment was amended to appoint the Management Board as Watermaster. The Management Board is comprised of representatives appointed by the producers within the Raymond Basin. The Management Board is responsible for overseeing the implementation of the adjudicated provisions. One of the most significant powers conferred on the Management Board in the 1984 amendments was the authority to approve plans for storage of native and imported water in the Raymond Basin.

The Judgment has been amended several times over the years with PWP taking the lead in securing consensus for the amendments among the producers. Each amendment has given the producers more flexibility in the management of the Raymond Basin. The Raymond Basin is now well positioned to participate in expanded groundwater storage programs, which should enhance the value and security of the groundwater resource. The Management Board, in cooperation with PWP and MWD, has recently completed a major study of the storage resources of the Raymond Basin. As a result of this study, significantly larger amounts of water have been and will be stored in the Raymond Basin in the future. Increased storage will enable all basin producers to better meet seasonal demand variations as well as provide reserves against periods of drought.

The Metropolitan Water District of Southern California

The following information has been obtained from MWD and sources that the City and PWP believe to be reliable, but the City and PWP take no responsibility for the accuracy or completeness hereof.

MWD is a public agency organized in 1928 by vote of the electorates of several Southern California cities, including the City, following adoption of the original Metropolitan Water District Act (the "MWD Act") by the California Legislature. MWD is not subject to regulation by the California Public Utilities Commission, although its enabling statute is subject to amendment by the California Legislature. MWD currently has full authority to set rates and policies as necessary to provide a dependable water supply to Southern California. MWD provides nearly between 40% and 60% in any given year of the water used in its service area, which consists of approximately 5,200 square miles in portions of Los Angeles, Orange, Riverside, San Bernardino, San Diego and Ventura Counties. MWD serves a population of almost 19 million people.

MWD is governed by a 37-member Board of Directors consisting of at least one representative from each of the 26 member public agencies, including the City, that comprise the MWD. Each member public agency is entitled to have at least one representative on the Board, plus an additional representative for each full 5% of its assessed valuation of property in MWD's service area. Accordingly, from time to time, the Board may have more than 37 members. Representation and voting rights are based upon each agency's assessed valuation.

MWD Water Supply. MWD's two primary sources of water are the State Water Project and the Colorado River.

The State Water Project is owned by the State and operated by the State Department of Water Resources ("DWR"). The State Water Project transports water available from the San Francisco Bay/Sacramento-San Joaquin Delta (the "Bay/Delta") to Southern California via the California Aqueduct. MWD contracted with DWR in the 1960s (as amended, the "State Water Contract") for a share of the State Water Project water (approximately 46%). The State Water Contract, under a 100% allocation,

provides MWD 1,911,500 acre-feet of water. Deliveries from the State Water Project to MWD over the past eight years (2002 through 2009), including water from water transfer, groundwater banking and exchange programs described below, varied from a low of 908,000 acre-feet in calendar year 2009 to a high of 1,800,000 acre-feet in 2004. (An acre-foot is the amount of water that will cover one acre to a depth of one foot and equal's approximately 326,000 gallons.) For calendar year 2010, DWR's initial allocation estimate to State Water Project contractors was set at 5% of contracted amounts. The estimate was adjusted upward during the winter and spring and on June 22, 2010, DWR adjusted its allocation to 50% of contracted amounts, reflecting late spring storms, a return to normal precipitation and reservoir levels and an above normal Sierra snowpack. For MWD, the revised allocation provides 955,750 acre-feet.

Management of the availability of State Water Project supplies through water marketing and groundwater banking plays an important role in meeting California water needs. MWD is participating in groundwater banking programs, including the Arvin-Edison/MWD Water Management Program, the Semitropic/MWD Groundwater Storage and Exchange Program and the California Aqueduct Dry-Year Transfer Program. MWD also has been negotiating, and will continue to pursue, water purchase, storage and exchange programs with other agencies in the Sacramento and San Joaquin Valleys. These programs involve the storage of both State Water Project supplies and water purchased from other sources to enhance MWD's dry-year supplies and the exchange of normal year supplies to enhance MWD's water reliability and water quality, in view of dry conditions and potential impacts from recent Endangered Species Act litigation.

The State Water Resources Control Board ("SWRCB") is the agency responsible for setting water quality standards and administering water rights throughout California. Decisions of the SWRCB can affect the availability of water to MWD and other users of State Water Project water. The SWRCB exercises its regulatory authority over the Bay/Delta by means of public proceedings leading to regulations and decisions. These include the Bay/Delta Water Quality Control Plan ("WQCP"), which establishes the water quality standards and proposed flow regime of the estuary, and water rights decisions, which assign responsibility for implementing the objectives of the WQCP to users throughout the system by adjusting their respective water rights. The SWRCB is required by law to periodically review its WQCP to ensure that it meets the changing needs of this complex system.

To obtain its Colorado River supply, MWD has a permanent service contract with the United States Secretary of the Interior for delivery of water via the Colorado River Aqueduct. California is apportioned the use of 4.4 million acre-feet of water from the Colorado River each year plus one-half of any surplus that may be available for use collectively in Arizona, California and Nevada. In addition, California has historically been allowed to use Colorado River water apportioned to but not used by Arizona and Nevada. Under the priority system that governs the distribution of Colorado River water made available to California, MWD holds the fourth priority right to 550,000 acre-feet per year. This is the last priority within California's basic apportionment of 4.4 million acre-feet. In addition, MWD holds the fifth priority right to 662,000 acre-feet of water, which is in excess of California's basic apportionment. Until 2003, MWD had been able to take full advantage of its fifth priority right entitlement as a result of the availability of surplus water and unused water. However, Arizona and Nevada increased their use of water from the Colorado River, significantly reducing unused apportionment available for California since 2002. In addition, a severe drought in the Colorado River Basin reduced storage in system reservoirs, such that MWD stopped taking surplus deliveries in 2003 in an effort to mitigate the effects of the drought. If surplus and/or unused water is not available in future years, Colorado River water under MWD's fifth priority could be limited or unavailable. See "– Risks to Water Supply" below. MWD has taken steps to augment its share of Colorado River water through agreements with other agencies that have rights to use such water.

MWD has entered into agreements with the Imperial Irrigation District, Central Arizona Water Conservation District and Palo Verde Irrigation District and is seeking additional agreements with other agencies to reduce their diversions from the Colorado River, thereby augmenting MWD's available supply.

In January 2001, the Secretary of the Interior adopted guidelines (the "Interim Surplus Guidelines") for use through 2016 in determining if there is surplus Colorado River water available for use in California, Arizona and Nevada. The purpose of the Interim Surplus Guidelines is to provide a greater degree of predictability with respect to the availability and quantity of surplus water through 2016. The Interim Surplus Guidelines were later extended through 2026.

Under the Interim Surplus Guidelines, MWD initially expected to divert up to 1.25 million acre-feet of Colorado River water annually under foreseeable runoff and reservoir storage scenarios from 2004 through 2016. However, an extended drought in the Colorado River Basin reduced these initial expectations. From 2000 to 2004, snowpack and runoff in the Colorado River Basin were well below average. Although runoff was slightly above average in 2005, the runoff in 2006 and 2007 was again below average, making 2000 through 2007 the driest eight-year period on record. Although 2008 and 2009 runoff was near normal, combined storage in Lake Mead and Lake Powell remains at 50% of capacity. MWD's initial 2010 diversion approval from the Bureau of Reclamation totaled 935,700 acre-feet plus any unused Priority 1 through 3 water. MWD anticipates its ultimate 2010 diversion approval from the Bureau of Reclamation will exceed 1 million acre-feet.

The Southern Nevada Water Authority ("SNWA") and MWD entered into an Agreement Relating to Implementation of Interim Colorado River Surplus Guidelines on May 16, 2002, in which SNWA and MWD agreed on the allocation of unused Arizona apportionment and on the priority of SNWA for interstate banking in Arizona. SNWA and MWD entered into a storage and interstate release agreement on October 21, 2004. Under this program, Nevada can request MWD to store unused Nevada apportionment of Colorado River water in California. The amount of water stored through 2009 under this agreement was 70,000 acre-feet. In subsequent years, Nevada may request recovery of this stored water. As part of a recently executed amendment, it is expected that Nevada will not request return of this water until 2022. The stored water provides flexibility to MWD for blending Colorado River water with State Water Project water and improves near-term water supply reliability.

MWD's storage capacity, which includes reservoirs, conjunctive use and other groundwater storage programs within MWD's service area and groundwater and surface storage accounts delivered through the State Water Project or Colorado River Aqueduct, has increased to 5.62 million acre-feet. In 2010, approximately 626,000 acre-feet of stored water is emergency storage that is reserved for use in the event of supply interruptions from earthquakes or similar emergencies, as well as extended drought. MWD's ability to replenish water storage, both in the local groundwater basins and in surface storage and banking programs, has been limited by Bay-Delta pumping restrictions and Endangered Species Act considerations. MWD replenishes its storage accounts when imported supplies exceed demands. Effective storage management is dependent on having sufficient years of excess supplies to store water so that it can be used during times of shortage. Historically, excess supplies have been available in about seven of every ten years. MWD forecasts that, with anticipated supply reductions from the State Water Project due to pumping restrictions, it will need to draw down on storage in about seven of ten years and will be able to replenish storage in about three years out of ten. This reduction in available supplies extends the time required for storage to recover from drawdowns and could require MWD to implement its Water Supply Allocation Plan (described below) during extended dry periods.

Reliability of MWD Water Supply to Meet with City Requirements. MWD faces a number of challenges in providing faces a number of challenges in providing a reliable and high quality water supply

for southern California. These include, among others: (1) population growth within the service area; (2) increased competition for low-cost water supplies; (3) variable weather conditions; and (4) increased environmental regulations. In April 2008, MWD staff began working with MWD's member agencies on a Five-Year Supply Plan to identify specific resource and conservation actions over a five year period, in order to manage water deliveries under continued drought conditions and court-ordered restrictions.

MWD's current approach to managing water shortages has evolved from its experiences during the droughts of 1976-77 and 1987-92 into the Water Surplus and Drought Management Plan ("WSDM Plan"). The WSDM Plan splits resource actions into two major categories: Surplus Actions and Shortage Actions. The Surplus Actions store surplus water, first inside then outside the region. The Shortage Actions of the WSDM Plan are split into three subcategories: Shortage, Severe Shortage and Extreme Shortage. Each category has associated actions that could be taken as a part of the response to prevailing shortage conditions. Conservation and water efficiency programs are part of MWD's resource management strategy through all categories.

In August 2007, MWD launched a significant water conservation outreach and public education effort for voluntary water conservation, promotion of water-saving rebates and incentives and education of the public about the uncertainties of future water supplies. The campaign was intensified following MWD's declaration of a regional Water Supply Alert on June 10, 2008 and with the February 2009 declaration of statewide water emergency by the Governor of California. MWD urged cities, counties and water districts in its service area to achieve extraordinary conservation by adopting and enforcing drought ordinances, accelerating public outreach and conservation messaging, and developing additional local supplies. MWD's Board also authorized agreements with public agencies to provide financial incentives for water saving measures, ranging from \$195 to \$500 per acre-foot of potable water saved, up to a maximum of \$15 million for the Public Sector Water Efficiency Partnership Demonstration Program. This program aims to continue public support for conservation through public agency accomplishments and efforts.

