

*In the opinion of Orrick, Herrington & Sutcliffe LLP, Bond Counsel to the Authority, based upon an analysis of existing laws, regulations, rulings and court decisions and assuming, among other matters, the accuracy of certain representations and compliance with certain covenants, interest on the Series 2007 Water Bonds is excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986 and is exempt from State of California personal income taxes. In the further opinion of Bond Counsel, interest on the Series 2007 Water Bonds is not a specific preference item for purposes of the federal individual or corporate alternative minimum taxes, although Bond Counsel observes that such interest is included in adjusted current earnings in calculating federal corporate alternative minimum taxable income. Bond Counsel expresses no opinion regarding any other tax consequences related to the ownership or disposition of, or the accrual or receipt of interest on, the Series 2007 Water Bonds. See “TAX MATTERS” herein.*

**\$93,190,000**

**MODESTO IRRIGATION DISTRICT FINANCING AUTHORITY  
DOMESTIC WATER PROJECT REVENUE BONDS  
SERIES 2007F (Index Rate)**

**Dated: Date of Delivery****Due: September 1, as set forth on the inside front cover**

The Modesto Irrigation District Financing Authority Domestic Water Project Revenue Bonds, Series 2007F in the aggregate principal amount of \$93,190,000 (the “Series 2007 Water Bonds”) are being issued to provide funds to (i) finance a portion of the costs of the expansion of the domestic water treatment and delivery system (the “2007 Project”) of the Modesto Irrigation District (the “District”), (ii) fund capitalized interest on the Series 2007 Water Bonds, (iii) provide for the funding of a reserve fund for the Series 2007 Water Bonds and (iv) pay costs of issuance of the Series 2007 Water Bonds, as more fully described herein. See “PLAN OF FINANCE” herein.

The Series 2007 Water Bonds will be dated their date of delivery. Interest on the Series 2007 Water Bonds will be payable on the first Business Day of each September, December, March, and June commencing September 4, 2007. The Series 2007 Water Bonds will bear interest from their date of delivery at the LIBOR-Based Interest Rate, as described herein. The Series 2007 Water Bonds will be issued in fully registered form, and when issued, will be registered in the name of Cede & Co. as nominee of The Depository Trust Company, New York, New York (“DTC”). DTC will act as securities depository of the Series 2007 Water Bonds. Individual purchases will be made in book-entry form only, in denominations of \$5,000 or any integral multiple thereof.

**The Series 2007 Water Bonds are subject to redemption prior to maturity as described herein.**

The Series 2007 Water Bonds are being issued pursuant to a Trust Agreement, dated as of June 1, 2007 (the “Trust Agreement”), among the Modesto Irrigation District Financing Authority (the “Authority”), the District and The Bank of New York Trust Company, N.A., San Francisco, California, as trustee (the “Trustee”). The Series 2007 Water Bonds are special, limited obligations of the Authority payable from Revenues (as herein defined) of the Authority, consisting principally of installment payments (the “Series 2007 Installment Payments”) received by the Trustee, as assignee of the Authority, from the District pursuant to an Installment Purchase Contract, dated as of June 1, 2007 (the “Installment Purchase Contract”), by and between the Authority and the District. The District entered into a Treatment and Delivery Agreement in 1992, as superseded by an Amended and Restated Treatment and Delivery Agreement entered into in 2005, as amended (the “Treatment and Delivery Agreement”) with the City of Modesto, a California charter city and municipal corporation (the “City”), pursuant to which the District agreed to construct and operate a surface water treatment plant and distribution facilities, including the 2007 Project (collectively, the “Domestic Water Project”), and to supply treated water from the Domestic Water Project to the City, in consideration for which the City has agreed to pay, subject to the terms of the Treatment and Delivery Agreement, the costs of the operation of the Domestic Water Project as well as debt service relating to the Domestic Water Project (including the Series 2007 Installment Payments). The Series 2007 Installment Payments to be paid by the District are payable from and are secured by a pledge of and first lien upon payments by the City under the Treatment and Delivery Agreement (the “Treatment and Delivery Agreement,” as further described herein), unless the District elects to appropriate monies to pay such obligations (as further described herein). The City’s obligations under the Treatment and Delivery Agreement are payable from and are secured by a lien upon City Gross Water Revenues (as defined herein) from the operation of the City’s Municipal Water System, as further described herein.

Payment of the principal of and interest on the Series 2007 Water Bonds when due will be insured by a financial guaranty insurance policy to be issued by MBIA Insurance Corporation simultaneously with the delivery of the Series 2007 Water Bonds. See “BOND INSURANCE” herein.



THE SERIES 2007 WATER BONDS ARE SPECIAL, LIMITED OBLIGATIONS OF THE AUTHORITY AND ARE NOT SECURED BY A LEGAL OR EQUITABLE PLEDGE OF, OR CHARGE OR LIEN UPON, ANY PROPERTY OF THE AUTHORITY OR ANY OF ITS INCOME OR RECEIPTS, EXCEPT THE REVENUES. NEITHER THE FULL FAITH AND CREDIT OF THE AUTHORITY NOR OF ITS MEMBERS (INCLUDING THE DISTRICT) NOR OF ANY OTHER PUBLIC ENTITY (INCLUDING THE CITY) IS PLEDGED FOR THE PAYMENT OF THE INTEREST ON OR PRINCIPAL OF OR REDEMPTION PREMIUMS, IF ANY, ON THE SERIES 2007 WATER BONDS AND NO TAX OR OTHER SOURCE OF FUNDS, OTHER THAN THE REVENUES, IS PLEDGED TO PAY THE INTEREST ON OR PRINCIPAL OF OR REDEMPTION PREMIUMS, IF ANY, ON THE SERIES 2007 WATER BONDS. THE PAYMENT OF THE INTEREST ON OR PRINCIPAL OF OR REDEMPTION PREMIUMS, IF ANY, ON THE SERIES 2007 WATER BONDS DOES NOT CONSTITUTE A DEBT, LIABILITY OR OBLIGATION OF THE AUTHORITY NOR OF ANY MEMBER OF THE AUTHORITY (INCLUDING THE DISTRICT) NOR OF ANY OTHER PUBLIC ENTITY (INCLUDING THE CITY) FOR WHICH ANY SUCH ENTITY IS OBLIGATED TO LEVY OR PLEDGE ANY FORM OF TAXATION OR FOR WHICH ANY SUCH ENTITY HAS LEVIED OR PLEDGED ANY FORM OF TAXATION.

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

Maturity Schedule  
(See Inside Front Cover)

The Series 2007 Water Bonds will be offered when, as and if issued and received by the Underwriter, subject to the approval of legality by Orrick, Herrington & Sutcliffe LLP, San Francisco, California, Bond Counsel to the Authority. Certain legal matters will be passed upon for the District and the Authority by the District’s Legal Department. Certain legal matters will be passed upon for the City by the City Attorney. Certain legal matters will be passed upon for the Underwriter by Sidley Austin LLP, San Francisco, California. First Southwest Company is serving as financial advisor to the District in connection with the issuance of the Series 2007 Water Bonds. It is expected that the Series 2007 Water Bonds will be available for delivery through the DTC book-entry system in New York, New York on or about June 26, 2007.

**BEAR, STEARNS & CO. INC.**

Dated: June 5, 2007

## Maturity Schedule

### Series 2007F (Index Rate) Water Bonds

\$23,370,000 Term Series 2007<sup>(1)</sup> Water Bonds due September 1, 2027 Price 100%; CUSIP Number<sup>†</sup>: 607769EK8

\$69,820,000 Term Series 2007<sup>(2)</sup> Water Bonds due September 1, 2037 Price 100%; CUSIP Number<sup>†</sup>: 607769EL6

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<sup>(1)</sup> The Series 2007 Water Bonds maturing on September 1, 2027 will bear interest at the rate of 4.16095% from the date of delivery through and including September 3, 2007, and thereafter, at a per annum rate equal to (a) 67% of the Three-Month LIBOR Rate for such period plus (b) a per annum spread equal to 0.58%; provided that the LIBOR-Based Interest Rate will never exceed the Maximum Rate of 12% per annum.

<sup>(2)</sup> The Series 2007 Water Bonds maturing on September 1, 2037 will bear interest at the rate of 4.21095% from the date of delivery through and including September 3, 2007, and thereafter, at a per annum rate equal to (a) 67% of the Three-Month LIBOR Rate for such period plus (b) a per annum spread equal to 0.63%; provided that the LIBOR-Based Interest Rate will never exceed the Maximum Rate of 12% per annum.

<sup>†</sup> A registered trademark of the American Bankers Association. CUSIP data herein is provided by Standard & Poor's CUSIP Service Bureau, a division of The McGraw-Hill Companies, Inc. This data is not intended to create a database and does not serve in any way as a substitute for the CUSIP Service. CUSIP numbers are provided for convenience of reference only. None of the Authority, the District, nor the City take any responsibility for the accuracy of such numbers.

**MODESTO IRRIGATION DISTRICT**

1231 Eleventh Street  
P.O. Box 4060  
Modesto, California 95352  
(209) 526 7373

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**DISTRICT BOARD OF DIRECTORS AND AUTHORITY GOVERNING BOARD**

John E. Kidd, President

Paul Warda, Vice President

Mike Serpa

Cecil O. Hensley

Dr. Tom Van Groningen

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**DISTRICT STAFF**

Allen Short  
General Manager

Lou Hampel  
Assistant General Manager, Finance and Treasurer

Jake Sonke  
Controller

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**PROFESSIONAL SERVICES**

Orrick, Herrington & Sutcliffe LLP  
Bond Counsel

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

First Southwest Company  
District Financial Advisor

R.W. Beck, Inc.  
Consulting Engineer

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No dealer, broker, salesperson or other person has been authorized by the Authority, the District, the City or the Underwriter to give any information or to make any representations other than those contained herein and, if given or made, such other information or representations must not be relied upon as having been authorized by the Authority, the District, the City or the Underwriter. This Official Statement does not constitute an offer to sell or the solicitation of an offer to buy nor shall there be any sale of the Series 2007 Water Bonds by a person in any jurisdiction in which it is unlawful for such person to make such an offer, solicitation or sale.

This Official Statement is not to be construed as a contract with the purchasers of the Series 2007 Water Bonds. Statements contained in this Official Statement which involve estimates, forecasts or matters of opinion, whether or not expressly so described herein, are intended solely as such and are not to be construed as representations of fact.

The information set forth herein has been furnished by the Authority, the District, the City and other sources which are believed to be reliable, but it is not guaranteed as to accuracy or completeness by, and is not to be construed as a representation by, the Underwriter. The information and expressions of opinions herein are subject to change without notice and neither delivery of this Official Statement nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of the Authority, the District or the City since the date hereof. This Official Statement, including any supplement or amendment hereto, is intended to be deposited with one or more repositories.

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

**IN CONNECTION WITH THE OFFERING OF THE SERIES 2007 WATER BONDS THE UNDERWRITER MAY OVERALLOT OR EFFECT TRANSACTIONS THAT STABILIZE OR MAINTAIN THE MARKET PRICE OF THE SERIES 2007 WATER BONDS AT LEVELS ABOVE THOSE WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.**

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CAUTIONARY STATEMENTS REGARDING  
FORWARD-LOOKING STATEMENTS IN  
THIS OFFICIAL STATEMENT

Certain statements included or incorporated by reference in this Official Statement and the Appendices hereto constitute "forward-looking statements." Such statements are generally identifiable by the terminology used such as "plan," "expect," "estimate," "budget" or other similar words. Such forward-looking statements include, but are not limited to, certain statements contained in the information under the captions "THE MODESTO IRRIGATION DISTRICT" and "THE CITY OF MODESTO MUNICIPAL WATER UTILITY SYSTEM" in this Official Statement. Forward-looking statements in this Official Statement are subject to risks and uncertainties, including, but not limited to statements that describe possible future connections to and revenues and expenses of the City Water Utility System.

The achievement of any results or the realization of other expectations contained in such forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. The District does not plan to issue any updates or revisions to those forward-looking statements.

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## OFFICIAL STATEMENT

**\$93,190,000**

**MODESTO IRRIGATION DISTRICT FINANCING AUTHORITY  
Domestic Water Project Revenue Bonds  
Series 2007F (Index Rate)**

### INTRODUCTION

This Introduction is subject in all respects to the more complete information contained elsewhere in this Official Statement, and the offering of the Series 2007 Water Bonds to potential investors is made only by means of the entire Official Statement. Terms used in this Introduction and not otherwise defined shall have the respective meanings assigned to them elsewhere in this Official Statement.

#### **Purpose**

The purpose of this Official Statement, which includes the cover page and appendices hereto, is to set forth certain information concerning the issuance and sale of the Modesto Irrigation District Financing Authority Domestic Water Project Revenue Bonds, Series 2007F in the aggregate principal amount of \$93,190,000 (the "Series 2007 Water Bonds"). The Series 2007 Water Bonds are being issued pursuant to a Trust Agreement, dated as of June 1, 2007 (the "Trust Agreement"), among the Modesto Irrigation District Financing Authority (the "Authority"), the Modesto Irrigation District (the "District" or "MID") and The Bank of New York Trust Company, N.A., as trustee (the "Trustee"). The Series 2007 Water Bonds will be issued pursuant to the Marks Roos Local Bond Pooling Act of 1985, consisting of Article 4 of Chapter 5 of Division 7 of Title 1 of the Government Code of the State of California (the "State") (commencing with Section 6584 (the "Act")).

The proceeds of the sale of the Series 2007 Water Bonds will be used to provide funds to (i) finance a portion of the costs of the acquisition, design, construction, improvement and installation of an expansion of the domestic water treatment and delivery system of the District (the "2007 Project"), (ii) fund capitalized interest on the Series 2007 Water Bonds, (iii) provide for the funding of a reserve fund for the Series 2007 Water Bonds and (iv) pay costs of issuance of the Series 2007 Water Bonds. See "ESTIMATED SOURCES AND USES OF FUNDS" and "THE DOMESTIC WATER PROJECT—The 2007 Project."

In 1992, the District entered into a Treatment and Delivery Agreement with the City of Modesto, a California charter city and municipal corporation (the "City"), as superseded by an Amended and Restated Treatment and Delivery Agreement entered into in 2005, and in connection with the issuance of the Series 2007 Water Bonds, the District and the City will execute financing amendments to such Amended and Restated Treatment and Delivery Agreement, dated as of June 1, 2007 (as amended, the "Treatment and Delivery Agreement"). Pursuant to the Treatment and Delivery Agreement, the District agreed to construct and operate a surface water treatment plant and distribution facilities, including the 2007 Project (collectively, the "Domestic Water Project") and to supply treated water from the Domestic Water Project to the City which currently provides municipal water service within the District's irrigation service boundaries, in consideration for which the City has agreed to pay the costs of acquisition and construction and operation of the Domestic Water Project, as well as debt service relating to the Domestic Water Project (including the Series 2007 Installment Payments (defined herein)). See "THE DOMESTIC WATER PROJECT—Background and History."

#### **The District**

The District is a California irrigation district organized and existing under the provisions of the California Irrigation District Law, Division 11 of the California Water Code (the "Irrigation District Act"). The District has the powers under the Irrigation District Act to, among other things, provide irrigation within its irrigation service area.

## **The Authority**

The Authority was created by a Joint Exercise of Powers Agreement, dated as of July 1, 1989 (the “Joint Exercise of Powers Agreement”), between the District and the City of Redding (“Redding”) pursuant to the provisions of the Joint Exercise of Powers Act, Chapter 5 of Division 7 of Title 1 of the Government Code of the State (the “Joint Exercise of Powers Act”). The Authority was created for the purpose of facilitating the financing of public capital improvements and facilities for the District. Under the Joint Exercise of Powers Agreement and the Joint Exercise of Powers Act, Redding has no liability whatsoever for the Series 2007 Water Bonds, the Series 2007 Installment Payments (as defined herein), any public capital improvements or facilities financed or refinanced with the proceeds of the Series 2007 Water Bonds or any other financial obligation in connection therewith. See “THE AUTHORITY.”

## **Security and Sources of Payment for the Series 2007 Water Bonds**

The Series 2007 Water Bonds are special, limited obligations of the Authority payable solely from Revenues (as defined herein) of the Authority, consisting principally of Series 2007 installment payments (the “Series 2007 Installment Payments”) received by the Authority from the District pursuant to an Installment Purchase Contract, dated as of June 1, 2007 (the “Installment Purchase Contract”), by and between the Authority and the District. The Series 2007 Installment Payments are payable solely from and secured by a pledge of all Treatment and Delivery Revenues (as defined herein) received by the District from the City under the Treatment and Delivery Agreement, unless the District in its discretion elects to appropriate monies to pay the Series 2007 Installment Payments as provided herein. See “SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2007 WATER BONDS.”

In April 1992, the District entered into the Treatment and Delivery Agreement with the City and the Del Este Water Company (“Del Este”). Pursuant to the Treatment and Delivery Agreement, the City was initially allocated a 70% share of the Domestic Water Project and Del Este was allocated a 30% share of the Domestic Water Project. In July 1995, the City purchased substantially all of the assets and liabilities of Del Este and assumed all interests, rights and obligations of Del Este under the Treatment and Delivery Agreement. See “THE DOMESTIC WATER PROJECT.” In order to finance a portion of the City’s share of the estimated costs of acquisition and construction of the Domestic Water Project, the Authority issued Domestic Water Project Revenue Bonds, Series 1992A in the aggregate initial principal amount of \$71,885,000 (the “Series 1992A Water Bonds”), Domestic Water Project Revenue Bonds, Series 1992B in the aggregate initial principal amount of \$5,500,000 (the “Series 1992B Water Bonds”) and Domestic Water Project Revenue Bonds, Series 1995C in the aggregate initial principal amount of \$24,235,000 (the “Series 1995C Water Bonds”). In 1998, the Authority issued \$94,715,000 aggregate principal amount of Domestic Water Project Refunding Revenue Bonds, Series 1998D (the “Series 1998D Water Bonds,” and together with the Series 1992A Water Bonds, the Series 1992B Water Bonds and the Series 1995C Water Bonds, the “Prior Bonds”) to refund all of the outstanding Series 1992A Water Bonds and Series 1995C Water Bonds. The Series 1992B Water Bonds were retired as of September 1, 2002. The Series 1998D Water Bonds are payable from installment payments (the “Series 1998D Installment Payments”) received by the Authority from the District pursuant to an installment purchase contract, dated as of February 1, 1998 (the “1998 Installment Purchase Contract”). The Series 2007 Installment Payments will be payable by the District on a parity with the Series 1998D Installment Payments. The Series 1998 Installment Payments and the Series 2007 Installment Payments are collectively referred to herein as the “Domestic Water Installment Payments.” The Series 1998D Water Bonds and the Series 2007 Water Bonds are collectively referred to herein as the “Domestic Water Bonds.” See “SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2007 WATER BONDS—The Treatment and Delivery Agreement.”

THE SERIES 2007 WATER BONDS ARE SPECIAL, LIMITED OBLIGATIONS OF THE AUTHORITY AND ARE NOT SECURED BY A LEGAL OR EQUITABLE PLEDGE OF, OR CHARGE OR LIEN UPON, ANY PROPERTY OF THE AUTHORITY OR ANY OF ITS INCOME OR RECEIPTS, EXCEPT THE REVENUES. NEITHER THE FULL FAITH AND CREDIT OF THE AUTHORITY NOR OF ITS MEMBERS (INCLUDING THE DISTRICT) NOR ANY OTHER PUBLIC ENTITY (INCLUDING THE CITY) IS PLEDGED FOR THE PAYMENT OF THE INTEREST ON OR PRINCIPAL OF OR REDEMPTION PREMIUMS, IF ANY, ON THE SERIES 2007 WATER BONDS AND NO TAX OR OTHER SOURCE OF FUNDS, OTHER THAN THE REVENUES, IS PLEDGED TO PAY THE INTEREST ON OR PRINCIPAL OF OR REDEMPTION

PREMIUMS, IF ANY, ON THE SERIES 2007 WATER BONDS. NEITHER THE PAYMENT OF THE INTEREST ON OR PRINCIPAL OF OR REDEMPTION PREMIUMS, IF ANY, ON THE SERIES 2007 WATER BONDS CONSTITUTES A DEBT, LIABILITY OR OBLIGATION OF THE AUTHORITY NOR OF ANY MEMBER OF THE AUTHORITY (INCLUDING THE DISTRICT) NOR ANY OTHER PUBLIC ENTITY (INCLUDING THE CITY) FOR WHICH ANY SUCH ENTITY IS OBLIGATED TO LEVY OR PLEDGE ANY FORM OF TAXATION OR FOR WHICH ANY SUCH ENTITY HAS LEVIED OR PLEDGED ANY FORM OF TAXATION.

### **City's Obligation under Treatment and Delivery Agreement**

The obligation of the City to make Payments under the Treatment and Delivery Agreement is a special limited obligation of the City payable solely from the City's Gross Water Revenues (as defined herein). Pursuant to the Treatment and Delivery Agreement, the City has covenanted to fix, prescribe and collect water rates and charges which shall be at least sufficient to yield City Gross Water Revenues during each fiscal year of the City in an amount equal to: (i) the payment obligations of the City under the Treatment and Delivery Agreement other than Debt Service, plus (ii) City Municipal Water System Maintenance and Operation Costs to the extent not included in (i) above, plus (iii) 125% of the Debt Service to be paid during the fiscal year (the "City Rate Covenant"). See "SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2007 WATER BONDS—The Treatment and Delivery Agreement—City Rate Covenant."

### **Series 2007 Reserve Fund**

A Series 2007 Reserve Fund for the Series 2007 Water Bonds will be held by The Bank of New York Trust Company, N.A., as depository (the "Depository") in accordance with a Depository Agreement, dated as of June 1, 2007 (the "Depository Agreement"), by and among the District, the Authority and the Depository. The Installment Purchase Contract provides for the funding of the Series 2007 Reserve Fund in an amount equal to the maximum annual Series 2007 Installment Payments. Moneys in the Series 2007 Reserve Fund will be used solely for the purpose of paying the Series 2007 Installment Payments in the event that amounts paid by the District to the Trustee, as assignee of the Authority, are insufficient therefor. The Series 2007 Reserve Fund (or any portion thereof) may be funded from proceeds of the Series 2007 Water Bonds or from one or more surety bonds issued by a municipal bond insurer meeting the requirements set forth in the Installment Purchase Contract. The Series 2007 Reserve Fund will initially be funded from proceeds of the Series 2007 Water Bonds and a surety bond issued by MBIA Insurance Corporation ("MBIA"). See "SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2007 WATER BONDS—Series 2007 Reserve Fund."

### **Bond Insurance**

Payment of the principal and interest on the Series 2007 Water Bonds when due will be insured by a municipal bond insurance policy (the "Municipal Bond Insurance Policy") to be issued by MBIA simultaneously with the delivery of the Series 2007 Water Bonds. See "BOND INSURANCE."

### **Other Matters**

This Official Statement speaks only as of its date, and the information and expressions of opinions contained herein are subject to change without notice and neither delivery of this Official Statement nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of the Authority, the District or the City since the date hereof. This Official Statement, including any supplement or amendment hereto, is intended to be deposited with one or more repositories.

This Official Statement includes summaries of the terms of the Series 2007 Water Bonds, the Trust Agreement, the Installment Purchase Contract, the Treatment and Delivery Agreement and certain other agreements and documents. The summaries of and references to all documents, statutes, reports and other instruments referred to herein do not purport to be complete, comprehensive or definitive, and each such summary and reference is qualified in its entirety by reference to each document, statute, report or instrument. The capitalization of any word

not conventionally capitalized, or otherwise defined herein, indicates that such word is defined in a particular agreement or other document and, as used herein, has the meaning given it in such agreement or document.

Copies of the Trust Agreement, the Installment Purchase Contract, the Treatment and Delivery Agreement and the Continuing Disclosure Agreement will be available for inspection at the offices of the District in Modesto, California, and will be available upon request and payment of duplication costs from the Trustee.

**Continuing Disclosure**

Pursuant to a Continuing Disclosure Agreement, between the City and the Trustee, the City has agreed to provide to certain national repositories a copy of the annual financial statement and certain other operating data relating to the City’s Municipal Water System. Such financial statement is required to be prepared in accordance with generally accepted accounting principles and to be provided, together with the operating data, to the national repositories no later than nine months after the end of its fiscal year (June 30). In addition, the City has agreed to give timely notice to the national repositories or the Municipal Securities Rulemaking Board of the occurrence of certain material events relating to its obligations for the Series 2007 Water Bonds, as described in “APPENDIX I — FORM OF CONTINUING DISCLOSURE AGREEMENT.”

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

**Additional Information**

Additional information regarding the Official Statement, including information pertaining to the District or the City, may be obtained by contacting the Trustee or by contacting either the District or the City at the addresses below:

Assistant General Manager, Finance and Treasurer  
Modesto Irrigation District  
1231 Eleventh Street  
Modesto, California 95352  
(209) 526-7373

Finance Director  
City of Modesto  
1010 10<sup>th</sup> Street  
P.O. Box 642  
Modesto, California 95353  
(209) 577-5369

## ESTIMATED SOURCES AND USES OF FUNDS

The estimated sources and uses of funds with respect to the Series 2007 Water Bonds are as follows:

<u>Estimated Sources</u>	
Principal Amount of Series 2007 Water Bonds	\$93,190,000
Total	<u>\$93,190,000</u>
<u>Estimated Uses</u>	
Deposit to Project Fund	\$72,812,364
Deposit to Capitalized Interest Subaccount within Interest Account	11,052,323
Deposit to Series 2007 Reserve Fund	8,008,289
Costs of Issuance <sup>(1)</sup>	1,317,024
Total	<u>\$93,190,000</u>

<sup>(1)</sup> Includes Underwriter's discount, premiums for bond insurance and surety bond, fees of Bond Counsel, fees of financial advisors, fees of the Trustee, rating agencies' fees, printing costs and certain miscellaneous expenses. See "UNDERWRITING."

## PLAN OF FINANCE

### General

The Series 2007 Water Bonds are being issued to provide funds to (i) finance the costs of the acquisition, design, construction, improvement and installation of the District's Domestic Water Project, (ii) fund capitalized interest on the Series 2007 Water Bonds, (iii) provide for the funding of a reserve fund for the Series 2007 Water Bonds and (iv) pay costs of issuance of the Series 2007 Water Bonds. See "THE DOMESTIC WATER PROJECT—The 2007 Project."

### Domestic Water Swap Agreement

In connection with the issuance of the Series 2007 Water Bonds, the Authority will enter into an interest rate swap agreement in the form of an ISDA Master Agreement (Local Currency – Single Jurisdiction), the U.S. Municipal Counterparty Schedule thereto, a Credit Support Annex and two Confirmations each dated as of and entered into on June 5, 2007 (collectively, the "Domestic Water Swap Agreement") with Bear Stearns Capital Markets Inc. (the "Swap Provider"). The Domestic Water Swap Agreement is scheduled to expire on the maturity date of the Series 2007 Water Bonds; and the notional amount of the Domestic Water Swap Agreement is scheduled to be reduced on the same dates and in the same amounts as the principal on the Series 2007 Water Bonds is scheduled to be reduced. Pursuant to the Domestic Water Swap Agreement, the Authority will be required to make periodic payments to the Swap Provider calculated on the basis of a fixed rate of interest equal to 4.378% on an initial notional amount equal to the principal amount of the Series 2007 Water Bonds maturing on September 1, 2027 and a fixed rate of interest equal to 4.440% on an initial notional amount equal to the principal amount of the Series 2007 Water Bonds maturing on September 1, 2037. In return, the Swap Provider will be required to make periodic payments to the Authority for deposit in the Interest Account pursuant to the Trust Agreement calculated on the basis of a variable rate of interest equal to 67% of the Three Month LIBOR Rate plus 0.58% on the same notional amount of the Series 2007 Water Bonds maturing on September 1, 2027 and a variable rate of interest equal to 67% of the Three Month LIBOR Rate plus 0.63% on the same notional amount of the Series 2007 Water Bonds maturing on September 1, 2037. The amounts payable by each party pursuant to the Domestic Water Swap Agreement are netted against the payments to be received by such party thereunder.

