

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. Historically, MWD has been able to take full advantage of its fifth priority right entitlement as a result of the availability of surplus water and unused water. In recent years, Arizona and Nevada have increased their diversions of water from the Colorado River. This trend is expected to continue. 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 "RISK FACTORS – Water Supply." 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 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 issued a decision to adopt 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 Arizona Department of Water Resources and MWD entered into an Interim Surplus Guidelines Agreement on May 23, 2001, creating specific contractual responsibilities for implementation of the Interim Surplus Guidelines. Covenants include the intentional forbearance from the use of Colorado River water that the parties might otherwise be entitled to divert under existing law and contracts. MWD is to implement or facilitate implementation of conservation measures within California to gradually reduce diversions of Colorado River water. 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. In subsequent years, Nevada may request recovery of this stored water. The stored water provides flexibility to MWD for blending Colorado River water with State Project water and improves water quality.

Under the Interim Surplus Guidelines, MWD initially expected to divert up to 850,000 acre-feet of Colorado River water annually under foreseeable runoff and reservoir storage scenarios from 2004 through 2016. However, a severe 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 was again below average. As of June 2006, Lake Mead was at 54 percent of capacity and Lake Powell was at 53 percent of capacity. Deliveries of water from the Colorado River to MWD in 2005 totaled approximately 897,000 acre-feet, including water transfers and unused agricultural priority water. MWD's initial water order for 2005, approximately 531,000 acre-feet, was supplemented by unusually high volumes of unused agricultural priority water. The Department of the Interior approved MWD's initial water order for 2006 of 667,000 acre-feet on April 3, 2006 and may approve an increase or decrease in this amount during the year. The amount of water in storage in the Colorado River system reservoirs did not change from June 2005 to June 2006. Surplus water may be available in 2007 under the Interim Surplus Guidelines, although it is

unlikely that MWD will divert any surplus water. However, in the absence of several years of above-normal runoff, surplus water supplies are not likely to be available after 2007.

Reliability of MWD Water Supply to Meet with City Requirements. MWD estimates that it can meet its member agencies' supplemental demands through the year 2025, even under a repeat of the worst single-year and multiple-year drought events. MWD has committed to make additional resource and infrastructure improvements in order to maintain reliability and high water quality for at least the next 25 years, as demands grow. MWD's current practices of diversifying water supplies and securing supply reserves allow MWD and its member agencies to adjust to changes in demands and supplies and maintain a high degree of reliability. MWD's diversified storage capacity, divided among reservoirs, conjunctive use and other groundwater storage programs within MWD's service area and by delivery through the State Water Project or Colorado River Aqueduct, has increased to 3.58 million acre-feet of storage capacity. As of March 31, 2006, MWD had 2.45 million acre-feet of water in storage.

The Metropolitan Water District Act (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 to be delivered at various delivery points within MWD's service area. For planning purposes, each MWD member agency advises MWD annually in December of its anticipated delivery requirements for each of the following fiscal years. Charges for water delivered are billed monthly and a one percent late charge is assessed for delinquent payments not exceeding five business days, and two percent for delinquencies of more than five business days and for each month thereafter. Metropolitan 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. The primary source of MWD revenue is water sales. Revenues from water sales are projected to represent approximately 75-80% of MWD's total revenues. Remaining income is derived from ad valorem taxes, hydroelectric power sales, interest income and additional revenue sources, including water standby charges, readiness-to-serve and connection maintenance charges.

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 adopted a new rate structure which became effective in January 2003. On March 14, 2006, MWD's Board adopted an overall 3.4 percent increase in the treated and untreated full service rates effective January 1, 2007. The increase in rates is due to increased costs and a forecasted return to more normal demand levels. [In October 2002, PWP entered into a 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 MWD rate structure is summarized below.

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

	<u>2007 Rates⁽¹⁾</u>	
	<u>Tier 1</u>	<u>Tier 2</u>
Supply Rate	\$ 73	\$169
System Access Rate	143	143
Water Stewardship Rate	25	25
System Power Rate	<u>90</u>	<u>90</u>
Untreated Full Service	\$331	\$427
Treatment Surcharge	<u>\$147</u>	<u>\$147</u>
Treated Full Service	\$478	\$574

Source: MWD.

⁽¹⁾ Rates to be effective January 1, 2007 through December 31, 2007.

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 annual share of the readiness-to-serve charge is [1.00 percent, or \$859,000], paid on a monthly basis.

The capacity reservation 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. This charge is set at \$6,800/CFS. It is intended that the total peaking surcharges paid by the member agency after three years will be returned to the member agency at that time to implement specific capital projects and programs to avoid future peaking charges.

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, the Water System Master Plan (as defined below) projects a future supply shortfall of approximately 2,000-acre feet/year by the year 2008, which shortfall would be made up by purchasing more expensive Tier 2 MWD water. See “RISK FACTORS – Water Supply.” 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. Staff is currently preparing the necessary environmental documentation for the program.

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 "RISK FACTORS – Environmental Issues." 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.

Reclaimed Water. In April 1993, PWP entered into an agreement with the City of Glendale to purchase up to 6,000 acre-feet/year of reclaimed water through 2018. The use of this reclaimed water includes serving Brookside Park and Golf Course, Annandale Golf Course, Upper and Lower Arroyo Parks and Defenders Parkway. Demands from these users total 897 acre-feet/year.

Other 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
- (3) extending the reclaimed 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.

These three potential sources have been studied, however, there are no definitive plans to implement them.

Water Conservation Programs

PWP has implemented a variety of water conservation programs, which are divided into residential programs and commercial programs. The residential programs include the ultra low flow toilet program and the high efficiency clothes washer program. The commercial programs include cooling tower conductivity controllers, automatic faucet shut-off valves and water saving devices for x-ray machines.

To date, no estimate of the potential future water savings associated with PWP's existing and planned conservation programs has been made. However, according to estimates reported for Los Angeles County in MWD's 2000 Urban Water Management Plan, PWP could potentially realize water savings of up to 11.4 percent, or 5,180 acre-feet/year, by the year 2020 with the implementation of appropriate conservation measures. This could result in an annual cost savings of up to \$2,500,000.