MWD's plan for allocation of water supplies in the event of shortage (the "MWD Water Supply Allocation Plan") allocates MWD's water supplies among its member agencies, based on the principles contained in the WSDM Plan, to reduce water use and drawdowns from water storage reserves. The Water Supply Allocation Plan was approved by the Board in February 2008. The Water Supply Allocation Plan provides a formula for equitable distribution of available supplies in case of extreme water shortages within MWD's service area. On April 14, 2009, MWD's Board adopted a resolution declaring a regional water shortage and implementing the Water Supply Allocation Plan, effective July 1, 2009. The MWD Board set the "Regional Shortage Level" at Water Supply Allocation Plan Level 2, which required reduction of regional water use by approximately 10% and resulted in the sale of about 1.89 million acre-feet of MWD water in Fiscal Year 2009-10. The final 2009-10 allocation for each member agency is dependent upon its local production during the allocation year and is currently being determined through a formal local supply certification process with the member agencies. On April 13, 2010, the MWD Board adopted a resolution recognizing the continuing regional water shortage and again setting the Regional Shortage Level at Water Supply Allocation Plan Level 2, which sustains the prior year's regional water use reduction of approximately 10% and allows for the sale of about 1.96 million acre-feet of MWD water in Fiscal Year 2010-11.

Delivery within a member agency of more than its allocated amount of MWD supplies will subject the member agency to a penalty of one to four times MWD's full service rate for untreated Tier 2 water, depending on how much the member agency's water use for the twelve-month period beginning on July 1 exceeds its allocated amount. Any penalties collected may be rebated to the member agency that paid them to fund water management projects.

The MWD Act provides a preferential entitlement for the purchase of water by each of the MWD member agencies. This preferential right is based on the ratio of all payments made to MWD by each agency compared to total payments made by all member agencies on tax assessments and otherwise, except purchases of water, toward the capital cost and operating expenses of MWD. Historically MWD has not used this criterion in allocating water. The MWD Act provides that water surplus to MWD's needs for domestic and municipal uses may be sold for other beneficial uses.

MWD Scheduling and Operations. MWD member agencies request water from MWD at various delivery points within MWD's system and pay for such water at uniform rates established by the MWD Board for each class of service. No member is required to purchase water from MWD, but all member agencies are required to pay readiness-to-serve charges (as described below) whether or not they purchase water from MWD. The current rate structure provides for a member agency's agreement to purchase water from MWD by means of a voluntary purchase order. In consideration of executing its purchase order, the member agency is entitled to purchase a greater amount of water at the lower "Tier 1 Water Supply Rate", as described under " – MWD Rates" below. Under each purchase order, a member agency agrees to purchase, over the ten-year term of the contract, an amount of water equal to at least 60% of its highest firm demand for MWD water in any Fiscal Year from 1989-90 through 2001-02 multiplied by ten. MWD Member agencies are allowed to vary their purchases from year to year, but a member agency will be obligated to pay for the full amount committed under the purchase order, even if it does not take its full purchase order commitment by the end of the ten-year period.

Water is delivered to the member agencies on demand and is metered at the point of delivery. Member agencies are billed monthly and a late charge of 1% of the delinquent payment is assessed for delinquent payments not exceeding five business days. A late charge of 2% of the amount of the delinquent payment is charged for a payment that is delinquent for more than five business days for each month or portion of a month that the payment remains delinquent. MWD has the authority to suspend service to any agency delinquent for more than 30 days. Delinquencies have been rare; in such instances late charges have been collected. No service has been suspended because of delinquencies.

MWD Rates. MWD water rates are established by majority vote of the MWD board in March of each year, after a public hearing held in February. Rates are not subject to regulation by any local, state or federal agency. Under the MWD Act, MWD must, so far as practicable, fix such rates for water as will result in revenue which, together with revenue from any water standby or availability of service charge or assessment, will pay the operating expenses of MWD, provide for repairs and maintenance, provide for payment of the purchase price or other charges for property or services or other rights acquired by MWD and provide for the payment of the interest and principal of the bonded debt of MWD.

MWD's current rate structure became effective in January 2003. In October 2002, PWP entered into a voluntary purchase order contract with MWD, whereby PWP will be able to purchase up to 90% of its "initial base demand" at the "Tier 1" rate. The "initial base demand" is defined as the maximum firm demand (not including water delivered for in-lieu groundwater storage programs) for MWD water experienced since Fiscal Year 1989. PWP estimates its "initial base demand" to be 23,520 acre-feet/year. This means that with the purchase order contract, PWP may currently purchase up to 21,170 acre-feet/year of water at the Tier 1 rate. In the future, "base demand" is defined as either the agency's "initial base demand" or the rolling 10-year average of firm demands for MWD water, whichever is higher. Any water purchased from MWD in excess of 90% of the "base demand" must be purchased at the higher Tier 2 rate.

The following table summarizes water rates under MWD's current rate structure. This table includes rates effective January 1, 2010. As footnotes in the table below, in early 2010, MWD's Board

approved two rate increases of 7.5% each to the rates set forth in the table below. These increases will become effective January 1, 2011 and January 1, 2012.

TABLE 4
MWD WATER RATES
(Dollars per Acre-Foot)

	<u>2010 Rates⁽¹⁾</u>	
	<u>Tier 1</u>	<u>Tier 2</u>
Supply Rate	\$101	\$280
Delta Supply Surcharge	69	--
System Access Rate	154	154
Water Stewardship Rate	41	41
System Power Rate	<u>119</u>	<u>119</u>
Untreated Full Service	\$484	\$594
Treatment Surcharge	<u>\$217</u>	<u>\$217</u>
Treated Full Service	\$701	\$811

Source: MWD.

⁽¹⁾ Rates to be effective January 1, 2010 through December 31, 2010. In early 2010, MWD's Board approved two rate increases of 7.5% each to the rates above. These increases will become effective January 1, 2011 and January 1, 2012.

The Tier 1 and Tier 2 Water Supply Rates are designed to recover MWD's water supply costs. The Tier 2 Supply Rate is designed to reflect MWD's costs of acquiring new supplies. MWD member agencies are charged the Tier 1 or Tier 2 Water Supply Rate for water purchases, as described above.

The System Access Rate is intended to recover a portion of the costs associated with the conveyance and distribution system, including capital, operating and maintenance costs. All users (including member agencies and third-party wheeling entities of the MWD system) pay the System Access Rate.

The Water Stewardship Rate is charged on a dollar per acre-foot basis to collect revenues to support MWD's financial commitment to conservation, water recycling, groundwater recovery and other water management programs approved by MWD's Board. The Water Stewardship Rate is charged for every acre-foot of water conveyed by MWD.

The System Power Rate is charged on a dollar per acre-foot basis to recover the cost of power necessary to pump water from the State Water Project and Colorado River through the conveyance and distribution system for MWD's member agencies. The System Power Rate is charged for all MWD supplies. Entities wheeling water will continue to pay the actual cost of power to convey water on the State Water Project, the Colorado River Aqueduct or the MWD distribution system, whichever is applicable.

MWD charges a treatment surcharge on a dollar per acre-foot basis for treated deliveries. The treatment surcharge is set to recover the cost of providing treated water service, including capital and operating cost.

The Delta Supply Surcharge is applicable to (among other rates) all Tier 1 untreated and treated water rates and reflects the additional supply costs that MWD faces along with other costs due to the pumping restrictions on the State Water Project.

Additional charges for the availability of MWD's water are: the Readiness-to-Serve Charge and the Capacity Charge.

The Readiness-to-Serve Charge is a variable annual charge of approximately \$80 million that is divided proportionally among all agencies that receive water from MWD. This money is used by MWD to recover costs associated with standby and peak conveyance capacity and system emergency storage capacity. Currently, PWP's share of MWD's annual readiness to serve charge is about 1%.

The Capacity Charge is a fixed annual charge, which is based on the capacity that is requested by the member agency. This charge will be used by MWD to recover the cost of providing peak capacity within the distribution system. Effective January 1, 2010, the capacity charge was \$7,200/ per cfs of maximum daily flow. The capacity charge is scheduled to increase to \$7,400 per cfs effective January 1, 2012.

Future Sources of Water Supply and/or Reliability

Based on projected demand and the estimated supply from the Raymond Basin groundwater and surface water and imported Tier 1 MWD water, there is a need to purchase approximately 3,000 acre-feet or more of higher priced Tier 2 MWD water annually to meet projected demand. See "Risks to Water Supply" below. Additional potential future water sources such as those outlined below, could help decrease the amount of Tier 2 MWD water that PWP will need to purchase.

Pasadena Groundwater Storage Program. The Pasadena Groundwater Storage Program is a conjunctive use program between MWD and PWP. The goal of the program is to improve the reliability of water supply to PWP and surrounding water agencies and reduce dependence on imported MWD water deliveries during periods of drought and emergency conditions. The program would store up to 66,000 acre feet of imported MWD water in the Raymond Basin when imported water supply is plentiful. The water could then be extracted at a rate up to 22,000 acre feet per year when imported supplies are limited due to a drought or emergency. This program is currently on hold.

Micro-filtration Plant. Historically, a portion of the surface water diverted from the Arroyo Seco was treated by the Behner Water Treatment Plant. However, the Behner Water Treatment Plant does not comply with the Surface Water Treatment Rule. See " – Environmental Regulation" above. For this reason, a new plant utilizing micro-filtration ("MF") technology would need to be constructed at the Behner Water Treatment Plant to treat the Arroyo Seco surface water diversions. Based on a review of the historical production records of the Behner Water Treatment Plant and stream flow data, the average amount of surface water that would be treated by a new MF plant would be approximately 1,150 acre-feet/year. An economic feasibility study must be performed before plans for the treatment plant upgrade go forward.

Recycled Water. In April 1993, PWP entered into an agreement with the City of Glendale to purchase up to 6,000 acre-feet/year of recycled water through 2018. The built out recycled water project will provide approximately 2,000 acre-feet per year of recycled water for landscape irrigation and industrial uses. This project will be implemented in three phases. The first phase will deliver approximately 900 acre-feet per year of recycled water to the west side of the City to serve the Brookside Park and Golf Course, Annandale Golf Course, 210 Freeway – Caltrans, Upper and Lower Arroyo Parks and Defenders Parkway. The second phase will deliver approximately 700 acre-feet per year of recycled water to the south side of the City and the third phase will deliver approximately 400 acre-feet per year of recycled water to the north side of the City.

Other potential future sources of water supply include:

- (1) intercepting and collecting surface water below the stream bed in Eaton Canyon;
- (2) increasing the groundwater recharge capacity in the Arroyo by reconfiguration of existing spreading facilities and construction of new facilities in the Hahamonga Park area; and/or
- (3) extending the recycled water pipeline to JPL with a diversion pipeline to the spreading facilities in the Arroyo to utilize more of PWP's 6,000 acre-feet/year right.

Water Integrated Resource Plan. In September 2009, PWP initiated the process to develop a Water Integrated Resources Plan (WIRP). The WIRP is a 25-year water supply plan that will establish a framework for future investment in water supply and conservation programs to reliably meet the projected needs of its water customers. The WIRP will also form the basis of the 2010 Urban Water Management Plan that must be adopted by July 1, 2011. In addition, the WIRP will provide an achievable, long-term strategy to meet current and future water needs. The goals of the WIRP are to sustainably and cost-effectively address local and regional water supply and demand issues, reflect community values, and adapt to changing conditions. The Final WIRP document is expected to be submitted to City Council for approval in December 2010.