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

Both the Authority and the Swap Provider have the right to terminate the Domestic Water Swap Agreement prior to its stated termination date under certain conditions. Any such termination could result in an obligation on

the part of the Authority or the Swap Provider to make termination payments to the other party, and the amount of such termination payments could be substantial.

Pursuant to the Treatment and Delivery Agreement, “Debt Service” for which the City is obligated to make payments to the District under the Treatment and Delivery Agreement, is defined to include all scheduled payments, termination payments or other types of payments required to be made under the terms of any swap contract entered into in connection with variable rate financing for the Domestic Water Project, including the Domestic Water Swap Agreement. The Authority’s obligations under the Domestic Water Swap Agreement to make scheduled payments and termination payments constitute Debt Service under the Treatment and Delivery Agreement. See “SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2007 WATER BONDS—The Treatment and Delivery Agreement.”

## **THE SERIES 2007 WATER BONDS**

### **General Provisions**

The Series 2007 Water Bonds will be issued in the aggregate principal amount of \$93,190,000. The Series 2007 Water Bonds shall be dated the date of delivery, will be issued in fully registered form in denominations of \$5,000 or any integral multiple thereof, and will mature on the dates and in the principal amounts as set forth on the inside cover page of this Official Statement. The Series 2007 Water Bonds will be issued in fully registered form, and when issued, will be registered in the name of Cede & Co., as nominee of The Depository Trust Company, New York, New York (“DTC”). DTC will act as securities depository for the Series 2007 Water Bonds. For so long as Cede & Co., as nominee of DTC, is registered owner of the Series 2007 Water Bonds, payments of the principal of, premium, if any, and interest on the Series 2007 Water Bonds will be made directly to DTC, which is obligated in turn to remit such payments to its DTC Participants for subsequent disbursement to the beneficial owners of the Series 2007 Water Bonds. See APPENDIX G – “DTC AND THE BOOK-ENTRY ONLY SYSTEM” hereto.

### **Interest**

The Series 2007 Water Bonds maturing on September 1, 2027 will bear interest at the rate of 4.16095% from their date of delivery through and including September 3, 2007. The Series 2007 Water Bonds maturing on September 1, 2037 will bear interest at the rate of 4.21095% from their date of delivery through and including September 3, 2007. Thereafter the Series 2007 Water Bonds will bear interest for each Series 2007 Interest Period at the LIBOR-Based Interest Rate except that the Series 2007 Water Bonds may not bear interest in any Series 2007 Interest Period at more than the Maximum Rate.

Interest on the Series 2007 Water Bonds will be payable on the first Business Day of each September, December, March and June, commencing on September 4, 2007 (each a “Series 2007 Interest Payment Date”). Interest on the Series 2007 Water Bonds will be computed on the basis of a 365- or 366-day year, as applicable, for the actual number of days elapsed.

“LIBOR-Based Interest Rate” means for each Series 2007 Interest Period, 67% of the Three-Month LIBOR Rate plus (i) the per annum spread of 0.58% in the case of the Series 2007 Water Bonds with a stated maturity of September 1, 2027 and (ii) the per annum spread of 0.63% in the case of the Series 2007 Water Bonds with a stated maturity of September 1, 2037.

“Maximum Rate” means the lesser of (i) the maximum rate of interest allowed under State law or (ii) 12% per annum.

“Series 2007 Interest Period” means each period commencing on and including a Series 2007 Interest Payment Date to but not including the next succeeding Series 2007 Interest Payment Date.

“Three-Month LIBOR Rate” means the rate for deposits in U.S. dollars with a three-month maturity that appears on Telerate Page 3750 (or such other page as may replace that page on that service, or such other service as

may be nominated by the British Bankers' Association, for the purpose of displaying London interbank offered rates for U.S. dollar deposits) as of 11:00 a.m., London time, on the LIBOR Rate Determination Date, except that, if such rate does not appear on such page on the LIBOR Rate Determination Date, the "Three-Month LIBOR Rate" means a rate determined on the basis of the rates at which deposits in U.S. dollars for a three-month maturity and in a principal amount of at least U.S. \$1,000,000 are offered at approximately 11:00 a.m., London time, on the LIBOR Rate Determination Date, to prime banks in the London interbank market by four major banks in the London interbank market (herein referred to as the "Reference Banks") selected by the Trustee. The Trustee is to request the principal London office of each of such Reference Banks to provide a quotation of its rate. If at least two such quotations are provided, the Three-Month LIBOR Rate will be the arithmetic mean of such quotations. If fewer than two quotations are provided, the Three-Month LIBOR Rate will be the arithmetic mean of the rates quoted by major banks in New York City, selected by the Trustee, at approximately 11:00 a.m., New York City time, on the LIBOR Rate Determination Date for loans in U.S. dollars to leading European banks in a principal amount of at least U.S. \$1,000,000 having a three-month maturity. If none of the banks in New York City selected by the Trustee are then quoting rates for such loans, then the "Three-Month LIBOR Rate" for the ensuing Series 2007 Interest Period will mean the Three-Month LIBOR rate in effect in the immediately preceding Series 2007 Interest Period.

"LIBOR Rate Determination Date" means the date that is two London Banking Days preceding the first day of each Series 2007 Interest Period.

**Redemption**

**Optional Redemption**

The Series 2007 Water Bonds are subject to optional redemption by the Authority prior to their respective maturity dates, as a whole or in part on any date prior to September 1, 2017, from any available funds at the option of the District, provided that the amount of Series 2007 Water Bonds of each maturity to be redeemed shall be specified in a written request of the City, at a redemption price equal to the sum of the principal amount thereof together with the Spread Premium plus accrued interest thereon to the redemption date, without a redemption premium.

The Series 2007 Water Bonds are also subject to optional redemption by the Authority prior to their respective maturity dates, as a whole or in part on any date on or after September 1, 2017, from any available funds at the option of the District, provided that the amount of Series 2007 Water Bonds of each maturity to be redeemed shall be specified in a written request of the City, at a redemption price equal to the sum of the principal amount thereof plus accrued interest thereon to the redemption date, without a redemption premium.

"Spread Premium" means, as of any redemption date for the Series 2007 Water Bonds, the present value of the product of (a) the excess, if any, of (i) the per annum spread above the percentage of the Three-Month LIBOR Rate at which such Series 2007 Water Bond bears interest over (ii) 0.25% per annum, as summarized in the following table, and (b) the principal amount of the Series 2007 Water Bonds to be redeemed, determined as if such product were payable quarterly from such redemption date to the maturity of such Series 2007 Water Bond, determined as if any such Series 2007 Water Bonds were redeemed on the Sinking Fund Payment date as of which 50% of the Series 2007 Water Bonds of the same maturity then Outstanding will have been redeemed (the "Median Maturity") but no such Series 2007 Water Bond were otherwise redeemed prior to maturity, discounting to the redemption date quarterly at a discount rate equal to (a) 67% of the USD-ISDA-Swap Rate (for the designated maturity which is closest to the Median Maturity) appearing on Reuters at 11:00 a.m., New York City time, two U.S. Government Securities Business Days prior to the first mailing of notice of such redemption, plus (b) 0.25% per annum.

<b>Series 2007 Water Bond due September 1</b>	<b>Interest Rate Spread</b>	<b>Net Spread for Calculating Redemption Premium</b>
2027	0.58%	0.33%
2037	0.63	0.38

**The Spread Premium will only be payable upon optional redemption of Series 2007 Water Bonds before September 1, 2017. No Spread Premium will be payable upon Mandatory Sinking Fund Redemption of Series 2007 Water Bonds.**

“USD-ISDA-Swap Rate” for a designated maturity and date means the rate for U.S. dollar swaps of such maturity, expressed as a percentage, which appears on the Reuters Money 3000 Service on the page designated ISDAFIX1 (or such other page as may replace that page on such service for the purpose of displaying comparable rates) at 11:00 a.m., New York City time, on the day which is two U.S. Government Securities Business Days prior to such date. If such rate does not appear on such page on such day, then “USD-ISDA-Swap Rate” for such maturity and date shall mean the percentage determined on the basis of mid-market semiannual swap rate quotations provided by five leading swap dealers in the New York City interbank market (as selected by Bear, Stearns & Co. Inc. or its successors and assigns and subject to the approval of the District, which approval shall not be unreasonably withheld) at approximately such time on such day as the mean of the bid and offered rates for the semiannual fixed leg, calculated on a 30/360 day count basis, of a fixed-for-floating U.S. dollar interest rate swap transaction with an effective date of the relevant early termination date and a termination date equal to such maturity, in an amount that is representative for a single transaction in such market at such time, with an acknowledged dealer of good credit in such market, where the floating rate, calculated on the basis of a 360-day year for actual days elapsed, is equal to the London Interbank Offered Rate for loans with a three-month duration.

“U.S. Government Securities Business Day” means any day except for a Saturday, a Sunday, or a day on which the Securities Industry and Financial Markets Association recommends that the fixed income departments of its members be closed for the entire day for purposes of trading U.S. government securities.

**Mandatory Redemption**

The Series 2007 Water Bonds maturing on September 1, 2027 are subject to mandatory redemption prior to maturity, in part by lot, on September 1, 2023 and on each September 1 thereafter to and including September 1, 2027 from Series 2007 Installment Payments made by the District on such dates, at a redemption price equal to the principal amount thereof to be redeemed, plus accrued interest thereon to the date fixed for redemption, without premium, according to the following schedule:

**Series 2007 Water Bonds Maturing September 1, 2027**

<b>Redemption Date (September 1)</b>	<b>Principal Amount</b>
2023	\$4,275,000
2024	4,455,000
2025	4,650,000
2026	4,885,000
2027 <sup>†</sup>	5,105,000

<sup>†</sup> Final maturity.

The Series 2007 Water Bonds maturing on September 1, 2037 are subject to mandatory redemption prior to maturity, in part by lot, on September 1, 2028 and on each September 1 thereafter to and including September 1, 2037 from Series 2007 Installment Payments made by the District on such dates, at a redemption price equal to the principal amount thereof to be redeemed, plus accrued interest thereon to the date fixed for redemption, without premium, according to the following schedule:

### Series 2007 Water Bonds Maturing September 1, 2037

<u>Redemption Date (September 1)</u>	<u>Principal Amount</u>
2028	\$ 5,340,000
2029	5,570,000
2030	5,840,000
2031	6,100,000
2032	6,400,000
2033	6,695,000
2034	7,005,000
2035	7,335,000
2036	7,665,000
2037†	11,870,000

† Final maturity.

#### **Extraordinary Redemption**

The Series 2007 Water Bonds are subject to redemption prior to maturity as a whole on any date or in part by lot (in integral multiples of \$5,000 principal amount) on any interest payment date, from prepaid Series 2007 Installment Payments made by the District from funds received by the District due to a casualty loss or governmental taking of the District's Domestic Water System or portions thereof by eminent domain proceedings, under the circumstances and upon the conditions and terms prescribed in the Trust Agreement and the Installment Purchase Contract, at a redemption price equal to the principal amount thereof to be redeemed, plus accrued interest thereon to the date fixed for redemption, without premium. See "APPENDIX D—SUMMARY OF LEGAL DOCUMENTS — Summary of the Installment Purchase Contract — Covenants of the District — Insurance."

#### **Selection of Series 2007 Water Bonds for Redemption**

If less than all of the Series 2007 Water Bonds are to be redeemed, the principal amount of such Series 2007 Water Bonds of such maturities to be redeemed shall be specified by the City, or if not specified by the City, the Trustee shall select such Series 2007 Water Bonds to be redeemed, in inverse order of maturity. If less than all of the Series 2007 Water Bonds of any one maturity are to be redeemed on any date, the Trustee shall select the Series 2007 Water Bonds of such maturity by lot.

#### **Notice**

Notice of redemption shall be given by the Trustee by mail to the registered owner of each Series 2007 Water Bond to be redeemed not less than 30 nor more than 60 days prior to the redemption date at the address shown on the registration books of the Trustee on the date such notice is mailed. So long as DTC is acting as securities depository for the Series 2007 Water Bonds, notice of redemption will be mailed to DTC and not to Beneficial Owners of the Series 2007 Water Bonds. Each notice of redemption shall state the date of such notice, the date of issuance of the Series 2007 Water Bonds, the redemption date, the redemption prices, the place or places of redemption (including the name and appropriate address or addresses of the Trustee), the CUSIP number of the Series 2007 Water Bonds, the source of the funds to be used for such redemption, the principal amount of the Series 2007 Water Bonds to be redeemed, the distinctive bond numbers of the Series 2007 Water Bonds or portions thereof to be redeemed, the rate of interest payable on the Series 2007 Water Bonds to be redeemed and the maturity date of the Series 2007 Water Bonds to be redeemed, and shall also state that the interest payable on the Series 2007 Water Bonds designated for redemption shall cease to accrue from and after such redemption date and that on said date there will become due and payable on each of said Series 2007 Water Bonds the principal amount of the Series 2007 Water Bonds to be redeemed, interest accrued thereon to the redemption date and the premium, if any, thereon (such premium to be specified) and shall require that such Series 2007 Water Bonds be then surrendered at the address or addresses of the Trustee specified in the redemption notice.

### **Effect of Redemption**

From and after the date so designated for redemption, and moneys for payment of the redemption price being held by the Trustee, the interest on the Series 2007 Water Bonds so called for redemption will cease to accrue. Such Series 2007 Water Bonds will cease to be entitled to any lien, benefit or security under the Trust Agreement and the owners of such Series 2007 Water Bonds will have no rights in respect thereof except to receive payment of the redemption price thereof.

## **SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2007 WATER BONDS**

### **Pledge Under the Trust Agreement**

The Series 2007 Water Bonds are special, limited obligations of the Authority payable solely from and secured solely by a first pledge of and charge and lien upon (i) all Series 2007 Installment Payments and other payments made by the District and received by the Authority pursuant to the Installment Purchase Contract and (ii) all interest or other income derived from the investment of any money in any fund or account (other than the Rebate Fund) held under the Trust Agreement (collectively, the "Revenues"), and any other amounts (including proceeds of the sale of the Series 2007 Water Bonds) held by the Trustee in any fund or account established under the Trust Agreement (other than amounts on deposit in the Rebate Fund), all under the terms and conditions set forth in the Trust Agreement. As and to the extent set forth in the Trust Agreement all the Revenues and such other amounts are irrevocably pledged to the payment of the interest on and principal of the Series 2007 Water Bonds as provided in the Trust Agreement and the Revenues shall not be used for any other purpose while any of the Series 2007 Water Bonds remain outstanding; provided, however, that out of such Revenues and other moneys certain sums may be applied for other purposes as permitted under the Trust Agreement. See "APPENDIX D—SUMMARY OF LEGAL DOCUMENTS."

THE SERIES 2007 WATER BONDS ARE SPECIAL, LIMITED OBLIGATIONS OF THE AUTHORITY AND ARE NOT SECURED BY A LEGAL OR EQUITABLE PLEDGE OF, OR CHARGE OR LIEN UPON, ANY PROPERTY OF THE AUTHORITY OR ANY OF ITS INCOME OR RECEIPTS, EXCEPT THE REVENUES. NEITHER THE FULL FAITH AND CREDIT OF THE AUTHORITY NOR OF ITS MEMBERS (INCLUDING THE DISTRICT) NOR OF ANY OTHER PUBLIC ENTITY (INCLUDING THE CITY) IS PLEDGED FOR THE PAYMENT OF THE INTEREST ON OR PRINCIPAL OF OR REDEMPTION PREMIUMS, IF ANY, ON THE SERIES 2007 WATER BONDS AND NO TAX OR OTHER SOURCE OF FUNDS, OTHER THAN THE REVENUES IS PLEDGED TO PAY THE INTEREST ON OR PRINCIPAL OF OR REDEMPTION PREMIUMS, IF ANY, ON THE SERIES 2007 WATER BONDS. THE PAYMENT OF THE INTEREST ON OR PRINCIPAL OF OR REDEMPTION PREMIUMS, IF ANY, ON THE SERIES 2007 WATER BONDS DOES NOT CONSTITUTE A DEBT, LIABILITY OR OBLIGATION OF THE AUTHORITY NOR OF ANY MEMBER OF THE AUTHORITY (INCLUDING THE DISTRICT) NOR OF ANY OTHER PUBLIC ENTITY (INCLUDING THE CITY) FOR WHICH ANY SUCH ENTITY IS OBLIGATED TO LEVY OR PLEDGE ANY FORM OF TAXATION OR FOR WHICH ANY SUCH ENTITY HAS LEVIED OR PLEDGED ANY FORM OF TAXATION.

### **Installment Payments**

The District has agreed in the Installment Purchase Contract to make the Series 2007 Installment Payments as payment of a portion of the purchase price of the 2007 Project, but solely from Treatment and Delivery Revenues (as defined herein) received by the District from the City pursuant to the Treatment and Delivery Agreement, unless the District elects to appropriate monies to pay such obligations. See "—Special Budgeting Covenant of the District." The District is required to make Series 2007 Installment Payments whether or not the 2007 Project or any part thereof is operating or operable, or its use is suspended, interfered with, reduced or curtailed or terminated in whole or in part, and such payments shall not be subject to reduction whether by offset or otherwise and shall not be conditioned upon the performance or nonperformance by any party of any agreement for any cause whatsoever.

## **The Treatment and Delivery Agreement**

***Treatment and Delivery Revenues.*** Pursuant to the Treatment and Delivery Agreement, the City has agreed to pay the payments (“Payments”) due thereunder during each twelve month period beginning on May 1 and ending on the next succeeding April 30 (a “Domestic Water Year”) in equal monthly installments. Payments to be made by the City under the Treatment and Delivery Agreement will include, among other things, so long as any Domestic Water Bonds are outstanding, principal, interest and other charges, if any, due with respect to the Domestic Water Bonds and all payments due under the Domestic Water Swap Agreement (“Debt Service”). Debt Service Payments received by the District from the City pursuant to the Treatment and Delivery Agreement are referred to herein as “Treatment and Delivery Revenues.” See “THE DOMESTIC WATER PROJECT—The Treatment and Delivery Agreement” for a further discussion of the Payments required to be made by the City under the Treatment and Delivery Agreement.

***Pledge of Treatment and Delivery Revenues.*** Pursuant to the Installment Purchase Contract, the District has pledged to the payment of the Series 2007 Installment Payments, all Treatment and Delivery Revenues received by the District from the City pursuant to the Treatment and Delivery Agreement; and such Treatment and Delivery Revenues shall not be used for any other purpose while any of the Series 2007 Installment Payments remain unpaid; provided, however, that out of Treatment and Delivery Revenues there may be apportioned such sums for such purposes as are expressly permitted by the Installment Purchase Contract. Such pledge shall constitute a first lien on the Treatment and Delivery Revenues for the payment of the Domestic Water Installment Payments and all other Domestic Water Contracts (as defined in Appendix D hereto) and Domestic Water Bonds (collectively “Domestic Water Obligations”) in accordance with the terms of the Installment Purchase Contract.

***City Obligations Limited to City Gross Water Revenues; Pledge of City Gross Water Revenues.*** The obligation of the City to make Payments under the Treatment and Delivery Agreement is limited to City Gross Water Revenues. “City Gross Water Revenues” is defined in the Treatment and Delivery Agreement as all gross income and revenue received or receivable by the City from the ownership and operation of the City Municipal Water System (see “THE CITY OF MODESTO MUNICIPAL WATER UTILITY SYSTEM”), which gross income and revenue shall be calculated in accordance with generally accepted accounting principles, including all rates, fees and charges received by the City for water service and connection and hook up fees and all other income and revenue however derived by the City from the ownership and operation of or arising from the City Municipal Water System, but excluding in all cases any proceeds of taxes and any refundable deposits made to establish credit, federal or state grants, or advances or contributions in aid of construction, or monetary recoveries in lawsuits on behalf of City’s water rate payers for environmental and other torts and actions at law.

All City Gross Water Revenues are irrevocably pledged to the punctual payment of principal and interest and redemption premiums, if any, and to the payment of amounts due under the Domestic Water Swap Agreement, all as represented by the Debt Service component of the Payments made by the City pursuant to the Treatment and Delivery Agreement. Such pledge is on a parity with the pledge for the payment of any parity obligations that may heretofore or hereafter be incurred by the City pursuant to the terms of the Treatment and Delivery Agreement (see “—Additional Encumbrances of City Gross Water Revenues” below). and shall constitute a lien on and security interest in City Gross Water Revenues. The pledge thereof for the payment of termination amounts due under the Domestic Water Swap Agreement shall be on a basis subordinate to the pledge for the payment of such parity obligations, and such termination payments shall constitute subordinate debt under the Treatment and Delivery Agreement.

**THE OBLIGATION OF THE CITY TO MAKE PAYMENTS UNDER THE TREATMENT AND DELIVERY AGREEMENT IS A SPECIAL LIMITED OBLIGATION OF THE CITY PAYABLE SOLELY FROM CITY GROSS WATER REVENUES AS PROVIDED IN THE TREATMENT AND DELIVERY AGREEMENT. THE GENERAL FUND OF THE CITY IS NOT LIABLE FOR PAYMENTS UNDER THE TREATMENT AND DELIVERY AGREEMENT AND NEITHER THE CREDIT NOR THE TAXING POWER OF THE CITY IS PLEDGED TO SUCH PAYMENTS.**

***City Rate Covenant.*** Pursuant to the Treatment and Delivery Agreement, the City covenants, among other things, that it shall fix, prescribe and collect water rates and charges which shall be at least sufficient to yield City Gross Water Revenues during each fiscal year of the City in an amount equal to: (i) the payment obligations of the

City under the Treatment and Delivery Agreement during the fiscal year other than Debt Service (see “THE DOMESTIC WATER PROJECT—The Treatment and Delivery Agreement”), plus (ii) City Municipal Water System Maintenance and Operation Costs to the extent not included in (i) above, plus (iii) 125% of the Debt Service to be paid during the fiscal year.

***Outstanding Parity Lien Obligations of the District.*** As of May 1, 2007, the Series 1998D Water Bonds in the principal amount of \$73.78 million were outstanding. The Series 1998D Water Bonds are payable from the Series 1998D Installment Payments, to be made by the District to the Authority pursuant to the 1998 Installment Purchase Contract, solely from Treatment and Delivery Revenues received by the District from the City pursuant to the Treatment and Delivery Agreement. The Series 2007 Installment Payments received by the Authority from the District pursuant to the Installment Purchase Contract will be payable by the District on a parity with the Series 1998D Installment Payments. In the event of any insufficiency of Treatment and Delivery Revenues to make the Series 1998D Installment Payments and Series 2007 Installment Payments in full when due to pay the Series 1998D Water Bonds and Series 2007 Water Bonds, the District has covenanted in the Installment Purchase Contract that in any year that Treatment and Delivery Revenues are so insufficient, an Authorized District Representative will submit a special budget item to the District Board seeking a special appropriation in the amount of such insufficiency. The District Board shall have absolute discretion in determining whether or not to make such special appropriation. See “—Special Budgeting Covenant of the District” and see “APPENDIX F—SCHEDULE OF INSTALLMENT PAYMENTS” for a schedule of the Series 1998D Installment Payments and the Series 2007 Installment Payments.

***Additional Encumbrances of City Gross Water Revenues.*** In addition to its obligations under the Treatment and Delivery Agreement, including its obligations relating to the Series 1998D Installment Payments and the Series 2007 Installment Payments and the Domestic Water Swap Agreement (see “PLAN OF FINANCE” herein), as of May 1, 2007, the City has outstanding \$19.67 million aggregate principal amount of 1997 Refunding Revenue Certificates of Participation (1997 Water Utility System Refunding Project) (the “1997 Certificates”) evidencing and representing the interests of the Owners thereof in installment payments to be made by the City pursuant to the Master Installment Purchase Contract, dated as of November 1, 1997, as supplemented by the 1997 Supplemental Installment Purchase Contract, dated as of November 1, 1997 (collectively, the “Master Contract”), by and between the City and the Modesto Public Financing Authority and \$46.275 million aggregate principal amount of Revenue Certificates of Participation, 2006 Series A (the “2006 Certificates”) evidencing and representing the interests of the Owners thereof in installment payments to be made by the City pursuant to the Master Contract, as amended and supplemented by the 2006 Supplemental Installment Purchase Contract, dated as of November 1, 2006, as well as certain obligations under an interest rate swap agreement entered into by the City relating thereto (the “2006 Supplemental Installment Purchase Contract”). The City also has outstanding a loan from the State of California Department of Water Resources in the principal amount of \$3.90 million (of which \$1.96 million was outstanding as of May 1, 2007) (the “CDWR Loan”). Payments of the CDWR Loan, the 1997 Certificates and the 2006 Certificates and, as well as certain payment obligations under the interest rate swap agreement and insurance and reimbursement agreement relating thereto as described below (collectively, the “City Parity Obligations”), are secured by a pledge of City Gross Water Revenues on a parity with the City’s obligations under the Treatment and Delivery Agreement. In connection with the execution and delivery of the 2006 Certificates, the City entered into an interest rate swap agreement in the form of an ISDA Master Agreement (Local Currency – Single Jurisdiction), the U.S. Municipal Counterparty Schedule thereto, a Credit Support Annex and a Confirmation each dated as of and entered into on September 27, 2006 (collectively, the “2006 Swap Agreement”) with Bank of America, N.A. (the “Swap Provider”). The 2006 Swap Agreement is scheduled to expire on the maturity date of the 2006 Certificates; and the notional amount of the 2006 Swap Agreement is scheduled to be reduced on the same dates and in the same amounts as the principal evidenced by the 2006 Certificates is scheduled to be reduced. Pursuant to the 2006 Swap Agreement, the City is required to make periodic payments to the Swap Provider calculated on the basis of a fixed rate of interest of 3.48% per annum on an initial notional amount equal to the principal amount represented by the 2006 Certificates. In return, the Swap Provider is required to make periodic payments to the City calculated on the basis of a variable rate of interest equal to 63.7% percent of one month LIBOR plus 0.154% on the same notional amount. The amounts payable by each party pursuant to the 2006 Swap Agreement are netted against the payments to be received by such party thereunder. Certain of the amounts that may be payable by the City to the Swap Provider are insured pursuant to a policy of interest rate swap insurance (the “Swap Policy”) issued by MBIA Insurance Corporation pursuant to the Insurance and Reimbursement Agreement. The City’s obligations under the 2006 Swap Agreement to make scheduled payments and certain termination payments (but only if such termination

payments are insured pursuant to the Swap Policy), as well as the City's obligation to make payments under the Insurance and Reimbursement Agreement if any amounts which have been drawn thereunder have not been reimbursed by the City, are payable on a parity with the City's obligations to make installment payments relating to the 1997 Certificates and the 2006 Certificates and to make payments on the CDWR Loan, and payments under the Treatment and Delivery Agreement relating to the outstanding Series 1998D Water Bonds and the Series 2007 Water Bonds.

The City may issue or incur other obligations secured by a pledge of the City Gross Water Revenues on a parity with its obligations under the Treatment and Delivery Agreement and the outstanding City Parity Obligations, subject to the terms and conditions of the Treatment and Delivery Agreement and the Master Contract.

Pursuant to the Treatment and Delivery Agreement, the City has covenanted that it will require a covenant substantially similar to the City rate covenant in the Treatment and Delivery Agreement with respect to all obligations issued by the City on a parity with its obligations under the Treatment and Delivery Agreement. The City may also issue or incur loans, bonds, notes, advances or indebtedness payable from City Gross Water Revenues on a junior and subordinated basis to its obligations under the Treatment and Delivery Agreement and the Master Contract in such principal amount as shall be determined by the City. The City will not incur any obligations payable from City Gross Water Revenues prior to its obligations under the Treatment and Delivery Agreement and the Master Contract.