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 2006 Annual Water Quality Report indicated that in calendar year 2005 water delivered by PWP met all State and Federal water quality standards.

The quality of water in the Raymond Basin, the source of approximately 40% 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 2002 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 Caltech 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 Caltech 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 "Water Quality" above, and "CAPITAL IMPROVEMENT PROGRAM" and "RISK FACTORS – Environmental Issues."

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 \$234.6 million over the next 18 years would be required to address existing deficiencies and to adequately and reliably produce and distribute water. Of this amount, the study calls for PWP to fund \$204 million of the identified improvements and for others to fund the remaining amount of \$30.6 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 "WATER SUPPLY – 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. The capital improvements identified in the WSMP is ongoing and on schedule with the first financing. The City currently forecasts approximately \$98.4 million of additional capital improvements for the Water System over the next five years (Fiscal Years 2007 – 2011).

The 2007 Bonds constitutes the second issuance. In order to support the debt service and operating and maintenance expenses for the Water System, the City Council adopted in January 2003 the Capital improvement Charge (CIC) as part of its water rate ordinance. Through the CIC, the City has imposed water user charge increases three times totaling \$0.54 per billing unit. Based on water consumption for Fiscal Year 2007 and the current rate, the CIC is estimated to generate approximately \$7.98 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 2007 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 2006. The CIP for Fiscal Years 2006-2010 identified approximately \$104.3 million in projects for the Water System. The following table lists the expected capital requirements over the next five years. The proceeds of the 2007 Bonds will be used to finance a portion of the capital expenditures of Fiscal Years 2007 and 2008.

**TABLE 5
WATER SYSTEM CAPITAL REQUIREMENTS
(In thousands)**

<u>Fiscal Year</u>	<u>Capital Requirements</u>
2007	\$18,578
2008	24,469
2009	24,863
2010	18,448
2011	12,045

OPERATIONS OF THE WATER SYSTEM

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, 2006 are included as “APPENDIX B – PASADENA WATER & POWER 2006 ANNUAL REPORT.”

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 2007 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.

Revenues

As shown in the table below, customers inside the City’s boundary consumed approximately 83% of the volume of water sold by the Water System in Fiscal Year 2006. Receipts from customers within the City limits represent approximately 57% of the revenues collected by the Water System in Fiscal Year 2006. Each meter is considered a separate customer.

**TABLE 6
WATER SALES**

	Fiscal Year Ended June 30,				
	2002	2003	2004	2005	2006
Volume (000's Billing Units)					
Inside City Limits	12,952	13,057	12,708	12,246	12,164
Outside City Limits	2,314	2,479	2,146	1,995	2,054
Municipal and Other	<u>566</u>	<u>577</u>	<u>632</u>	<u>463</u>	<u>404</u>
Total	<u>15,832</u>	<u>16,113</u>	<u>15,485</u>	<u>14,704</u>	<u>14,622</u>
Revenue (000's Dollars)					
Inside City Limits	\$20,038	\$20,163	\$20,464	\$19,944	\$19,645
Outside City Limits	4,729	4,964	4,538	4,276	4,403
Municipal and Other	<u>1,752</u>	<u>3,830</u>	<u>6,858</u>	<u>10,047</u>	<u>10,433</u>
Total	<u>\$26,519</u>	<u>\$28,958</u>	<u>\$31,860</u>	<u>\$34,267</u>	<u>\$34,508</u>

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

The ten largest customers of the Water System for the Fiscal Year ended June 2006 are listed in the table below.

**TABLE 7
10 LARGEST CUSTOMERS
(BILLING UNITS)**

<u>Customer</u>	<u>Percent of Total Operating Revenues</u>
CalTech./JPL	2.88%
American Golf (Brookside Golf Course)	1.63
City of Pasadena Steam Power Plant	1.27
Douglas Colliflower (Eaton Canyon Golf Course)	1.20
City of Pasadena Parks & Landscaping	1.12
Pasadena City College	0.88
Department of Transportation/Caltrans	0.84
Huntington Hospital	0.74
Norman's Nursery	0.71
Annandale Golf Club	<u>0.67</u>
Total	11.94%

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 XIID 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 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 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.

**TABLE 8
RATE STRUCTURE⁽¹⁾**

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

	<u>April 1-September 30</u>		<u>October 1-March 31</u>	
(Area A)	First Block	\$0.65180	First Block	\$0.60166
	Second Block	1.90311	Second Block	1.79866
	Third Block	2.07858	Third Block	2.07127
(Area B)	First Block	\$0.83145	First Block	\$0.76565
	Second Block	2.52249	Second Block	2.38149
	Third Block	2.75855	Third Block	2.74915

MONTHLY DISTRIBUTION AND CUSTOMER CHARGE FOR SERVICE:

<u>Meter Size (Inches)</u>		<u>Meter Size (Inches)</u>	
<u>Area B⁽²⁾</u>		<u>Area A⁽²⁾</u>	
5/8" and 3/4"	\$ 8.02	5/8" and 3/4"	\$ 5.94
1"	15.24	1"	11.29
1 1/2"	35.31	1 1/2"	22.80
2"	72.21	2"	53.49
3"	176.51	3"	130.75
4"	272.78	4"	202.05
6"	417.19	6"	309.03
8"	681.94	8"	505.14
10"	842.34	10"	657.43
12"	1,002.78	12"	742.76

⁽¹⁾ Includes any purchased water adjustment charges.

⁽²⁾ Includes fire protection service.

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

Effective July 1, 2004, the following CIC was added to water rates to recover the capital improvement costs of the Water System.

**TABLE 9
CAPITAL IMPROVEMENTS CHARGE
(PER 100 CUBIC FEET)**

	<u>April 1-September 30</u>	<u>October 1-March 31</u>
Area A	\$0.51667	\$0.48743
Area B	\$0.69746	\$0.65798

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

The following table shows average residential monthly billing information for the last three fiscal years.