Water Conservation Programs

Due to the long-term drought conditions and allocation cutbacks from MWD, PWP adopted a Comprehensive Water Conservation Plan in 2009. The plan provides a multi-pronged approach for achieving water conservation targets of 10%, 20% and 30%. As part of this plan PWP took the following steps:

- Amended Pasadena's Water Shortage Ordinance and established permanent water waste prohibitions
- Adopted new ordinances to promote sustainable practices such as efficient landscaping
- Provided customers with an extensive array of water conservation workshops and online instructional videos for improving water efficiency

PWP is also implementing the following programs as part of this plan:

- Offering customers enhanced incentives for high efficiency clothes washers, weather based irrigation controllers and a turf replacement program. The commercial programs include rebates for cooling tower conductivity controllers, high efficiency toilets and urinals, air cooled ice machines and central control irrigation controllers.
- Offering landscaping and irrigation audits to both residential and commercial customers, which includes a water budget based on California's statewide landscape irrigation efficiency model.

Pasadena signed the Urban Environmental Accords ("UEA") agreement in 2005, targeting a 10 per cent reduction in per capita water use by 2015. The UEA base usage is 38,416 AF, the goal is 34,575 AF. Water consumption in FY 2010 was 30,520, 20% below the 2005 base year. The utility is focused on the next benchmark of 20% per capita water consumption reduction by 2020, based on PWP's historical ten year water consumption average between 1997 and 2007 (consistent with the State of California's mandated 20x2020 water conservation plan (a plan being developed by DWR to achieve the goal of a 20% reduction in urban per capita water use in California by 2020, the draft which 20x2020 plan served

as a basis for legislation that was enacted in November 2009 to incorporate into law (Senate Bill X7 7) the goal to achieve a 20% reduction in urban per capita water use in California by 2020).

Risks to Water Supply

PWP's water supply is affected by many factors, including annual rainfall precipitation, production patterns, recharge trends and the percentage allocation of PWP's sources of water supply. Sustained drought conditions or continued low water levels could adversely affect PWP's water supply and could impact operational expenses of the Water System or demand for water services. There is no guarantee that PWP's sources of water supply will remain constant throughout the period the 2010 Bonds are outstanding. However, regional and local water storage programs are designed to mitigate the potential effects of lower water levels in the Raymond Basin.

The City's water supply is highly dependent on the reliability of imported water from MWD. Imported water accounted for approximately 65% of the City's water supply in Fiscal Year 2010. See "WATER SUPPLY – The Metropolitan Water District of Southern California" above.

The City has stored approximately 47,000 acre-feet of water in the Raymond Basin. This amount of stored water is in addition to the City's annual pumping entitlement and is equal to more than the total of two years' imported water supply. The City is also looking into developing alternative sources of supply such as recycled water. See "–Future Sources of Water Supply and/or Reliability" above.

Water Quality

For the past 20 years, PWP has consistently complied with all material Federal and State regulations. PWP collects water samples on a regular basis from all sources of supply, reservoirs and 43 locations throughout the distribution system. General mineral, general physical, bacteriological, volatile organic chemicals ("VOCs"), total trihalomethanes ("THMs"), perchlorate, nitrate, ammonia, nitrite, fluoride and metals analyses are performed in PWP's State certified Water Chemistry Laboratory. The Water System's State certified Water Chemistry Laboratory, the Pasadena Health Department and contract laboratories perform over 25,000 chemical and bacteriological analyses of water samples. The chemical analyses include tests for pesticides, herbicides, radiochemicals, organic, inorganic and mineral compounds.

PWP's 2009 Annual Water Quality Report indicated that in calendar year 2009 water delivered by PWP met all State and Federal water quality standards.

The quality of water in the Raymond Basin, the source of approximately 35% of the City's total supply, is generally good. The Raymond Basin has not suffered from the widespread contamination evident in some of Southern California's groundwater basins. In some portions of the Raymond Basin, the presence of nitrates requires blending of some sources to meet drinking water quality standards. There is some contamination from VOCs in scattered parts of the Raymond Basin, as well as contamination from perchlorate. See "Perchlorate Contamination" below.

The most notable VOCs contamination is in the vicinity of JPL located in the northwest part of the City's service area adjacent to the Arroyo Seco Stream, a major recharge area for the Raymond Basin. Contamination in this area had resulted in the inability to operate several wells. Four of the contaminated wells belong to the City and have historically supplied approximately 30% of the City's annual groundwater supply. In early 1990, the City and California Institute of Technology (Caltech) reached an agreement whereby Caltech paid for the construction of a treatment plant to remove the VOCs contamination from the City's four contaminated wells. The agreement also provided for Caltech to pay

all of the operating costs of the treatment plant. The treatment method for the plant is air stripping with activated carbon off-gas air pollution control. This treatment results in no contamination being released to the atmosphere, but does require the periodic removal of contaminated carbon. Responsibility for the construction and handling of the contaminated carbon, lies with Calgon Carbon Corporation as the City's contractor. The treatment plant was completed and all four wells were returned to full production in September 1990; however, all four wells were subsequently taken out of service due to perchlorate contamination. During the term of the agreement, JPL is to conduct additional investigations to determine more precisely the extent, origin and remediation required to address the contamination. NASA recently released the results of their study to determine if perchlorate in the Sunset Wells is associated with the migration of perchlorate from the JPL facility. NASA's conclusion is the perchlorate is from other sources. The study conclusions are being review by the City and various regulatory agencies (i.e. EPA, DHS, etc.). See "Perchlorate Contamination" below.

The total supply of MWD water imported by PWP is treated at MWD's Weymouth Water Treatment Plant. Water quality data for the Weymouth Water Treatment Plant reported in MWD's annual Water Quality Report for 2009 shows no objectionable water quality characteristics.

The primary water quality concern for Arroyo Seco surface water is the lack of protection of the Arroyo Seco watershed area. Because of numerous hikers, native animals and the possibility of people dumping materials, it is very difficult to ensure that the watershed will remain free from contamination.

Perchlorate Contamination

As of 2002, eight of PWP's sixteen groundwater wells had been removed from service due to levels of perchlorate above the action level designated by DHS. Recent testing indicates that some of the remaining active wells have trace levels of perchlorate but are below the action level. Perchlorate is generally recognized as a compound of solid rocket and missile propellant and a common waste by-product from the production and use of solid rocket fuel. PWP's groundwater wells are most vulnerable to contamination from automobile gas stations, repair shops and body shops, dry cleaners, underground storage tanks and military installations.

Caltech is believed to be responsible for the perchlorate contamination in one of the two areas. Caltech has accepted liability for such contamination in the Arroyo Seco area. The City has an agreement with Caltech for remediation. The agreement which became effective on January 23, 2006 is a funding agreement whereby NASA reimburses the City for the procurement, operations, and maintenance of a proposed 7,000 gallons per minute perchlorate and VOC treatment plant. NASA, Caltech's administrator of the agreement, provides technical assistance and services and groundwater monitoring. The annual amount to be reimbursed by NASA is about \$3.5 million, with conditions to permit for future escalated expenses should the cost of operating and maintaining the treatment plant increase. See "– Environmental Regulation," "– Water Quality" and "– Capital Improvement Program."

In March 2009, the City began construction on a 7,000 gallons per minute perchlorate and VOC treatment plant, the Monk Hill Groundwater Treatment Plant. The plant is expected to be operational in March 2011. The plant will treat the four contaminated wells in the Arroyo near JPL. The plant is designed to remove perchlorate from the extracted groundwater by passing the contaminated water through ion exchange tanks system which is made up of four pairs of steel tanks containing 12,000 to 16,000 pounds of plastic beads call resin., and then passing the water through carbon filter system, made up of five pairs of steel tanks containing about 40,000 pounds of charcoal-like carbon particles to remove VOCs.

Environmental Regulation

The Water System is subject to continuing extensive environmental regulation at both the State and federal level. The following are some of the rules and regulations applicable to the Water System.

Groundwater Rule. The United States Environmental Protection Agency (the “EPA”) published the Groundwater Rule on November 8, 2006. The Groundwater Rule is to provide increased protection against microbial pathogens in water systems that use groundwater.

Perchlorate. The California Department of Public Health Services (“CDPH”) has established a perchlorate Maximum Contaminate Level (“MCL”) of 6 parts per billion (ppb) effective October 2007. Some of the City wells are affected by this perchlorate MCL. See “– Perchlorate Contamination” above for a discussion of the eight of PWP’s sixteen groundwater wells which have been removed from service due to levels of perchlorate above the action level established by CDPH.

Surface Water Treatment Rules. In 1989, the EPA published a surface water treatment rule which required all water systems to provide treatment to ensure at least 99.9% removal and/or inactivation of *giardia lamblia* cysts and at least 99.99% removal and/or inactivation of viruses (the “Surface Water Treatment Rule”). In 1998, the EPA published the Interim Enhanced Surface Water Treatment Rule (the “Interim Rule”), which added, among other things, the requirement of a 99% reduction in *cryptosporidium* for surface water systems that filter. The Interim Rule applies to water systems using surface water and/or groundwater under the direct influence of surface water, and which serve more than 10,000 people.

In addition to the above regulations, the EPA also regulates metals, organic compounds, nitrate, trihalomethane (disinfectant/disinfection by-products), radionuclides, radon, arsenic, nitrosodimethylamine and total chromium. The EPA regulations set out a MCL for each organic chemical. The regulations also require that a water utility using treatment to comply with an MCL collect monthly samples of the treated water at a location prior to the distribution system. If results in the treated water exceed the MCL the water utility must resample the treated water to confirm the results and report the result to CDPH within 48 hours of confirmation.

Future Regulation. Water utilities are subject to continuing environmental regulation. Federal, state and local standards and procedures which regulate water utilities are subject to change. These changes may arise from continuing legislative, regulatory and judicial action regarding such standards and procedures. Consequently, there is no assurance that any City facility will remain subject to the regulations currently in effect or will always be in compliance with future regulations. An inability to comply with environmental standards could result in additional capital expenditures to comply, reduced operating levels or the complete shutdown of individual water facilities not in compliance. See “– Capital Improvement Program” and “– Perchlorate Contamination” below.

If the federal government, acting through the EPA or additional legislation, or the State imposed stricter treatment standards, PWP’s expenses could increase and rates and charges would be required to be increased to offset those expenses.

Seismic Considerations

The areas in and surrounding the City-owned water facilities, like those in much of the State, may be subject to unpredictable seismic activity. The Water System’s facilities are not located near any known active fault lines. An occurrence of severe seismic activity in the area of the Water System’s facilities could result in substantial damage to and interference with the City’s water supply. The City

does not currently carry earthquake insurance. See APPENDIX A – “THE CITY OF PASADENA – Insurance” herein. In the event of significant earthquake damage to the Water System and/or the City’s service area, there can be no assurance that Pledged Revenues would be sufficient to pay the principal of and interest on any outstanding 2010 Bonds.

The Water System Master Plan has recommended that seismic analyses be conducted for all 14 reservoirs in the Water System constructed before 1972. The capital improvement plan for the Water System calls for any necessary improvements to the reservoirs to be completed by Fiscal Year 2014.

Capital Improvement Program

In 2001, the City engaged Montgomery Watson Harza (the “Consultant”) to evaluate the existing Water System and to develop a capital improvement program for the Water System. In June 2002, the Consultant delivered a report on the Water System and an 18-year plan for capital improvements to the Water System (the “Water System Master Plan”).