**Limited Take or Pay Obligations.** The Treatment and Delivery Agreement provides that, except as limited by the next sentence, the City shall pay the fixed costs of the Domestic Water Project and its Debt Service Payment obligations whether or not the Domestic Water Project or any part is operating or operable or its output or capability is suspended, interrupted, interfered with, reduced or curtailed, or terminated in whole or in part. The payments of such fixed costs of the Domestic Water Project and Debt Service shall not be subject to reduction whether by offset, counterclaim, recoupment, or otherwise and shall not be conditioned upon the performance or nonperformance by the District or the City of any agreement or for any cause or reason whatsoever; provided, however, that the City shall not be required to pay Debt Service or fixed costs, in the event any of the following certain specified conditions shall occur:

- (i) The District, for any reason other than drought, shall fail to deliver at least fifty percent of the treated water which the City is to receive under the Treatment and Delivery Agreement for a period in excess of 18 consecutive months.
- (ii) Eighty percent or more of the water treatment plant component of the Domestic Water Project shall be destroyed or disabled for a period in excess of 24 consecutive months.
- (iii) Fifty percent or more of the District's total annual water supply, as adjusted pursuant to the Treatment and Delivery Agreement, shall be lost or unavailable for physical reasons beyond the District's best efforts to control, other than drought, for a period in excess of 24 consecutive months.

**Special Budgeting Covenant of the District.** Pursuant to the Installment Purchase Contract, the District has covenanted that in the event Treatment and Delivery Revenues are insufficient to pay in full any amount then due and payable with respect to the Series 2007 Water Bonds, due to the suspension of the City's obligation to pay as described above under "Limited Take or Pay Obligation" or otherwise, an Authorized District Representative shall submit to the Board of Directors of the District a special budget item requesting a special appropriation from the Board of Directors of the District of the amount of such insufficiency; provided, however, the Board of Directors of the District shall have absolute discretion in determining whether such a special appropriation shall be made, and a determination not to make a special appropriation shall not in and of itself constitute an Event of Default under the Installment Purchase Contract. In the event of such insufficiency of Treatment and Delivery Revenues and a decision by the Board of Directors of the District not to make such special appropriation to pay interest and principal on the Series 2007 Water Bonds, there are no other amounts pledged to the payment of the Series 2007 Water Bonds. See "APPENDIX D— SUMMARY OF LEGAL DOCUMENTS."

**Reserve and Contingency Fund.** Pursuant to the Treatment and Delivery Agreement, the District has established and maintains a Reserve and Contingency Fund, in the initial amount of \$500,000. In the event amounts on deposit in the Reserve and Contingency Fund are less than \$500,000 at the end of any calendar year, then the amount of deficiency shall be added to the payments to be made by the City in equal monthly installments over the next ensuing Domestic Water Year. On April 5, 2007, the District notified the City that the District is planning to (i) increase the Reserve and Contingency Fund from \$500,000 to \$1,000,000, reflecting the doubling of the capacity of the Domestic Water Project with the undertaking of the 2007 Project and (ii) annually increase the amount of the Reserve and Contingency Fund by \$250,000 to build a membrane replacement account, which would occur at the onset of commercial operation of the 2007 Project and continue annually until the membrane replacement account is sufficient to fund membrane replacement. As of March 31, 2007, amounts on deposit in the Reserve and Contingency Fund were approximately \$970,000.

Amounts credited to the Reserve and Contingency Fund received from the City may be applied by the District to pay, among other things, Debt Service in the event Treatment and Delivery Revenues are insufficient therefor. The District may from time to time increase or decrease the amount required to be on deposit in the Reserve and Contingency Fund, subject to the requirements of the Treatment and Delivery Agreement. In the event of an increase in the amount required to be on deposit in the Reserve and Contingency Fund, such additional amount shall be funded in monthly installments made by the City over the next ensuing Domestic Water Year. In the event of a decrease in amounts required to be deposited therein, the excess amount shall be credited against Payments due from the City during the next succeeding Domestic Water Year.

If at any time the Reserve and Contingency Fund is depleted or contains insufficient funds so that the District must advance funds which otherwise would be obtained from withdrawals from the Reserve and Contingency Fund, then the aggregate amount of the advances during any year and the amount necessary to replenish the Reserve and Contingency Fund to its established balance shall be added to the payments to be made by the City during the next ensuing Domestic Water Year.

#### **Series 2007 Reserve Fund**

**General.** The Series 2007 Reserve Fund will be held by the Depository in accordance with the Depository Agreement. The Installment Purchase Contract provides for the funding of the Series 2007 Reserve Fund in an amount equal to the Series 2007 Reserve Fund Requirement, defined as an amount equal to the maximum annual Series 2007 Installment Payments. In the event that amounts paid by the District to the Trustee are insufficient to pay principal of and interest on the Series 2007 Water Bonds when due, the Depository shall transfer from the Series 2007 Reserve Fund the amount of such insufficiency. The Series 2007 Reserve Fund is not available for the payments of Domestic Water Bonds other than the Series 2007 Water Bonds.

In the event amounts on deposit in the Series 2007 Reserve Fund are less than the Series 2007 Reserve Fund Requirement, the District is required to deposit monthly, from moneys remaining in the Domestic Water Project Revenue Fund after the required deposits for the payment of principal and interest on all Domestic Water Obligations, 1/12 of the amount necessary to restore the Series 2007 Reserve Fund to an amount equal to the Series 2007 Reserve Fund Requirement.

The District may provide for the Series 2007 Reserve Fund by a policy of insurance issued by a municipal bond insurance company the claims paying ability of which is rated in the highest rating category of Moody's Investors Service and Standard & Poor's, or by a letter of credit or other credit facility issued by a bank or other financial institution, the obligations of which are rated in one of the two highest rating categories of Moody's Investors Service and Standard & Poor's, in each case, if such rating agency is then rating obligations of the District. See "APPENDIX D—SUMMARY OF LEGAL DOCUMENTS—Summary of the Installment Purchase Contract—Revenues—Series 2007 Reserve Fund."

The Series 2007 Reserve Fund shall be replenished in the following priority: (i) principal and interest on a letter of credit, insurance policy, surety bond or other such funding instrument, if any ("Additional Funding Instruments"), shall be paid from first available Treatment and Delivery Revenues on a pro rata basis and in accordance with and to the extent permitted by the Installment Purchase Contract; (ii) after all such amounts are paid in full, amounts necessary to fund the Series 2007 Reserve Fund to the Series 2007 Reserve Fund Requirement, after

taking into account the amounts available under the Surety Bond and any Additional Funding Instrument, shall be deposited from next available Treatment and Delivery Revenues.

Notwithstanding anything to the contrary contained in the Trust Agreement, at any time one or more surety bonds or insurance policies are on deposit in the Series 2007 Reserve Fund, the Trustee shall: (i) withdraw and use all cash, if any, on deposit in the Series 2007 Reserve Fund prior to using and withdrawing any amounts derived from payments under any surety bonds or insurance policies; and (ii) draw on all surety bonds or insurance policies on a pro rata basis based on the draw limit of each such surety bond or insurance policy, if there is more than one surety bond and /or insurance policy on deposit in the Series 2007 Reserve Fund.

Upon the delivery of the Series 2007 Water Bonds, it is expected that a portion of the Series 2007 Reserve Fund Requirement in the amount of \$8,008,288.63 will be funded from the proceeds of the Series 2007 Water Bonds and a portion of the Series 2007 Reserve Fund Requirement will be funded from a surety bond (the "Surety Bond") in the amount of \$4,388,739.37 to be issued by MBIA.

***Surety Bond.*** Application has been made to MBIA to issue the Surety Bond. The Surety Bond will provide that upon notice from the Trustee to the Insurer to the effect that insufficient amounts are on deposit in the Installment Payment Fund to pay the principal of (at maturity or pursuant to mandatory redemption requirements) and interest on the Series 2007 Water Bonds, MBIA will promptly deposit with the Trustee an amount sufficient to pay the principal of and interest on the Series 2007 Water Bonds or the available amount of the Surety Bond, whichever is less. Upon the later of: (i) three (3) days after receipt by MBIA of a Demand for Payment in the form attached to the Surety Bond, duly executed by the Trustee; or (ii) the payment date of the Series 2007 Water Bonds as specified in the Demand for Payment presented by the Trustee to the Insurer, the Insurer will make a deposit of funds in an account with U.S. Bank Trust National Association, in New York, New York, or its successor, sufficient for the payment to the Trustee, of amounts which are then due to the Trustee (as specified in the Demand for Payment) subject to the Surety Bond coverage.

The available amount of the Surety Bond is the initial face amount of the Surety Bond less the amount of any previous deposits by MBIA with the Trustee which have not been reimbursed by the District. The District and the Insurer have entered into a Financial Guaranty Agreement (the "Guaranty Agreement"). Pursuant to the Guaranty Agreement, the District is required to reimburse the Insurer, within one year of any deposit, the amount of such deposit made by the Insurer with the Trustee under the Surety Bond. Such reimbursement shall be made only after all required deposits to the Installment Payment Fund have been made.

Under the terms of the Guaranty Agreement, the Trustee is required to reimburse MBIA, with interest, until the face amount of the Surety Bond is reinstated before any other deposit is made. No optional redemption of the Series 2007 Water Bonds may be made until the Insurer's Surety Bond is reinstated. The Surety Bond will be held by the Trustee in the Series 2007 Reserve Fund and is provided as an alternative to the District depositing funds equal to the total Series 2007 Reserve Fund Requirement. The Surety Bond will be issued in the face amount equal to \$4,388,739.37 and the premium therefor will be fully paid by the District at the time of delivery of the Series 2007 Water Bonds. The remainder of the Series 2007 Reserve Requirement will be funded from the proceeds of the Series 2007 Water Bonds.

## **Insurance**

The District covenants pursuant to the Installment Purchase Contract that it shall procure and maintain or cause to be procured and maintained insurance on the Domestic Water System with responsible insurers in such amounts and against such risks (including accident to or destruction of the Domestic Water System) as are usually covered in connection with domestic water systems similar to the Domestic Water System so long as such insurance is available from reputable insurance companies at reasonable costs. See "APPENDIX D—SUMMARY OF LEGAL DOCUMENTS—Summary of the Installment Purchase Contract—Covenants of the District—Insurance."

## **Limitations of Remedies**

In addition to the limitations on remedies contained in the Trust Agreement and the Installment Purchase Contract, the rights and remedies provided in the Trust Agreement and the Installment Purchase Contract may be limited by and are subject to bankruptcy, insolvency, reorganization, moratorium and other similar laws affecting creditors' rights, to the application of equitable principles and to the exercise of judicial discretion in appropriate cases.

## **BOND INSURANCE**

*The following information has been furnished by MBIA for use in this Official Statement. Such information has not been independently verified or confirmed by the Authority, the District, the City or the Underwriter. No representation is made herein as to the accuracy or adequacy of such information, or as to the absence of material adverse changes in such information subsequent to the date hereof, or that the information contained and incorporated herein by reference is correct. Reference is made to APPENDIX H for a specimen of MBIA's policy (the "Policy") with respect to the Series 2007 Water Bonds.*

### **The MBIA Insurance Corporation Insurance Policy**

MBIA does not accept any responsibility for the accuracy or completeness of this Official Statement or any information or disclosure contained herein, or omitted herefrom, other than with respect to the accuracy of the information regarding the Policy and MBIA set forth under the heading "BOND INSURANCE." Additionally, MBIA makes no representation regarding the Bonds or the advisability of investing in the Series 2007 Water Bonds.

The Policy unconditionally and irrevocably guarantees the full and complete payment required to be made by or on behalf of the Authority to the Trustee or its successor of an amount equal to (i) the principal of (either at the stated maturity or by an advancement of maturity pursuant to a mandatory sinking fund payment) and interest on, the Series 2007 Water Bonds as such payments shall become due but shall not be so paid (except that in the event of any acceleration of the due date of such principal by reason of mandatory or optional redemption or acceleration resulting from default or otherwise, other than any advancement of maturity pursuant to a mandatory sinking fund payment, the payments guaranteed by the Policy shall be made in such amounts and at such times as such payments of principal would have been due had there not been any such acceleration, unless MBIA elects in its sole discretion, to pay in whole or in part any principal due by reason of such acceleration); and (ii) the reimbursement of any such payment which is subsequently recovered from any Owner of the Series 2007 Water Bonds pursuant to a final judgment by a court of competent jurisdiction that such payment constitutes an avoidable preference to such Owner within the meaning of any applicable bankruptcy law (a "Preference").

The Policy does not insure against loss of any prepayment premium which may at any time be payable with respect to any Series 2007 Water Bonds. The Policy does not, under any circumstance, insure against loss relating to: (i) optional or mandatory redemptions (other than mandatory sinking fund redemptions); (ii) any payments to be made on an accelerated basis; or (iii) any Preference relating to (i) and (ii) above. The Policy also does not insure against nonpayment of principal of or interest on the Series 2007 Water Bonds resulting from the insolvency, negligence or any other act or omission of the Trustee or any other paying agent for the Series 2007 Water Bonds.

Upon receipt of telephonic or telegraphic notice, such notice subsequently confirmed in writing by registered or certified mail, or upon receipt of written notice by registered or certified mail, by MBIA from the Trustee or any owner of a Series 2007K Bond the payment of an insured amount for which is then due, that such required payment has not been made, MBIA on the due date of such payment or within one business day after receipt of notice of such nonpayment, whichever is later, will make a deposit of funds, in an account with U.S. Bank Trust National Association, in New York, New York, or its successor, sufficient for the payment of any such insured amounts which are then due. Upon presentment and surrender of such Bonds or presentment of such other proof of ownership of the Series 2007 Water Bonds, together with any appropriate instruments of assignment to evidence the assignment of the insured amounts due on the Series 2007 Water Bonds as are paid by MBIA, and appropriate instruments to effect the appointment of MBIA as agent for such owners of the Series 2007 Water Bonds in any

legal proceeding related to payment of insured amounts on the Series 2007 Water Bonds, such instruments being in a form satisfactory to U.S. Bank Trust National Association, U.S. Bank Trust National Association shall disburse to such owners or the Trustee payment of the insured amounts due on such Bonds, less any amount held by the Trustee for the payment of such insured amounts and legally available therefor.

### **MBIA Insurance Corporation**

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

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

### **Regulation**

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

The Policy is not covered by the Property/Casualty Insurance Security Fund specified in Article 76 of the New York Insurance Law.

### **Financial Strength Ratings of MBIA**

Moody's Investors Service, Inc. rates the financial strength of MBIA "Aaa."

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

Fitch Ratings rates the financial strength of MBIA "AAA."

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

The above ratings are not recommendations to buy, sell or hold the Series 2007 Water Bonds, and such ratings may be subject to revision or withdrawal at any time by the rating agencies. Any downward revision or withdrawal of any of the above ratings may have an adverse effect on the market price of the Series 2007 Water Bonds. MBIA does not guaranty the market price of the Series 2007 Water Bonds nor does it guaranty that the ratings on the Series 2007 Water Bonds will not be revised or withdrawn.

### **MBIA Financial Information**

As of December 31, 2006, MBIA had admitted assets of \$10.9 billion (audited), total liabilities of \$6.9 billion (audited), and total capital and surplus of \$4.0 billion (audited) determined in accordance with statutory accounting practices prescribed or permitted by insurance regulatory authorities. As of March 31, 2007, MBIA had

admitted assets of \$11.2 billion (unaudited), total liabilities of \$7.0 billion (unaudited), and total capital and surplus of \$4.2 billion (unaudited) determined in accordance with statutory accounting practices prescribed or permitted by insurance regulatory authorities.

For further information concerning MBIA, see the consolidated financial statements of MBIA and its subsidiaries as of December 31, 2006 and December 31, 2005 and for each of the three years in the period ended December 31, 2006, prepared in accordance with generally accepted accounting principles, included in the Annual Report on Form 10-K of the Company for the year ended December 31, 2006 and the consolidated financial statements of MBIA and its subsidiaries as of March 31, 2007 and for the three month period ended March 31, 2007 and March 31, 2006 included in the Quarterly Report on Form 10-Q of the Company for the quarter ended March 31, 2007, which are hereby incorporated by reference into this Official Statement and shall be deemed to be a part hereof.

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

### **Incorporation of Certain Documents by Reference**

The following documents filed by the Company with the Securities and Exchange Commission (the "SEC") are incorporated by reference into this Official Statement:

- (1) The Company's Annual Report on Form 10-K for the year ended December 31, 2006; and
- (2) The Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2007.

Any documents, including any financial statements of MBIA and its subsidiaries that are included therein or attached as exhibits thereto, filed by the Company pursuant to Sections 13(a), 13(c), 14 or 15(d) of the Exchange Act after the date of the Company's most recent Quarterly Report on Form 10-Q or Annual Report on Form 10-K, and prior to the termination of the offering of the Series 2007 Water Bonds offered hereby shall be deemed to be incorporated by reference in this Official Statement and to be a part hereof from the respective dates of filing such documents. Any statement contained in a document incorporated or deemed to be incorporated by reference herein, or contained in this Official Statement, shall be deemed to be modified or superseded for purposes of this Official Statement to the extent that a statement contained herein or in any other subsequently filed document which also is or is deemed to be incorporated by reference herein modifies or supersedes such statement. Any such statement so modified or superseded shall not be deemed, except as so modified or superseded, to constitute a part of this Official Statement.

The Company files annual, quarterly and special reports, information statements and other information with the SEC under File No. 1-9583. Copies of the Company's SEC filings (including (1) the Company's Annual Report on Form 10-K for the year ended December 31, 2006, and (2) the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2007) are available (i) over the Internet at the SEC's web site at <http://www.sec.gov>; (ii) at the SEC's public reference room in Washington, D.C. (iii) over the Internet at the Company's web site at <http://www.mbia.com>; and (iv) at no cost, upon request to MBIA at its principal executive offices.

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

## THE DOMESTIC WATER PROJECT

### Background and History

Since 1904, the District has supplied all water for agricultural uses within its irrigation service area, primarily from its perfected water rights to Tuolumne River water. Water for municipal and industrial uses within the Modesto area has historically been supplied by the City (since 1895) and the Del Este Water Company (herein referred to as “Del Este”) (since 1912), solely from groundwater sources. See “THE CITY OF MODESTO MUNICIPAL WATER UTILITY SYSTEM” and “APPENDIX B—CERTAIN INFORMATION REGARDING THE CITY OF MODESTO.” Rapid urbanization of the region in recent history has resulted in a reduction in the irrigated acreage within the District’s service area and an increase in the demand for municipal water uses, with a corresponding decline in groundwater availability and quality. Beginning in 1984, the District, the City and Del Este retained James M. Montgomery, Consulting Engineers, Inc. (“JMM”) to undertake a series of studies resulting in the development of a water management plan for the conjunctive use of groundwater and treated surface water to meet the area’s municipal and industrial water needs, while protecting and managing the limited groundwater resources. As a result of these studies, the District, in cooperation with the City and Del Este, determined to undertake the Domestic Water Project.

In April 1992, the District entered into the Treatment and Delivery Agreement with the City and Del Este. Pursuant to the Treatment and Delivery Agreement, the District agreed to construct and operate the Domestic Water Project and to supply treated water from the Domestic Water Project to the City and Del Este, in consideration for which the City and Del Este agreed to pay the costs of acquisition and construction and operation of the Domestic Water Project. Pursuant to the Treatment and Delivery Agreement, the City was initially allocated a 70% share of the output of the Domestic Water Project, and was likewise responsible for 70% of the costs of the Domestic Water Project; Del Este was allocated a 30% share of the output of the Domestic Water Project and was likewise responsible for 30% of its cost. Proceeds of the Prior Bonds were used to pay for the costs of the acquisition and construction of the first phase of the Domestic Water Project, which was designed by Black & Veatch, as consulting engineers. Proceeds of the Series 2007 Water Bonds will be used to pay for the costs of the 2007 Project. See “—The 2007 Project” below.

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

### Domestic Water Project Description

The Domestic Water Project consists of a surface water treatment plant, transmission, storage and distribution facilities. The design capacity of the initial Domestic Water Project facilities was approximately 36 million gallons per day of treated surface water. The water treatment plant is located directly south of the Modesto Reservoir on an approximately 30 acre site, about 15 miles east of the City. The District supplies raw water to the treatment plant. The raw water supply system consists of an intake structure and a delivery pipeline to the plant. Treated water is pumped from two 2.5 million gallon treated water storage reservoirs through approximately 14 miles of transmission pipeline to two five-million gallon terminal storage reservoirs. The water is then distributed through approximately 14 miles of transmission mains to distribution mains in the City’s Municipal Water System.

Construction of the initial Domestic Water Project facilities began in October 1992 and the initial Domestic Water Project facilities were placed into operation in January 1995. The actual total cost of acquisition and construction of the initial Domestic Water Project facilities (including contingencies but exclusive of interest during construction, allowance for funds utilized during construction, debt service reserve funds and any financing costs of the Authority) was \$95.877 million. The initial Domestic Water Project facilities were completed 9% under budget.

Since the initial construction of the Domestic Water Project, the Domestic Water Project has sustained certain water and other damage which is necessary to repair. The District expects to undertake such repairs over the next three years. Such costs are anticipated to be allocated between the City and the District in a manner to be

determined between them. It is expected that the District will initially pay the costs of such repairs and that the City will reimburse, under the terms of the Treatment and Delivery Agreement, a portion of the costs as yet to be determined.

To help ensure that the District will be able to deliver a firm drinking water supply to the City, the District petitioned and received from the California State Water Resources Control Board permission to treat and deliver to the City water stored in Don Pedro Reservoir (WR Order No. 2005-0022-DWR). The water treated during the initial phase of the water treatment plant was supplied by the District's pre-1914 water rights. In connection with the proposed expansion of the plant (*i.e.*, the 2007 Project), the District obtained WR Order No. 2005-0022-DWR, which amended a license held by the District to permit long-term water transfers to the City for municipal and industrial purposes, in amounts sufficient to serve the expanded plant. The District will utilize water held under this licensed right, or both rights, to serve the expanded plant.

## **The 2007 Project**

### **Description**

The District and the City agreed upon an expansion of the initial Domestic Water Project facilities beyond the existing design capacity of 36 million gallons per day ("mgd") to a design capacity of 72 mgd. The 2007 Project will essentially leave the existing treatment facilities in place, while adding a second 36 mgd membrane filtration plant in parallel. The District awarded the design contract for the second plant to design engineers, Black and Veatch, a firm that has completed 12 designs of membrane water treatment facilities in California and 56 nationwide. The membrane filtration plant will employ a microfiltration technology involving the installation of a series of submerged membranes for the treatment of surface water. In addition to the membrane filtration systems, other major categories of equipment included in the 2007 Project are the ozone system modifications, the dissolved air flotation treatment system, chemical feed building modifications, replacement of the Supervisory Control and Data Acquisition and Programmable Logic Controller computer systems that control plant operations, and treated water pumping system modifications. Source water for the 2007 Project will be supplied by the District from the existing intake from Modesto Reservoir, which will flow by gravity to the 2007 Project. Raw water will flow through a 60-inch water line that will empty into a raw water head tank which will serve as the primary controlled water service elevation upstream of the membrane system. The 2007 Project includes the installation of a rapid mix pump station downstream of the raw water head tank to mix alum with the raw water for the purpose of improving membrane performance. The submerged membrane treatment will be followed by application of ozone through new oxygen-fed ozone generators which will provide ozone for both the existing and new treatment facilities. A dissolved air filtration unit, which removes solids and other contaminants using air flotation, will be supplied for both the existing conventional solids handling system and the new membrane solids handling system. The treated water pumps will convey treated water to the Terminal Reservoir Pump Station. The 2007 Project consists of the acquisition, design, construction, improvement and installation of the parallel membrane filtration plant and related facilities. For a detailed description of the 2007 Project and related facilities to be financed with the proceeds of the Series 2007 Water Bonds, see "APPENDIX A – CONSULTING ENGINEER'S REPORT" herein.

### **2007 Project Cost Estimates and Financing Plan**

The total estimated cost of acquisition and construction of the 2007 Project (including contingencies but exclusive of interest during construction, allowance for funds utilized during construction, debt service reserve funds and any financing costs of the Authority) is approximately \$77.2 million. The cost estimate includes the following:

### 2007 Project Cost Estimate

Design and construction consulting costs <sup>(1)</sup>	\$ 9,740,000
Water treatment plant construction <sup>(2)</sup>	56,637,179
Membrane Filtration System	5,283,436
District costs and additional services	5,589,000
Total	\$77,249,615

<sup>(1)</sup> Includes approximately \$5.66 million of costs advanced by the District as of April 18, 2007 as described below.

<sup>(2)</sup> Based on bid of contractor plus 8% contingency minus membrane filtration bid allocation.

This estimate assumes no delays in construction resulting from such matters as strikes, shortages or delays in receipt of equipment or, materials, shortages of labor or other similar matters. No assurances can be given that actual construction costs will not exceed this estimate. In the event that actual construction costs exceed this estimate, such costs will be paid by the City pursuant to the Treatment and Delivery Agreement. In such event, such additional costs may be financed through the issuance of additional Domestic Water Bonds.

As of April 18, 2007, the District had advanced on behalf of the City approximately \$5.66 million for the payment of certain costs of engineering and design work, feasibility studies, permit and licensing costs and other work required and conducted during the design phase of the 2007 Project. Such portion of the acquisition and construction costs of the 2007 Project advanced by the District will be reimbursed to the District from the proceeds of the Series 2007 Water Bonds.

The estimated sources of construction financing for the 2007 Project are set forth below:

#### Sources of Construction Financing

Series 2007 Water Bond proceeds	\$72,812,364
Interest Earnings <sup>(1)</sup>	4,437,251
Total	\$77,249,615

<sup>(1)</sup> Includes interest earnings on the Project Fund, Capitalized Interest Subaccount within the Interest Account and the Series 2007 Reserve Fund.

### 2007 Project Permits and Approvals

The acquisition and construction of the 2007 Project requires demonstration of compliance with the California Environmental Quality Act, as amended, Division 13 of the California Public Resources Code ("CEQA"). The District, as lead agency for CEQA compliance, prepared a supplemental Environmental Impact Report covering the 2007 Project and other related City water utility improvements which was certified by the District's Board of Directors on July 12, 2005. All other major permits and approvals have been or are expected by the District to be obtained for the acquisition, construction and operation of the 2007 Project in a timely fashion.

### Current 2007 Project Status

Design work for the 2007 Project is 100% complete. The bids for the construction of the 2007 Project took place in two parts to facilitate design and construction: (i) the water filtration system, conducted in May 2006, and (ii) the construction contract, conducted in April 2007.

The District conducted the initial bid process among qualified manufacturers of submerged water filtration systems, and Siemen's Water Technologies ("SWT"), a successor in interest to USFilter Wastewater Group, was the lowest responsible and responsive bidder. The initial bid provided by SWT of \$4,313,866 was accepted by the District and the City. SWT and the District entered into a Memorandum of Understanding for Procurement of a Low Pressure Membrane Water Filtration System and related contract documents. Additional goods and special services were added to SWT's scope of work that resulted in a revised contract amount of \$5,433,436, \$150,000 of

which are design related costs included in the Design and Construction Consulting costs of the 2007 Project Cost Estimate described above. See “—2007 Project Cost Estimates and Financing Plan,” above.

The bids for the construction of the 2007 Project were submitted on April 26, 2007, and a contract was awarded on May 22, 2007. The construction of the 2007 Project is expected to be completed by September 30, 2009 and performance testing is expected to be completed in June 2010. The following table sets forth the District’s schedule of the major 2007 Project tasks remaining to be completed and their projected completion date:

<b>Project Task</b>	<b>Projected Completion Date</b>
Notice to Proceed	By July 15, 2007
Complete Chemical Feed Improvements	February 29, 2008
Complete Ozone Generator No. 3	May 30, 2008
Demonstrate DAF system	October 31, 2008
SCADA Integration & PLCs 2&3	February 27, 2009
Ozone Improvements at Existing Contactor	February 27, 2009
Complete Treated Water and Terminal Pump Stations	February 27, 2009
Substantial Completion	August 31, 2009
Final Project Completion	September 30, 2009
Complete Performance Testing	June 30, 2010

#### **Independent Consulting Engineer**

The District has retained R.W. Beck Inc. as Independent Consulting Engineer for the 2007 Project. The Independent Consulting Engineer has prepared a report on the 2007 Project and has concluded that the 2007 Project’s estimated cost of acquisition and construction has been developed in accordance with generally accepted practices and methods of estimation and the provision for construction contingency, profit and overhead falls within the middle of the range of other reasonably similar projects. The Independent Consulting Engineer has further concluded that the technology proposed for the 2007 Project is commercially demonstrated and is based on the designs of other facilities. The Independent Consulting Engineer’s report should be read in its entirety to understand the principal assumptions and considerations upon which the Independent Consulting Engineer’s conclusions are based. Reference is made to Appendix A hereto for a copy of such Independent Consulting Engineer’s Report.