**TABLE 10
AVERAGE RESIDENTIAL BILLING INFORMATION**

	Fiscal Year Ended June 30,		
	2004	2005	2006
Billing Units (100 Cubic Feet)	9,124,547	8,877,434	8,811,254
Total (Water System)	15,485,245	14,704,001	14,621,930
Residential as a Percent of Total Water System	58.9%	60.4%	60.3%
Revenues	\$17,476,352	\$19,183,994	\$19,304,587
Total (Water System)	\$31,860,095	\$34,266,780	\$34,507,502
Residential as a Percent of Total Water System	54.9%	56.0%	55.9%
Number of Residential Customers	32,566	32,614	32,459
Total (Water System)	37,143	37,359	37,135
Residential as a Percent of Total Water System	87.7%	87.3%	87.4%
Average Residential Monthly Billing Unit	23.3	22.7	22.6
Average Residential Bill	\$44.72	\$49.02	\$49.56

Source: Pasadena Water and Power Department.

Historical Operating Results and Cash Flows

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

**TABLE 11
HISTORICAL OPERATING DATA
(THOUSANDS OF BILLING UNITS)**

	Fiscal Year Ended June 30,				
	2002	2003	2004	2005	2006
Total Production	<u>16,364</u>	<u>16,271</u>	<u>16,994</u>	<u>15,649</u>	<u>15,388</u>
Water Sold	15,832	16,113	15,485	14,705	14,622
Water System Losses	532	158	1,509	944	766
Number of Services	37,643	37,933	37,143	37,359	37,135

Billing Unit = 100 Cubic Feet.

Source: Pasadena Water and Power Department.

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

TABLE 12
HISTORICAL OPERATING RESULTS AND CASH FLOWS
(\$ IN THOUSANDS)

	Fiscal Year Ended June 30,				
	2002	2003	2004	2005	2006
Revenue					
Sales Within City Limits	\$20,038	\$20,163	\$20,464	\$19,944	\$19,645
Sales Outside City Limits	4,729	4,964	4,538	4,276	4,403
Municipal Sales & Misc. Others ⁽¹⁾	<u>1,752</u>	<u>3,830</u>	<u>6,858</u>	<u>10,047</u>	<u>10,459</u>
Total Revenues	<u>\$26,519</u>	<u>\$28,957</u>	<u>\$31,860</u>	<u>\$34,267</u>	<u>\$34,507</u>
Operating Expenses					
Purchased Water	9,804	11,192	10,570	11,369	9,600
Fuel and Purchased Power	2,384	1,902	2,239	1,985	2,142
Direct Operating Expenses	4,935	7,091	7,737	6,304	7,179
Administrative and General Expenses	<u>5,699</u>	<u>4,141</u>	<u>4,112</u>	<u>5,897</u>	<u>5,476</u>
Total Expenses ⁽²⁾	<u>\$22,822</u>	<u>\$24,326</u>	<u>\$24,658</u>	<u>\$25,555</u>	<u>\$24,397</u>
Earnings from Operations	3,697	4,631	7,202	8,712	10,110
Non-Operating Income ⁽³⁾	<u>1,564</u>	<u>1,865</u>	<u>2,291</u>	<u>1,539</u>	<u>3,006</u>
Cash Flow Available for Debt Service	<u>\$ 5,261</u>	<u>\$6,496</u>	<u>\$9,493</u>	<u>\$10,251</u>	<u>\$13,116</u>
Debt Service	2,219	2,207	4,131	3,620	3,615
Debt Service Coverage	<u>2.37x</u>	<u>2.95x</u>	<u>2.27x</u>	<u>2.83x</u>	<u>3.63x</u>
Amount Available after Debt Service	<u>\$ 3,042</u>	<u>\$4,289</u>	<u>\$5,362</u>	<u>\$6,631</u>	<u>\$9,501</u>
General Fund Transfer	<u>1,516</u>	<u>2,140</u>	<u>2,295</u>	<u>2,456</u>	<u>2,596</u>
Cash Available after Debt Service and Transfer	<u>\$ 1,526</u>	<u>\$2,149</u>	<u>\$3,067</u>	<u>\$4,175</u>	<u>\$6,905</u>

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

⁽²⁾ Excludes Depreciation and Interest Expense.

⁽³⁾ Includes Interest Income and Capital Contributions.

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

Projected Coverage and Five-Year Forecast

The following tables show summaries of the projected operating results of the Water System for the five Fiscal Years listed, one assuming CIC and distribution and customer (D&C) charge increases and the other assuming no CIC and D&C charge increases. The financial forecast represents the City's estimate of projected financial results based upon its judgment of the most probable occurrence of certain important future events. **Actual operating results achieved during the projection period may vary from those presented in the 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 13A revenue projection assumptions include (a) an annual sales growth rate of 0.6%, (b) distribution and customer (D&C) charge increase of \$1.5 million in Fiscal Year 2008, and (c) CIC increase adjustments in Fiscal Years 2007 and 2009 of approximately \$1.8 million. Table 13A expense projections assume that full-time employee (FTE) in Fiscal Year 2007 will increase by 2.6% and that administrative and general expenses will escalate by 4% annually. In addition to the 2007 Bonds, it is assumed that a future bond issue of approximately \$20 million will occur in Fiscal Year 2009.