The Consultant determined that an investment of approximately \$234 million over the 18 years of the plan would be required to address existing deficiencies and to adequately and reliably produce and distribute water. Of this amount, the study called for PWP to fund \$204 million of the identified improvements and for others to fund the remaining amount of approximately \$30 million for perchlorate treatment. The City currently has a commitment from NASA to fund the full anticipated cost of perchlorate treatment in the Arroyo Seco area. See “– Perchlorate Contamination.”

In developing the funding requirements for the proposed Water System Master Plan capital improvement program and the cost of service study, staff conducted an analysis to determine a financial structure that supports the needed capital investments and minimizes the rate impacts on water customers. Staff also examined the impact of various levels of debt financing for the capital improvement program. Based on this financial analysis, staff intends to use a funding mix of revenue bond financing and cash from rates on a 65%:35% basis.

In 2003, the City issued the 2003 Bonds that refunded its outstanding 1993 Water Revenue Bonds, prepaid its obligation with the Financing Authority for Resource Efficiency of California (FARECal) and provided \$22 million to finance the first phase of the Water System Master Plan and an additional \$1 million to finance the initial phase of the water reclamation program.

In 2007, the City issued the 2007 Bonds to continue the implementation of its Water System Master Plan.

The capital improvements identified in the Water System Master Plan are ongoing and on schedule with the timing contemplated with the second financing. As further discussed below, the City currently forecasts approximately \$101.9 million of additional capital improvements for the Water System over the next five years (Fiscal Years 2011 – 2015).

The 2010A Bonds constitute the third issuance of bonds for the implementation of the Water System Master Plan. In order to support the debt service and operating and maintenance expenses for the Water System, the City Council approved an increase to the Capital improvement Charge (CIC) in August 2007. Through the CIC, the City has imposed water user charge increases four times totaling approximately \$0.65 per billing unit. Based on water consumption for Fiscal Year 2010 and the current rate, the CIC is estimated to generate approximately \$10 million each year. The CIC revenues are specifically dedicated to fund the proposed Water System Master Plan water system improvements. See

“SECURITY AND SOURCES OF PAYMENT FOR THE 2010 BONDS – Capital Improvements Charge Account.”

Each year the City Council approves a five-year capital improvement program (“CIP”) for the Water System. The last CIP for the Water System was approved in May 2010. The CIP for Fiscal Years 2011-2015 identified approximately \$101.9 million in projects for the Water System. The following table lists the expected capital requirements over the next five years.

TABLE 5
WATER SYSTEM CAPITAL REQUIREMENTS
(In Thousands)

<u>Fiscal Year</u>	<u>Capital Requirements</u>
2011	\$14,696
2012	20,728
2013	24,170
2014	19,645
2015	22,695

Source: Pasadena Water and Power Department.

The proceeds of the 2010A Bonds will be used to finance a portion of the capital expenditures for Fiscal Years 2011 through 2013, including some capital projects that are not expressly included in the Water System Master Plan. Specifically, the proceeds of the 2010A Bonds will be used to:

- (a) complete Phase I of the Recycled Water Program which includes the design, permitting, and construction of facilities to connect to the recycled water treatment plant in the City of Glendale. This will supply and distribute recycled water within the City’s water service area;
- (b) continue the installation of water mains, meters and services, and upgrade of facilities in accordance with the Water System Master Plan;
- (c) design and install chloramine disinfection facilities to replace existing chlorine stations. Chloramine disinfection reduces by-products produced when using chlorine in the water system; and
- (d) design and construct the Sunset Perchlorate Treatment Plant for the Sunset Reservoir wells to remove perchlorate from the groundwater and increase local water supply. Although efforts will continue to secure alternative sources of funding for a portion this project, construction of the treatment plant will be required even if such funding is not secured.

Water Sales

The following table shows historical production and sales information for the Water System.

TABLE 6
HISTORICAL PRODUCTION AND SALES DATA
(In Thousands of Billing Units)

	Fiscal Year Ended June 30,				
	2006	2007	2008	2009	2010
Total Production	15,388	16,977	16,195	15,029	13,199
Water Sold	14,622	16,088	15,390	14,574 ⁽¹⁾	12,504 ⁽¹⁾
Water System Losses	766	889	805	455	695
Number of Services	37,135	37,457	37,783	37,602	37,586

Billing Unit = 100 Cubic Feet.

⁽¹⁾ Declines reflect implementation of conservation measures as a result of drought conditions and reduced post-drought consumption, as well as effects of current economic conditions.

Source: Pasadena Water and Power Department.

As shown in the table below, customers inside the City's boundary (including municipal and other customers) consumed approximately 86% of the volume of water sold by the Water System in Fiscal Year 2010. Receipts from customers within the City limits (including municipal and other customers) represent approximately 87% of the revenues collected by the Water System in Fiscal Year 2010. Each meter is considered a separate customer.

TABLE 7
WATER SALES VOLUME AND REVENUE

	Fiscal Year Ended June 30,				
	2006	2007	2008	2009	2010*
Volume (000's Billing Units)					
Inside City Limits	12,164	13,340	12,765	12,059	10,437
Outside City Limits	2,054	2,293	2,179	2,071	1,744
Municipal and Other	404	455	445	444	323
Total	<u>14,622</u>	<u>16,088</u>	<u>15,389</u>	<u>14,574</u>	<u>12,504</u>
Revenue (000's Dollars)					
Inside City Limits	\$19,645	\$21,563	\$20,752	\$20,880	\$26,731
Outside City Limits	4,403	4,928	4,742	4,747	5,524
Municipal and Other	10,460	13,451	14,066	17,469	11,225
Total	<u>\$34,508</u>	<u>\$39,942</u>	<u>\$39,560</u>	<u>\$43,096</u>	<u>\$43,480</u>

Billing Unit = 100 Cubic Feet.

* Unaudited.

Source: Pasadena Water and Power Department.

Largest Customers

The ten largest customers of the Water System for the Fiscal Year ended June 30, 2010 are listed in the table below.

**TABLE 8
TEN LARGEST CUSTOMERS
(Billing Units)**

<u>Customer</u>	<u>Percent of Total Operating Revenues</u>
CalTech/JPL	2.81%
American Golf (Brookside)	1.79
Annandale Golf Club	0.90
Douglas Colliflower (Golf)	0.99
Rose Bowl Operating Co.	0.65
Huntington Memorial Hospital	0.64
Dept. of Transportation/Caltrans	0.29
City of Pasadena Steam Power Plant	0.29
Paseo Colorado Holdings	0.27
Pasadena City College	<u>0.23</u>
Total	8.86%

Billing Unit = 100 Cubic Feet.
Source: Pasadena Water and Power Department.

Rate Structure

The Charter provides that the City Council shall set water rates by ordinance. Such rates are not subject to approval by any other body or agency, but under Article XIIIID of the California Constitution are subject to a majority protest procedure of property owners subject to the rates. The Rate Ordinance sets rates and charges for Water System customers. Water rates charged to customers are comprised of the commodity rates, a monthly distribution and customer charge, a capital improvement charge and may include a purchased water adjustment charge.

Under the City’s Water Ordinance, Chapter 13.20 of the Pasadena Municipal Code, costs associated with water projected to be purchased from MWD are passed through to customers via the First Block, Second Block and Third Block commodity rates. The commodity rates are re-set from time to time to recover all costs associated with the purchase and distribution of MWD water. In order to accommodate changes in MWD’s rates, water delivered under commodity rates is subject to an automatic adjustment, the purchased water adjustment charge, which tracks changes in MWD’s prices occurring since the last change in rates.

The City’s current rate structure is an inverted block structure. Water usage rates are higher for higher levels of consumption. The rates also have seasonal and inside City limits/outside City limits price differentials, with higher water rates in the summer and in areas outside the City limits.

The water commodity rate structure was amended in June 2009 to include, in addition to the First Block, Second Block and Third Block commodity rates, two additional higher priced blocks (Blocks 4 and 5) to further encourage water conservation and provide the necessary price signals required to achieve the desired water conservation objectives of reducing water demands by 10%. In addition, the water rate structure was amended to recover higher costs of purchased water in excess of the City’s water allocation from MWD, including the cost of higher penalty rates, in the event that the City exceeded its water allocation level.

In June 2010, the water commodity rate structure was further modified to reduce Block 4 rates and to eliminate Block 5 rates in response to favorable conservation efforts by City's customers and based on the City's reassessment of MWD's program and pricing scheme. Additionally, in June 2010, in response to MWD's approved January 2011 and January 2012 rate increases, the City also approved increases to its purchased water adjustment charge to be implemented in October 2010 and October 2011.

In June 2009, the City also approved increases to its distribution and customer charge over a three-year period. The first increase was implemented in July 2009 and it added approximately \$3.0 million to the distribution and customer charge revenue. The second increase was implemented in July 2010 and it is expected to generate an additional \$3.2 million in distribution and customer charge revenue in Fiscal Year 2011. The third increase is scheduled to be implemented in July 2011 and it is expected to add an additional \$3.7 million to the distribution and customer charge revenue.

The following chart outlines the current water rate structure for the City. Area A includes all areas inside the City limits and Area B includes all areas outside the City limits. A customer is charged First Block rates for initial quantity consumed, Second Block rates over initial quantity, and Third Block rates for any excess over First and Second Block quantities.

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**TABLE 9
RATE STRUCTURE**

COMMODITY RATES FOR ALL WATER DELIVERED (PER 100 CUBIC FEET) ⁽¹⁾

	<u>April 1-September 30</u>		<u>October 1-March 31</u>	
<u>Area A</u>	First Block	\$1.00537	First Block	\$0.97885
	Second Block	2.59851	Second Block	2.52559
	Third Block	3.09921	Third Block	3.01171
	Fourth Block	3.85026	Fourth Block	3.74089
<u>Area B</u>	First Block	\$1.23296	First Block	\$1.19981
	Second Block	3.22438	Second Block	3.13323
	Third Block	3.85026	Third Block	3.74088
	Fourth Block	4.78908	Fourth Block	4.65236

FIRST, SECOND, AND THIRD BLOCK ALLOCATIONS ⁽²⁾

<u>Size of Meter (Inches)</u>	<u>Volume of First Block Allocation</u>	<u>Volume of Second Block Allocation</u>	<u>Volume of Third Block Allocation</u>
5/8", 3/4"	0-8	9-24	25-34
1"	0-12	13-40	41-60
1-1/2"	0-22	23-86	87-132
2"	0-48	49-188	189-290
3"	0-116	117-500	501-860
4"	0-225	226-1,000	1,001-1,800
6"	0-500	501-5,600	5,601-8,800
8"	0-500	501-5,600	5,601-10,000
10", 12"	0-500	501-24,000	24,001-32,000

MONTHLY DISTRIBUTION AND CUSTOMER CHARGE FOR SERVICE ⁽³⁾

<u>Meter Size (Inches)</u> <u>Area A</u>		<u>Meter Size (Inches)</u> <u>Area B</u>	
5/8" and 3/4"	\$ 14.06	5/8" and 3/4"	\$ 17.48
1"	26.70	1"	33.19
1 1/2"	55.18	1 1/2"	68.31
2"	126.62	2"	157.41
3"	309.21	3"	384.48
4"	474.87	4"	591.19
6"	733.61	6"	911.51
8"	1,192.68	8"	1,483.48
10"	1,552.08	10"	1,930.55
12"	1,761.31	12"	2,188.93

⁽¹⁾ The rates include 9.5¢ per 100 cubic feet of purchased water adjustment charge effective October 1, 2010. An additional 12¢ per 100 cubic feet will become effective October 1, 2011.

⁽²⁾ In Units of 100 cubic feet.

⁽³⁾ Includes fire protection service.