#### **The Treatment and Delivery Agreement**

**General.** The Domestic Water Project (including the 2007 Project) will be operated pursuant to the Treatment and Delivery Agreement. In accordance with the Treatment and Delivery Agreement, the District designed, financed and constructed the Domestic Water Project and owns, operates and maintains the Domestic Water Project for the purposes of treatment and delivery of water to the City. The District may not assign its maintenance and operation responsibility for the Domestic Water Project without the consent of the City. The City is granted a permanent beneficial interest in the Domestic Water Project output, which may not be transferred or assigned without the consent of the District.

**Obligations of the City.** The City has agreed to pay all costs and expenses of all phases of the Domestic Water Project, including (i) payments of Debt Service (including the Series 1998D Water Bonds and the Series 2007 Water Bonds) in connection with the financing of the Domestic Water Project, (ii) raw water charges for raw water furnished to the Domestic Water Project by the District, (iii) payments of operation, maintenance, repair, replacement and modification costs attributable to the operation of the Domestic Water Project, which will include the membrane replacement costs and a portion of the allocable costs to the Domestic Water Project for water damage (see “Domestic Water Project Description” above), (iv) costs of administrative services of the District attributable to the operation of the Domestic Water Project and the administration of the Treatment and Delivery Agreement, (v) costs of insurance required to be maintained by the District pursuant to the Treatment and Delivery Agreement (as described below), (vi) cost of electric energy provided to the Domestic Water Project by the District, and (vii) other payments or costs (and deductions from payments or costs from the Reserve and Contingency Fund and the Series 2007 Reserve Fund) and other amounts as specified by the Treatment and Delivery Agreement.

***Delivery of Treated Water.*** Upon completion of the 2007 Project, the District will make available an average annual of 60 million gallons per day (67,204 acre feet) of treated water from the Domestic Water Project to the City, subject to a lesser allocation of treated water in the event of drought or other contingencies as provided in the Treatment and Delivery Agreement. The City may exchange groundwater for use by the District's Irrigation System for treated water in the event of a reduced allocation. The City will bear all costs, including the costs of additional capital facilities, if any are necessary, associated with delivering the groundwater supply to the District's Irrigation System. The District may not sell any treated water from the Domestic Water Project without first offering such water to the City. Treated water delivered by the District to the City must be utilized by the City within the District's irrigation service area. The District will consult with the City regularly with respect to the scheduling of delivery of treated water from the Domestic Water Project. The District shall be excused from its obligation to deliver treated water in the event that the District is rendered unable, wholly or in part, by force majeure to carry out its obligations under the Treatment and Delivery Agreement. Upon the occurrence of any event of force majeure which impacts the District's ability to deliver treated water, the provisions of the Treatment and Delivery Agreement discussed under "SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2007 WATER BONDS—The Treatment and Delivery Agreement—Limited Take or Pay Obligations" shall be determinative as to whether the City is excused from its obligation to pay Debt Service and fixed costs pursuant to the Treatment and Delivery Agreement.

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

The Board of Directors of the District has the authority to make final decisions with respect to the Domestic Water Project, subject to the rights of the City to review and advise the District with respect to certain budgetary matters as provided in the Treatment and Delivery Agreement.

See also "SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2007 WATER BONDS—The Treatment and Delivery Agreement" for additional information regarding the terms of the Treatment and Delivery Agreement.

## **THE AUTHORITY**

The Authority was created in July 1989 by the Joint Exercise of Powers Agreement which was entered into between the District and Redding pursuant to the Joint Exercise of Powers Act. The Authority has the power to enter into contracts, such as the Installment Purchase Contract, to assist the District and Redding in financing public capital improvements, working capital, liability and other insurance needs and other projects whenever there are significant public benefits, as determined by the District or Redding, as appropriate. The Authority is administered by a governing board consisting of the board of directors of the District. Under the Joint Exercise of Powers Agreement, the Authority is a public entity, separate from the District and Redding. The debts, liabilities and obligations of the Authority shall not constitute debts, liabilities or obligations of Redding or the District.

## **THE MODESTO IRRIGATION DISTRICT**

The following information regarding the District's Irrigation System is provided for informational purposes only. *The Series 2007 Water Bonds are payable solely from the Revenues pledged therefor under the Trust Agreement, consisting primarily of Treatment and Delivery Revenues pledged therefor pursuant to the Installment Purchase Contract. Other revenues of the District are neither pledged to, nor available for, any payment with respect to the Installment Purchase Contract or the Series 2007 Water Bonds, provided that the District has covenanted to submit to the Board of Directors of the District a special budget item requesting a special appropriation in the amount of any deficiency in Revenues necessary to pay the Series 2007 Water Bonds; The Board of Directors of the District shall have absolute discretion in determining whether such a special appropriation shall be made. See "SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2007 WATER BONDS—Special Budgeting Covenant of the District" above.*

The District is a California irrigation district organized in 1887 under the provisions of the Irrigation District Law. The District has the powers under the Irrigation District Law to, among other things, provide irrigation and electric service within its irrigation and electric service areas. In connection therewith, the District has the powers of eminent domain, to contract, to construct works, to fix rates and charges for commodities or services furnished and to incur indebtedness.

The District is governed by a board of directors, the five members of which are elected from separate electoral divisions of the District for staggered four-year terms. The members of the board of directors also serve as the governing board of the Authority.

The District is located in the San Joaquin Valley of central California, approximately 90 miles east of San Francisco, California. The District began providing electric service in 1923, and since 1940 has provided all electric service within its original 160 square mile service area, which includes the major portion of Stanislaus County. Beginning in 1996, the District has also provided electric service on a competitive basis in portions of the service area of Pacific Gas & Electric Company ("PG&E"). California Assembly Bill 2638 ("AB 2638"), effective on January 1, 2001, added the 7.5 square mile Mountain House Community Services District in western San Joaquin County to the District's exclusive electric service area and also designated a 400 square mile area in Southern San Joaquin County, Northern Stanislaus County, and western Tuolumne County as the District's non-exclusive electric service area. Pursuant to AB 2638, other than as set forth therein, the District is further prohibited from providing electric transmission or distribution service to retail customers in the service territory of PG&E. For the year ended December 31, 2006, the District served 112,366 customers, had total retail sales of 2.56 billion kWh and a peak demand of 697 MW.

To provide electric service within its service area, the District owns and operates an electric system which includes generation, transmission and distribution facilities. The District also purchases and sells power and transmission service and participates in pooling and other utility arrangements.

The District also supplies water for irrigation use in portions of Stanislaus County. The District receives virtually all of its water supply from the Tuolumne River, pursuant to vested water rights. The District historically has been capable of supplementing its surface water supply by pumping groundwater during periods of drought. Prior to the construction of the Domestic Water Project, the groundwater resource were in a condition of overdraft. Pursuant to the Treatment and Delivery Agreement, the City exchanged groundwater for surface treated water which halted the overdraft condition. The District's irrigation facilities include the Don Pedro Reservoir, the La Grange Diversion Dam, the Modesto Reservoir, and a canal network.

The audited financial statements of the District for the fiscal year ended December 31, 2006 have been deposited with the national repositories and are hereby incorporated by reference.

## **THE CITY OF MODESTO MUNICIPAL WATER UTILITY SYSTEM**

The following information concerning the City Municipal Water Utility System (referred to herein as the "City Water Utility System") was obtained from City officials except where otherwise indicated.

### **History of the City Water Utility System**

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

In April 1992, the City entered into the original Treatment and Delivery Agreement with the District and Del Este. See "Sources of Water" below. In July 1995, the City purchased substantially all of the assets and liabilities of Del Este, the last private water company within City limits. The acquisition included Del Este's other water service areas, including the communities of Salida, Waterford, Empire, Hickman, Grayson, and parts of

Turlock, Ceres and Del Rio Estates. As a consequence of the varying operating conditions among these communities, the City initially operated the City Water Utility System in three separate zones. However, the three zones were essentially merged into a single zone for rate purposes when the City Council of the City (the "City Council") adopted a new rate structure that went into effect on January 1, 2005.

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

A map showing the City's water service area appears on the following page.



## Existing Facilities

The principal facilities of the existing City Water Utility System consist of 125 domestic wells (111 of which are currently active), over 900 miles of mains, seven storage tanks, the District's Domestic Water Project and a terminal storage area serving surface water and/or groundwater to its customers through nearly 77,000 water connections.

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

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

The following table sets forth statistical information relating to the City Water Utility System during the calendar years shown.

### CITY WATER UTILITY SYSTEM STATISTICS (Calendar Years 2002 through 2006)

	2002	2003	2004	2005	2006
Number of Service Accounts	71,847	72,907	73,916	74,779	75,227
Total Water Production (MG) <sup>(1)</sup>	27,060	27,000	26,580	25,720	25,660
Capacity (MGD) <sup>(2)</sup>	166	166	166	166	166
Peak Daily Distribution (MGD)	131.2	133.6	124.9	129.8	125
Average Daily Distribution (MGD)	75.4	73.7	72.4	70.4	69.8

<sup>(1)</sup> "MG" means million gallons.

<sup>(2)</sup> "MGD" means million gallons daily.

Source: City of Modesto

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

## Sources of Water

The City's primary sources of water supply are surface water provided by the District under the Treatment and Delivery Agreement and its local groundwater sources. The Domestic Water Project serves as the baseline supply, and seasonal demands are served by the groundwater wells. In general, the Domestic Water Project currently supplies approximately 60% of the City's water requirement during the winter and 35% thereof during the summer season. Groundwater supplies the remainder. The 2007 Project is expected to increase the capacity of the Domestic Water Project to 72 mgd. For a discussion of the Treatment and Delivery Agreement, see "SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2007 WATER BONDS—The Treatment and Delivery Agreement" and "THE DOMESTIC WATER PROJECT—The Treatment and Delivery Agreement."

The following table sets forth the total water production for the City Water Utility System during the calendar years shown.

**CITY WATER UTILITY SYSTEM**  
**Service Area Total Production (Billion Gallons)**  
**(Calendar Years 2002 to 2006)**

Year Ending December 31	Well Water	Treated Water	Total
2002	16.01	11.05	27.06
2003	15.49	11.51	27.00
2004	15.15	11.43	26.58
2005	15.13	10.59	25.72
2006	14.74	10.92	25.66

Source: City of Modesto

Outside of the City corporate limits there are no regulations controlling the number of water wells that are drilled or the quantity of water pumped from such wells. Prior to the availability of surface water from the Domestic Water Project, the groundwater pumpage had been increasing and water levels had been declining since the early 1950's. As a result thereof, the groundwater resources of the City Water Utility System were subject to long-term overdraft, i.e., the depletion of the water table was greater than the replenishment, of an average of 3,000 acre-feet per year. With the introduction of surface water from the Domestic Water Project, this long-term overdraft was halted, and the City's dependency upon groundwater was reduced. The City expects that the expansion of the Domestic Water Project and the installation of the various capital projects associated therewith, including the 2007 Project, will further reduce its reliance on groundwater supplies.

**Water Quality**

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

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

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

In addition to water wells as a domestic supply source, the City manages approximately 9,500 rock wells for the drainage of stormwater. Stormwater runoff occurs when rainfall intensity exceeds the infiltration rate of the soil. Suspended solids, heavy metals, and oil and grease are the major types of pollutants conveyed by runoff water to drainage facilities. The pollutant loading in runoff typically increases with increased urbanization. About 70 percent of the City service area employs rock wells which vary in depth from 25 to 50 feet. As a precaution to any risk of pollutants from stormwater and other wastewater entering the rock wells and percolating into the usable groundwater aquifer, the City seals its water wells at appropriate depths in relation to rock wells. After 40 years of

operation of rock wells, no pollutants attributable to urban drainage have been detected in the drinking water supply. Recent studies of the federal Environmental Protection Agency conclude that properly operated rock wells provide significant treatment and removal of pollutants from percolating water.

### **DBCP Settlement Agreement**

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

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

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

### **PCE Litigation**

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

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

The plaintiffs tried five “bellweather” suits before a jury from February to June of 2006, and won a verdict for compensatory damages of \$3.1 million and a verdict for punitive damages of \$175 million, later lowered to \$12 million. This result stalled settlement negotiations while both sides appeal various liability and damage issues, although a trial date has now been set for November 13, 2007. In any event, previous settlements and insurance payments have rendered the litigation essentially cost neutral to the City’s Water and Sewer Enterprise Funds, which have funded the litigation to date on a roughly equal basis; however, the City expects litigation expenses to increase significantly in the near term in connection with preparation for trial. It is not anticipated that the cost/settlement ratio will change dramatically in the 15 months following the issuance of the Series 2007 Water Bonds, which is as far as the City believes reasonable forecasting may be done on the cost issue.

## **Employees**

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

## **Retirement Programs**

The City contributes to the Public Employees’ Retirement System of the State of California (“PERS”), an agent multiple employer public employee retirement program that acts as a common investment and administrative agent for participating entities in California. The City’s total pension cost for the fiscal year ended June 30, 2006 was \$11,748,699. The City’s payments to PERS for the fiscal year ending June 30, 2007 are estimated to be \$18,064,718.

All full time City employees are eligible to participate in the retirement program. Benefits vest after five years of service. Safety (fire and police) employees who retire at or after age 50 are entitled to an annual retirement benefit payable monthly for life in an amount equal to 3% percent of their average salary during the highest paid one year period of employment, multiplied by their years of service. All other covered employees may retire at age 55, with an annual benefit payable monthly for life equal to 2% percent of their average salary during the highest paid one year period of employment, multiplied by their years of service. These employees may retire at age 50 with reduced benefit at retirement. The retirement program also provides death and disability benefits. These benefit provisions and all other requirements are established by state statute and City ordinance. Under GASB 27, an employer reports an annual pension cost (APC) equal to the annual required contribution (ARC) plus an adjustment for the cumulative difference between the APC and the employer’s actual plan contributions for the year.

The City pays most of the required employee contribution to the program, which totals 9% percent for safety and 7% percent for miscellaneous employees, in accordance with contractual agreements. The City is required to contribute the remaining amounts necessary to fund the benefits for its members, using the actuarial basis adopted by the PERS Board of Administration. The current rate is 9.124% of the annual covered payroll for miscellaneous employees and 24.421% for safety employees.

In addition to the pension benefits described above, the City provides health care benefits to employees who retire from the City under contractual arrangement with all employee groups. All full-time employees, except firefighters who receive a cash payout, are eligible to set-aside a percentage of accumulated sick leave upon retirement to be used for contributions towards future healthcare premiums to a choice of 4 insurance plans. The City has no obligation to make health contributions for retirees who have no accumulated sick leave. The estimated liability for current retirees’ future City contributions was \$14,534,598 as of June 30, 2006. The estimated current portion thereof, \$1,659,707, is fully funded. The long-term portion thereof is partially funded, with the balance being funded over time by charges to the City’s operating funds. The City reports the current and long-term portions of this liability in the Employee Benefits Management Fund as part of the compensated absences liability balances. For firefighters, the City’s obligation for retiree health benefits is not a function of accumulated sick leave. Firefighters are covered under PERS Health plans and the City has a statutory obligation to make designated contributions to fund firefighters’ retiree health premiums. The current statutory contribution is \$80.80 per month.

In June 2004, the Governmental Accounting Standards Board (“GASB”) issued Statement No. 45 (“GASB 45”), which addresses how state and local governments should account for and report their costs and obligations related to post-employment health care and other non-pension benefits (“OPEB”). GASB 45 generally requires that employers account for and report the annual cost of OPEB and the outstanding obligations and commitments related to OPEB in essentially the same manner as they currently do for pensions. Annual OPEB costs for most employers will be based on actuarially determined amounts that, if paid on an ongoing basis, generally would provide sufficient resources to pay benefits as they come due. The provisions of GASB 45 may be applied prospectively and do not require governments to fund their OPEB plans. An employer may establish its OPEB liability at zero as of the beginning of the initial year of implementation. However, the unfunded actuarial liability is required to be amortized over future periods on the income statement. GASB 45 also established disclosure requirements for information about the plans in which an employer participates, the funding policy followed, the actuarial valuation process and assumptions, and for certain employers, the extent to which the plan has been funded over time. These disclosure requirements will be effective for the City’s fiscal year ending June 30, 2008. GASB 45 may result in an increase in the annual expense recognized by the City for post retirement health care benefits. The City has retained the services of an actuary to determine the extent of the City’s OPEB liability. The amount of the liability and the increase in the annual expense to be recognized, if any, has not yet been determined by the City.

### **Insurance**

The City is exposed to various risks of loss related to torts, damage to and loss of assets, errors and omissions, injuries to and illness of employees, and natural disasters. The City maintains an Insurance Internal Service Fund to account for and finance its risks of loss. Under this program, the City is self-insured for the following risks up to the maximum amount per claim shown: workers’ compensation - \$750,000; liability - \$1,000,000; and dental care - \$1,200. The City no longer self-insures for risks associated with employee illnesses and instead offers a variety of commercial plans to its employees. The City obtains commercial insurance for property loss, airport liability, and for claims in excess of the preceding self-insured coverage amounts.

For liability claims the City is one of twelve members of the Authority for California Cities Excess Liability (ACCEL) risk pool, which provides workers’ compensation insurance and general liability insurance for the member agencies. This pool covers City claims between \$1,000,000 and \$5,000,000. The City contributes its pro rata share of anticipated losses to the pool. Should actual losses be greater than anticipated, the City will be assigned its pro rata share of the deficiency. Conversely, if actual losses are less than anticipated, the City will be refunded its pro rata share of the excess. Total claims in the pool are estimated to be \$2,000,000 for fiscal year 2006-07. Commercial insurance covers claims over \$5,000,000 in three excess layers of \$10,000,000 each for an additional \$30,000,000 per claim. Settled claims have not exceeded the commercial coverage in any of the past five fiscal years.

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

### **Service Area and Customers**

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

The following tables set forth the revenues for the periods indicated and the ten largest water customers of the City Water Utility System in terms of total water sales and total billings for the fiscal year ended June 30, 2006. During calendar year 2006, the City Water Utility System delivered approximately 25.66 billion gallons of water to an average of approximately 75,000 customers. Residential accounts (single family as well as multi-family accounts) represent approximately 75% of the City’s water consumption and water sales revenues. Commercial, industrial and municipal accounts represent approximately 25% of the City’s water consumption and water sales revenues. The City’s ten largest customers represented approximately 6.9% of total water revenues in fiscal year 2005-06.

**CITY WATER UTILITY SYSTEM  
Sale of Water  
(Fiscal Year Ended June 30)**

	2002	2003	2004	2005	2006
Revenues (\$000)					
Residential (Flat Rates)	\$16,419	\$16,682	\$16,849	\$19,117	\$26,591
Commercial, Industrial and Municipal (Metered)	10,233	10,075	10,524	10,847	14,516
Total	\$26,652	\$26,757	\$27,373	\$29,964	\$41,107

Source: City of Modesto

**CITY WATER UTILITY SYSTEM  
Ten Largest Customers  
(Fiscal Year ended June 30, 2006)**

Customer	Business Type	Water Usage (ccf) <sup>(1)</sup>	% of Total Usage	Water Sales Revenues	% of Total Water Sales Revenues
Signature Foods	Cannery	503,795	1.45%	\$522,634	1.27%
Modesto City Schools	Education	413,695	1.19	504,923	1.23
Stanislaus Foods	Cannery	416,744	1.20	441,305	1.07
Foster Farms	Dairy Processor	320,805	0.92	328,345	0.80
Modesto Irrigation District	Power Company	196,337	0.56	219,219	0.53
Stanislaus County	Government	158,775	0.46	208,767	0.51
E&J Gallo Winery	Winery	147,772	0.43	169,434	0.41
Sylvan Union School District	Education	141,167	0.41	163,366	0.40
Yosemite Community College	Community College	129,288	0.37	158,762	0.39
Del Monte Foods	Cannery	109,911	0.32	117,906	0.29
Top Ten Total		2,538,289	7.30%	\$2,834,661	6.90%
Total Flat/Metered Revenues				\$41,107,414	

<sup>(1)</sup> "ccf" means hundred cubic feet  
Source: City of Modesto

**Water Charges and Billing**

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

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

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

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

In addition to the new rate structure, the City Council also approved a series of uniform rate increases of 20% effective July 1, 2005, 15% effective July 1, 2006, 5% effective July 1, 2007 and 5% effective July 1, 2008. On each July 1, commencing July 1, 2009 rates are expected to be adjusted to reflect increases in the Consumer Price Index.

The table below sets forth the adopted single family residential flat rates approved through fiscal year 2008-09.

**CITY WATER UTILITY SYSTEM  
Monthly Single Family Residential Flat Water Rates<sup>(1)</sup>**

<b>Lot Size</b>	<b>Effective January 1, 2005</b>	<b>Effective July 1, 2005</b>	<b>Effective July 1, 2006</b>	<b>Effective July 1, 2007</b>	<b>Effective July 1, 2008</b>
0-5,000 sq. ft. lot	\$24.47	\$29.36	\$33.77	\$35.45	\$37.23
5,001-7,000 sq. ft. lot	27.81	33.37	38.38	40.30	42.31
7,001-11,000 sq. ft. lot	33.00	39.60	45.54	47.82	50.21
11,001-17,000 sq. ft. lot	35.03	42.04	48.34	50.76	53.30
Over 17,000 sq. ft. lot	41.19	49.42	56.84	59.68	62.66

<sup>(1)</sup> Single family residential properties with water meters that are read for billing purposes, are charged the metered water rate.  
Source: City of Modesto.

The following table sets forth the adopted monthly service charge and volume charge for commercial accounts through fiscal year 2008-09.

**CITY WATER UTILITY SYSTEM  
Water Rates and Charges  
Commercial Accounts**

	<b>Effective January 1, 2005</b>	<b>Effective July 1, 2005</b>	<b>Effective July 1, 2006</b>	<b>Effective July 1, 2007</b>	<b>Effective July 1, 2008</b>
<b>Volume-based Rate (\$/hcf)</b>	\$0.84	\$1.01	\$1.16	\$1.22	\$1.28
<b>Fixed Monthly Meter Charge (in addition to volume-based charges)</b>					
5/8" - 3/4" meter	\$9.01	\$10.82	\$12.44	\$13.06	\$13.71
1" meter	12.78	15.34	17.64	18.52	19.45
1-1/2" meter	22.13	26.55	30.53	32.06	33.66
2" meter	33.38	40.06	46.06	48.37	50.79
3" meter	63.43	76.12	87.53	91.91	96.51
4" meter	97.19	116.63	134.13	140.83	147.88
6" meter	190.95	229.14	263.51	276.68	290.51
8" meter	303.49	364.19	418.82	439.76	461.75
10" meter	434.84	521.80	600.07	630.08	661.58
12" meter	809.95	971.95	1,117.74	1,173.62	1,232.31

Source: City of Modesto.

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

**CITY WATER UTILITY SYSTEM  
Connection Fees for All Users  
Except Multiple Family Units  
(Fiscal Year 2006-07)**

<b>Meter Size</b>	<b>Connection Fees</b>
5/8"	\$ 2,003
1"	5,008
1-1/2"	10,016
2"	16,025
3"	32,050
4"	50,078
6"	100,156
8"	160,250
10"	230,359
12" or larger	430,671

Source: City of Modesto.

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

**CITY WATER UTILITY SYSTEM  
Comparison of  
Average Monthly Water Rates  
Flat Rate (1" Service)  
As of July 1, 2006**

City	Flat Rate Typical Home
Modesto	\$33.77-\$38.38
Stockton	33.64
Tracy	33.00
Turlock	29.90
Sacramento	28.80
Merced	28.76

Source: City of Modesto.

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

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

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

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

**Challenges to Rates.** The 2005/2006 Stanislaus County Civil Grand Jury received complaints from Del Rio, an outlying community that receives its water from the City's Water Utility System. Del Rio is a wealthy area which includes homes on large lots that had previously received flat rate water. Part of the City's new rate structure (see "—Water Charges and Billing—Water Service Rates" above) required metering rates for Del Rio, which had the effect of accentuating the accompanying rate hikes. However, the Civil Grand Jury found no evidence to support Del Rio's contention that the City's Proposition 218 notice informing the public of the new rate schedule

was inadequate. Del Rio also charged that the City's water rate policy violated a Proposition 218 requirement that a parcel be charged only its proportional costs. The Civil Grand Jury concluded there is no difference in the rate structure between Del Rio and the rest of the City's water customers that are billed a metered rate; and the Civil Grand Jury made no recommendation regarding the proportionality issues. Del Rio further charged that there was a misuse of funds by using water collections for purposes other than water. While it did make study recommendations, the Civil Grand Jury ultimately determined that the City is accounting for water costs and revenues separately from non-water related accounts. Del Rio's last charge was that unfairness in the rate process led to Del Rio paying more than other water customers. The Civil Grand Jury could not substantiate this charge, but rather made study recommendations regarding actual customer costs between metered and flat rates, and a further recommendation that conversion from flat to metered rates occur as quickly as possible.

### **Delinquencies**

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

### **Outstanding Long-Term Obligations**

As of May 1, 2007, the City had outstanding \$65.945 million aggregate principal amount of certificates of participation evidencing and representing the interests of the owners thereof in installment payments to be made by the City relating to the 1997 Certificates and the 2006 Certificates. The City also has outstanding the CDWR Loan in the principal amount of \$3.90 million (of which \$1.96 million was outstanding as of May 1, 2007). In connection with the 2006 Certificates, the City executed and delivered the 2006 Swap Agreement. The City's obligations under the 2006 Swap Agreement to make scheduled payments and certain termination payments (but only if such termination payments are insured pursuant to the Swap Policy), as well as the City's obligation to make payments under the Insurance and Reimbursement Agreement if any amounts which have drawn thereunder have not been reimbursed by the City, are payable on a parity with the City's obligations to make installment payments relating to the 1997 Certificates and the 2006 Certificates and to make payments on the CDWR Loan, and Debt Service payments under the Treatment and Delivery Agreement relating to the outstanding Series 1998D Water Bonds and the Series 2007 Water Bonds (including regularly scheduled payments due under the Domestic Water Swap Agreement). The City's obligations to make termination payments under the 2006 Swap Agreement which are not insured and its obligations to pay amounts under the Treatment and Delivery Agreement relating to termination payments due under the Domestic Water Swap Agreement are payable on a subordinate basis. See "SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2007 WATER BONDS – The Treatment and Delivery Agreement – Additional Encumbrances of City Gross Water Revenues."