**TABLE 13A
OPERATING STATEMENT
FIVE YEAR FORECAST
WITH CIC AND D&T RATE INCREASES
(\$ IN THOUSANDS)**

	Fiscal Year Ended June 30,				
	2007	2008	2009	2010	2011
Revenue					
Sales Within City Limits	\$20,781	\$22,029	\$23,351	\$24,985	\$26,859
Sales Outside City Limits	5,115	6,017	6,378	6,824	7,336
Municipal Sales & Misc. Others ⁽¹⁾	<u>12,400</u>	<u>13,906</u>	<u>15,240</u>	<u>16,307</u>	<u>17,530</u>
Total Revenues	<u>\$38,296</u>	<u>\$41,142</u>	<u>\$44,969</u>	<u>\$48,117</u>	<u>\$51,725</u>
Operating Expenses					
Purchased Water	12,197	12,643	12,896	13,154	13,417
Fuel and Purchased Power	2,434	2,556	2,684	2,845	3,015
Direct Operating Expenses	8,763	9,318	9,562	9,849	10,145
Administrative and General Expenses	<u>5,074</u>	<u>5,500</u>	<u>5,622</u>	<u>5,791</u>	<u>5,968</u>
Total Expenses ⁽²⁾	<u>\$28,468</u>	<u>\$30,017</u>	<u>\$30,764</u>	<u>\$31,639</u>	<u>\$32,545</u>
Earnings from Operations	9,828	11,125	14,205	16,478	19,180
Non-Operating Income ⁽³⁾	<u>3,984</u>	<u>3,985</u>	<u>3,493</u>	<u>3,500</u>	<u>3,507</u>
Cash Flow Available for Debt Service	<u>\$13,812</u>	<u>\$15,110</u>	<u>\$17,698</u>	<u>\$19,978</u>	<u>\$22,687</u>
2003 Bonds Debt Service ⁽⁴⁾	3,569	3,623	3,628	3,628	3,625
2007 Bonds Debt Service ⁽⁴⁾	---	---	---	---	---
Potential Future Debt Service	---	---	---	---	---
Total Debt Service	3,690	4,994	5,199	6,500	6,128
Debt Service Coverage	3.74 X	3.03 X	3.40 X	3.07 X	3.70 X
Amount Available after Debt Service	\$10,122	\$10,116	\$12,499	\$13,478	\$16,559
General Fund Transfer	<u>2,596</u>	<u>2,740</u>	<u>3,009</u>	<u>3,238</u>	<u>3,427</u>
Cash Available after Debt Service and Transfer	<u>\$7,526</u>	<u>\$7,376</u>	<u>\$9,490</u>	<u>\$10,239</u>	<u>\$13,132</u>

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

⁽²⁾ Excludes Depreciation and Interest Expense.

⁽³⁾ Includes Interest Income and Capital Contributions.

⁽⁴⁾ Actual debt service for 2003 Bonds and estimated debt service for 2007 Bonds.

Table 13B revenue projection assumptions include annual sales growth rates of 1%, 6%, 7% and 7.5%, respectively, for Fiscal Years 2008, 2009, 2010 and 2011 respectively. Table 13B assumptions do not include any increases in CIC or D&C charges. Table 13B expense projections assume _____. In addition to the 2007 Bonds, it is assumed that a future bond issue of approximately \$20 million will occur in Fiscal Year 2009.

**TABLE 13B
OPERATING STATEMENT
FIVE YEAR FORECAST
WITHOUT CIC AND D&T RATE INCREASES
(\$ IN THOUSANDS)**

	Fiscal Year Ended June 30,				
	2007	2008	2009	2010	2011
Revenue		1%	6%	7%	7.5%
Sales Within City Limits	\$20,781	\$20,849	\$22,100	\$23,647	\$25,420
Sales Outside City Limits	5,115	5,295	5,613	6,006	6,456
Municipal Sales & Misc. Others ⁽¹⁾	12,400	12,557	13,310	14,109	14,956
Total Revenues	<u>\$38,296</u>	<u>\$38,701</u>	<u>\$41,023</u>	<u>\$43,762</u>	<u>\$46,832</u>
Operating Expenses		1%	6%	7%	7%
Purchased Water	12,197	12,643	12,896	13,154	13,417
Fuel and Purchased Power	2,434	2,556	2,684	2,845	3,015
Direct Operating Expenses	8,763	9,284	9,562	9,849	10,145
Administrative and General Expenses	5,074	5,475	5,622	5,791	5,968
Total Expenses ⁽²⁾	<u>\$28,468</u>	<u>\$29,958</u>	<u>\$30,764</u>	<u>\$31,639</u>	<u>\$32,545</u>
Earnings from Operations	9,828	8,743	10,259	12,123	14,287
Non-Operating Income ⁽³⁾	<u>3,984</u>	<u>3,985</u>	<u>3,493</u>	<u>3,500</u>	<u>3,507</u>
Cash Flow Available for Debt Service	<u>\$13,812</u>	<u>\$12,728</u>	<u>\$13,752</u>	<u>\$15,623</u>	<u>\$17,794</u>
2003 Bonds Debt Service ⁽⁴⁾	3,569	3,623	3,628	3,628	3,625
2007 Bonds Debt Service ⁽⁴⁾					
Potential Future Debt Service	---	---			
Total Debt Service	3,690	4,994	5,199	6,500	6,128
Debt Service Coverage	<u>3.74X</u>	<u>2.55X</u>	<u>2.65X</u>	<u>2.40X</u>	<u>2.90X</u>
Amount Available after Debt Service	\$10,122	\$7,734	\$8,553	\$9,123	\$11,666
General Fund Transfer	<u>2,596</u>	<u>2,740</u>	<u>2,862</u>	<u>3,001</u>	<u>3,166</u>
Cash Available after Debt Service and Transfer	<u>\$7,526</u>	<u>\$4,994</u>	<u>\$5,691</u>	<u>\$6,121</u>	<u>\$8,500</u>

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

⁽²⁾ Excludes Depreciation and Interest Expense.

⁽³⁾ Includes Interest Income and Capital Contributions.

⁽⁴⁾ Actual debt service for 2003 Bonds and estimated debt service for 2007 Bonds.

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 14
HISTORICAL CUSTOMER BAD DEBT
(\$ IN THOUSANDS)**

	Fiscal Year Ended June 30,				
	2002	2003	2004	2005	2006
Bad Debt Written Off	\$ 116	\$ 158	\$ 135	\$ 167	\$ 75
Total Operating Revenue	26,519	28,958	31,860	34,267	34,508
Bad Debt as a Percent of Operating Revenue	.44%	.55%	.42%	.49%	.22%

Source: Pasadena Water and Power Department.