Sources: Pasadena Water and Power Department, Pasadena Municipal Code.

In 2003, the CIC was added to water rates to recover the capital improvement costs of the Water System. The current effective CIC rates (approved in August 2007) are shown in the table below.

TABLE 10
CAPITAL IMPROVEMENTS CHARGE
(per 100 Cubic Feet)

	<u>April 1-September 30</u>	<u>October 1-March 31</u>
Area A	\$0.62429	\$0.58896
Area B	\$0.84274	\$0.79504

Source: Pasadena Water and Power Department; Pasadena Municipal Code.

The following table shows average residential monthly billing information for the last three Fiscal Years.

TABLE 11
AVERAGE RESIDENTIAL BILLING INFORMATION

	<u>Fiscal Year Ended June 30,</u>		
	<u>2008</u>	<u>2009</u>	<u>2010</u>
Residential Billing Units Sold (100 Cubic Feet)	8,523,032	8,168,089	6,799,196
Total Billing Units Sold (Water System)	15,389,894	14,576,707	12,503,665
Residential as a Percent of Total Water System	55.4%	56.0%	54.4%
Revenues From Residential Sales	\$21,720,775	\$23,628,258	\$23,269,538
Total (Water System)	\$39,559,565	\$43,095,822	\$43,480,017
Residential as a Percent of Total Water System	54.9%	54.8%	53.8%
Number of Residential Customers	30,722	32,205	32,562
Total (Water System)	37,522	37,602	37,586
Residential as a Percent of Total Water System	82.0%	85.6%	86.6%
Average Residential Monthly Billing Unit	23.1	21.1	17.40
Average Residential Bill	\$58.82	\$61.14	\$59.55

Source: Pasadena Water and Power Department.

Billing and Collection Procedures

Billing and collection services for all water services are provided by PWP and the City's Finance Department. Most residential and certain commercial water customers are billed bimonthly for electric and/or water service; most large commercial users are billed monthly for electric and water service. The City prepares a single bill for electric, water, refuse and sewer collection services. Payments received for the billed period are credited first to the oldest charges, then to current charges for each service in the order stated.

The City's policy is that utility bills are due when rendered and delinquent after 30 days. Any amount over \$25 and outstanding after 30 days from actual billing date, is assessed a 3% delinquent penalty charge. Lifeline customers are exempted. A 48-hour notice of termination is generated approximately 45 days after the actual billing date and is mailed to the service address. If payment is not received and the delinquent amount due is more than \$100 and the customer has both electric and water service, the water service is interrupted. Should the bill not be paid within a week, the electric service is

also interrupted. The total bill plus all reconnection charges must be paid to resume service. If after both water service and electric service have been shut off, the bill remains unpaid, the meters are checked twice to insure that they have not been turned back on or tampered with, then the account is closed. After 90 days, the account is written off by the PWP Collection Department and sent to the City Finance Department for collection.

TABLE 12
HISTORICAL CUSTOMER BAD DEBT
(**\$ in Thousands**)

	Fiscal Year Ended June 30,				
	2006	2007	2008	2009	2010
Bad Debt Written Off	\$ 75	\$ 152	\$ 144	\$ 112	\$ 127
Total Operating Revenue	\$34,507	\$39,943	\$39,560	\$43,096	\$43,480
Bad Debt as a Percent of Operating Revenue	0.22%	0.38%	0.36%	0.26%	0.29%

Source: Pasadena Water and Power Department.

Basis of Financial Reporting

The City’s financial statements are prepared in accordance with generally accepted accounting principles for municipal governments. Financial statements of the Water System are prepared on the accrual basis of accounting. Financial statements for the Water System for the Fiscal Year ended June 30, [2009] are included as APPENDIX B – “AUDITED FINANCIAL STATEMENTS OF PASADENA WATER AND POWER ENTERPRISE FUNDS FOR THE FISCAL YEAR ENDED JUNE 30, [2009].”

All revenues of the Water System are generated by charges and other activities of the Water System. The Water System does not receive funds from the City or any tax revenues. All revenues generated by the Water System are deposited into the Water Fund as required by the Charter. See “SECURITY AND SOURCES OF PAYMENT FOR THE 2010 BONDS – The Water Fund.” Labor costs for personnel working in both the Water System and the Electric System are allocated on the basis of time worked for each division.

Employees

For Fiscal Year 2011, the City has budgeted approximately 129 full time employees (FTE) for the Water System. All Water System employees are represented either by the International Brotherhood of Electrical Workers, International Union of Operating Engineers, the American Federation of State and Municipal Employees, the Pasadena Association of Clerical and Technical Employees or Pasadena Management Association in all matters pertaining to wages, benefits and working conditions. The current arrangements with these unions and/or associations, which are in the form of either a contract or a memorandum of understanding, expire by their respective terms on various dates through 2012, at which time each is expected to be subject to renegotiation. See APPENDIX A – “THE CITY OF PASADENA – Employee Relations.”

The Water System’s permanent employees are all covered by the California Public Employees Retirement System (“PERS”), administered by the State, to which contributions are made by both the City and the employees. As of June 30, 2008 (the latest available information), the actuarial staff of PERS reported an unfunded liability of \$59.0 million for the City’s miscellaneous employees as compared to an unfunded liability of \$46.2 million the previous year. As of June 30, 2008, the City

reported that its PERS obligation with respect to the City’s miscellaneous employees was 90.7% funded. The City expects that its unfunded liability for PERS has increased since June 30, 2008.

The City provides a subsidy to retirees of the City that are members of PERS (as well as members of the Pasadena Fire and Police Pension System) toward the purchase of medical insurance from PERS. Benefit provisions are established and amended through negotiations between the City and the respective unions. As of June 30, 2008, the City reported its unfunded actuarial accrued liability for these post-retirement benefits of \$23.7 million. The City funds these benefits on a “pay-as-you-go” basis. The City expects that its unfunded liability for post-retirement benefits has increased since June 30, 2008.

Insurance

The insurable property and facilities of the Water System are covered under the City’s general insurance policies. The City does not carry earthquake insurance on its water facilities. For additional information on the City’s insurance, see “APPENDIX A – THE CITY OF PASADENA – Insurance.”

Historical Operating Results and Cash Flows

The following table presents the historical operating results and cash flows for the Water System for the last five Fiscal Years.

TABLE 13
HISTORICAL OPERATING RESULTS AND CASH FLOWS
(**\$ in Thousands**)

	Fiscal Year Ended June 30,				
	2006	2007	2008	2009	2010⁽⁴⁾
Revenue					
Sales Within City Limits	\$19,645	\$21,563	\$20,752	\$20,880	\$26,731
Sales Outside City Limits	4,403	4,928	4,742	4,747	5,524
Municipal Sales & Misc. Others ⁽¹⁾	<u>10,459</u>	<u>13,452</u>	<u>14,066</u>	<u>17,469</u>	<u>11,225</u>
Total Revenues	<u>\$34,507</u>	<u>\$39,943</u>	<u>\$39,560</u>	<u>\$43,096</u>	<u>\$43,480</u>
Operating Expenses					
Purchased Water	9,600	12,155	14,001	12,997	13,642
Fuel and Purchased Power	2,142	2,520	2,304	2,326	2,196
Direct Operating Expenses	7,179	6,699	6,677	8,233	7,056
Administrative and General Expenses	<u>5,476</u>	<u>6,068</u>	<u>7,210</u>	<u>6,615</u>	<u>5,773</u>
Total Expenses ⁽²⁾	<u>\$24,397</u>	<u>\$27,442</u>	<u>\$30,192</u>	<u>\$30,171</u>	<u>\$28,667</u>
Earnings from Operations	10,110	12,501	9,368	12,925	14,813
Non-Operating Income ⁽³⁾	<u>3,006</u>	<u>3,141</u>	<u>3,141</u>	<u>3,837</u>	<u>4,881</u>
Cash Flow Available for Debt Service	<u>\$ 13,116</u>	<u>\$15,642</u>	<u>\$12,509</u>	<u>\$16,762</u>	<u>\$19,694</u>
Debt Service	3,615	3,768	4,944	4,976	4,947
Debt Service Coverage	<u>3.63x</u>	<u>4.15x</u>	<u>2.53x</u>	<u>3.37x</u>	<u>3.98x</u>
Amount Available after Debt Service	\$ 9,501	\$11,874	\$ 7,565	\$11,786	\$14,747
General Fund Transfer	<u>2,596</u>	<u>2,599</u>	<u>2,923</u>	<u>2,872</u>	<u>3,066</u>
Cash Available after Debt Service and Transfer	<u>\$ 6,905</u>	<u>\$ 9,275</u>	<u>\$ 4,642</u>	<u>\$ 8,914</u>	<u>\$11,681</u>

⁽¹⁾ Includes CIC & Purchased Water Adjustment Cost Revenues.

⁽²⁾ Excludes Depreciation and Interest Expense

⁽³⁾ Includes Interest Income and Capital Contributions.

⁽⁴⁾ [Unaudited.] [2010 unaudited but may be audited by printing]

Sources: Audited Financial Statements of the City and Pasadena Water and Power Department.

Projected Coverage and Five-Year Forecast

The following table shows a summary of the projected operating results of the Water System for the five Fiscal Years listed, assuming CIC and distribution and customer charge increases, as described below. In the preparation of the projections in this section, the City has made certain assumptions with respect to conditions that may occur in the future. While the City believes these assumptions are reasonable for the purpose of the projections, they are dependent on future events, and actual conditions may differ from those assumed. **To the extent actual future factors differ from those assumed by the City or provided to the City by others, the actual results will vary from those forecast and such variations may be material.** The City does not plan to issue any updates or revisions to the forecast if or when its assumptions, expectations, or events, conditions or circumstances on which such forecast is based, occur or do not occur.

Table 14 revenue projection assumptions include (a) an annual sales growth rate of 0.6%, (b) distribution and customer charge increases generating approximately \$3.2 million and \$3.7 million in Fiscal Year 2011 and Fiscal Year 2012, respectively, and (c) approximately \$1.1 million to \$1.7 million in purchased water adjustment charge revenues for Fiscal Year 2012 through Fiscal Year 2015. Table 14 expense projections assume 3% annual escalation in expenses and 4.5% annual increase in purchased water cost. It also assumes the issuance of the Series 2010A Bonds in Fiscal Year 2011.