### **Historical Operating Results**

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

**CITY WATER UTILITY SYSTEM  
Historical Debt Service Coverage**

	<u>Fiscal Year 2002</u>	<u>Fiscal Year 2003</u>	<u>Fiscal Year 2004</u>	<u>Fiscal Year 2005</u>	<u>Fiscal Year 2006</u>
<b>GROSS OPERATING REVENUES</b>					
Charges for services	\$27,376,240	\$27,986,082	\$31,353,046	\$31,315,920	\$42,639,348
DBCP Settlement	230,241	214,803	210,834	2,960,781	1,334,259
Connection charges	1,248,689	1,169,995	1,159,296	1,371,958	1,728,873
Interest and Rental Income	929,353	964,817	316,688	279,616	534,234
Draw from (Deposit to) Rate Stab. Fund	0	153,200	0	0	(153,200)
<b>GROSS OPERATING REVENUES</b>	<b>\$29,784,523</b>	<b>\$30,488,897</b>	<b>\$33,039,864</b>	<b>\$35,928,275</b>	<b>\$46,083,514</b>
<b>OPERATING EXPENSES:</b>					
Total operating expenses	\$25,968,732	\$27,815,253	\$26,757,108	\$29,227,465	\$28,672,955
Less: Depreciation	(2,297,851)	(1,884,768)	(2,173,845)	(2,305,953)	2,383,566
T&DA debt service component paid to MID <sup>(1)</sup>	(6,715,638)	(6,713,244)	(6,700,881)	(6,705,344)	(6,690,994)
Property taxes	71,579	77,676	89,921	82,673	84,556
Plus: Operating Transfers	0	0	0	218,902	95,385
<b>TOTAL OPERATING EXPENSES</b>	<b>\$17,026,822</b>	<b>\$19,294,917</b>	<b>\$17,972,303</b>	<b>\$20,517,743</b>	<b>\$19,778,336</b>
<b>NET OPERATING REVENUES</b>	<b>\$12,757,701</b>	<b>\$11,193,980</b>	<b>\$15,067,561</b>	<b>\$15,410,532</b>	<b>\$26,305,178</b>
<b>TOTAL DEBT SERVICE:</b>					
Revenue obligations:					
1997 Certificates of Participation	\$1,771,768	\$1,774,093	\$1,780,288	\$1,784,908	\$1,790,658
Treatment & Delivery Agreement	6,715,638	6,713,244	6,700,881	6,705,344	6,690,994
CDWR Loan	264,654	264,656	264,656	264,654	264,654
<b>TOTAL DEBT SERVICE</b>	<b>\$8,752,060</b>	<b>\$8,751,993</b>	<b>\$8,745,825</b>	<b>\$8,754,906</b>	<b>\$8,746,306</b>
<b>DEBT SERVICE COVERAGE</b>					
(Net Operating Revenues/Total Debt Service)	1.46	1.27	1.72	1.76	3.01

<sup>(1)</sup> Based on debt service paid pursuant to the Treatment and Delivery Agreement.  
Source: City of Modesto.

**Capital Improvement Program**

The capital improvement program of the City for the City Water Utility System for fiscal years 2006-07 through 2014-15 includes budgeted or planned programs and projects expected to be funded by the City from annual revenues. Improvements required to be made by the City in connection with the expansion of the Domestic Water Project (in addition to the 2007 Project) are planned for fiscal years 2007-08 and are expected to be financed through additional City Parity Obligations.

Other future projects planned include new wells, well head treatment, design work in connection with a projected water treatment plant under consideration by the Turlock Irrigation District (from which the City may purchase additional water supplies), water main extensions and pump replacements. The costs of such projects, as well as any costs associated with any funding obligation of the City under the Treatment and Delivery Agreement in connection with the membrane replacement account establishment and the costs of repair of damage to the Domestic Water Project allocation to the City will be taken into account in the City's rate setting process in 2008.

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

**Summary of Projected Operating Results of the City Water Utility System**

The City has prepared the following table of projections of operating results of the City Water Utility System for the fiscal years ending June 30, 2007 through 2011. The projected amounts set forth below are based on

certain assumptions made by the City. To the extent that actual future conditions vary from those assumed in preparing the projections, the actual results will vary from those set forth herein.

**CITY WATER UTILITY SYSTEM  
Projected Operating Results<sup>(1)</sup>**

	<b>Fiscal Year 2007</b>	<b>Fiscal Year 2008</b>	<b>Fiscal Year 2009</b>	<b>Fiscal Year 2010</b>	<b>Fiscal Year 2011</b>
<b>GROSS OPERATING REVENUES</b>					
Charges for services <sup>(2)</sup>	\$48,105,000	\$49,257,000	\$50,233,000	\$51,472,000	\$52,743,000
DBCP Settlement	--	--	--	--	--
Connection charges	2,677,000	2,995,000	2,995,000	3,495,000	3,495,000
Interest and Rental Income	431,000	431,000	463,000	396,000	296,000
Draw from (Deposit to) Rate Stab. Fund	--	--	--	--	--
<b>GROSS OPERATING REVENUES</b>	<b>\$51,213,000</b>	<b>\$52,683,000</b>	<b>\$53,691,000</b>	<b>\$55,363,000</b>	<b>\$56,533,000</b>
<b>OPERATING EXPENSES:</b>					
Total operating expenses <sup>(3)</sup>	\$30,922,000	\$33,004,000	\$35,510,000	\$40,100,000	\$46,205,000
Less: Depreciation	--	--	--	--	--
T&DA debt service component paid to MID	(6,687,000)	(6,682,000)	(6,672,000)	(6,682,000)	(10,015,000)
Property taxes	--	--	--	--	--
Plus: Operating Transfers	--	--	--	--	--
Expenditure Adjustment	500,000	250,000	250,000	250,000	250,000
<b>TOTAL OPERATING EXPENSES</b>	<b>\$24,735,000</b>	<b>\$26,572,000</b>	<b>\$29,088,000</b>	<b>\$33,668,000</b>	<b>\$36,441,000</b>
<b>NET OPERATING REVENUES</b>	<b>\$26,479,000</b>	<b>\$26,111,000</b>	<b>\$24,603,000</b>	<b>\$21,695,000</b>	<b>\$20,093,000</b>
<b>TOTAL DEBT SERVICE:</b>					
Revenue obligations:					
1997 Certificates of Participation Treatment & Delivery	\$1,794,000	\$1,792,000	\$1,792,000	\$1,795,000	\$1,794,000
Agreement Debt Service	6,687,000	6,682,000	6,672,000	6,682,000	10,015,000
CDWR Loan	265,000	265,000	265,000	265,000	265,000
2006 Certificates <sup>(4)</sup>	47,000	1,243,000	2,053,000	2,068,000	2,059,000
Future Certificates	--	--	651,000	1,677,000	1,677,000
<b>TOTAL DEBT SERVICE</b>	<b>\$8,793,000</b>	<b>\$9,982,000</b>	<b>\$11,433,000</b>	<b>\$12,486,000</b>	<b>\$15,809,000</b>
<b>DEBT SERVICE COVERAGE</b>					
(Net Operating Revenues/Total Debt Service)	3.01	2.62	2.15	1.74	1.27

<sup>(1)</sup> Totals may not add up because of rounding.

<sup>(2)</sup> Estimated based on projected increase in rates of 5% on each of July 1, 2007 and July 1, 2008 and of 2.5% on each subsequent July 1.

<sup>(3)</sup> Includes estimated Treatment and Delivery Agreement debt service component payable to MID.

<sup>(4)</sup> Assumes an interest rate equal to the fixed rate of interest used in calculating the scheduled payments to be made by the City pursuant to the Domestic Water Swap Agreement. Includes certain estimated ongoing expenses.

Source: City of Modesto.

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

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

**Article XIID.** Article XIID defines the terms “fee” and “charge” to mean “any levy other than an ad valorem tax, a special tax or an assessment, imposed by an agency upon a parcel or upon a person as an incident of property ownership, including user fees or charges for a property-related service.” A “property related service” is defined as “a public service having a direct relationship to property ownership.” Article XIID further provides that reliance by an agency on any parcel map (including an assessor’s parcel map) may be considered a significant factor in determining whether a fee or charge is imposed as an incident of property ownership.

Article XIID requires that any agency imposing or increasing any property-related fee or charge must provide written notice thereof to the record owner of each identified parcel upon which such fee or charge is to be imposed and must conduct a public hearing with respect thereto. The proposed fee or charge may not be imposed or increased if a majority of owners of the identified parcels file written protests against it. As a result, if and to the extent that a fee or charge imposed by a local government for water service is ultimately determined to be a “fee” or “charge” as defined in Article XIID, the local government’s ability to increase such fee or charge may be limited by a majority protest.

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

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

**Article XIIC.** Article XIIC provides that the initiative power shall not be prohibited or otherwise limited in matters of reducing or repealing any local tax, assessment, fee or charge and that the power of initiative to affect local taxes, assessments, fees and charges shall be applicable to all local governments. Article XIIC does not define the terms “local tax,” “assessment,” “fee” or “charge.” However, in *dicta* in its decision in *Bighorn-Desert View Water Agency, supra*, the California Supreme Court concluded that a public water agency’s charges for ongoing water delivery (which, as noted above, it had concluded were fees and charges within the meaning of Article XIID) are also fees within the meaning of Article XIIC and are therefore subject to initiative measures. However, the Court did note that, in doing so:

... [W]e are not holding that the authorized initiative power is free of all limitations. In particular, we are not determining whether the electorate’s initiative power is subject to the statutory provision [applicable to Bighorn-Desert View Water Agency] requiring that water service charges be set at a level that “will pay the operating expenses of the agency, ... provide for repairs and depreciation of works, provide a reasonable surplus for improvements, extensions, and enlargements, pay the interest on any bonded debt, and provide a sinking or other fund for the payment of the principal of such debt as it may become due.” ... That issue is not currently before us.

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

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

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

The ability of the City to comply with its covenants under the Treatment and Delivery Agreement and to generate City Gross Water Revenues sufficient to enable the District to make the payment of 2007 Installment Payments 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) under Article XIIC or Article XIID by voters, property owners, taxpayers or payers of assessments, fees and charges. Furthermore, any remedies available to the Owners and Beneficial Owners of the Series 2007 Water Bonds upon the occurrence of an Event of Default under the Trust Agreement are in many respects dependent upon judicial actions which are often subject to discretion and delay and could prove both expensive and time consuming to obtain. In addition to the possible limitations on the ability of the City to comply with its covenants under the Treatment and Delivery Agreement, the rights and obligations of the District and the Authority under the Trust Agreement and the Treatment and Delivery Agreement may be subject to bankruptcy, insolvency, reorganization, arrangement, fraudulent conveyance, moratorium and other laws relating to or affecting creditors' rights, to the application of equitable principles, to the exercise of judicial discretion in appropriate cases and to limitations on legal remedies against cities in the State of California.

Based on the foregoing, in the event the City fails to comply with its covenants under the Treatment and Delivery Agreement, including its covenants to generate sufficient City Gross Water Revenues, as a consequence of the application of Article XIIC and Article XIID, or to pay Payments due under the Treatment and Delivery Agreement, there can be no assurance that available remedies will be adequate to fully protect the interests of the Owners or Beneficial Owners of the Series 2007 Water Bonds.

### **Investment Policy**

The cash attributable to the City Water Utility System must be invested in accordance with the City's Investment Policy, adopted by the City Council during 1984 and most recently revised during 2006. In accordance with Sections 53601 and following of the California Government Code, idle cash management and investment transactions are the responsibility of the City Finance Director/Treasurer and permitted investments include the following:

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

Criteria for selecting investments and the order of priority are:

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

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

## **Audited Financial Statements**

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

The basic financial statements of the City as of June 30, 2006, which are incorporated by reference in and portions of which are included in APPENDIX C to this Official Statement, have been audited by Maze & Associates (the "Auditor"), independent certified public accountants, as set forth in their report. In connection with the incorporation of the financial statements and the report of the Auditor thereon in APPENDIX C to this Official Statement, the City did not request the Auditor to, and the Auditor has not undertaken to, update its report or to take any action intended or likely to elicit information concerning the accuracy, completeness or fairness of the statements made in this Official Statement; and no opinion is expressed by the Auditor with respect to any event subsequent to the date of its report. The Auditor has not been engaged to perform, and has not performed, since the date of its report included herein any procedures on the financial statements addressed in that report.

## **TAX MATTERS**

In the opinion of Orrick, Herrington & Sutcliffe LLP, Bond Counsel, based upon an analysis of existing laws, regulations, rulings and court decisions, and assuming, among other matters, the accuracy of certain representations and compliance with certain covenants, interest on the Series 2007 Water Bonds is excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986 (the "Code") and is exempt from State of California personal income taxes. Bond Counsel is of the further opinion that interest on the Series 2007 Water Bonds is not a specific preference item for purposes of the federal individual and corporate alternative minimum taxes, although Bond Counsel observes that such interest is included in adjusted current earnings in calculating federal corporate alternative minimum taxable income. Bond Counsel expects to deliver an opinion at the time of delivery of the Series 2007 Water Bonds substantially in the form set forth in Appendix E hereto, subject to the matters discussed below.

To the extent the issue price of any maturity of the Series 2007 Water Bonds is less than the amount to be paid at maturity of such Series 2007 Water Bonds (excluding amounts stated to be interest and payable at least annually over the term of such Series 2007 Water Bonds), the difference constitutes "original issue discount," the accrual of which, to the extent properly allocable to each Series 2007 Water Bond Owner thereof, is treated as interest on the Series 2007 Water Bonds which is excluded from gross income for federal income tax purposes and State of California personal income taxes. For this purpose, the issue price of a particular maturity of the Series 2007 Water Bonds is the first price at which a substantial amount of such maturity of the Series 2007 Water Bonds is sold to the public (excluding bond houses, brokers, or similar persons or organizations acting in the capacity of underwriters, placement agents or wholesalers). The original issue discount with respect to any maturity of the Series 2007 Water Bonds accrues daily over the term to maturity of such Series 2007 Water Bonds on the basis of a constant interest rate compounded semiannually (with straight-line interpolations between compounding dates). The accruing original issue discount is added to the adjusted basis of such Series 2007 Water Bonds to determine taxable gain or loss upon disposition (including sale, redemption, or payment on maturity) of such Series 2007 Water Bonds. Series 2007 Water Bond Owners of the Series 2007 Water Bonds should consult their own tax advisors with respect to the tax consequences of ownership of Series 2007 Water Bonds with original issue discount, including the treatment of 2007 Water Bond Owners who do not purchase such Series 2007 Water Bonds in the original offering to the public at the first price at which a substantial amount of such Series 2007 Water Bonds is sold to the public.

Series 2007 Water Bonds purchased, whether at original execution and delivery or otherwise, for an amount higher than their principal amount payable at maturity (or, in some cases, at their earlier call date) ("Premium Series 2007 Water Bonds") will be treated as having amortizable bond premium. No deduction is allowable for the amortizable bond premium in the case of Series 2007 Water Bonds, like the Premium Series 2007 Water Bonds, the interest on which is excluded from gross income for federal income tax purposes. However, the amount of tax-exempt interest received, and a Series 2007 Water Bonds Owner's basis in a Premium 2007 Water

Bond, will be reduced by the amount of amortizable bond premium properly allocable to such Series 2007 Water Bond Owner. Series 2007 Water Bond Owners of Premium Series 2007 Water Bonds should consult their own tax advisors with respect to the proper treatment of amortizable bond premium in their particular circumstances.

The Code imposes various restrictions, conditions and requirements relating to the exclusion from gross income for federal income tax purposes of interest on obligations such as the Series 2007 Water Bonds. The Authority and the District have made certain representations and covenanted to comply with certain restrictions, conditions and requirements designed to ensure that interest on the Series 2007 Water Bonds will not be included in federal gross income. Inaccuracy of these representations or failure to comply with these covenants may result in interest on the Series 2007 Water Bonds being included in gross income for federal income tax purposes, possibly from the date of issuance of the Series 2007 Water Bonds. The opinion of Bond Counsel assumes the accuracy of these representations and compliance with these covenants. Bond Counsel has not undertaken to determine (or to inform any person) whether any actions taken (or not taken), or events occurring (or not occurring), or any other matters coming to Bond Counsel's attention after the date of execution and delivery of the Series 2007 Water Bonds may adversely affect the value of, or the tax status of interest on, the Series 2007 Water Bonds. Accordingly, the opinion of Bond Counsel is not intended to, and may not, be relied upon in connection with such actions, events or matters.

Although Bond Counsel is of the opinion that interest on the Series 2007 Water Bonds is excluded from gross income for federal income tax purposes and is exempt from State of California personal income taxes, the ownership or disposition of, or the accrual or receipt of interest on, the Series 2007 Water Bonds may otherwise affect a Series 2007 Water Bond Owner's federal, state or local tax liability. The nature and extent of these other tax consequences depends upon the particular tax status of the Series 2007 Water Bond or the Series 2007 Water Bond Owner's other items of income or deduction. Bond Counsel expresses no opinion regarding any such other tax consequences.

Future legislative proposals, if enacted into law, or clarification of the Code, or court decisions, may cause interest on the Series 2007 Water Bonds to be subject, directly or indirectly, to federal income taxation or to be subject to or exempted from state income taxation, or otherwise prevent Beneficial Owners from realizing the full current benefit of the tax status of such interest. As one example, on May 21, 2007, the United States Supreme Court agreed to hear an appeal from a Kentucky state court which ruled that the United States Constitution prohibited the state from providing a tax exemption for interest on bonds issued by the state and its political subdivisions but taxing interest on obligations issued by other states and their political subdivisions. The introduction or enactment of any such future legislative proposals, clarification of the Code or court decisions may also affect the market price for, or marketability of, the Series 2007 Water Bonds. Prospective purchasers of the Series 2007 Water Bonds should consult their own tax advisers regarding any pending or proposed federal or state tax legislation, regulations or litigation, as to which Bond Counsel expresses no opinion.

The opinion of Bond Counsel is based on current legal authority, covers certain matters not directly addressed by such authorities, and represents Bond Counsel's judgment as to the proper treatment of the Series 2007 Water Bonds for federal income tax purposes. It is not binding on the Internal Revenue Service ("IRS") or the courts. Furthermore, Bond Counsel cannot give and has not given any opinion or assurance about the future activities of the District, or about the effect of future changes in the Code, the applicable regulations, the interpretation thereof or the enforcement thereof by the IRS. The District has covenanted, however, to comply with the requirements of the Code.

Bond Counsel's engagement with respect to the Series 2007 Water Bonds ends with the execution and delivery of the Series 2007 Water Bonds, and, unless separately engaged, Bond Counsel is not obligated to defend the District or the Series 2007 Water Bond Owners regarding the tax-exempt status of interest on the Series 2007 Water Bonds in the event of an audit examination by the IRS. Under current procedures, parties other than the District and their appointed counsel, including the Series 2007 Water Bond Owners, would have little, if any, right to participate in the audit examination process. Moreover, because achieving judicial review in connection with an audit examination of tax-exempt bonds or certificates of participation is difficult, obtaining an independent review of IRS positions with which the District legitimately disagrees may not be practicable. Any action of the IRS, including but not limited to selection of the Series 2007 Water Bonds for audit, or the course or result of such audit, or an audit of bonds or certificates of participation presenting similar tax issues may affect the market price for, or

the marketability of, the Series 2007 Water Bonds, and may cause the District or the Series 2007 Water Bond Owners to incur significant expense.

### **ABSENCE OF LITIGATION**

There is no action, suit or proceeding known to be pending or threatened, restraining or enjoining the execution or delivery of the Series 2007 Water Bonds, the Installment Purchase Contract, the Trust Agreement, or in any way contesting or affecting the validity of the foregoing or any proceedings of the Authority, the District or the City taken with respect to any of the foregoing.

There is no litigation pending or, to the knowledge of the Authority, the District or the City, threatened, questioning the corporate existence of the Authority, the District or the City, or the title of the officers of the Authority, the District or the City to their respective offices, or the power and authority of the Authority, the District or the City to execute the Installment Purchase Contract or of the District to make payments thereunder. There is no litigation pending, or to the knowledge of the District or the City, threatened, questioning or affecting in any material respect any of the financial information or projections with respect to the District or the City contained in this Official Statement.

### **RATINGS**

Standard & Poor's Rating Services ("S&P") and Fitch Ratings ("Fitch") are expected to assign their municipal bond ratings of "AAA" and "AAA," respectively, to the Series 2007 Water Bonds, with the understanding that upon delivery of the Series 2007 Water Bonds, a policy insuring the payment when due of principal and interest on the Series 2007 Water Bonds will be issued by MBIA Insurance Corporation. In addition, the Series 2007 Water Bonds have been assigned the underlying ratings of "A+" and "A+," by S&P and Fitch, respectively. These ratings reflect only the views of the rating agencies and any explanation of the significance of such ratings may be obtained only from such rating agencies as follows: Standard & Poor's Rating Services, 25 Broadway, 21st Floor, New York, New York 10004; and Fitch Ratings, One State Street Plaza, New York, New York 10004.

There is no assurance that any of such ratings will continue for any given period of time or that it will not be revised downward or withdrawn entirely by the rating agency that issued it, if in the judgment of such rating agency, circumstances so warrant. Any such downward revision or withdrawal of any of such ratings may have an adverse effect on the market price of the Series 2007 Water Bonds.

### **UNDERWRITING**

The Series 2007 Water Bonds are to be purchased by Bear, Stearns & Co. Inc. (the "Underwriter") at a price of \$92,719,709.95 consisting of \$93,190,000.00 aggregate principal amount of the Series 2007 Water Bonds, less \$470,290.05 of Underwriter's discount. The Purchase Contract provides that the Underwriter will purchase all of the Series 2007 Water Bonds if any are purchased, the obligation to make such purchase being subject to certain terms and conditions set forth in the Purchase Contract, the approval of certain legal matters by counsel and certain other conditions.

The Underwriter may offer and sell Series 2007 Water Bonds to certain dealers and others at prices lower than the offering prices stated on the cover page hereof. The offering prices may be changed from time to time by the Underwriter.

### **FINANCIAL ADVISOR**

First Southwest Company is employed as Financial Advisor to the District in connection with the issuance of the Series 2007 Water Bonds. The Financial Advisor's fee for services rendered with respect to the sale of the Series 2007 Water Bonds is contingent upon the issuance and delivery of the Series 2007 Water Bonds. First

Southwest Company, in its capacity as Financial Advisor, does not assume any responsibility for the information, covenants and representations contained in any of the legal documents with respect to the federal income tax status of the Series 2007 Water Bonds, or the possible impact of any present, pending or future actions taken by any legislative or judicial bodies.

The Financial Advisor to the District has provided the following sentence for inclusion in this Official Statement. The Financial Advisor has reviewed the information in this Official Statement in accordance with, and as part of, its responsibilities to the District and, as applicable, to investors under the federal securities laws as applied to the facts and circumstances of this transaction, but the Financial Advisor does not guarantee the accuracy or completeness of such information.

### **CERTAIN LEGAL MATTERS**

The validity of the Series 2007 Water Bonds and certain other legal matters are subject to the approving opinion of Orrick, Herrington & Sutcliffe LLP, Bond Counsel to the Authority. A complete copy of the proposed form of Bond Counsel opinion is contained in Appendix E hereto. Bond Counsel undertakes no responsibility for the accuracy, completeness or fairness of this Official Statement.

Certain legal matters will be passed upon for the Authority and the District by the District's Legal Department. Certain legal matters will be passed upon for the City by the City Attorney of the City of Modesto. Certain legal matters will be passed upon for the Underwriter by Sidley Austin LLP, San Francisco, California. Payment of the fees of Bond Counsel and Underwriter's Counsel is contingent upon sale and delivery of the Series 2007 Water Bonds.

### **MISCELLANEOUS**

The purpose of this Official Statement is to provide information to prospective purchasers of the Series 2007 Water Bonds. References are made herein to the Trust Agreement, the Installment Purchase Contract and other agreements, documents and reports that are brief summaries thereof which do not purport to be complete or definitive, and reference is hereby made to all such agreements, documents and reports for a full and complete statement of the contents thereof.

Any statements made in this Official Statement involving matters of opinion, estimates or projections, whether or not expressly stated, are set forth as such and not as representations of fact, and no representation is made that any of such estimates or projections will be realized. This Official Statement is not to be construed as a contract or agreement between the purchasers of any of the Series 2007 Water Bonds and the Authority or the District.

This Official Statement contains forward-looking statements, including (a) statements containing projections of City Gross Water Revenues, capital expenditures and other financial items, (b) statements of the plans and objectives of the City for future operations of the City Water Utility System, (c) statements of future economic performance of the City Water Utility System, and (d) statements of the assumptions underlying or relating to statements described in (a), (b) and (c) above (collectively, "Forward-Looking Statements"). All statements other than statements of historical facts included in this Official Statement, including without limitation statements under "THE CITY OF MODESTO WATER UTILITY SYSTEM," regarding the City Water Utility System's financial position, business strategy, capital resources and plans and objectives of the City for future operations of the City Water Utility System are Forward-Looking Statements. Although such expectations reflected in such Forward-Looking Statements are reasonable, no assurance that such expectations will prove to have been correct. Important factors that could cause actual results to differ materially from expectations of the City (collectively, the "Cautionary Statements") are disclosed in this Official Statement. All subsequent written and oral Forward-Looking Statements attributable to the City or persons acting on behalf of the City are expressly qualified in their entirety by the Cautionary Statements.



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**APPENDIX A**

**INDEPENDENT ENGINEER'S REPORT**

**MODESTO IRRIGATION DISTRICT  
MODESTO REGIONAL WTP PHASE TWO  
EXPANSION PROJECT  
May 2007**



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**APPENDIX A  
INDEPENDENT ENGINEER'S REPORT**

**MODESTO IRRIGATION DISTRICT  
MODESTO REGIONAL WTP PHASE TWO EXPANSION PROJECT**

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INDEPENDENT ENGINEER’S REPORT  
MODESTO IRRIGATION DISTRICT  
MODESTO REGIONAL WTP PHASE TWO EXPANSION PROJECT**

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May 30, 2007

Modesto Irrigation District  
1231 Eleventh Street  
Modesto, California 95354

Ladies and Gentlemen:

**Subject: Independent Engineer's Report on the  
MID Modesto Regional Water Treatment Plant – Phase Two Expansion Project**

Presented herein is the report (the "Report") of our review and analyses of the proposed water treatment plant expansion project (the "Project") to be owned by Modesto Irrigation District (MID), an independent publicly owned utility. MID is located in Modesto, California and provides electric and irrigation service to the greater Modesto area and wholesale treated water to the City of Modesto.

The existing Modesto Regional Water Treatment Plant (MRWTP) is capable of producing 36 million gallons per day ("mgd") of water. The Project is to be designed and constructed so as to expand the capacity of MRWTP to make it capable of producing 72 mgd. The Project, which is located in the Tuolumne and San Joaquin River watersheds in Stanislaus County, California, will employ a microfiltration technology involving the installation of a series of submerged membranes for the treatment of surface water. The approved source of supply for the MRWTP is surface water obtained from the man-made Modesto Reservoir. This reservoir obtains water from the Tuolumne River watershed via the Don Pedro Reservoir.

MID received competitive proposals for the design of the Project from design engineers and awarded the design contract to Black and Veatch (B&V), a firm who reports it has completed 12 designs of membrane water treatment facilities in California and 56 nationwide. MID also screened a number of general contractors and pre-qualified three of these contractors to submit bids for construction of the Project. On May 22, 2007 MID awarded the construction contract to Western Summit Constructors Inc. In addition, MID has selected Siemens Water Technologies Inc. (Siemens) to provide the membranes for the Project.

B&V has submitted to MID the 100% design of the Project and the 100% Preliminary Construction Schedule. MID plans to achieve the construction of the Project through a public bid construction contract using Western Summit Constructors Inc. ("Contractor") and the executed Memorandum of Understanding between Siemens and MID. MID will operate and maintain the Project. The Contractor will be responsible for the installation, start-up and testing of the Project.

The cost of construction of the Project will be provided by the issuance by the Modesto Irrigation District Financing Authority (the "Authority") of \$93,190,000 of its Domestic Water Project Revenue Bonds Series 2007F (the "Bonds"). The Bonds are authorized to be issued pursuant to resolutions to be adopted by the City, the Authority and MID and a Trust Agreement dated June 1, 2007, among the Authority, MID and the Bank of New York Trust Company, N.A. as Trustee.

Construction of the Project is scheduled to commence in June 2007.

The Project will be located within the limits of the MRWTP site (the "Project Site") which is owned by MID.

The Project will consist of four major categories of equipment: 1) the membrane filtration systems; 2) the ozone system; 3) the dissolved air flotation treatment systems; and 4) the treated water pumping system. A process schematic for the Project is presented in Figure 1.