Employees

For Fiscal Year 2007, the City has budgeted approximately _____ employees 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 between 20__ and 20__. Several of these contracts are currently under negotiation. 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 ("CalPERS"). Pension costs are funded by biweekly contributions to CalPERS by the City. The City had no unfunded pension benefit obligations as of June 30, 200__ (the most recent actuarial data available).

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."

CONSTITUTIONAL LIMITATIONS ON GOVERNMENTAL SPENDING

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 XIII D 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 XIII D.

Under Article XIII D, 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.

The City has not complied with the applicable notice and protest procedures of Article XIID for its most recent rates and charges. 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. The City will comply with its rate covenant in conformity with the provisions of Article XIID of the California State Constitution.

The City is unable to predict how Article XIIC and Article XIID will be interpreted by the courts in the future and what, if any, implementing legislation will be enacted. 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 2007 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 2007 Bonds. See “SECURITY AND SOURCES OF PAYMENT FOR THE 2007 BONDS – Limitations on Remedies” herein.

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 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.*).

RISK FACTORS

The purchase and ownership of the 2007 Bonds involve investment risk. Investors must read this Official Statement in its entirety. The factors set forth below, among others, may affect the security for the 2007 Bonds.

Water Supply

The most vulnerable aspect of the City's water supply is the reliability of imported water from MWD. Imported water accounts for approximately 61% of the City's water supply. In January 2003, the United States Department of the Interior mandated MWD to reduce its water take from the Colorado River. The City understands that MWD has taken steps to augment its share of Colorado River water through agreements with other agencies that have rights to use such water. See "WATER SUPPLY – The Metropolitan Water District of Southern California."

The City has stored approximately 45,000 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 reclaimed water.

System Operation and Expenses

There can be no assurance that the City's expenses for the Water System will be consistent with the descriptions in this Official Statement. Changes in technology, changes in quality standards, availability and cost of water, loss of large customers, increased or decreased development, increases in

the cost of operation and/or other expenses could require increases in rates or charges in order to comply with the City's rate covenant.

System Demand

There can be no assurance that the demand for water services will occur as described in this Official Statement. Reduction in levels of demand could require an increase in rates or charges in order to comply with the City's rate covenant.

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.

The Water System Master Plan has recommended that seismic analyses be conducted for all 14 reservoirs in the Water System constructed before 1972.

Environmental Issues

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 "THE WATER SYSTEM OF PWP – Environmental Regulation," "WATER SUPPLY – Perchlorate Contamination" and "CAPITAL IMPROVEMENT PROGRAM."

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.

Terrorist Threats

Military conflicts and terrorist activities may adversely impact the operations and finances of the City or PWP, however, the City and PWP have re-aligned security resources to promote the protection of the City and the Water System. On September 11, 2001, terrorist attacks occurred in New York City and Washington, D.C. (the "Attacks") and resulted in significant damage and casualties. Neither the City nor PWP is able to determine the effects of future events similar to the Attacks, if any, on, among other things, the demand for PWP's services or an impact upon the allocation of PWP resources. In addition, the City could experience a decrease with respect to certain tourism-related or other revenues because of changes in economic circumstances indirectly related to these events.

Limited Obligations

The 2007 Bonds are limited obligations of the City and are not secured by a legal or equitable pledge of, or charge or lien upon, any property of the City or any of its income or receipts, except the Pledged Revenues. Neither the full faith and credit nor the taxing power of the City is pledged to the payment of the principal of, premium, if any, or interest on the 2007 Bonds. No tax or other source of funds, other than the Pledged Revenues, is pledged to pay the principal of, premium, if any, or interest on the 2007 Bonds. Neither the payment of the principal of, nor the interest on, the 2007 Bonds constitutes a debt, liability or obligation of the City for which the City is obligated to levy or pledge any form of taxation or for which it has levied or pledged any form of taxation.

Loss of Tax Exemption

As discussed under the caption "TAX MATTERS" herein, interest with respect to the 2007 Bonds could become includable in gross income for purposes of federal income taxation retroactive to the date the execution and delivery of the 2007 Bonds as a result of future acts or omissions of the City in violation of its covenants contained in the Indenture. Should such an event of taxability occur, the 2007 Bonds are not subject to special redemption or any increase in interest rate and will remain outstanding until maturity or until redeemed under one of the redemption provisions contained in the Indenture.

Secondary Market

There can be no guarantee that there will be a secondary market for the 2007 Bonds or, if a secondary market exists, that the 2007 Bonds can be sold for any particular price. Occasionally, because of general market conditions or because of adverse history or economic prospects connected with a particular issue, secondary marketing practices in connection with a particular issue are suspended or terminated. Additionally, prices of issues for which a market is being made will depend upon then prevailing circumstances. Such prices could be substantially different from the original purchase price.

Limitations on Remedies

The ability of the City to comply with its covenants under the Indenture and to generate Pledged Revenues sufficient to pay principal of and interest on the 2007 Bonds may be adversely affected by actions and events outside of the control of the City and may be adversely affected by actions taken (or not taken) by voters, property owners, taxpayers or payers of assessments, fees and charges. See "CONSTITUTIONAL LIMITATIONS ON GOVERNMENT SPENDING." Furthermore, any remedies available to the owners of the 2007 Bonds upon the occurrence of an event of default are in many respects dependent upon judicial actions which are often subject to discretion and delay and could prove both expensive and time consuming to obtain.