TABLE 14
OPERATING STATEMENT
FIVE YEAR FORECAST
(**\$ in Thousands**)

	Fiscal Year Ended June 30,				
	2011	2012	2013	2014	2015
Revenue					
Sales Within City Limits	\$35,131	\$38,487	\$38,718	\$38,950	\$39,184
Sales Outside City Limits	7,444	8,044	8,092	8,140	8,189
Municipal Sales & Misc. Others ⁽¹⁾	<u>13,187</u>	<u>14,565</u>	<u>15,753</u>	<u>16,947</u>	<u>18,149</u>
Total Revenues	<u>\$55,762</u>	<u>\$61,096</u>	<u>\$62,562</u>	<u>\$64,038</u>	<u>\$65,522</u>
Operating Expenses					
Purchased Water	18,706	19,548	20,427	21,347	22,414
Fuel and Purchased Power	2,969	3,058	3,150	3,244	3,342
Direct Operating Expenses	7,646	7,968	8,207	8,453	10,578
Administrative and General Expenses	<u>6,255</u>	<u>6,519</u>	<u>6,714</u>	<u>6,916</u>	<u>5,253</u>
Total Expenses ⁽²⁾	<u>\$35,576</u>	<u>\$37,093</u>	<u>\$38,499</u>	<u>\$39,960</u>	<u>\$41,586</u>
Earnings from Operations	20,186	24,003	24,064	24,078	23,936
Non-Operating Income ⁽³⁾	<u>3,850</u>	<u>3,927</u>	<u>4,006</u>	<u>4,086</u>	<u>4,167</u>
Cash Flow Available for Debt Service	<u>\$24,036</u>	<u>\$27,930</u>	<u>\$28,069</u>	<u>\$28,163</u>	<u>\$28,103</u>
Total Debt Service ⁽⁴⁾	4,947	7,063	7,013	6,963	6,928
Debt Service Coverage	<u>4.86x</u>	<u>3.95x</u>	<u>4.00x</u>	<u>4.04x</u>	<u>4.06x</u>
Amount Available after Debt Service	\$19,089	\$20,867	\$21,056	\$21,200	\$21,175
General Fund Transfer	<u>3,394</u>	<u>3,657</u>	<u>3,968</u>	<u>4,053</u>	<u>4,141</u>
Cash Available after Debt Service and Transfer	<u>\$15,695</u>	<u>\$17,210</u>	<u>\$17,088</u>	<u>\$17,147</u>	<u>\$17,034</u>

⁽¹⁾ Includes CIC and Purchased Water Adjustment Cost Revenues.

⁽²⁾ Excludes Depreciation and Interest Expense.

⁽³⁾ Includes Interest Income and Capital Contributions.

⁽⁴⁾ Includes actual debt service for outstanding 2003 Bonds and 2007 Bonds and estimated debt service for 2010 Bonds. Debt service on the 2010 Bonds is preliminary; subject to change.

CONSTITUTIONAL AND STATUTORY LIMITATIONS ON TAXES AND APPROPRIATIONS

Article XIII A of the California Constitution

If a portion of PWP's rates or charges were determined by a court to exceed the reasonable costs of providing service, any fee which PWP charges may be considered to be a "special tax" which under Article XIII A of the State Constitution must be authorized by a two-thirds vote of the affected electorate. This requirement is applicable to PWP's rates for water service and charges for capital improvements to the Water System. The reasonable cost of providing water service has been determined by the State Controller to include depreciation and allowance for the cost of capital improvements. In addition, State courts have held that fees such as connection fees (capacity charges) will not be special taxes if they approximate the reasonable cost of constructing improvements to the Water System contemplated by the local agency imposing the fee. Such court determinations have been codified in the Government Code of the State of California (Section 6000 *et seq.*).

Article XIII B of the California Constitution

Article XIII B of the State Constitution limits the annual appropriations of State and local governmental entities to the amount of appropriations of the entity for the prior Fiscal Year, as adjusted for changes in the cost of living, changes in population and changes in services rendered by the entity.

Pending clarification of certain of its provisions by the courts, or by the State Legislature, the full impact of Article XIII B on the amounts and uses of moneys to be deposited in the Water Fund is not clear. However, to the extent moneys in the Water Fund are used to pay costs of maintaining and operating the Water System and debt service on the Bonds and Parity Debt, such moneys should not, under the terms of Article XIII B, as supplemented by legislation, and based upon the official ballot argument supporting the measure, be held to be subject to the appropriation limit.

Article XIII C and XIII D of the California Constitution

Proposition 218, a state ballot initiative known as the "Right to Vote on Taxes Act" was approved by California voters on November 5, 1996 and, except for certain provisions which became effective on July 1, 1997, became effective on November 6, 1996. Proposition 218 added Article XIII C, entitled "Voter Approval of Local Tax Levies" ("Article XIII C"), and Article XIII D, entitled "Assessment and Property Related Fee Reform ("Article XIII D"), to the California Constitution. Article XIII C and Article XIII D limit the imposition by a local government of "general taxes," "special taxes," "assessments" and "fees" or "charges." The City is a local government within the meaning of Article XIII C and Article XIII D.

Article XIII C, provides, among other things, that the initiative power shall not be prohibited or otherwise limited in matters of reducing or repealing any local fee or charge. This extension of the initiative power is not limited by the terms of Article XIII C to fees and charges imposed after November 6, 1996 and, absent other authority, could result in retroactive reduction in existing fees and charges. Although the terms "fees" and "charges" are not defined in Article XIII C, the California Supreme Court, in *Bighorn-Desert View Water Agency v. Kari Verjil; E.W. Kelley* (July 2006), has stated that there is no basis for excluding from Article XIII C's authorization any of the fees subject to Article XIII D. If fees or charges charged or collected by the City for its Water System are subjected to the initiative process and the outcome of any initiative proceedings results in a reduction or repeal of such fees or charges, the ability of the City to generate Gross Aggregate Revenues sufficient to comply with its covenants under the Indenture may be adversely affected. Furthermore, if voters were to approve an initiative lowering the City's water rates or other charges, the City would need voter approval before it

could change the rate or charge that had been set by initiative. The City could, however, increase a charge that was not affected by initiative or to impose an entirely new charge without voter approval.

The California Supreme Court further stated in *Bighorn* that it was not holding that the initiative power is free of all limitations and was not determining whether the initiative power is subject to the statutory provision requiring that water service charges be set at a level that will pay debt service on bonded debt and operating expenses. Such initiative power could be subject to the limitations imposed on the impairment of contracts under the contract clause of the United States Constitution. Additionally, SB 919 provides that the initiative power provided for in Proposition 218 “shall not be construed to mean that any owner or beneficial owner of a municipal security, purchased before or after (the effective date of Proposition 218) assumes the risk of, or in any way consents to, any action by initiative measure that constitutes an impairment of contractual rights” protected by the United States Constitution. However, no assurance can be given that the voters of the City will not, in the future, approve an initiative which reduces or repeals local taxes, assessments, fees or charges.

Article XIID prohibits the assessment upon any parcel of property or upon any person “as an incident of property ownership” (defined to exclude fees for the provision of electrical or gas service) by a local government of any tax, assessment, fee or charge except voter-approved ad valorem property taxes and special taxes, fees or charges as a condition of property development, and assessments and “fees or charges for property related services” levied or imposed in accordance with the provisions of Article XIID.

Under Article XIID, revenues derived from a “fee” or “charge” (defined as “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”) may not exceed the funds required to provide the “property-related service” and may not be used for any purpose other than that for which the fee or charge was imposed. Further, the amount of a “fee” or “charge” may not exceed the proportional cost of the service attributable to the parcel, no “fee” or “charge” may be imposed for a service unless that service is actually used by, or is immediately available to, the owner of the property in question, and no “fee” or “charge” may be imposed for general governmental service where the service is “available to the public at large in substantially the same manner as it is to the property owners.”

In addition, in order for a “fee” or “charge” to be imposed or increased, Article XIID provides that, among other things, the parcel upon which a fee or charge is proposed for imposition must be identified, the amount of the fee or charge proposed to be imposed on each such parcel must be calculated, written notice by mail of the proposed fee or charge must be provided to the “record owner” of each identified parcel, and a public hearing must be conducted upon the proposed fee or charge. If written protests against the proposed “fee” or “charge” are presented by a majority of owners of the identified parcels, the fee or charge may not be imposed. The California Supreme Court in *Bighorn* indicated that once a property owner or resident has paid the connection charges and has become a customer of a public water agency, all charges for water delivery incurred thereafter are charges for a property-related service, whether the charge is calculated on the basis of consumption or is imposed as a fixed monthly fee. Accordingly, the imposition or increase of any fee or charge by the City for its water service will be the subject of such a majority protest. If such a majority protest occurs, the ability of the City to generate Gross Aggregate Revenues sufficient to comply with its covenants under the Indenture may be adversely affected.

Article XIID states that, beginning July 1, 1997, all “fees” or “charges” must comply with its provisions. It is unclear how the provisions of Article XIID will be applied to fees or charges established

prior to such date. It is also unclear how the provisions of Article XIID will be applied to fees or charges established after such date but prior to the *Bighorn* decision.

As a result of the *Bighorn* decision, there can be no assurance that Proposition 218 will not limit the ability of the City to impose, levy, charge and collect increased fees and charges for water services.

Prior to 2008, the City did not comply with the applicable notice and protest procedures of Article XIID for its water rate increases. There is no pending challenge to the City's water fees, and the City cannot predict the outcome of any such challenge, if a challenge were brought. Since 2008, the City has followed the notice, hearing and protest procedures in Article XIID in connection with its water rate increased and plans to follow such notice, hearing and protest procedure in connection with future rate increases.

The City is unable to predict how Article XIIC and Article XIID will be interpreted by the courts in the future. Bond Counsel has advised that there can be no assurance that Article XIIC and Article XIID will not limit the ability of the City to charge and collect fees and charges for its water service sufficient to enable the City to comply with its covenants under the Indenture or that the ability of the City to generate Gross Aggregate Revenues sufficient to pay principal and interest on the 2010 Bonds will not be adversely affected. See "SECURITY FOR THE BONDS – Rate Covenant." Further, in such event, there can be no assurance that remedies will be available to fully protect the interests of the holders of the 2010 Bonds. See "SECURITY AND SOURCES OF PAYMENT FOR THE 2010 BONDS – Limitations on Remedies."

Future Initiatives

Articles XIIA, XIIB, XIIC and XIID were adopted as measures that qualified for the ballot pursuant to California's initiative process. From time to time other initiatives have been and could be proposed and adopted affecting PWP's revenues or ability to increase revenues. Neither the nature and impact of these measures nor the likelihood of qualification for ballot or passage can be anticipated by the City.

One such initiative, recently qualified for the November 2010 ballot, is Proposition 26. The proposition, if approved by majority vote, would impose a two-thirds voter approval requirement for the imposition of fees and charges by the State. It would also impose a majority voter approval requirement on local governments with respect to fees and charges for general purposes, and a two-thirds voter approval requirement with respect to fees and charges for special purposes. The initiative, according to its supporters, is intended to prevent the circumvention of tax limitations imposed by the voters pursuant to Proposition 13, approved in 1978, and other measures through the use of non-tax fees and charges. Proposition 26 expressly excludes from its scope "a charge imposed for a specific government service or product provided directly to the payor that is not provided to those not charged, and which does not exceed the reasonable cost to the [State/local government] of providing the service or product to the payor." The City believes that the initiative is not intended to and would not apply to fees for utility services charged by special districts such as the City. The City, however, is unable to predict whether Proposition 26 will be approved by the voters or whether it would be interpreted by the courts to apply to the provision of utility services by local governments such as the City.

RATINGS

Fitch Ratings ("Fitch") and Standard & Poor's Ratings Service, a division of the McGraw-Hill Companies, Inc. ("S&P") have assigned their municipal bond ratings of "____" and "____," respectively, to the 2010 Bonds. Such ratings reflect only the views of such organizations and any desired explanation

of the significance of such ratings may be obtained from the rating agency furnishing the same, at the following addresses: Fitch Ratings, One State Street Plaza, New York, New York 10004; S&P, 55 Water Street, New York, New York 10041 and Standard & Poor's, 55 Water Street, New York, New York 10041. Generally, a rating agency bases its rating on the information and materials furnished to it and on investigations, studies and assumptions of its own. There is no assurance that any of such ratings will continue for any given, period of time or that any of them will not be revised downward or withdrawn entirely by the respective rating agency, if in the judgment of such rating agency circumstances so warrant. Any such downward revision or withdrawal of such ratings may have an adverse effect on the 2010 Bonds.