During the preparation of this Report, we have reviewed certain of the agreements and proposed agreements between MID, Siemens, and B&V. These agreements include the "Memorandum of Understanding for Procurement of a Low Pressure Membrane Water Filtration System" dated May 4, 2006 between Siemens and MID (the MOU), certain portions of the 100% Contract Documents for the Construction of the Project, and the construction phase services agreement between MID and B&V. These agreements (collectively, the "Project Agreements"), set forth the obligations of each of the parties with respect to providing equipment and undertaking and overseeing construction of the Project. As Independent Engineer, we have made no determination as to the validity and enforceability of the Project Agreements; however, for the purposes of this Report, we have assumed that the Project Agreements will be enforceable in accordance with their terms to the extent permitted by law and that all parties will comply with the provisions of their respective agreements. Representatives of R. W. Beck, Inc. visited and performed general field observations of the Project Site. The general field observations were visual, above ground examinations of selected areas which we deemed adequate to comment on the general appearance of the Project Site and were not in the detail which would be necessary to reveal conditions with respect to safety; the subsurface physical condition of the Project Site; or the conformance with agreements, codes and permits, rules or regulations of any party having jurisdiction with respect to the construction, operation and maintenance of the Project.

In addition, we have met with representatives of MID, the State of California Department of Health Services and B&V. We have reviewed the process design of the Project; the proposed method of operating the Project; the plans and specifications of the major systems of the Project; the projected levels of water treatment; and the method used by B&V in developing the 100% preliminary construction schedule, the estimated capital cost and operations and maintenance costs of the Project.



## PROJECT PARTICIPANTS

### Introduction

The sponsor, design engineer, membrane supplier, and the process for selecting the potential contractors responsible for the construction of the Project are discussed below.

### Modesto Irrigation District (MID)

#### **General**

For a general description of MID, see the Official Statement for the Bonds.

#### **Board of Directors of MID**

The Board of Directors (the "Board") of MID is composed of 5 directors. Each member of the Board is an elected official representing one of 5 geographic divisions within MID.

#### **Operating Capability of MID**

MID currently operates the existing MRWTP. MID reports that the MRWTP is in compliance with its regulatory requirements, and has had one reportable noncompliance event. MID reports that it does not presently operate any membrane water treatment plants.

#### ***Proposed Operation of the Project***

MID has represented that the process it plans to utilize for the staffing of the Project will follow the same process that MID has previously used for the start-up and operation of the existing MRWTP.

The DHS requires MID to prepare an updated O&M manual for the MRWTP as a condition for receiving a permit. MID already has an experienced staff led by three Grade 5 Certified Treatment Operators with an average of approximately 20 years of previous experience operating water treatment facilities in California. MID management has reported that it is having B&V prepare a staffing plan that will balance short-term staffing requirements with long-term staffing requirements. An Instrumentation and Control position will be added in 2007. A strategy will be developed by MID for addressing staffing levels of other positions required to effectively and efficiently operate both the existing and Project facilities. Succession planning will be considered by MID. Contract operations staff additions are being investigated by MID as a short term option until specific staffing requirements are verified by operational experience. Any staffing plan will be required to address Department of Health Services requirements. The Water Treatment Plant Manager will have the responsibility to provide the operational technical guidance for the Project.

The Water Treatment Plant Manager will have the primary responsibility for maintaining the staff of supervisors, mechanics, electricians, and operators that will ultimately staff and run the Project; will play a leading role in determining the operational requirements of the treatment equipment; and will be involved in the preparation of the Operations and Maintenance manual. After the Project startup, the Construction Project Manager will transition the day-to-day responsibility of the Project to the Water Treatment Plant Manager and the permanent staff of MID. We are of the opinion that MID's approach to staffing of the Project and the role of senior staff members is reasonable and consistent with industry standards.

#### ***Standard Operating Procedures***

MID has represented that it plans to amend the existing Standard Operating Procedures ("SOPs") previously developed by MID for Process Control and consistency of reporting for the Project. MID has developed and uses process control and analytical quality assurance that have been certified by state regulatory agencies for the existing MRWTP.

### ***Maintenance Management***

The development and execution of the preventative computerized maintenance management program during the operation of the Project is critical to assure that the equipment: (1) is available to perform its principal function; (2) is operating cost effectively; and (3) experiences an optimum useful life. MID has represented that it intends to use Datastream MP2 maintenance management software on the Project. This software program has been effectively used in water treatment facilities and projects of comparable size and complexity to manage maintenance programs.

The existing MRWTP is a 36 MGD conventional water treatment plant. The Project will operate in parallel with the existing plant which will continue to operate with essentially the same technology except for the ozone source. We reviewed the methodology used by MID to develop the estimated cost of operating and maintaining the existing conventional treatment plant. MID developed a budget process that includes five major accounts: Administration (direct plant costs); Administrative and General (A&G – support from MID overhead); Operations; Laboratory; and Maintenance. We reviewed information about the methodology from budget spreadsheets provided by MID and discussed the information with MID staff. The accounts include the general cost categories we would anticipate for this type of facility. The operations and maintenance costs for the existing facilities were established utilizing a base cost for operations and maintenance which was developed by MID from a review of several years of actual cost data. The projected budget costs for subsequent years are estimated by MID using the previous year's actual costs plus a 3 to 3.5 % cost of living increase (generally). Anomalies to historic data identified in an operations or maintenance account are investigated by MID and a determination is made if the cost will be sustained or if it represents a one time variance. The methodology also incorporates cyclical costs which are due to equipment replacement and varying maintenance schedules. The yearly budget includes funding for maintenance by outside parties (contract work). To facilitate full utilization of MID staff throughout the year, base maintenance is normally provided by MID staff and short term maintenance increases or specialty maintenance are performed by outside parties. Approximately 10-12% of the maintenance work is contracted out per year.

According to MID staff, they have not developed an equipment replacement plan. As noted earlier, the maintenance records are managed by a computerized maintenance management system MP2 developed by Infor Datastream. Infor is one of the largest global providers of enterprise software. The equipment maintenance records are reviewed by MID at the time of repair and yearly, and the decision to repair or replace is made on an on-going basis. The repair or replacement funds are then allocated in the next year's budget. Funds are also allocated in the budget for unexpected replacements that are needed during the budget year. The budget spread sheet is utilized throughout the year to track actual versus budgeted expenses.

Based on our review, we are of the opinion the methodology MID used for developing the operations and maintenance costs for the existing conventional treatment process is reasonable.

We reviewed the methodology B&V used to develop the operations and maintenance costs for the Project. We compared the estimated operation and maintenance cost to other water treatment plants of similar size and scope with which we are familiar. In order to develop a meaningful comparison of membrane treatment plants or membrane treatment versus conventional treatment plants it is important to clearly identify the costs that are included or excluded from the estimate. The costs for operations and maintenance for a utility vary with the water quality, electrical costs, chemical costs and other operational factors. Operation and maintenance costs for membranes are greatly impacted by the required values for microbe removal and the number of fiber breaks experienced by the plant. The term fiber break describes the breakage or dislodging from an end connection point of the hollow fiber strands upon which the membrane coating exists. Significant fiber breaks will greatly increase the maintenance time required and the down time or lost production of the plant. The chemical cleaning frequency is related to the fouling of membranes. Chemical cleaning intervals impact chemicals costs and down time or loss of production of the process.

Inadequate cleaning results in reduced permeability and lower water production. Water production can be maintained by increasing pressure which may void the warranty and could result in increased fiber breaks, permanent fouling and increased electrical costs. Increased pressure and more frequent chemical cleaning may also significantly impact the integrity of the membranes and reduce their life expectancy.

The comparable membrane plants that we reviewed are presently meeting design capacities and design turbidity values. The design parameters of the MID Project appear to be consistent with the other membrane facilities we reviewed.

The comparable membrane treatment plant data that we obtained contained little information about operations and maintenance costs. The facilities we surveyed had either a general or no formal accounting of O&M costs for the membrane facility, itself. As noted above, the reported operations and maintenance costs can vary from plant to plant due to a number of variables including the categories of operations and maintenance activities included in the O&M cost reporting. Based on this understanding and our review of the estimating methodology used by B&V, we are of the opinion the estimated operations and maintenance costs for the Project appear reasonable for a facility of this size.

### **Findings Regarding Operating Capabilities of MID**

For the purposes of identifying MID's capabilities of operating the MRWTP, we have reviewed the MRWTP's existing permit and had discussions with the State Department of Health Services (DHS) Staff for the purpose of identifying MID's obligations set forth in the permit. We reviewed the qualification materials supplied by MID for this Project. We reviewed with MID's Water Treatment Plant Manager MID's proposed methodology for executing the operating and maintenance obligations of the future permit from DHS. Based upon this review, our findings are as follows:

- MID has a long-term history of demonstrated experience in the start-up and transition to operation of a major municipal water treatment facility. The MRWTP is reported to have been successfully operated in compliance with permit conditions.
- MID has demonstrated experience with facility management, maintenance management, and long-term and capital repair and replacement programs at the MRWTP.
- MID has a Water Treatment Plant Manager, named as the responsible position for the start-up and operations of the Project, with experience in water utility operations and management.
- MID operates its facilities twenty-four hours a day, seven days a week (24/7). MID has 5 Senior Operators, 2 Operators and 1 Apprentice Operator to provide coverage of the operations facilities for two twelve hour shifts per day 7 days per week. A staffing plan is currently under development by MID.
- MID has 5 Senior Operators that have Grade 4 or 5 Treatment Certification and each has over 20 years of experience. The Water Treatment Plant Manager and the Water Quality Supervisor have Grade 5 Treatment Certification and they have 20 and 12 years of experience, respectively.
- MID Operator positions are part of the succession plan for maintaining institutional and technical knowledge of the MID water treatment plants. The two Operators have Grade 3 Treatment Certification.
- The MID Water Quality Supervisor has Grade 4 Distribution Certification. The Water Treatment Plant Manager and five operations staff have Grade 3 Distribution Certification and they have 10-25 years of experience.
- MID Water Treatment Plant processes do not have remote access for plant operations. The Water Treatment Plant Manager, Water Quality Supervisor and Maintenance Supervisor are reachable by cell phone. The Instrument Technician and Maintenance Worker II have pagers 24/7.
- MID maintenance staff works one 10 hour shift per day Monday through Friday each week. Due to the addition of the Project and the related systems, MID has plans to hire an additional instrumentation technician and is reviewing staffing needs for the existing and Project facilities.
- MID laboratory staff work one 9 hour shift per day Monday through Friday with every other Friday off. The Water Quality Supervisor works one 10 hour shift per day, 4 days per week. The operations staff covers the laboratory work on the weekends.

- MID operated a membrane pilot unit supplied by Siemens/USFilter for eleven (11) months in 2004 to determine the feasibility and reliability of submerged membrane treatment and to familiarize MID staff with the new technology. The pilot study was expanded in December 2004 to include a pilot unit from GE/Zenon. Only submerged membranes were tested due to the size of the plant, their ability to handle solids in a direct filtration configuration and the desire for reduced energy use. The GE/Zenon and Siemens/USFilter units were tested side by side from January through July 2005, at the MID facilities, to ensure competitive bidding and confirmation of the best available technology. The objectives of the testing were to demonstrate stable and reliable performance of the tested membrane technologies; gather data for establishing appropriate design and operating parameters; provide operational experience for MID staff; and establish operating conditions to meet Project criteria. Training will be provided to MID by vendors for the Liquid Oxygen equipment; Membrane and other equipment; SCADA computer monitoring and control system; and Programmable Logic Controllers. Most of the computer software maintenance work is performed by MID staff.
- Although MID's direct experience with membrane water treatment is currently limited to the pilot plant and upcoming training, the experience of MID's overall management and key project personnel is sufficient to reasonably expect MID to be capable of performing the work required by the DHS permit.

### **Summary**

Based on our review of the existing DHS permit; B&V's previous experience in the design of membrane water treatment plants; MID's methodology in screening contractors to bid on the proposed project; MID's previous experience in the operation of the MRWTP; and the methodology MID plans to utilize in the staffing, operation, and maintenance of the Project, we have reached the following conclusions:

1. The contractors pre-qualified by MID have previously demonstrated the ability to construct large municipal water treatment plant projects.
2. B&V has previous experience in the design of membrane water treatment systems.
3. MID has previously demonstrated the ability to operate and maintain water treatment facilities.
4. MID has assigned personnel to key positions with the necessary experience to operate water treatment facilities.

In summary, MID, B&V and the pre-qualified contractors have previously demonstrated the ability to design, construct and operate municipal water treatment plant projects and, based on such experience, the experience of existing operations staff, and the reported staff planning for the Project, it is reasonable to expect that MID, B&V and the pre-qualified contractors should be capable of meeting their respective contractual obligations under the design and construction contracts and the DHS permit.

### **The Design Engineer**

#### ***Black and Veatch***

B&V was retained by MID to perform preliminary design and design services in conjunction with the Project. B&V will provide the design, drawings, and specifications for all elements of the Project except those being provided by certain vendors such as the membrane system being provided by Siemens. B&V reports it has had experience with the design of over 56 membrane filtration water treatment plants throughout the world and at 12 membrane water filtration plants in California. One such plant is the 36 MGD South San Joaquin Irrigation District (SSJID) plant.

## **Summary**

We have reviewed B&V's reported relevant experience in the planning and design of membrane water treatment facilities and reviewed their proposed approach to providing design engineering assistance to MID during construction of the Project. We are of the opinion that B&V's direct membrane water treatment experience is sufficient to reasonably expect that B&V should be capable of adequately performing all of the work required by the design engineer.

### **Siemens Water Technologies Inc. (Siemens)**

#### **Membrane Supplier**

Pursuant to the terms of the MOU, Siemens will engineer, manufacture, deliver, and provide start-up and testing services for the membrane filtration system. Siemens reports that it installed its first Memcor drinking water pressure Membrane Filtration system in 1987. Memcor projects are reported to produce potable water for a variety of municipal and industrial applications, and are currently in use throughout the world. Siemens reports since 1970 it has designed, provided equipment and services to numerous municipal membrane filtration plants in the US. Siemens reports it has installed membranes used in projects with over 100 mgd of treatment capability. Such projects are reported to have a total contract value exceeding \$50 million.

The Siemens Memcor CMF-S S10V module has successfully been certified by the State of California as an approved alternative filtration technology.

#### **Summary**

Based on our review of the information provided to us by Siemens, we are of the opinion that Siemens has previously demonstrated the ability to manufacture and design the equipment comprising a membrane system and has provided one other submerged membrane system using PVdF of this size in the treatment of municipal drinking water. We are of the opinion that the qualifications of Siemens are consistent with companies providing similar equipment in the membrane filtration industry.

### **The Construction Contractor Pre-Qualification Process**

MID conducted a pre-qualification process which created a list of bidders for the Project. MID required interested firms to submit a Statement of Pre-Qualifications (SOQP) package. This package was divided into four parts: Part I – Essential Requirements for Qualification; Part II – Organization, History, Organizational Performance, Compliance with Civil and Criminal laws; Part III – Recent Construction Projects Completed and Project Manager Experience; and Part IV – Project Experience Interview Questions.

Part I consisted of a list of yes or no questions that addressed licensing, insurance, financial statements, bonding, experience, willingness to accept assignment of the membrane supply contract, performance, labor code issues and criminal activity. This portion was graded pass/fail with one incorrect answer generally causing a failing grade.

Part II gathered information specific to the Contractor regarding: current organization and structure of the business; history of the business and organizational performance; licenses; disputes; criminal matters and related civil suits; bonding; compliance with OSHA laws and with other labor safety legislation; and prevailing wage and apprenticeship compliance record.

Part III required information from recent construction projects completed and project manager experience. Information on three water or wastewater treatment projects completed by the firm as prime or general Contractor within the last 5 years each valued at greater than \$20 million was required. Similar information on the project manager to be assigned to the work was also required which included one \$20 million project within the last 4 years in which they had served as project manager and three \$20 million projects across their career.

Part IV was comprised of a list of questions used to interview randomly selected owners of at least two projects completed either by the firm or the project manager. MID conducted the interviews which featured a 1 to 10 scale ranking by the owners of the projects.

Certain ratings had to be achieved by a Contractor on each of the four parts or the firm was not pre-qualified. The pre-qualified firms are: Kiewit Pacific Co., Concord, CA; Monterey Mechanical, Oakland, CA; and Western Summit Constructors Inc., Denver, CO.

### **Summary**

Based on our review of the pre-qualification process for the Construction Contractor for the Project, we are of the opinion that the process followed by MID was a reasonable means to result in the prequalification of a group of Contractors, each of which has demonstrated the ability to construct large municipal water or wastewater treatment plants.

### **Summary**

Based on our review of information provided to us by MID, B&V and Siemens, we are of the opinion that 1) B&V has previously demonstrated the ability to engineer and design municipal water membrane filtration projects, 2) all of the Contractors that have been pre-qualified have previously demonstrated the ability to construct large municipal water or wastewater treatment plant projects; and 3) Siemens has demonstrated the ability to design and manufacture membrane systems which have successfully been used for municipal water treatment.

## **THE PROJECT SITE**

### **Project Site**

The Project will be constructed on the Project Site. The Project Site is owned by MID and located in Waterford, California, approximately 13 miles from the City of Modesto.

A representative of R. W. Beck conducted a site visit to the Project Site in January 2007 and performed general field observations of the Project Site. The general field observations were visual and above ground and were not in the detail necessary to reveal conditions with regard to safety conditions, subsurface conditions, or the conformance with agreements, codes, permits, rules or regulations of any party having jurisdiction with respect to the construction, operation and maintenance of the Project.

MRWTP is also located on the Project Site. The Project Site has security measures in place. The topography of the Project Site consists primarily of a relatively flat area covered with mostly grass and some bare soil. The flatness and layout of the Project Site should provide sufficient area for Contractor mobilization and staging. The areas adjacent to the Ozone Generation and Chemical Feed Buildings and the Ozone Contact Basins are congested with paved roads interspersed with various equipment and buildings that are part of the operation of the MRWTP. The area topographies are generally flat and the ground is generally paved or grassed. Construction in these areas may require phasing and coordination with the operations staff of MRWTP to maintain access to their facility.

### **Geotechnical Investigations**

We reviewed the following reports of geotechnical investigations for the Project Site:

- Final Geotechnical Interpretive Report Modesto Regional Water Treatment Plant Phase II Expansion Project, dated February 2007 (the "Interpretive Report"), prepared by Geomatrix Consultants, Inc.
- Final Geotechnical Data Report Modesto Regional Water Treatment Plant Phase II Expansion Project, dated January 2007 (the "Data Report"), prepared by Geomatrix Consultants, Inc.

The Interpretive Report presents geologic/geotechnical evaluations, interpretation and recommendations to the design team for the design of the Project. The Data Report contains the information compiled during the field explorations and laboratory tests. Three exploratory borings were drilled, logged and sampled as part of this work. No groundwater was observed. The 2007 geotechnical effort was undertaken to supplement the original geological study for the MRWTP performed in 1992 by Geomatrix. As part of that project, 14 borings and 17 test pits were excavated and logged to help generate a subsurface profile and identify geological features. In that study only one of 3 locations indicated

groundwater. That location was near the Modesto Main Canal at a depth of 147 feet. All of the above formed the basis for the geotechnical recommendations.

The Interpretive Report includes recommendations for earthwork including: clearing, grubbing, stripping and preparatory work; excavation conditions and ground support; groundwater conditions and dewatering requirements; temporary and permanent slopes; building pads; fill materials and compaction criteria; subsurface drainage and erosion control; and soil corrosivity. Recommendations were also made for foundations, retaining walls, slabs on grade, seismic considerations, road improvements, sludge storage lagoons and pipelines.

The Interpretive Report presents recommendations that, if followed, should allow the Project to be constructed on the Project site. The Geotechnical Report appears to have been prepared consistent with standard geotechnical engineering practice.

B&V reports that the recommendations contained in the Geotechnical Reports were taken into account in the project design. Assuming that B&V follows the recommendation set forth in the Geotechnical Reports, we are of the opinion that the Project Site should be suitable to support the construction and operation of the Project.

### **Environmental Site Assessment**

We have reviewed the "MRWTP Phase Two Expansion Project Subsequent Environmental Impact Report Assessment" dated November 2004, prepared for MID by Jones and Stokes (SEIR). This work was performed to identify changes in the Project or the conditions under which the Project is undertaken, that could cause the Project to result in new or more severe impacts than those identified in the 1990 Final Environmental Impact Report for the MRWTP.

One significant and unavoidable impact of the Project is the emissions of ozone and ozone precursors from construction activities and to a lesser extent, project operations. Though the City and MID have committed to implement multiple measures to reduce emission effects, this impact could not be reduced below significant thresholds. The SEIR considered two alternative expansion technology options at the plant: the membrane option and the conventional option. The selected membrane option is considered by Jones and Stokes to have reduced construction related impacts relative to the conventional option because it was estimated to have a shorter construction time and occupy a smaller footprint. The membrane option is identified by Jones and Stokes as the environmentally superior alternative for the MRWTP expansion.

### **Summary**

Based upon our review of the SEIR conducted by Jones and Stokes, it is our opinion that the investigations were conducted in a manner consistent with industry standards, using comparable industry protocols for similar studies with which we are familiar.

## **WATER TREATMENT PROCESSES AND TRANSMISSION PUMPING**

### **Introduction**

The Project is a significant component of MID's infrastructure which is required to treat and deliver the new treated water capacity. The timing of completion of construction and commencement of operation of the Project is of importance to MID.

Pre-design for the Project was performed by B&V. In October 2005 a Preliminary Design Plan was completed by B&V which summarized the various treatment processes including membrane filtration and provided a detailed evaluation of the ozone contactor, generator and other miscellaneous appurtenances. The ozone generators will be changed from air feed to liquid oxygen feed (LOX) to minimize power consumption and to reduce operational and maintenance issues. The results of pre-design are presented in the Design Report by Black & Veatch, June 2006. The principal components of the Project consist of: 1) the membrane system, 2) the ozone system, 3) the dissolved air flotation systems, 4) treated water pumping system.

MID made the decision to use a submerged microfiltration membrane process as the core process for the Project. Through a competitive procurement process using life cycle costs as an evaluation basis, MID chose Siemens to provide the membrane system for the Project.

Presented below is a general condition assessment of key existing facilities followed by a discussion of the major equipment components of the Project.

### **Condition Assessment of Existing Facilities**

We performed a site visit of existing facilities on January 19, 2007 and we made a condition assessment of surface structures that could be accessed at the time. Access was granted to all areas requested.

The review of the water treatment facilities at MRWTP presented a facility with all components of significance in working order and all others generally well maintained. Periodic maintenance was being performed on several items in conjunction with the Standard Operating Procedures used by staff. The Treated Water Pump Station was reviewed and found to be in good working order. Locations existed for the 4 new 800 HP pumps and associated switchgear.

We undertook a review of the Terminal Reservoir Site on the same day. The Terminal Storage Reservoirs and Pump Station were in good working condition with the appearance of being in above average condition. The locations for the new 800 HP pump and switchgear were available to install the new facilities.

It had been reported that water damage in some of the buildings had occurred. This damage has been identified by MID and is being funded and repaired.

### **Summary**

Our review indicated that the condition of existing facilities is in keeping with what would be expected of a facility constructed in 1995 that was being well maintained. With the minor modifications planned in the design, the existing facilities appear in condition to be able to continue in service as expected.

### **Raw Water Quality**

MID has owned and operated the MRWTP since the completion of construction in December 1994. MID has conducted the source water quality monitoring required by the Long Term 2 Enhanced Surface Water Treatment Rule (LT2ESWTR) imposed by the U.S. Environmental Protection Agency (EPA). This monitoring has resulted in a Risk Bin Classification of Bin 1 per LT@ESWTR which represents a cryptosporidium concentration of less than 0.075 oocysts/L. This classification means that no additional treatment beyond current requirement for cryptosporidium removal is necessary.

Another regulation that MID must consider is the Stage 2 Disinfection Byproducts Rule (DBPR) imposed by the EPA. DBPs are formed when a chemical disinfectant reacts with natural organic matter ("NOM") in raw water. An indication of the amount of NOM in the water is the level of total organic carbon ("TOC"). MID has very low TOCs in its raw water, ranging from 1.0 to 2.6 mg/l, and thus has few precursors to be concerned with. MID also does not have an extensive distribution system. For the above reasons DHS has indicated that the DBPR does not pose any significant issue to MRWTP. We are also of the opinion that, if properly operated and maintained, the Project should be capable of meeting the regulations regarding MCL's (0.08 mg/l for TTHM; 0.06 mg/l for HAA5) for DBP's.

B&V has been required to design the Project to be capable of producing drinking water at specified quantities and quality. MID has contracted with the Contractor to construct the Project so as to be capable of meeting such specified quantities and quality. B&V had available to it at a minimum: (1) over 10 years of water quality data from MID; (2) pilot plant water quality data from side-by-side pilot testing from January 2005 through July 2005; and (3) water quality data from monitoring required by the LT2ESWTR.

Based on their review of the historical data and the more recent water sampling, B&V has stated that they believe they have used reasonable engineering practice in evaluating the composition of the influent water in developing the design of the Project, and confirming the design with pilot plant testing. In the event that actual concentrations of certain

parameters in the raw water are greater than currently anticipated by B&V, it is possible that certain operation and maintenance costs could be greater than estimated by B&V.

### **Overview of the Design**

B&V prepared a design for the Project to be capable of producing 36 MGD of potable water in the new process train, and 72 MGD of potable water in the overall facility. B&V submitted a 100% design to MID in February 2007. We have reviewed certain portions of the design submittal prepared by B&V and discussed with B&V the basis of design as part of the preparation of this Report and in reaching certain of the conclusions presented herein. We also reviewed operating data from similar facilities, which use the same technology, to identify a range of the annual processing capability of the Project. Decisions made by MID and B&V regarding the facilities we reviewed were based in part on pilot plant testing that had been performed by Siemens using source water. Pilot plant testing is the common practice to identify the membranes' capability to treat the source water of the utility. Variable water quality and temperature affect the production capacity that can be attained. The required processing capacity of the Project was established by MID. In accordance with the MOU between Siemens and MID, Siemens is responsible for the design and manufacture of the equipment for the membrane systems. The membrane system is to be capable of producing 36 MGD of drinking water. Siemens submitted to MID a Functional Design Specification dated November 8, 2006.

MID has sufficient data to support the design of the Project. This data has resulted from the fact that MID has been collecting raw water quality data at the MRWTP for over 10 years. MID has performed source water quality monitoring in conjunction with EPA rules and a pilot plant test was performed on each of two submerged membrane manufacturer systems. An accurate characterization of the source water quality is important for two reasons: (1) it provides a firm basis for establishing the process design; and (2) it allows various contractual commitments to be firmly established with an identifiable risk. Therefore, our review of B&V's design focused on the raw water characterization and the overall process design including the membrane and ozone processes.

Source water for the Project will come from the existing intake from the Modesto Reservoir. The water will flow by gravity to the Project. The design provides for the addition of sodium hypochlorite in the raw water inlet as necessary, to limit biofouling by controlling the growth of macro and micro organisms. Raw water will flow through a 60-inch raw water line which will contain a flow meter and rate control valve. This will empty into a raw water head tank which will serve as the primary controlled water surface elevation upstream of the membrane system. This tank will also have an overflow weir which will serve as the primary overflow control point for the new side of the plant.

#### **Rapid Mix**

A rapid mix pump station will be installed downstream of the raw water head tank. This is used to mix alum with the raw water for the purpose of improving membrane performance.

#### **Submerged Membrane Technology**

##### ***General***

The first MF/UF plant of significant size in North America was constructed in the early 1990's. There are presently in excess of 250 Membrane Water Treatment Plants in operation. Submerged membranes were initially used mostly for treating wastewater with higher solids concentration. The system was later adapted to more efficiently treat water for drinking water systems. Typical applications for submerged microfiltration membrane technology are: tertiary filtration; removal of turbidity, bacteria, viruses and cysts; removal of organics, color and Trihalomethane (THM) precursors; treatment of filter backwash; retrofit of conventional multi-media filters; and pretreatment for reverse osmosis membrane systems.

The supplier of the submerged microfiltration membrane system, Siemens, was selected by MID through a competitive selection process. The membrane filtration system will consist of filtration units, cleaning-in-place (CIP) equipment, backwash equipment, compressed air equipment, and control systems. Siemens will furnish the membrane filtration system equipment.

We reviewed the Design Report by B&V dated June 2006 and the Functional Design Specification by Siemens for the Memcor CS Low Pressure Membrane Filtration System dated November 8, 2006. We compared the design

parameters of the Siemens system with CMF-S S10V modules, against the California Department of Health Services Surface Water Treatment requirements and the Alternative Filtration Technology Demonstration Report.