In addition to the limitations on remedies contained in the Indenture, the rights and obligations under the 2007 Bonds and the Indenture may be subject to bankruptcy, insolvency, reorganization, arrangement, fraudulent conveyance, moratorium and other laws relating to or affecting creditors' rights, to the application of equitable principles, to the exercise of judicial discretion in appropriate cases and to limitations on legal remedies against cities in the State of California. The opinion to be delivered by Fulbright & Jaworski L.L.P., Bond Counsel, concurrently with the issuance of the 2007 Bonds, that the 2007 Bonds constitute valid and binding limited obligations of the City payable from and secured by a pledge of Pledged Revenues as and to the extent provided in the Indenture will be subject to such limitations and the various other legal opinions to be delivered concurrently with the issuance of the 2007 Bonds will be similarly qualified. In the event the City fails to comply with its covenants under the

Indenture or to pay principal of or interest on the 2007 Bonds, there can be no assurance that remedies will be available to fully protect the interests of the holders of the 2007 Bonds.

Voter Initiatives - State Constitutional Amendment

California's voter initiative process allows measures which qualify for the ballot to be approved or disapproved by voters in a State of California statewide election. From time to time initiative measures could be adopted which adversely affect the ability of the City to generate revenues. See "CONSTITUTIONAL LIMITATIONS ON GOVERNMENT SPENDING."

RATINGS

Fitch Ratings and S&P have assigned their municipal bond ratings of "____" and "____," respectively, to the 2007 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. 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 2007 Bonds.

TAX MATTERS

The Internal Revenue Code of 1986 (the "Code") imposes certain requirements that must be met subsequent to the issuance and delivery of the 2007 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 2007 Bonds to be included in gross income for federal income tax purposes retroactive to the date of issuance of the 2007 Bonds. The Authority and the City have covenanted to comply with each applicable requirement of the Code necessary to maintain the exclusion pursuant to section 103(a) of the Code of the interest on the 2007 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 2007 Bonds is exempt from personal income taxes of the State of California and, assuming compliance with the aforementioned covenants, interest on the 2007 Bonds is excluded pursuant to section 103(a) of the Code from the gross income of the owners thereof for federal income tax purposes. Bond Counsel is also of the opinion that, assuming compliance with the aforementioned covenants, the 2007 Bonds are not "specified private activity bonds" within the meaning of section 57(a)(5) of the Code and, therefore, the interest on the 2007 Bonds will not be treated as an item of tax preference for purposes of computing the alternative minimum tax imposed by section 55 of the Code. Receipt or accrual of interest on the 2007 Bonds owned by a corporation may affect the computation of the alternative minimum taxable income, upon which the alternative minimum tax is imposed, to the extent that such interest is taken into account in determining the adjusted current earnings of that corporation (75 percent of the excess, if any, of such adjusted current earnings over the alternative minimum taxable income being an adjustment to alternative minimum taxable income (determined without regard to such adjustment or to the alternative tax net operating loss deduction)).

[To the extent that a purchaser of a 2007 Bond acquires that 2007 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 2007 Bonds (determined, in the case of a callable 2007 Bond, under the assumption described below), 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. In the case of a purchase of a 2007 Bond that is callable, the determination whether there is amortizable bond premium, and the computation of the accrual of that premium, must be made under the assumption that the 2007 Bond will be called on the redemption date that would minimize the purchaser's yield on the 2007 Bond (or that the 2007 Bond will not be called prior to maturity if that would minimize the purchaser's yield). 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 a 2007 Bond owned by such owner is sold or disposed of for an amount equal to or in some circumstances even less than the original cost of the 2007 Bond to the owner.

The excess, if any, of the stated redemption price at maturity of 2007 Bonds of a maturity over the initial offering price to the public of the 2007 Bonds of that maturity set forth on the cover of this Official Statement is "original issue discount" under the Code. Such original issue discount accruing on a 2007 Bond is treated as interest excluded from the gross income of the owner thereof for federal income tax purposes and exempt from California personal income tax to the same extent as would be stated interest on the 2007 Bond. Original issue discount on any 2007 Bond purchased at such initial offering price and pursuant to such initial offering will accrue on a semiannual basis over the term of the 2007 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 2007 Bond accruing during each period is added to the adjusted basis of such 2007 Bond to determine taxable gain upon disposition (including sale, redemption or payment on maturity) of such 2007 Bond. The Code includes certain provisions relating to the accrual of original issue discount in the case of purchasers of 2007 Bonds who purchase such 2007 Bonds other than at the initial offering price and pursuant to the initial offering.

Any person considering purchasing a 2007 Bond at a price that includes bond premium should consult his or her 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 the 2007 Bond. Any person considering purchasing a 2007 Bond of a maturity having original issue discount should consult his or her own tax advisors with respect to the tax consequences of ownership of 2007 Bonds with original issue discount, including the treatment of purchasers who do not purchase in the original offering and at the original offering price, the allowance of a deduction for any loss on a sale or other disposition, and the treatment of accrued original issue discount on such 2007 Bonds under federal individual and corporate alternative minimum taxes.]

Bond Counsel has not undertaken to advise in the future whether any events after the date of issuance of the 2007 Bonds may affect the tax status of interest on the 2007 Bonds or the tax consequences of the ownership of the 2007 Bonds. No assurance can be given that future legislation, or amendments to the Code, if enacted into law, will not contain provisions that could directly or indirectly eliminate, or reduce the benefit of, the exclusion of the interest on the 2007 Bonds from the gross income of the owners thereof for federal income tax purposes. Furthermore, Bond Counsel expresses no opinion as to any federal, state or local tax law consequences with respect to the 2007 Bonds, or the interest thereon, if any action is taken with respect to the 2007 Bonds or the proceeds thereof predicated or permitted upon the advice or approval of bond counsel if such advice or approval is given by counsel other than Fulbright & Jaworski L.L.P.

Although Bond Counsel is of the opinion that interest on the 2007 Bonds is excluded from the gross income of the owners thereof for federal income tax purposes, and is exempt from personal income taxes of the State of California, an owner's federal, state or local tax liability may be otherwise affected by the ownership or disposition of the 2007 Bonds. The nature and extent of these other tax consequences will depend upon the owner's tax status and other items of income or deduction. Without limiting the generality of the foregoing, prospective purchasers of the 2007 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 2007 Bonds or, in the case of a financial institution, that portion of an owner's interest expense allocated to interest on the 2007 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 percent of the sum of certain items, including interest on the 2007 Bonds, (iii) interest on the 2007 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 2007 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 2007 Bonds, and (vi) under section 32(i) of the Code, receipt of investment income, including interest on the 2007 Bonds, may disqualify the recipient thereof from obtaining the earned income credit. Bond Counsel has expressed no opinion regarding any such other tax consequences.