TAX MATTERS

2010A Bonds

State Tax Exemption. In the opinion of Bond Counsel, under existing law interest on the 2010A Bonds is exempt from personal income taxes of the State of California.

Certain Federal Income Tax Considerations. The following is a general summary of certain United States federal income tax consequences of the purchase and ownership of the 2010A Bonds. The discussion is based upon laws, Treasury Regulations, rulings and decisions now in effect, all of which are subject to change (possibly, with retroactive effect) or possibly differing interpretations. No assurances can be given that future changes in the law will not alter the conclusions reached herein.

The discussion below does not purport to deal with United States federal income tax consequences applicable to all categories of investors and generally does not address consequences relating to the disposition of a 2010A Bond by a Beneficial Owner thereof. Further, this summary does not discuss all aspects of United States federal income taxation that may be relevant to a particular investor in the 2010A Bonds in light of the investor's particular circumstances or to certain types of investors subject to special treatment under United States federal income tax laws (including insurance companies, tax-exempt organizations, financial institutions, broker-dealers, and persons who have hedged the risk of owning any 2010A Bonds). Except as expressly set forth below, the discussion below does not discuss any aspect of state, local or foreign law or United States federal tax laws other than United States federal income tax law. This summary is limited to certain issues relating to initial investors who will hold the 2010A Bonds as "capital assets" within the meaning of section 1221 of the Internal Revenue Code of 1986 (the "Code"), and acquire such 2010A Bonds for investment and not as a dealer or for resale. This summary addresses certain federal income tax consequences applicable to initial investors of the 2010A Bonds who are United States persons within the meaning of section 7701(a)(30) of the Code ("United States persons") and, except as discussed below, does not address any consequences to persons other than United States persons.

Prospective investors should note that no rulings have been or will be sought from the IRS with respect to any United States federal income tax consequences, including those discussed below, and no assurance can be given that the IRS will not take contrary positions.

INVESTORS SHOULD CONSULT THEIR OWN TAX ADVISORS IN DETERMINING THE FEDERAL, STATE, LOCAL, FOREIGN AND ANY OTHER TAX CONSEQUENCES TO THEM FROM THE PURCHASE, OWNERSHIP AND DISPOSITION OF THE 2010A BONDS.

Internal Revenue Service Circular 230 Notice.

Investors should be aware that:

the discussion herein with respect to United States federal income tax consequences of purchasing and owning the 2010A Bonds is not intended or written to be used, and cannot be used, by any taxpayer for the purpose of avoiding penalties that may be imposed under the Code;

such discussion was written in connection with the promotion or marketing (within the meaning of IRS Circular 230) of the transactions or matters addressed herein; and

each taxpayer should seek advice based on its particular circumstances from an independent tax advisor.

This notice is given solely for the purposes of ensuring compliance with IRS Circular 230.

Stated Interest and Reporting of Interest Payments. The stated interest on the 2010A Bonds will be included in the gross income, as defined in Section 61 of the Code, of the Beneficial Owners thereof for federal income tax purposes as ordinary income at the time it is paid or accrued, depending on the tax accounting method applicable to such Beneficial Owners. Subject to certain exceptions, the stated interest on the 2010A Bonds will be reported to the Service. Such information will be filed each year with the Service on Form 1099 which will reflect the name, address and taxpayer identification number (“TIN”) of the Beneficial Owner. A copy of Form 1099 will be sent to each Beneficial Owner of a 2010A Bond.

Original Issue Discount. If the first price at which a substantial amount of the 2010A Bonds of any stated maturity is sold at original issuance (the “Issue Price”) is less than the face amount by more than one quarter of one percent times the number of complete years to maturity, the 2010A Bonds of that maturity will be treated as being issued with “original issue discount”. The amount of the original issue discount on each 2010A Bond of that maturity will equal the excess of the principal amount payable on that 2010A Bond at maturity over the Issue Price, and the amount of the original issue discount on such 2010A Bond will be accrued over its term using the “constant yield method” provided in the Treasury Regulations. As original issue discount on a 2010A Bond accrues under the constant yield method, the Beneficial Owner of a 2010A Bond with original issue discount will be required to include as interest each such accrual in its gross income regardless of its regular method of accounting. This can result in taxable income to the Beneficial Owner of a 2010A Bond issued with original issue discount that exceeds actual cash distributions on that 2010A Bond in the taxable year.

The amount of any original issue discount that accrues on the 2010A Bonds each year will be reported annually to the IRS and to the Beneficial Owners. The portion of the original issue discount included in each Beneficial Owner’s gross income while the Beneficial Owner holds a 2010A Bond will increase the adjusted tax basis of the 2010A Bond in the hands of such Beneficial Owner.

Defeasance. Persons considering the purchase of a 2010A Bond should be aware that the bond documents permit the City under certain circumstances to deposit monies or securities with the Trustee, resulting in the release of the security interests created under the Indenture (a “defeasance”). A defeasance could result in the realization of gain or loss by the Beneficial Owner of a 2010A Bond for federal income tax purposes, without any corresponding receipts of monies by the Beneficial Owner. Such gain or loss generally would be subject to recognition for the tax year in which such realization

occurs, as in the case of a sale or exchange. Owners are advised to consult their own tax advisers with respect to the tax consequences resulting from such events.

Backup Withholding. Under section 3406 of the Code, a Beneficial Owner of the 2010A Bonds who is a United States person, as defined in section 7701(a)(30) of the Code, may, under certain circumstances, be subject to “backup withholding” on current or accrued interest on the 2010A Bonds or with respect to proceeds received from a disposition of the 2010A Bonds. This withholding applies if such Beneficial Owner of 2010A Bonds: (i) fails to furnish to the payor such Beneficial Owner’s social security number or other TIN; (ii) furnishes the payor an incorrect TIN; (iii) fails to properly report interest, dividends, or other “reportable payments” as defined in the Code; or (iv) under certain circumstances, fails to provide the payor with a certified statement, signed under penalty of perjury, that the TIN provided to the payor is correct and that such Beneficial Owner is not subject to backup withholding.

Backup withholding will not apply, however, with respect to payments made to certain Beneficial Owners of the 2010A Bonds. Beneficial Owners of the 2010A Bonds should consult their own tax advisers regarding their qualification for exemption from backup withholding and the procedures for obtaining such exemption.

Withholding on Payments to Nonresident Alien Individuals and Foreign Corporations. Under sections 1441 and 1442 of the Code, nonresident alien individuals and foreign corporations are generally subject to withholding at the current rate of 30% (subject to change) on periodic income items arising from sources within the United States, provided such income is not effectively connected with the conduct of a United States trade or business. Assuming the interest income of such a Beneficial Owner of the 2010A Bonds is not treated as effectively connected income within the meaning of section 864 of the Code, such interest will be subject to 30% withholding, or any lower rate specified in an income tax treaty, unless such income is treated as portfolio interest. Interest will be treated as portfolio interest if: (i) the Beneficial Owner provides a statement to the payor certifying, under penalties of perjury, that such Beneficial Owner is not a United States person and providing the name and address of such Beneficial Owner; (ii) such interest is treated as not effectively connected with the Beneficial Owner’s United States trade or business; (iii) interest payments are not made to a person within a foreign country that the IRS has included on a list of countries having provisions inadequate to prevent United States tax evasion; (iv) interest payable with respect to the 2010A Bonds is not deemed contingent interest within the meaning of the portfolio debt provision; (v) such Beneficial Owner is not a controlled foreign corporation, within the meaning of section 957 of the Code; and (vi) such Beneficial Owner is not a bank receiving interest on the 2010A Bonds pursuant to a loan agreement entered into in the ordinary course of the bank’s trade or business.

Assuming payments on the 2010A Bonds are treated as portfolio interest within the meaning of sections 871 and 881 of the Code, then no withholding under section 1441 and 1442 of the Code and no backup withholding under section 3406 of the Code is required with respect to Beneficial Owners or intermediaries who have furnished Form W-8 BEN, Form W-8 EXP or Form W-8 IMY, as applicable, provided the payor does not have actual knowledge or reason to know that such person is a United States person.

2010B Bonds

The Code imposes certain requirements that must be met subsequent to the issuance and delivery of the 2010B Bonds for interest thereon to be and remain excluded pursuant to section 103(a) of the Code from the gross income of the owners thereof for federal income tax purposes. Noncompliance with such requirements could cause the interest on the 2010B Bonds to be included in the gross income of the

owners thereof for federal income tax purposes retroactive to the date of issue of the 2010B Bonds. The City has covenanted in the Indenture not to take any action or omit to take any action which, if taken or omitted, respectively, would adversely affect the exclusion of the interest on the 2010B Bonds from the gross income of the owners thereof for federal income tax purposes.

In the opinion of Fulbright & Jaworski L.L.P., Bond Counsel, under existing law interest on the 2010B Bonds is exempt from personal income taxes of the State of California and, assuming compliance with the aforementioned covenants, interest on the 2010B Bonds is excluded pursuant to section 103(a) of the Code from the gross income of the owners thereof for federal income tax purposes and will not be included in the computation of the alternative minimum taxable income of the owners thereof for federal income tax purposes.

To the extent that a purchaser of a 2010B Bond acquires that 2010B Bond at a price that exceeds the aggregate amount of payments (other than payments of qualified stated interest within the meaning of section 1.1273-1 of the Treasury Regulations) to be made on the 2010B Bond (determined, in the case of a callable 2010B Bond, under certain assumptions specified in the Code), such excess will constitute "bond premium" under the Code. Section 171 of the Code, and the Treasury Regulations promulgated thereunder, provide generally that bond premium on a tax-exempt obligation must be amortized on a constant yield, economic accrual, basis; the amount of premium so amortized will reduce the owner's basis in such obligation for federal income tax purposes, but such amortized premium will not be deductible for federal income tax purposes. The rate and timing of the amortization of the bond premium and the corresponding basis reduction may result in an owner realizing a taxable gain when its 2010B Bond is sold or disposed of for an amount equal to or in some circumstances even less than the original cost of the 2010B Bond to such owner. Persons considering purchasing a 2010B Bond at a price that includes bond premium should consult their own tax advisors with respect to the amortization and treatment of such bond premium, including, but not limited to, the calculation of gain or loss upon the sale, redemption or other disposition of such 2010B Bond.

The excess, if any, of the stated redemption price at maturity of 2010B Bonds of a maturity over the initial offering price to the public of the 2010B Bonds of that maturity is "original issue discount." Original issue discount accruing on a 2010B Bond is treated as interest excluded to the same extent as would be interest on such 2010B Bond from gross income of the owner thereof for federal income tax purposes and is exempt from California personal income tax. Original issue discount on any 2010B Bond purchased at such initial offering price and pursuant to such initial offering will accrue on a semiannual basis over the term of the 2010B Bond on the basis of a constant yield method and, within each semiannual period, will accrue on a ratable daily basis. The amount of original issue discount on such a 2010B Bond accruing during each period is added to the adjusted basis of such 2010B Bond to determine taxable gain upon disposition (including sale, redemption or payment at maturity) of such 2010B Bond. The Code includes certain provisions relating to the accrual of original issue discount by a purchaser of a 2010B Bond who purchases such 2010B Bond other than at its initial offering price and pursuant to the initial offering. Persons considering purchasing a 2010B Bond of a maturity having original issue discount should consult their own tax advisors with respect to the tax consequences of ownership of a 2010B Bond with original issue discount.