The turbidity of the MRWTP's recycled water was identified in the Design Report as not being capable of meeting the project goal of 2.0 NTU or less, year around. The Design Report identifies that in the winter months the turbidity exceeds the 2.0 NTU goal and that the goal cannot be met on a year round basis without improvements to the existing system. The resolution of this deficiency is addressed in the Project Design Report.

We are of the opinion that the design parameters in the Design Report for the Project are consistent with the California Department of Health Services requirements and are consistent with the California surface Water Treatment Alternative Filtration Technology Demonstration Report.

### ***The Project***

The submerged microfiltration membrane technology proposed for the Project is commercially available and based on the designs of similar installations that have limited operating histories. The combination of membrane technology with post-ozonation is an accepted industry practice. The primary potential advantage of the Project is its anticipated ability to provide multiple-barrier protection through physical barrier membrane treatment followed by secondary barrier disinfection and taste and odor reduction using an automated process that reduces operator requirements and chemical usage.

### ***The Siemens Submerged Microfiltration Membrane System***

The selected membrane process has membrane modules with a nominal pore size of 0.04 microns. Microbes removed by this pore size include viruses, bacteria, Giardia and Cryptosporidium. Total removal of these constituents is not accomplished in the membrane operation but sufficient removal is accomplished to meet or exceed water quality requirements for this phase of the treatment scheme. In simple form, submerged microfiltration membrane treatment means applying a liquid containing water and molecules (feed water) into a basin with submerged membrane fibers. A vacuum is applied to the membrane and water is drawn through the pores of the fibers and as a result most particles of 0.04 microns or larger are filtered out. The water that passes through the membrane is called the permeate. The amount of permeate flow expressed as a percentage of the feed flow is the recovery rate of the membrane for those operating conditions. The membrane system purchased for the Project has a guaranteed recovery rate of 94 percent per the manufacturer. This means that for every 100 gallons of feed water applied, 94 gallons of permeate water is delivered as product water to the system. The membrane has carefully sized pores that are the size of small microbes. The smaller the pore size and the higher the operating pressure, the more small microbes that will be removed.

Following the pretreatment of the source water, the treated water will be transported to modular trains which utilize the membrane technology. The pretreated water is conveyed to the membrane basin. A vacuum of -1 to -10 psi will be applied to the membrane fibers and the feed water will be drawn through the fibers. The membrane system will include six trains equipped with membrane modules. Five of the trains are intended to meet plant capacity design (duty) and the sixth train is for back-up to the system to meet design capacity and use during a chemical cleaning-in-place (CIP). The rated capacity of each train was established by Siemens based on the water temperature range and treatability of the water at that temperature. The treated water from the membrane process will be directed via siphon or onsite membrane filtrate pumps for delivery to the Ozone Contactors.

The process wastewater streams are directed into the membrane backwash equalization basin. From the basin the water is fed into the membrane DAF system. The clear water will be captured and returned to a point ahead of the membrane plant. Waste solids will be contained on site in existing sludge lagoons.

The chemicals identified in the Design Report to be used for cleaning the membranes were verified by Siemens through pilot testing. The chemicals identified for the cleaning regimes are commercially available (not membrane vendor patented chemicals) and include Sodium Hypochlorite, Phosphoric acid, Sulfuric acid, Citric acid, Sodium Hydroxide (for waste neutralization) and Calcium Thiosulfate (for chlorine neutralization). Chemical CIP is to be performed every 22 days to clean the membranes of mineral and organic build-up. Phosphoric or citric acid and sodium hypochlorite are proposed for use for the CIP process. After every 96 hours of operation, the membranes are to be cleaned with sodium

hypochlorite to remove organic material on the membranes. Maintenance washing of the membranes will be performed every 10 days with a low strength phosphoric or sulfuric acid between CIP operations, according to the design report. The purpose of this process is to clean loose debris from the membrane surface and revitalize the flux rate of the membrane between the CIPs. More frequent CIPs may reduce the life of the membrane.

Pilot plant testing was conducted by two submerged membrane suppliers, in part, to determine the efficacy of membranes for treatment of the MID source water. During the pilot testing MID monitored the following: (1) the turbidity and microbial removal; (2) flux rates; (3) backwash and CIP frequency required; (4) chemicals needed for cleaning; (5) electrical usage; and (6) other operational parameters. The testing indicated the membrane pilot plant was able to meet or exceed California Department of Health Services guidelines.

### **Ozone System**

Ozone is applied to the water after the membranes for disinfection of Giardia (a microbe) and virus and to control taste and odor causing compounds. Existing “air-fed” ozone generators at the MRWTP are being replaced with more efficient “oxygen-fed” ozone generators which will provide ozone for both the existing and new facilities. Ozone addition is automatically controlled and occurs near the beginning of channelized tanks (called contactors) in order to allow sufficient contact time for disinfection. A single Ozone System Supplier will be responsible for the entire ozone system. A safety system is intended to prevent ozone from being discharged to the air.

Pressure tests will be performed for the ozone system, including the concrete ozone contactor. Performance warranty tests will be conducted to show that all of the equipment will perform within specified parameters, including power consumption limits. If the system exceeds specified requirements after various options available to the ozone system supplier, liquidated damages will be assessed at 1.5 times the difference between the “total present worth cost of the guaranteed values” and the “adjusted measured values” determined from the above testing.

R. W. Beck compared the ozone design to accepted standard design criteria and it was found to be in general conformance. In our opinion this system should be capable of providing the required disinfection, if constructed per the contract documents.

### **Dissolved Air Flotation (DAF) System**

DAF removes suspended solids and other contaminants using air flotation. It is especially well suited for removing light particulates that present settling problems for conventional thickeners. A percentage of the clarified effluent is recycled and super-saturated with air. This recycled water is mixed with the waste stream influent and dissolved air comes out of solution in the form of numerous fine bubbles. These bubbles contact and attach to solids and float the solids to the surface. This float is mechanically skimmed toward a collection trough. Typically, the solids percentage ranges from 1% to 3%.

A DAF unit is being supplied for both the existing conventional solids handling system and the new membrane solids handling system. An equalization tank will be located upstream of each DAF unit. Though the sludges generated from the conventional and membrane systems are co-mingled and treated with the same dewatering processes, the clarified effluents from each of the two DAF systems are kept separate and recycled back to the front of their respective treatment systems.

The DAF systems were pilot tested by B&V. The systems have stated effluent criteria of meeting 2.0 NTU for average daily turbidity. This is intended to resolve an existing issue whereby the recycle flow from the thickener often exceeds 2.0 NTU in the winter.

The DAF basin design was developed by B&V in accordance with standard design criteria. Given this fact, in addition to the pilot testing that has been performed, it is our opinion that the system should be capable of providing adequate thickening if constructed in accordance with the contract documents.

## Treated Water Pumping System

One of the largest power uses at the Project will be the treated water pump station. Four 800 horsepower (HP) pumps will be installed each with a variable frequency drive. At their rated head of 134 ft., each pump is designed to deliver approximately 18,500 gpm. The purpose of the pumps is to convey water to the Terminal Reservoir Pump Station. One additional 800 HP pump is being installed at the Terminal Reservoir. All of these pumps were planned for in the first design of these facilities and require minimal piping to be added to the system

### Summary

Based on our review of the 100% design plans and the Design Report prepared by B&V, we are of the opinion that the design plans were prepared in accordance with generally accepted design criteria for reasonably similar types of water treatment plants.

## ENVIRONMENTAL AND REGULATORY

### Status of Permits and Approvals

The Project must be designed, constructed, and operated in accordance with applicable federal, state, and local regulations, codes, standards, guidelines, policies, and laws. B&V, the design engineer of record, has identified the key permits and approvals required for construction and operation of the Project. Our review indicates that not all permits needed for construction are currently in hand, given the recent selection of a Contractor. We have talked with the Contractors and the responsible agencies and based on those discussions and our experience we are not aware of any technical reason why the Contractor should not be able to obtain these permits. The principal regulatory agency overseeing the major permit for the Project is the State Department of Health Services (DHS). We have contacted the DHS to discuss and confirm the status of the permit. The required key permits and approvals associated with the Project and the current status are listed in Table 4 and are discussed below.

**Table 4  
List of Key Permits and Approvals**

PERMIT/APPROVAL	RESPONSIBLE AGENCY	CURRENT STATUS	COMMENTS
<b>STATE</b>			
NPDES Storm Water Associated with Construction Activity Notice of Intent	California State Water Resources Control Board – Division of Water Quality	NOI not submitted.	MID will obtain this permit (with Contractor providing info to the Construction Manager) if required as part of the normal course of construction. Contractor will prepare and submit SWPPP. Contractor will prepare, Owner will file the NOI.
CRWQCB Central Valley Region General Order 5-00-175 for Dewatering – Notice of Intent to comply with terms	California Regional Water Quality Control Board - Central Valley Region	Permit request not submitted.	Contractor will obtain this permit if required as part of the normal course of construction.
Hot Work Permits	California – Dept of Industrial Relations, Div. of Occupational Safety and Health Standards Board	Permit request not submitted.	Contractor will obtain this permit if required as part of the normal course of construction. Deals with introducing source of ignition into workplace

**Table 4  
List of Key Permits and Approvals**

<b>PERMIT/APPROVAL</b>	<b>RESPONSIBLE AGENCY</b>	<b>CURRENT STATUS</b>	<b>COMMENTS</b>
Domestic Water Permit	California – Department of Health Services	MID has existing permit. Permit typically is obtained for new facility after construction.	This should not affect construction.
Construction Activities Permit – Buildings/Structures, Scaffolding/Falsework, Demolition, Trenches/Excavations	California – Dept of Industrial Relations, Div. of Occupational Safety and Health Standards Board	Permit request not submitted.	Contractor will obtain this permit if required as part of the normal course of construction.
<b>LOCAL</b>			
Application for Irrigation Water	Modesto Irrigation District	Permit request not submitted.	Contractor will obtain this permit if required as part of the normal course of construction.
Well permits for well points, borings, or cathodic protection	Stanislaus County Dept of Environmental Resources (Environmental Health Division)	Permit request not submitted.	Contractor will obtain this permit if required as part of the normal course of construction.
Fitness for Duty	Modesto Irrigation District	Obtained for all workers of the District	Pertains to District staff and all candidates selected for employment with the District

**Major Permitting and Regulatory Requirements**

**Major Permits**

The major permit required for the construction and operation of the Project is as follows:

- A Water Permit is issued by the State of California Department of Health Services, Stockton District in conjunction with the Federal Safe Drinking Water Act and the California Health and Safety Code. After the Project is constructed and meets certain requirements, a letter of authorization is issued which is used as an “interim permit.” Water can be delivered to customers after this “interim permit” is issued if satisfactory operational data is obtained. The regulations that must be met are the Federal Safe Drinking Water Act and the Surface Water Treatment Rule (SWTR). The State has not adopted many of the subsequent SWTR regulations but the State agrees that they will implement the rules. The permit will require MID to institute emergency procedures in case of process failures, submit a water treatment plant Operations Plan, and submit an annual report on Modesto Reservoir. MID will be required to periodically test the source water and distribution system for quality including chemical, radiological, and bacteriological contamination. A monthly filtration plant report will be required and washwater recovery process information will be maintained to be provided to DHS upon request. DHS reports that it sees no obstacles in issuing this permit.

**Other Required Permits**

There are a number of other permits and approvals identified in Table 4 that are required for the Project. Although there are several permits that have not been obtained to date, some of which cannot be obtained until the Project is ready to operate, we are not aware of any technical or engineering circumstances that would prevent the issuance of the

remaining required permits and approvals. The acquisition of these permits and approvals is considered to be relatively routine if these permits and approvals are pursued in a timely manner.

### **Summary**

B&V, the engineer of record for the Project, has identified the major permits and approvals necessary for the construction and operation of the Project. Based on our discussions with representatives of the principal regulatory agencies, we have confirmed the information presented to us by B&V. Our review of the permits indicates that the permits identified by B&V are consistent with the permits required for similar water treatment and conveyance facilities in California. Our review indicates that not all of the permits necessary to commence construction of the Project have been obtained. Some permits will be acquired by the Contractor. Certain of the permits required for the operation of the Project cannot be obtained until the completion of construction of the Project. We are not aware of any technical reason that such permits could not eventually be obtained.

## **PROCUREMENT AND CONSTRUCTION**

MID plans to achieve the construction of the Project through a construction contract that has yet to be executed. We have reviewed certain portions of a draft of this contract.

### **Procurement of Membranes**

MID invited firms to bid on the Low Pressure Membrane Filtration System Procurement for the MRWTP Phase Two Expansion Project. In order to qualify to bid, the bidders, among other requirements, must have been able to provide a system certified by California DHS as an approved alternative filtration technology and have designed, fabricated and furnished at least one 5 mgd plant with at least 2 years of continuous operation. A two stage approach to providing goods and services was specified. Stage One consisted of design and design support for the design engineer for the Project. Stage Two consisted of furnishing and delivering a complete membrane system, preparation of shop drawings, O&M manuals, coordination with the construction Contractor, performance testing and start-up and training services. Additionally, a one-year long contract for performance support, operations assistance and system maintenance was required.

Bids were evaluated by MID based on a 20-year life cycle analysis of the membranes and the qualifications of the bidder. Certain longevity and O&M cost factors were specified in order to allow meaningful comparison of bids.

The successful bidder, Siemens, was required to enter into the MOU. We have reviewed the MOU and presented below is a discussion of certain sections of the MOU.

### **Performance Bond**

A performance bond will be provided by Siemens for the manufacture, delivery, start-up, testing and training of the low pressure membrane filtration system in the required amount of 100% of the Stage 2 Contract Price, \$4,163,866. Such performance bond has been assigned to MID.

### **Permanent Demonstration Pilot Membrane Plant**

For the purpose of on-going testing of optimal operating conditions of the full scale plant, a permanently installed skid-mounted demonstration pilot plant is being provided in the gallery of the new Membrane Building.

### **Acceptance Testing**

Individual wet testing of the membrane system is outlined in the specifications. After all systems are installed and the entire Project is ready to operate, the System Demonstration Testing is to be performed by the Contractor which will confirm whether the facilities can be continuously operated for 7 consecutive days for their full intended function. Within 18 months of Substantial Completion, the System Performance Testing is to be performed and will consist of a 42 day and a 7 day test to verify that the system meets the performance requirements in the Contract Documents.

### **Siemens Performance Guarantee**

The Siemens Performance Guarantee shall be in effect for 1 year from the date of Stage 2 Substantial Completion. The system must meet specified guaranteed performance requirements for energy consumption, chemical usage and replacement price. The energy consumption guarantee includes the stipulation that Siemens shall pay liquidated damages if their unit cannot meet requirements during 30 consecutive days during Performance Testing. The damages shall amount to the present worth of the additional energy cost over 20 years using a specified interest rate and energy costs. The guarantee for membrane replacement price covers a 20 year span in which the original bid amount for a membrane module can be escalated at 85% of the change in the CPI as of the date of the contract. The chemical usage guarantee pertains to non-compliance during Performance Testing. The damages shall amount to the present worth of the additional chemical cost over 20 years using a specified interest rate and chemical costs.

### **Liquidated Damages**

Siemens has agreed to pay liquidated damages as outlined in Article 6 in the Instructions to Bidders of the Membrane Procurement contract documents, dated February 2006. Liquidated damages are assigned the following amounts for each day of delay beyond the agreed upon milestone date: shop drawing submittal - \$5,000; furnishing equipment - \$15,000; O&M Manual submittal - \$1,000; and Substantial Completion (Completion of Demonstration Test) - \$10,000.

### **Warranty for Membranes**

The membrane filtration equipment has a warranty of 2 years from Substantial Completion. Membranes have a warranty of 7 years from Substantial Completion. Membranes found defective in the first year are to be replaced free of charge. From 2 to 7 years, the membranes are to be replaced on a prorated price basis.

### **Contractor Assignment and Novation Agreement**

MID has obtained agreement from the pre-qualified Contractors to enter into an assignment and novation agreement at the award of the Project. This agreement assigns all aspects of MID's Agreement for Stage 2 Goods and Special Services as they pertain to construction to the Contractor including the Performance Bond.

## **PROJECT COSTS AND SCHEDULE**

### **Total Project Construction Costs**

#### **Construction Costs**

We have reviewed construction cost information regarding the Project provided to us by B&V. B&V's estimate of the total Project construction costs, including direct and indirect construction costs, is \$53,657,409.

The total direct and indirect construction costs for the Project, as estimated by B&V, are presented in Table 5, along with information provided by MID relating to Contractor bids received.

<b>Table 5 Total Construction Costs</b>		
<u>Costs Items</u>	<u>B&amp;V Estimate</u> <sup>(1)</sup>	<u>Contractor Bid</u>
<b>Water Treatment Plant Construction</b>	<b>\$47,508,069</b>	<b>\$56,637,179<sup>(2)</sup></b>
<b><u>Alternative Bid Items</u></b>		
Tekkem Lime Feed System	715,904	Included above
<b>SUBTOTAL</b>	<b>\$48,223,972</b>	<b>\$56,637,179</b>
Membrane Filtration Bid Allocation	5,283,436	5,283,436
<b>CONSTRUCTION TOTAL</b>	<b>\$53,657,409</b>	<b>\$61,920,615</b>
Design and Construction Consulting Costs	\$9,740,000	\$9,740,000
<u>MID costs, Interconnect Diagrams, &amp; Additional Services</u>	5,589,000	5,589,000
<b>TOTAL</b>	<b>\$68,986,409</b>	<b>\$77,249,615</b>
<p>(1) Source: Opinion of Probable Construction Cost 4/25/2007 B&amp;V.</p> <p>(2) Base bid of contractor plus 8% contingency minus membrane filtration bid allocation – Source: MID</p>		

We have reviewed the methodology used by B&V to develop the estimated construction cost for the Project. The construction costs were developed based on the use of material and equipment quotes, and B&V's cost experience in the construction of similar projects. B&V reports that they obtained quotes on all major pieces of equipment.

B&V reports that several of the engineering, cost estimating, and construction scheduling and management personnel on the B&V team have, within the last five years, prepared designs for several water treatment plants located in California. B&V based certain of the costs on their recent projects in California and other membrane water treatment projects that have a similar degree of mechanical sophistication, to develop the estimated construction cost of the Project. B&V reports it used industry standard values and indices of construction cost data in order to develop the remainder of the estimated construction costs.

The B&V construction cost estimate we reviewed indicates that the Direct Construction Costs include provision for construction contingency, profit and overhead which are equal to 10, 8.1 and 6.9 percent of the total Direct Construction Costs, respectively. This total amount, 25%, falls within the middle of the range of other reasonably similar projects with which we are familiar.

On April 26, 2007 MID reported that they received three bids, which have not been audited. The base bids ranged in amount from \$57,308,859 to \$ 60,289,000, which are 6.8% to 12.4% greater than B&V's opinion of probable construction cost of \$53,657,409. Three bids were all within 5.2% of each other and the two lowest bids were approximately \$25,000, or 0.05% apart. After an audit of the bids MID will award the construction contract based on a bid comparison that factors in the construction bids, as well as the present worth of ozone operating costs which are guaranteed by the bidders.

### Summary

Based on our review of information provided by B&V regarding the methodology it used to develop the estimated cost set forth in the Opinion of Probable Construction Cost 4/25/2007, we are of the opinion that such estimate was developed in accordance with generally accepted practices and methods of estimating. The construction contingency, overhead and profit amount of 25 percent of the total capital cost falls within the middle of the range we would anticipate for projects of this type.

## **Construction Schedule**

We have reviewed the 100% preliminary construction schedule in conjunction with the as-bid contract documents provided by B&V. We also interviewed the B&V design team scheduler to obtain an understanding of the methodology used to develop the 100% preliminary construction schedule. The design team scheduler was the owner of a construction company that specialized in the construction of water and wastewater treatment plant expansions. The schedule was assembled by B&V based on the scheduler's personal experience and discussions with local contractors that specialize in the construction and expansion of water and wastewater treatment plants. Schedule activity durations for the construction of concrete structures were established by B&V by applying time factors to material quantity take-offs from the 100% Opinion of Probable Cost. The schedule was constructed by B&V such that work is distributed to generate a reasonable monthly cash flow of approximately \$2.5 Million. The schedule is based on the assumption that an NTP will be issued by MID on June 20, 2007 and a Final Project Completion date of September 30, 2009.

B&V reports that the greatest risk for the schedule lies with the excavation, construction and backfill of the Phase 2 Membrane Building and Ozone Contactor below-grade structures, and continues through the building construction and start-up of the membrane facilities. The schedule was assembled by B&V based on the assumption that the Contactor will mass excavate these structures simultaneously. Due to the unstable nature of the sandy soils and the proximity of the excavations to existing structures, the excavations will require extensive shoring. A structural firm that specializes in shoring design was consulted by B&V for the excavation and shoring activity durations. The procurement and delivery of the liquid chemical feed system components and the ozone generators and power supply units are also critical to the successful execution of the schedule. A particularly challenging aspect associated with the construction of this project is that the Plant will remain in operation during construction. The contractor will be required to coordinate interconnections with existing Plant processes and site access with on-going plant operations. Contractual interim milestones with liquidated damages have been incorporated into the schedule to control contractor's progress and encourage performance.

### **Conclusion**

Based on our experience with the construction of large potable water facilities and our review of information provided to us by B&V, we are of the opinion that this schedule is achievable. In the absence of events such as the Contractor default, major labor difficulties, resolution of any disputes regarding easements, significant interruptions of transportation of materials and equipment, abnormal weather conditions, or other abnormal events detrimental to normal construction or installation, we are of the opinion that the schedule can be achieved.

## **Operating Costs**

### **Water Production**

Our review of the operating capability of the Project indicates that if the Project is designed, constructed and operated as currently proposed, the Project should be capable of increasing the capacity for producing treated water at MRWTP to 72 mgd.

### **Provisions for Power**

Standby power is provided for critical loads only, which are continuous process monitoring instrumentation, life safety alarms and power for a safe shutdown of the plant. Any new standby generator would NOT provide power for the entire plant.

As part of the Project two new 12 kV electrical utility circuits will be provided that originate from an on site utility substation. This circuit will provide redundancy to the existing 12 kV utility circuit, as well as additional capacity for the Project.

### **Operating and Maintenance Expenses**

B&V has developed an estimate of the annual expenses of operating and maintaining the Project. The estimate includes consideration of power, labor, overhead, operating supplies, chemicals, maintenance, membrane replacement and waste stream costs.

## **Conclusion**

We have reviewed the methodology used by MID and B&V in developing estimates of operating and maintenance expenses of the existing plant and the Project and we are of the opinion that such methodology is appropriate for this type of facility.

## **PRINCIPAL ASSUMPTIONS AND CONSIDERATIONS USED IN THE PREPARATION OF THE REPORT**

We have reviewed estimates of treatment capacity, construction documents for the Project, soils reports, preliminary design plans, design report, existing permits, quarterly reports to DHS for the existing plant, pilot plant reports, memorandum of understanding and contract documents for the membrane systems, construction schedules, the subsequent EIR, membrane functional design specification, and capital and annual operating costs of the Project made available to us by B&V and MID. On the basis of such data, we have prepared the Report. The Report is based on the principal considerations and assumptions listed below.

In the preparation of this Report and the opinions that follow, we have made certain assumptions with respect to conditions which may exist or events which may occur in the future. While we believe these assumptions to be reasonable for the purpose of this Report, they are dependent upon future events, and actual conditions may differ from those assumed. In addition we have used and relied upon certain information provided to us by sources which we believe to be reliable. We believe the use of such information and assumptions is reasonable for the purposes of our Report. However, some assumptions may vary significantly due to unanticipated events and circumstances. To the extent that actual future conditions differ from those assumed herein or provided to us by others, the actual results will vary from those forecast. This Report summarizes our work up to the date of the Report. Thus, changed conditions occurring or becoming known after such date could affect the material presented to the extent of such changes.

The principal considerations and assumptions made by us in preparing the Report and the principal information provided to us by others include the following:

1. As Independent Engineer, we have made no determination as to the validity and enforceability of any contract, agreement, rule, or regulation applicable to the Project and its operation. However, for the purposes of this Report, we have assumed that all such contracts, agreements, rules, and regulations will be fully enforceable in accordance with their contractual or regulatory terms. Moreover, it is assumed that all parties will comply with and fulfill the provisions of their respective contracts and agreements. We have made no determination as to the economic viability of any of the entities involved in the Project agreements and contracts.
2. The licenses, consents, and approvals, and consent modifications which have not or cannot be obtained until the Project is complete and in full operation, and other lesser licenses, consents and approvals which must be secured during the Project construction and prior to completion occurring after the date of this Report will be obtained on a timely basis. Any changes in required licenses, consents and approvals will not require major changes in design resulting in either material delays in the commencement of commercial operation of the Project or in significant increases in the cost of the Project.
3. All Project Participants will remain as viable corporate entities during the terms of the Project Agreements.
4. Defaults by any of the Project Participants will not result in delays in the construction of the Project as other Project Participants will perform the functions of the party in default.
5. One of the pre-screened Construction Contractors will construct the Project pursuant to the currently submitted 100% Contract Documents.
6. Siemens will design, manufacture, deliver and provide start-up, testing and training services for the membrane filtration system pursuant to the terms and conditions of the MOU dated May 4, 2006.

7. MID will operate the Project in accordance with the revised or new water permit obtained from DHS. MID will amend its Standard Operating Procedures for the process control of the Project. MID will continue to operate and maintain the existing MRWTP to the same standards that they have in the past.
8. The Construction Contractor will use generally accepted project and construction management practices.
9. The Construction Contractor will retain all the proposed qualified key employees involved in the construction of the Project.
10. MID will implement the staffing plan that it is currently developing for the purpose of operating and maintaining the Project and that it will meet all DHS requirements.
11. Membrane facility life will be 30 years with membrane replacement averaging 7 to 10 years.
12. MID will maintain the Project in accordance with good engineering and operating practice, will make all required renewals and replacements in a timely manner, and will not operate the equipment to cause it to exceed the equipment manufacturer's recommended maximum ratings.
13. MID will employ qualified and competent personnel who will properly operate and maintain the equipment in accordance with the manufacturer's recommendations and generally accepted engineering and operating practice and will generally operate the Project in a sound manner. In the event that any of MID's current Senior Operators should leave, they will be replaced by operators with similar experience.
14. MID will always have a Water Treatment Plant Manager with experience in water utility operations and management comparable to the individual currently filling that position.
15. The performance and delivery guarantees provided to the Construction Contractor by the suppliers of the major components of equipment and the major design parameters of this equipment therein will conform to performance and design data in the Contract Documents for the Project and the construction schedule submitted by B&V.
16. The physical and chemical characteristics and the temperature of the influent water will fall within the specifications established in the development of the Project, and the pilot plant determinations will remain valid in the full scale plant, i.e. cleaning frequency, chemical usage, etc.
17. No uncontrollable circumstances will occur during the construction period which would prevent the Project from being available for operation by September 30, 2009.
18. There will be no increased costs of construction or delays in construction which would cause the amount of liquidated damages available to MID under the Construction Contract to be insufficient (a) to pay for the cost of constructing the Project and (b) replacing lost revenues if construction is delayed.
19. All licenses, permits, and approvals and permit modifications necessary to construct and operate the Project will be obtained on a timely basis, and any changes in required licenses, permits and approvals will not require changes in design resulting in either material delays in the commencement of commercial operation of the Project or in significant increases in the costs of the Project.
20. The rate of inflation will increase at B&V's assumed rate of 6.0 percent per year which B&V used for planning purposes.
21. MID will implement a program of renewals and replacements to the Project as discussed herein.
22. B&V has followed the recommendations set forth in the Geotechnical Reports.
23. In order to meet the proposed construction schedule, the Contractor will simultaneously mass excavate the Phase 2 Membrane Building and Ozone Contactor below grade structures.