Bond Counsel's opinion is not a guarantee of a result, but represents its legal judgment based upon its review of existing statutes, regulations, published rulings and court decisions and the representations and covenants of the City described above. No ruling has been sought from the Internal Revenue Service (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 2007 Bonds 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 2007 Bonds, the City may have different or conflicting interest from the owners. Further, the disclosure of the initiation of an audit may adversely affect the market price of the 2007 Bonds, regardless of the final disposition of the audit.

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 2007 Bonds or in any way contesting or affecting the validity of the 2007 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 2007 Bonds or the use of 2007 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.

FINANCIAL STATEMENTS

The audited financial statements of the City's Water Enterprise Fund as of June 30, 2006 and for the Fiscal Year then ended are included in PWP's Annual Report, which is attached as "APPENDIX B" to this Official Statement. There has been no material adverse change in the finances of the City's Water

Enterprise Fund since June 30, 2006. A complete copy of the City's Comprehensive Annual Financial Report, which includes the financial statements of PWP, may be obtained from the City. The 2007 Bonds are revenue obligations of the City payable only from the Pledged Revenues of the Water System in the Water Fund. The financial statements of the City's Water Enterprise Fund have been audited by Mayer Hoffman McCann P.C., independent accountants (the "Auditor") as stated in their report appearing in "APPENDIX B." The City has not requested, nor has the Auditor given, the Auditor's consent to the inclusion in "APPENDIX B" of its report on such financial statements. No review or investigation with respect to subsequent events has been undertaken in connection with such financial statements by the Auditor.

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 2007 Bonds. The Financial Advisor has not undertaken to make an independent verification or to assume responsibility for the accuracy, completeness or fairness of the information contained in this Official Statement.

CERTAIN LEGAL MATTERS

The issuance of the 2007 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 2007 Bonds (the "Continuing Disclosure Agreement"), by and between the City and the Trustee, the City has covenanted for the benefit of the holders and beneficial owners of the 2007 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 2007, and to provide notices of the occurrence of certain enumerated events, if material. The Annual Report will be filed by the City with each Nationally Recognized Municipal Securities Information Repository. The notices of material events will be filed by the City with the Municipal Securities Rulemaking Board or the Nationally Recognized Municipal Securities Information Repositories. The specific nature of the information to be contained in the Annual Report and the notice of material events is set forth in "APPENDIX E - FORM OF CONTINUING DISCLOSURE AGREEMENT" herein. These covenants have been made in order to assist the Underwriter in complying with S.E.C. Rule 15c2-12(b)(5). The City has never failed to comply in all material respects with any previous undertakings with regard to said Rule to provide annual reports or notices of material events.

EXECUTION AND DELIVERY

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

CITY OF PASADENA, CALIFORNIA

By: _____

**Stephen C. Stark
Director of Finance**

APPENDIX A
THE CITY OF PASADENA

APPENDIX B

**PASADENA WATER & POWER
2006 ANNUAL REPORT**

APPENDIX C

BOOK-ENTRY SYSTEM

The information in this Appendix concerning DTC and DTC's book-entry system has been obtained from sources that the City believes to be reliable, but the City takes no responsibility for the accuracy thereof.

DTC will act as securities depository for the 2007 Bonds. The 2007 Bonds will be issued as fully-registered securities registered in the name of Cede & Co. (DTC's partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully-registered 2007 Bond will be issued for each maturity of the 2007 Bonds, in the aggregate principal amount of such maturity.

DTC is a limited-purpose trust company organized under the New York Banking Law, a "banking organization" within the meaning of the New York Banking Law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code, and a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for over 2.2 million issues of U.S. and non-U.S. equity issues, corporate and municipal debt issues, and money market instruments from over 100 countries that DTC's participants ("Direct Participants") deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities through electronic computerized book-entry transfers and pledges between Direct Participants' accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation ("DTCC"). DTCC, in turn, is owned by a number of Direct Participants of DTC and Members of the National Securities Clearing Corporation, Fixed Income Clearing Corporation and Emerging Markets Clearing Corporation (NSCC, FICC and EMCC, also subsidiaries of DTCC), as well as by the New York Stock Exchange, Inc., the American Stock Exchange LLC, and the National Association of Securities Dealers, Inc. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly ("Indirect Participants"). DTC has Standard & Poor's highest rating: AAA. The DTC Rules applicable to its Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at www.dtcc.com and www.dtc.org. The information contained on such websites is not incorporated herein by reference.

Purchases of 2007 Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the 2007 Bonds on DTC's records. The ownership interest of each actual purchaser of each 2007 Bond ("Beneficial Owner") is in turn to be recorded on the Direct and Indirect Participants' records. Beneficial Owners will not receive written confirmation from DTC of their purchase. Beneficial Owners are, however, expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the 2007 Bonds are to be accomplished by entries made on the books of Direct and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in 2007 Bonds, except in the event that use of the book-entry system for the 2007 Bonds is discontinued.

To facilitate subsequent transfers, all 2007 Bonds deposited by Direct Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co., or such other name as may be

requested by an authorized representative of DTC. The deposit of 2007 Bonds with DTC and their registration in the name of Cede & Co. or such other DTC nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the 2007 Bonds; DTC's records reflect only the identity of the Direct Participants to whose accounts such 2007 Bonds are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time.

Redemption notices shall be sent to DTC. If less than all of the 2007 Bonds within a series are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such series to be redeemed.

Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to 2007 Bonds unless authorized by a Direct Participant in accordance with DTC's Procedures. Under its usual procedures, DTC mails an Omnibus Proxy to the City as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts the 2007 Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Payments of principal of, premium, if any, and interest on the 2007 Bonds will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts upon DTC's receipt of funds and corresponding detail information from the City or the Trustee, on the payable date in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of such Participant and not of DTC, the Trustee or the City, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of such principal, premium and interest to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the City or the Trustee, disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners will be the responsibility of Direct and Indirect Participants.

DTC may discontinue providing its services as securities depository with respect to the 2007 Bonds at any time by giving reasonable notice to the City or the Trustee. Under such circumstances, in the event that a successor securities depository is not obtained, 2007 Bond certificates are required to be printed and delivered.

The City may decide to discontinue use of the system of book-entry-only transfers through DTC (or a successor securities depository). In that event, 2007 Bond certificates will be printed and delivered to DTC.

APPENDIX D

SUMMARY OF CERTAIN PROVISIONS OF THE INDENTURE

APPENDIX E
FORM OF CONTINUING DISCLOSURE AGREEMENT

APPENDIX F

PROPOSED FORM OF OPINION OF BOND COUNSEL

[Closing Date]

City of Pasadena
Pasadena, California

\$ _____
City of Pasadena, California
Water Revenue Bonds, 2007 Series

Ladies and Gentlemen:

We have acted as bond counsel to the City of Pasadena, California (the "City") in connection with the issuance of the City's Water Revenue Bonds, 2007 Series (the "Bonds") in the aggregate principal amount of \$ _____. The Bonds are being issued pursuant to the Charter of the City, as amended (the "Charter"), including Article XIV thereof, Ordinance No. _____ (the "Ordinance"), adopted by the City Council of the City (the "Council") on _____, 2007, and by a Water Revenue Bond Indenture, dated as of August 1, 2003, by and between the City and The Bank of New York Trust Company, N.A. (formerly known as BNY Western Trust Company), as trustee (the "Trustee"), as supplemented by a Second Supplement to Water Revenue Bond Indenture, dated as of April 1, 2007, by and between the City and the Trustee (collectively, the "Indenture").

As bond counsel, we have examined copies certified to us as being true and complete copies of the proceedings of the City in connection with the issuance of the Bonds. We have also examined such certificates of officers of the City and others as we have considered necessary for the purposes of this opinion.

Based upon the foregoing, we are of the opinion that:

1. The Bonds constitute valid and binding limited obligations of the City as provided in the Indenture, and are entitled to the benefits of the Indenture. The Bonds are payable from Pledged Revenues (as such term is defined in the Indenture).
2. The Indenture has been duly and validly authorized, executed and delivered by the City and, assuming the enforceability thereof against the Trustee, constitutes the legally valid and binding obligation of the City, enforceable against the City in accordance with its terms. The Indenture creates a valid pledge, to secure the payment of principal of and interest on the Bonds, of the Pledged Revenues and other amounts held by the Trustee in the funds and accounts established pursuant to the Indenture, subject to the provisions of the Indenture permitting the application thereof for other purposes and on the terms and conditions set forth therein.
3. The Internal Revenue Code of 1986 (the "Code") imposes certain requirements that must be met subsequent to the issuance and delivery of the Bonds for interest thereon to be and remain excluded from the gross income of the owners thereof for federal income tax purposes. Noncompliance with such requirements could cause the interest on the Bonds to be included in gross income retroactive to the date of issue of the Bonds. The City has covenanted

in the Indenture to maintain the exclusion of interest on the Bonds from the gross income of the owners thereof for federal income tax purposes.

In our opinion, under existing law interest on the Bonds is exempt from personal income taxes of the State of California and, assuming compliance with the aforementioned covenants, interest on the Bonds is excluded pursuant to section 103(a) of the Code from the gross income of the owners thereof for federal income tax purposes.

We are further of the opinion that under existing statutes, regulations, rulings and court decisions, the Bonds are not "specified private activity bonds" within the meaning of section 57(a)(5) of the Code and, therefore, interest on the Bonds will not be treated as an item of tax preference for purposes of computing the alternative minimum tax imposed by section 55 of the Code. Receipt or accrual of interest on Bonds owned by a corporation may affect the computation of the alternative minimum taxable income, upon which the alternative minimum tax is imposed, to the extent that such interest is taken into account in determining the adjusted current earnings of that corporation (75% of the excess, if any, of such adjusted current earnings over the alternative minimum taxable income being an adjustment to alternative minimum taxable income (determined without regard to such adjustment or to the alternative tax net operating loss deduction)).

Except as stated in the preceding three paragraphs, we express no opinion as to any federal or state tax consequences of the ownership or disposition of the Bonds. Furthermore, we express no opinion as to any federal, state or local tax law consequences with respect to the Bonds, or the interest thereon, if any action is taken with respect to the Bonds or the proceeds thereof predicated or permitted upon the advice or approval of other bond counsel.

The opinions expressed in paragraphs 1 through 3 above are qualified to the extent the enforceability of the Bonds and the Indenture may be limited by applicable bankruptcy, insolvency, debt adjustment, reorganization, moratorium or similar laws or equitable principles relating to or limiting creditors' rights generally or as to the availability of any particular remedy. The enforceability of the Bonds and the Indenture is subject to the effect of general principles of equity, including, without limitation, concepts of materiality, reasonableness, good faith and fair dealing, to the possible unavailability of specific performance or injunctive relief, regardless of whether considered in a proceeding in equity or at law, and to the limitations on legal remedies against governmental entities in California.

No opinion is expressed herein on the accuracy, completeness or sufficiency of the Official Statement or other offering material relating to the Bonds.

Our opinions are based on existing law, which is subject to change. Such opinions are further based on our knowledge of facts as of the date hereof. We assume no duty to update or supplement our opinions to reflect any facts or circumstances that may hereafter come to our attention or to reflect any changes in any law that may hereafter occur or become effective. Moreover, our opinions are not a guarantee of result and are not binding on the Internal Revenue Service; rather, such opinions represent our legal judgment based upon our review of existing law that we deem relevant to such opinions and in reliance upon the representations and covenants referenced above.