Bond Counsel have not undertaken to advise in the future whether any events after the date of issuance of the 2010B Bonds may affect the tax status of interest on the 2010B Bonds or the tax consequences of the ownership of the 2010B Bonds. No assurance can be given that pending or future legislation, or amendments to the Code, if enacted into law, or any proposed legislation or amendments to the Code, will not contain provisions that could directly or indirectly reduce the benefit of the exemption of interest on the 2010B Bonds from personal income taxation by the State of California or of the exclusion of the interest on the 2010B Bonds from the gross income of the owners thereof for federal

income tax purposes. Furthermore, Bond Counsel express no opinion as to any federal, state or local tax law consequences with respect to the 2010B Bonds, or the interest thereon, if any action is taken with respect to the 2010B Bonds or the proceeds thereof upon the advice or approval of other bond counsel.

Although Bond Counsel are of the opinion that interest on the 2010B Bonds is exempt from California personal income tax and that interest on the 2010B Bonds is excluded from the gross income of the owners thereof for federal income tax purposes, an owner's federal, state or local tax liability may otherwise be affected by the ownership or disposition of the 2010B Bonds. The nature and extent of these other tax consequences will depend upon the owner's other items of income or deduction. Without limiting the generality of the foregoing, prospective purchasers of the 2010B Bonds should be aware that (i) section 265 of the Code denies a deduction for interest on indebtedness incurred or continued to purchase or carry the 2010B Bonds and the Code contains additional limitations on interest deductions applicable to financial institutions that own tax-exempt obligations (such as the 2010B Bonds), (ii) with respect to insurance companies subject to the tax imposed by section 831 of the Code, section 832(b)(5)(B)(i) reduces the deduction for loss reserves by 15% of the sum of certain items, including interest on the 2010B Bonds, (iii) interest on the 2010B Bonds earned by certain foreign corporations doing business in the United States could be subject to a branch profits tax imposed by section 884 of the Code, (iv) passive investment income, including interest on the 2010B Bonds, may be subject to federal income taxation under section 1375 of the Code for Subchapter S corporations that have Subchapter C earnings and profits at the close of the taxable year if greater than 25% of the gross receipts of such Subchapter S corporation is passive investment income, (v) section 86 of the Code requires recipients of certain Social Security and certain Railroad Retirement benefits to take into account, in determining the taxability of such benefits, receipts or accruals of interest on the 2010B Bonds, and (vi) under section 32(i) of the Code, receipt of investment income, including interest on the 2010B Bonds, may disqualify the recipient thereof from obtaining the earned income credit. Bond Counsel have expressed no opinion regarding any such other tax consequences.

Bond Counsel's opinion is not a guarantee of a result, but represents their legal judgment based upon their review of existing statutes, regulations, published rulings and court decisions and the covenants of the City described above. No ruling has been sought from the Internal Revenue Service (the "IRS" or the "Service") with respect to the matters addressed in the opinion of Bond Counsel, and Bond Counsel's opinion is not binding on the Service. The Service has an ongoing program of auditing the tax-exempt status of the interest on municipal obligations. If an audit of the 2010B Bonds is commenced, under current procedures the Service is likely to treat the City as the "taxpayer," and the owners would have no right to participate in the audit process. In responding to or defending an audit of the tax-exempt status of the interest on the 2010B Bonds, the City may have different or conflicting interests from the owners of the 2010B Bonds. Public awareness of any future audit of the 2010B Bonds could adversely affect the value and liquidity of the 2010B Bonds during the pendency of the audit, regardless of the ultimate outcome.

LITIGATION

There is no litigation or action of any nature now pending against the City or, to the knowledge of its respective officers, threatened, seeking to restrain or enjoin the issuance, sale, execution or delivery of the 2010 Bonds or in any way contesting or affecting the validity of the 2010 Bonds or any proceedings of the City taken with respect to the issuance or sale thereof or the pledge or application of any moneys or security provided for the payment of the 2010 Bonds or the use of 2010 Bond proceeds. There is no litigation pending, or to the knowledge of the City, threatened, questioning the existence of the City or the title of the officers of the City to their respective offices. There is no litigation pending, or to the knowledge of the City, threatened, which materially questions or affects the financial condition of the City's Water System.

AUDITED FINANCIAL STATEMENTS

The audited financial statements of the City's Water and Power Enterprise Funds, as of June 30, [2009] and for the year then ended are included in Appendix B to this Official Statement. There has been no material adverse change in the finances of the City since June 30, [2009]. A complete copy of the City's Comprehensive Annual Financial Report may be obtained from the City. The 2010 Bonds are revenue obligations of the City payable only from the Pledged Revenues of the Water System. The financial statements of the City's Water and Power Enterprise Funds have been audited by Mayer Hoffman McCann P.C., independent accountants (the "Auditor") as stated in their report appearing in Appendix B. The Auditor has not updated its report or taken any action intended or likely to elicit information concerning the accuracy, completeness or fairness of the statements made in this Official Statement, and no opinion is expressed by Mayer Hoffman McCann P.C. with respect to any event or transaction subsequent to their report dated [December 17, 2009].

VERIFICATION OF MATHEMATICAL COMPUTATIONS

_____, a firm of independent arbitrage consultants, will verify the accuracy of (i) mathematical computations concerning the adequacy of the maturing principal amounts of and interest earned on the Defeasance Securities deposited in the Escrow Fund, together with amounts held as cash therein, to provide for payment of the interest due on the Refunded 2003 Bonds to the date of redemption and to pay the redemption price of the Refunded 2003 Bonds to be redeemed on such date of redemption and (ii) mathematical computations of the yield on the 2010B Bonds and the yield on the Defeasance Securities purchased with a portion of the proceeds of the sale of the 2010B Bonds and other available funds of the City, which will be used in part by Bond Counsel in concluding that the interest on the 2010B Bonds is excluded from gross income for federal income tax purposes under present laws, including applicable provisions of the Code, existing court rulings, regulations and Internal Revenue Service rulings.

The report of such independent arbitrage consultants will include the statement that the scope of their engagement was limited to verifying the mathematical accuracy of the computations contained in such schedules provided to them and that they have no obligation to update their report because of events occurring, or data or information coming to their attention, subsequent to the date of their report.

FINANCIAL ADVISOR

The City has retained Public Resources Advisory Group, Los Angeles, California, as financial advisor (the "Financial Advisor") in connection with the issuance of the 2010 Bonds. The Financial Advisor has not been engaged, nor has it undertaken, to audit, authenticate or otherwise verify the information set forth in this Official Statement, or any other related information available to the City, with respect to accuracy and completeness of disclosure of such information. The Financial Advisor has reviewed this Official Statement, but makes no guaranty, warranty or other representation respecting accuracy and completeness of the information contained in this Official Statement.

PURCHASE AND REOFFERING

_____ (the "Initial Purchaser") purchased the 2010A Bonds from the City at a competitive sale. The amount of net proceeds to be received by the City from the sale of the 2010A Bonds is \$ _____ (representing the aggregate principal amount of the 2010A Bonds less the Initial Purchaser's discount of \$ _____ to be retained by the Initial Purchaser). The public offering prices may be changed from time to time by the Initial Purchaser. The Initial Purchaser may offer and sell 2010A

Bonds to certain dealers and others at prices lower than the offering prices shown on the inside cover page hereof.

_____ (the “Initial Purchaser”) purchased the 2010B Bonds from the City at a competitive sale. The amount of net proceeds to be received by the City from the sale of the 2010B Bonds is \$ _____ (representing the aggregate principal amount of the 2010B Bonds, plus a net original issue premium of \$ _____, and less an Initial Purchaser’s discount of \$ _____ to be retained by the Initial Purchaser). The public offering prices may be changed from time to time by the Initial Purchaser. The Initial Purchaser may offer and sell 2010B Bonds to certain dealers and others at prices lower than the offering prices shown on the inside cover page hereof.

CERTAIN LEGAL MATTERS

The issuance of the 2010 Bonds is subject to the approving opinion of Fulbright & Jaworski L.L.P., Los Angeles, California, Bond Counsel. A complete copy of the proposed form of Bond Counsel opinion is contained in Appendix F. Fulbright & Jaworski L.L.P., in its role as Bond Counsel, undertakes no responsibility for the accuracy, completeness or fairness of this Official Statement. Certain legal matters will be passed upon for the City by Fulbright & Jaworski L.L.P., Los Angeles, California, Disclosure Counsel.

CONTINUING DISCLOSURE

Pursuant to a Continuing Disclosure Agreement to be entered into simultaneously with the issuance of the 2010 Bonds (the “Continuing Disclosure Agreement”) for the benefit of the holders of the 2010 Bonds with Digital Assurance Certification, L.L.C. (“DAC”), under which the City has designated DAC as Disclosure Dissemination Agent (the “Disclosure Dissemination Agent”). Pursuant to the Continuing Disclosure Agreement, the City has covenanted for the benefit of the holders and beneficial owners of the 2010 Bonds to provide certain financial information and operating data relating to the City and the Water System 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 2010-11, and to provide notices of the occurrence of certain enumerated events, if material. The Annual Report will be filed by the City with the Municipal Securities Rulemaking Board (“MSRB”) through the MSRB’s Electronic Municipal Market Access (EMMA) System. The notices of material events will be filed by the City with the MSRB. 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.” These covenants have been made in order to assist the Initial Purchaser in complying with S.E.C. Rule 15c2-12(b)(5) (the “Rule”). The City has not failed to comply in the last five years in all material respects with any previous undertakings with regard to the Rule to provide annual reports or notices of material events.

The City will reserve the right to amend the Continuing Disclosure Agreement, and to obtain the waiver of non-compliance with any provision of the Continuing Disclosure Agreement, if such amendment or waiver is supported by a written opinion of counsel expert in federal securities laws selected by the City to the effect that such amendment or waiver would not materially impair the interest of the holders of the 2010B Bond and would not, in and of itself, cause the Continuing Disclosure Agreement to violate the Rule if such amendment or waiver had been effective at the time of the primary offering of the 2010B Bonds, after taking into account any applicable amendments to or official interpretations of the Rule.

The Disclosure Dissemination Agent has only the duties specified in the Continuing Disclosure Agreement. The Disclosure Dissemination Agent’s obligation to deliver the information at the times and

with the contents described in the Continuing Disclosure Agreement is limited to the extent the City has provided that information to the Disclosure Dissemination Agent as required by the Continuing Disclosure Agreement. The Disclosure Dissemination Agent has no duty with respect to the content of any disclosures or notice made pursuant to the terms of the Continuing Disclosure Agreement or duty or obligation to review or verify any information in the Annual Report, Audited Financial Statements, notice of Notice Event or Voluntary Report (all as defined in the Continuing Disclosure Agreement), or any other information, disclosure or notices provided to it by the City, and the Disclosure Dissemination Agent shall not be deemed to be acting in any fiduciary capacity for the City, the holders of the 2010 Bonds or any other party. The Disclosure Dissemination Agent has no responsibility for any failure to report to the Disclosure Dissemination Agent a Notice Event or a duty to determine the materiality thereof, as to determine or liability for failing to determine whether the City has complied with the Continuing Disclosure Agreement, and the Disclosure Dissemination Agent may conclusively rely upon certification of the City at all times.

EXECUTION AND DELIVERY

Included herein are brief summaries of the terms of the 2010 Bonds, the Indenture, the Continuing Disclosure Agreement and certain contracts and other arrangements for the supply of capacity and energy, which summaries do not purport to be complete or definitive, and reference is made to such documents and reports for full and complete statements 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 with the purchasers of the 2010 Bonds.

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

CITY OF PASADENA, CALIFORNIA

By: _____
Director of Finance