## CONCLUSIONS

Set forth below are the principal opinions which we have reached regarding our review of the Project. All opinions presented in the Report are based on the principal assumptions and considerations discussed herein. For a complete understanding of the estimates, assumptions, and calculations upon which these opinions are based, the Report should be read in its entirety. On the basis of our review and analyses of the Project and the assumptions set forth in this Report, we are of the opinion that:

1. The Project Site is adequate, from an infrastructure and geotechnical perspective, for construction and operation of the Project.

2. The environmental site assessments have been conducted in a manner consistent with industry standards, using comparable industry protocols.

3. The Contractors that were pre-qualified have previously demonstrated the ability to construct large municipal treatment facilities. Based on the Contractors' previous experience, we are of the opinion that Western Summit Constructors Inc. should be capable of performing the technical obligations of the Contactor as set forth in the Contract Documents. In the event of a default by this Contractor, there are qualified replacement contractors who should be capable of completing construction of the Project.

4. Based on our review of the design of the Project as developed by B&V, we are of the opinion that if the Project is constructed, operated, and maintained as currently proposed by MID, the Project should be capable of treating the source water to the Project and producing the quantity and quality of water as set forth in the design. We are further of the opinion that if the Project is constructed, operated, and maintained as currently proposed by MID, the Project should be capable of meeting the anticipated requirements of its operating permits.

5. Siemens has significant experience in the manufacture of membrane systems. At the present time, there are over 250 membrane-based drinking water treatment plants in the United States with a cumulative capacity of over 800 mgd. The submerged membrane technology proposed for the Project is commercially demonstrated and is based on the designs of other facilities. Siemens has provided one other PVdF submerged membrane system for a facility of this size.

6. The Demonstration Testing provisions which are intended to confirm that the facilities can be continuously operated for 7 consecutive days for their full intended function, combined with the System Performance Testing provision which occurs after Substantial Completion and consists of a 42 day and a 7 day test to verify that the system meets the performance requirements in the Contract Documents, should be capable of demonstrating the ability of the Project to operate at expected levels.

7. Barring unforeseen circumstances and given proper operation and maintenance and timely renewals and replacements as proposed by MID, the Project should be capable of realizing a useful life extending beyond the final maturity of the Bonds.

8. MID has identified the major permits and approvals currently required from various state and local agencies necessary to commence full construction of the Project. Certain additional construction permits must be obtained during the construction period by the Contractor. The major operating permit from DHS that is required to for long term operation cannot be obtained until after the Project is operating. We are not aware of any technical reasons that the remaining permits and approvals required for a) constructing and operating the Project and b) operating the MRWTP could not be obtained.

9. The opinion of probable construction cost prepared by B&V has been developed in accordance with generally accepted practices and methods of estimation. The provision for construction contingency, profit and overhead of 25 percent falls within the middle of the range of other reasonably similar projects with which we are familiar. The unaudited construction bids MID received were 6.8% to 12.4% higher than B&V's opinion of probable construction cost. The two lowest bids were approximately \$25,000 apart.

10. In the absence of events such as default of Contractors, major labor difficulties, significant interruptions of transportation of materials and equipment, legal disputes, abnormal weather conditions, or other abnormal events detrimental to normal construction or installation, B&V's schedule for the construction, start-up and testing of the Project is achievable.

11. The methodology used by MID to estimate its existing plant operations and maintenance cost projections and the methodology used by B&V to estimate the cost of operating and maintaining the Project are reasonable.

12. MID has previously demonstrated the ability to operate and maintain the existing MRWTP. The Project represents MID's first operation of a membrane filtration system. Based on MID's previous operating experience, along with the specified training and follow-up training, it is reasonable to expect that MID should be capable of operating the Project to meet regulatory standards.

**Respectfully submitted**

**R. W. BECK, INC.**

## APPENDIX B

### CERTAIN INFORMATION REGARDING THE CITY OF MODESTO

The following information with respect to the City is presented for information purposes only. The Series 2007 Water Bonds do not constitute an indebtedness of the City within the meaning of any constitutional, statutory or charter limitations and the City is not obligated to levy any ad valorem taxes therefor or to use any other funds of the City to pay the Series 2007 Installment Payments or the interest thereon.

#### General Description

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

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

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

#### Population

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

#### CITY OF MODESTO Population Estimates<sup>(1)</sup>

Calendar Year	City of Modesto	Stanislaus County	State of California
2007	209,174	521,497	37,662,518
2006	207,738	513,441	37,195,240
2005	207,634	504,478	36,743,186
2004	207,376	494,747	36,252,878
2003	204,145	484,496	35,691,534

<sup>(1)</sup> As of January 1.

Source: California State Department of Finance Population Estimates for Cities, Counties and State, 2001-2007, with 2000 DRU Benchmark.

## Employment

The following table summarizes the civilian labor force, employment and unemployment in the County for the calendar years 2002 through 2006. These figures are county-wide statistics and may not necessarily accurately reflect employment trends in the City.

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

	2006	2005	2004	2003	2002
<u>Civilian Labor Force</u>					
Employment	227,100	210,800	204,600	201,500	198,900
Unemployment	18,100	19,000	20,700	22,000	21,200
Unemployment Rate	8.0%	8.3%	9.2%	9.8%	9.6%
<u>Wage and Salary Employment:</u>					
Total Farm	14,100	14,100	13,800	14,000	13,900
Natural Resources, Mining and Construction	13,400	13,300	12,300	11,400	10,700
Manufacturing	23,100	22,300	22,700	23,100	22,500
Wholesale Trade	5,900	6,200	6,000	5,700	5,600
Retail Trade	22,500	22,700	21,500	21,800	21,700
Transport., Warehousing, Utilities	5,200	5,200	4,700	4,600	4,500
Information	2,400	2,500	2,500	2,200	2,100
Financial Activities	6,400	6,200	6,100	6,000	5,600
Professional and Business Services	14,800	14,900	14,200	13,800	15,000
Educational and Health Services	19,600	19,500	19,200	18,900	18,100
Leisure and Hospitality	15,500	14,800	14,200	13,700	13,600
Other Services	5,900	6,100	6,200	6,200	6,200
Federal Government	1,200	1,200	1,200	1,200	1,200
State Government	1,800	1,700	1,700	1,900	1,900
Local Government	23,300	22,700	22,100	21,900	22,200
Total All Industries	172,500	173,300	168,500	166,300	164,600

Note: Totals may not add up because of rounding.

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

## Effective Buying Income

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

The following table summarizes the total effective buying income for the County and the State for the period from 2002 through 2005.

**CITY OF MODESTO, STANISLAUS COUNTY AND THE STATE OF CALIFORNIA  
Total Effective Buying Income and Median Household Effective Buying Income  
2002 through 2005<sup>(1)</sup>**

<b>Year</b>	<b>Area</b>	<b>Total Effective Buying Income (000's Omitted)</b>	<b>Median Household Effective Buying Income</b>
2005	City of Modesto	\$ 3,274,173	\$37,874
	Stanislaus County	7,416,705	37,815
	California	705,108,410	43,915
2004	City of Modesto	\$ 3,165,245	\$36,774
	Stanislaus County	7,078,408	36,670
	California	674,721,020	42,924
2003	City of Modesto	\$ 2,957,668	\$36,573
	Stanislaus County	6,679,400	36,331
	California	647,879,427	42,484
2002	City of Modesto	\$ 2,903,037	\$37,705
	Stanislaus County	6,517,967	36,180
	California	650,521,407	43,532

<sup>(1)</sup> In 2002, the publisher of Sales and Marketing Management, altered the methodology used in order to produce current year estimates. The 2006 edition of Sales and Marketing Management has not been published as of the date hereof, and therefore 2006 estimates are not available.

Source: Survey of Buying Power, Sales & Marketing Management Magazine, dated 2002, 2003, 2004 and 2005.

**Major Employers**

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

**COUNTY OF STANISLAUS  
Ten Largest Manufacturing Employers<sup>(1)</sup>**

<b>Company Name</b>	<b>No. Employees</b>	<b>Product</b>
E&J Gallo Wine	3,311	Winery
Del Monte Foods	2,600	Fruit Products
Signature Fruit	2,321	Fruit Products
Stanislaus Food Products	2,300	Tomato Products
Foster Farms	1,512	Poultry Processor
Con Agra	1,000	Food Processing
Racor	859	Filtration Products
Frito-Lay	700	Snack Food Products
Patterson Frozen Foods	650	Frozen Food Products
Bronco Winery	620	Winery

<sup>(1)</sup> As of December 2006.

Source: Modesto Chamber of Commerce.

## Commercial Activity

The following two tables show the dollar volume of taxable transactions in the City of Modesto and County of Stanislaus from 2001 through 2005.

### CITY OF MODESTO Taxable Transactions Calendar Years 2001 through 2005<sup>(1)</sup> (in Thousands of Dollars)

Retail Outlets	2005	2004	2003	2002	2001
Apparel stores	\$165,575	\$148,097	\$ 126,372	\$ 129,773	\$ 112,847
General merchandise stores	550,143	538,323	518,024	507,438	499,333
Food stores	131,100	133,058	136,462	119,423	115,743
Eating and drinking places	275,550	258,357	245,609	235,337	219,205
Home furnishing and appliances	138,642	136,143	130,089	131,234	109,395
Building materials and farm implements	248,287	233,124	204,427	188,388	188,459
Auto dealers and supplies	232,889	253,170	259,395	247,861	230,912
Service stations	153,008	131,695	115,317	101,551	106,229
Other retail stores	452,236	418,822	392,650	381,371	364,468
<b>Subtotal</b>	<u>2,347,430</u>	<u>2,250,789</u>	<u>2,128,345</u>	<u>2,042,376</u>	<u>1,946,591</u>
All Other Outlets	400,579	414,841	433,387	372,899	367,760
<b>All Outlets</b>	<u>\$2,748,009</u>	<u>\$2,665,630</u>	<u>\$2,561,732</u>	<u>\$2,415,275</u>	<u>\$2,314,351</u>

<sup>(1)</sup> Last full year information available.

Source: State of California, Board of Equalization.

### COUNTY OF STANISLAUS Taxable Transactions Calendar Years 2001 through 2005<sup>(1)</sup> (in Thousands of Dollars)

Retail Outlets	2005	2004	2003	2002	2001
Apparel stores	\$213,850	\$192,858	\$ 154,867	\$ 154,083	\$ 127,711
General merchandise stores	927,418	846,742	803,255	784,431	754,247
Specialty stores	535,480	501,694	465,562	432,777	411,996
Food stores	308,864	291,867	282,781	260,781	255,923
Eating and drinking places	489,169	452,120	421,793	403,421	378,985
Household	210,720	198,691	187,214	181,384	153,417
Building materials	572,552	508,825	416,983	368,472	360,337
Automotive	1,516,702	1,396,277	1,305,986	1,248,936	1,244,939
Other retail stores	368,269	331,376	297,729	273,693	249,876
<b>Subtotal</b>	<u>\$5,143,024</u>	<u>\$4,720,450</u>	<u>\$4,336,170</u>	<u>\$4,107,978</u>	<u>\$3,937,431</u>
Business and Personal Services	253,838	240,245	224,429	233,862	214,161
All Other Outlets	\$1,889,038	\$1,804,973	\$1,614,893	\$1,494,025	\$1,421,077
<b>All Outlets</b>	<u>\$7,285,900</u>	<u>\$6,765,668</u>	<u>\$6,175,492</u>	<u>\$5,825,865</u>	<u>\$5,572,669</u>

<sup>(1)</sup> Last full year information available.

Source: State of California, Board of Equalization.

## Construction Trends

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

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

Provided below are the building permits and valuations for the City of Modesto for calendar years 2002 through 2006.

### CITY OF MODESTO Residential and Nonresidential Building Permit Valuations and Total Residential Building Permits

	2002	2003	2004	2005	2006 <sup>(1)</sup>
<b>Permit Valuation</b>					
New Single-family	\$216,245,472	\$169,003,473	\$69,473,535	\$165,909,336	\$81,650,097
New Multi-family	1,719,426	6,087,705	20,721,736	1,719,478	3,812,649
Res. Alterations & Additions	9,062,856	9,793,040	15,707,552	17,947,953	49,896,219
<b>Total Residential</b>	<b>\$227,027,754</b>	<b>\$184,884,218</b>	<b>\$105,902,823</b>	<b>\$185,576,767</b>	<b>\$135,358,965</b>
New Commercial	20,306,197	30,255,734	35,298,696	62,592,553	27,027,078
New Industrial	6,580,320	1,183,692	2,003,992	0	2,279,197
New Other	19,899,918	26,649,779	61,628,516	32,919,890	19,182,213
Non-Res. Alterations & Additions	32,507,506	24,933,722	25,524,261	19,914,523	23,513,438
<b>Total Nonresidential</b>	<b>\$ 79,293,941</b>	<b>\$ 83,022,927</b>	<b>\$124,455,465</b>	<b>\$115,426,966</b>	<b>\$72,001,926</b>
<b>Total All Building</b>	<b>\$306,321,695</b>	<b>\$267,907,145</b>	<b>\$230,358,288</b>	<b>\$301,003,773</b>	<b>\$207,360,891</b>
<b>New Dwelling Units</b>					
Single Family	1,067	1,105	348	872	380
Multiple Family	21	78	297	9	35
<b>Total</b>	<b>1,088</b>	<b>1,183</b>	<b>645</b>	<b>881</b>	<b>415</b>

<sup>(1)</sup> Preliminary information.

Note: Totals may not add up because of rounding.

Source: Construction Industry Research Board and the City of Modesto.

## Agriculture

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

### STANISLAUS COUNTY Agricultural Production 2001-2005

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

Source: Stanislaus County Department of Agriculture.

## **APPENDIX C**

### **FINANCIAL STATEMENTS OF THE CITY OF MODESTO WATER UTILITY SYSTEM**

The City has filed its Comprehensive Annual Financial Report ("CAFR") for Fiscal Year 2005-06 with the Nationally Recognized Municipal Securities Information Repositories. Such CAFR is incorporated herein by reference. The following are excerpts from the CAFR relating to the City Water Utility System.

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**CITY OF MODESTO**  
**STATEMENT OF NET ASSETS - PROPRIETARY FUNDS**  
**June 30, 2006**

	Enterprise				Internal Service
	Water	Sewer	Other Enterprise	Total Enterprise	
<b>ASSETS</b>					
Current assets:					
Cash and cash equivalents	\$ 23,549,341	\$ 23,764,487	\$ 6,247,047	\$ 53,560,875	\$ 48,027,975
Cash and cash equivalents with fiscal agent	273,350	3,621,532	612,784	4,507,666	
Receivables:					
Accounts	1,440	58,709	366,147	426,296	834,058
Interest	124,354	208,228	61,395	393,977	219,559
Utilities, net	5,292,161	2,440,681	558,412	8,291,254	
Taxes	3,940			3,940	
Due from governments		127,064	3,508,748	3,635,812	38,687
Prepaid expenses	1,003,000			1,003,000	
Inventories					516,919
Property held for resale			630,000	630,000	
Advances to other funds					1,903,476
Total current assets	<u>30,247,586</u>	<u>30,220,701</u>	<u>11,984,533</u>	<u>72,452,820</u>	<u>51,540,674</u>
Noncurrent assets:					
Restricted assets-cash and cash equivalents	664,110	363,101		1,027,211	
Unamortized costs of issuance	240,613	599,512		840,125	
Land and construction in progress	10,241,729	26,615,981	18,323,936	55,181,646	821,033
Other capital assets, net of accumulated depreciation	<u>65,827,962</u>	<u>104,251,720</u>	<u>59,461,089</u>	<u>229,540,771</u>	<u>18,917,891</u>
Total assets	<u>107,222,000</u>	<u>162,051,015</u>	<u>89,769,558</u>	<u>359,042,573</u>	<u>71,279,598</u>
<b>LIABILITIES</b>					
Current liabilities:					
Accounts payable	\$ 818,584	\$ 341,524	\$ 1,255,849	\$ 2,415,957	\$ 1,516,490
Accrued salaries and benefits	68,500	99,803	59,505	227,808	84,435
Interest payable	275,213	302,907	55,798	633,918	
Current portion - compensated absences					2,769,104
Current portion - claims liability					5,156,560
Current portion - long-term debt	977,764	1,650,000	275,955	2,903,719	26,587
Current portion - developer advances	96,760			96,760	
Deferred revenues			2,124,426	2,124,426	
Total current liabilities	<u>2,236,821</u>	<u>2,394,234</u>	<u>3,771,533</u>	<u>8,402,588</u>	<u>9,553,176</u>
Noncurrent liabilities:					
Payable from restricted assets - refundable deposits	664,110	363,101		1,027,211	
Compensated absences					58,847,850
Claims liability					11,174,550
Long-term debt:					
Revenue bonds payable		35,192,020		35,192,020	
Loan payable	1,958,276			1,958,276	
Notes payable					144,446
Obligations under capital leases			151,633	151,633	
Certificates of participation	17,985,078		5,650,000	23,635,078	
Developer advances	<u>2,081,001</u>			<u>2,081,001</u>	
Total noncurrent liabilities	<u>22,688,465</u>	<u>35,555,121</u>	<u>5,801,633</u>	<u>64,045,219</u>	<u>70,166,846</u>
Total liabilities	<u>24,925,286</u>	<u>37,949,355</u>	<u>9,573,166</u>	<u>72,447,807</u>	<u>79,720,022</u>
<b>NET ASSETS</b>					
Invested in capital assets, net of related debt	55,148,573	94,025,681	71,707,437	220,881,691	19,567,891
Unrestricted	<u>27,148,141</u>	<u>30,075,979</u>	<u>8,488,955</u>	<u>65,713,075</u>	<u>(28,008,315)</u>
Total net assets	<u>\$ 82,296,714</u>	<u>\$ 124,101,660</u>	<u>\$ 80,196,392</u>	<u>286,594,766</u>	<u>\$ (8,440,424)</u>
Adjustment to reflect the consolidation of internal service fund activities related to enterprise funds.				<u>837,201</u>	
Net assets of business-type activities				<u>\$ 287,431,967</u>	

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

**CITY OF MODESTO**  
**STATEMENT OF REVENUES, EXPENSES, AND CHANGES**  
**IN FUND NET ASSETS - PROPRIETARY FUNDS**  
Year ended June 30, 2006

	Water	Sewer	Other Enterprise	Total Enterprise	Internal Service
<b>OPERATING REVENUES:</b>					
Charges for services	\$ 42,639,348	\$ 23,057,564	\$ 13,450,725	\$ 79,147,637	\$ 73,979,591
Sales					2,616,588
Cost of sales					(2,604,232)
Miscellaneous		25,716	308,878	334,594	
Total operating revenues	<u>42,639,348</u>	<u>23,083,280</u>	<u>13,759,603</u>	<u>79,482,231</u>	<u>73,991,947</u>
<b>OPERATING EXPENSES:</b>					
Salaries and wages	3,921,478	4,991,009	3,574,322	12,486,809	4,072,026
Contractual services	1,716,729	2,791,417	10,808,264	15,316,410	1,013,441
Utilities	1,703,202	1,048,853	576,197	3,328,252	473,011
Maintenance and supplies	3,425,200	2,542,441	3,660,229	9,627,870	4,085,997
Water purchases	10,674,717			10,674,717	
Insurance	133,175	245,008	176,119	554,302	11,054,260
Claims expense					7,458,436
Employee benefits	1,427,839	1,852,398	1,290,449	4,570,686	37,751,321
Administration services	2,186,919	1,425,147	1,599,526	5,211,592	1,492,365
Allocated indirect administrative costs	1,049,489	760,932	684,216	2,494,637	264,010
Other	50,641	124,429	235,925	410,995	160,718
Depreciation	2,383,566	5,027,753	3,656,417	11,067,736	2,838,477
Total operating expenses	<u>28,672,955</u>	<u>20,809,387</u>	<u>26,261,664</u>	<u>75,744,006</u>	<u>70,664,062</u>
<b>OPERATING INCOME (LOSS)</b>	<u>13,966,393</u>	<u>2,273,893</u>	<u>(12,502,061)</u>	<u>3,738,225</u>	<u>3,327,885</u>
<b>NONOPERATING REVENUES (EXPENSES)</b>					
Operating grants			8,317,889	8,317,889	
Gain (Loss) on disposition of capital assets	(241,380)	(46,939)	(24,043)	(312,362)	(241,883)
Tax revenue			207,749	207,749	
Tax expense	(84,556)	(91,215)	(17,286)	(193,057)	
Interest income	487,165	694,320	161,180	1,342,665	895,959
Net increase in fair value of investments	14,009	32,123	7,089	53,221	20,310
Rental income	33,060	39,182	1,036,163	1,108,405	
Settlements and recoveries	1,334,259	2,450,036		3,784,295	
Interest expense	(1,209,884)	(2,034,714)	(321,587)	(3,566,185)	(11,541)
Amortization of costs of issuance	(13,839)	(35,265)		(49,104)	
Total nonoperating revenues (expenses)	<u>318,834</u>	<u>1,007,528</u>	<u>9,367,154</u>	<u>10,693,516</u>	<u>662,845</u>
<b>INCOME (LOSS) BEFORE CAPITAL CONTRIBUTIONS AND TRANSFERS</b>	14,285,227	3,281,421	(3,134,907)	14,431,741	3,990,730
Capital contributions	4,156,357	3,343,231	2,968,285	10,467,873	318,634
Transfers in		608,400	1,741,437	2,349,837	1,712,361
Transfers out	(95,385)	(715,603)	(122,059)	(933,047)	(586,393)
Special item	(715,185)	(1,020,869)		(1,736,054)	
<b>CHANGE IN NET ASSETS</b>	17,631,014	5,496,580	1,452,756	24,580,350	5,435,332
<b>NET ASSETS, July 1</b>	<u>64,665,700</u>	<u>118,605,080</u>	<u>78,743,636</u>		<u>(13,875,756)</u>
<b>NET ASSETS, June 30</b>	<u>\$ 82,296,714</u>	<u>\$ 124,101,660</u>	<u>\$ 80,196,392</u>		<u>\$ (8,440,424)</u>
Adjustment to reflect the consolidation of internal service fund activities related to enterprise funds.				744,654	
Change in net assets of business-type activities				<u>\$ 25,325,004</u>	

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

**CITY OF MODESTO**  
**STATEMENT OF CASH FLOWS - PROPRIETARY FUNDS**  
Year ended June 30, 2006

	Enterprise			Total Enterprise	Internal Service
	Water	Sewer	Other Enterprise		
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>					
Receipts from customers and users	\$ 41,033,042	\$ 23,086,747	\$ 14,635,268	\$ 78,755,057	\$ 1,076,798
Receipts from interfund services provided	797,367	119,091	23,910	940,368	72,377,540
Payments to suppliers	(18,027,267)	(6,229,721)	(13,430,505)	(37,687,493)	(16,163,026)
Payment of insurance claims					(5,089,127)
Payments to employees	(5,331,913)	(6,812,624)	(4,847,597)	(16,992,134)	(42,611,729)
Payments for interfund services used	(3,541,710)	(4,078,294)	(3,924,272)	(11,544,276)	(2,200,479)
Net cash provided (used) by operating activities	<u>14,929,519</u>	<u>6,085,199</u>	<u>(7,543,196)</u>	<u>13,471,522</u>	<u>7,389,977</u>
<b>CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:</b>					
Operating grants received			6,593,915	6,593,915	
Taxes received			207,749	207,749	
Settlements and recoveries	1,334,259	2,450,036		3,784,295	
Transfers in		608,400	1,438,124	2,046,524	1,712,361
Transfers out	(95,385)	(1,643,481)	(122,059)	(1,860,925)	(586,393)
Repayments of advances to other funds					96,524
Net cash provided (used) by noncapital financing activities	<u>1,238,874</u>	<u>1,414,955</u>	<u>8,117,729</u>	<u>10,771,558</u>	<u>1,222,492</u>
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:</b>					
Acquisition and construction of capital assets	(5,170,271)	(1,126,014)	(1,904,104)	(8,200,389)	(4,264,019)
Principal repayments	(1,033,670)	(990,000)	(262,899)	(2,286,569)	(45,588)
Interest paid	(1,123,749)	(1,926,462)	(323,310)	(3,373,521)	(11,541)
Capital grants received			1,550,637	1,550,637	
Connection fees for capital purposes	3,029,293	705,614		3,734,907	
Net cash used by capital and related financing activities	<u>(4,298,397)</u>	<u>(3,336,862)</u>	<u>(939,676)</u>	<u>(8,574,935)</u>	<u>(4,321,148)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>					
Interest received	445,467	660,350	165,747	1,271,564	875,832
Net increase in the fair value of investments	14,009	32,123	7,089	53,221	20,310
Net cash provided by investing activities	<u>459,476</u>	<u>692,473</u>	<u>172,836</u>	<u>1,324,785</u>	<u>896,142</u>
Net increase (decrease) in cash and cash equivalents	12,329,472	4,855,765	(192,307)	16,992,930	5,138,677
CASH AND CASH EQUIVALENTS, JULY 1	<u>12,157,329</u>	<u>22,893,355</u>	<u>7,052,138</u>	<u>42,102,822</u>	<u>42,889,298</u>
CASH AND CASH EQUIVALENTS, JUNE 30	<u>\$ 24,486,801</u>	<u>\$ 27,749,120</u>	<u>\$ 6,859,831</u>	<u>\$ 59,095,752</u>	<u>\$ 48,027,975</u>
<b>RECONCILIATION TO STATEMENT OF NET ASSETS:</b>					
Cash and cash equivalents	\$ 23,549,341	\$ 23,764,487	\$ 6,247,047	\$ 53,560,875	\$ 48,027,975
Cash and cash equivalents with fiscal agent	273,350	3,621,532	612,784	4,507,666	
Restricted assets-cash and cash equivalents	664,110	363,101		1,027,211	
TOTAL CASH AND CASH EQUIVALENTS	<u>\$ 24,486,801</u>	<u>\$ 27,749,120</u>	<u>\$ 6,859,831</u>	<u>\$ 59,095,752</u>	<u>\$ 48,027,975</u>

(continued)

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

**CITY OF MODESTO**  
**STATEMENT OF CASH FLOWS - PROPRIETARY FUNDS (Continued)**  
**Year ended June 30, 2006**

	Enterprise			Total Enterprise	Internal Service
	Water	Sewer	Other Enterprise		
<b>RECONCILIATION OF OPERATING INCOME (LOSS)</b>					
<b>TO NET CASH PROVIDED (USED) BY OPERATING</b>					
<b>ACTIVITIES:</b>					
Operating income (loss)	\$ 13,966,393	\$ 2,273,893	\$ (12,502,061)	\$ 3,738,225	\$ 3,327,885
Adjustments to reconcile operating income (loss) to net cash provided (used) by operating activities:					
Depreciation	2,383,566	5,027,753	3,656,417	11,067,736	2,838,477
Rental income	33,060	39,182	1,036,163	1,108,405	
Taxes paid	(84,556)	(91,215)	(17,084)	(192,855)	
Special item	(715,185)	(1,020,869)		(1,736,054)	
Change in assets and liabilities:					
(Increase) in accounts receivable	(1,440)	109,052	(38,880)	68,732	(537,609)
(Increase) in utilities receivable	(1,002,841)	(73,545)	(9,538)	(1,085,924)	
(Increase) in taxes receivable	(569)			(569)	
Decrease in notes receivable					3,096
(Increase) in prepaid expenses	(61,825)			(61,825)	
(Increase) in inventories					(141,322)
(Decrease) in accounts payable and accrued expenses	232,661	(257,704)	402,985	377,942	321,619
Increase in accrued salaries and benefits	17,404	30,783	17,174	65,361	31,873
Increase in compensated absences					(823,351)
(Decrease) in claims liability					2,369,309
Increase in deferred revenues			(88,372)	(88,372)	
Increase (decrease) in refundable deposits	162,851	47,869		210,720	
Total adjustments	<u>963,126</u>	<u>3,811,306</u>	<u>4,958,865</u>	<u>9,733,297</u>	<u>4,062,092</u>
Net cash provided (used) by operating activities	<u>\$ 14,929,519</u>	<u>\$ 6,085,199</u>	<u>\$ (7,543,196)</u>	<u>\$ 13,471,522</u>	<u>\$ 7,389,977</u>
<b>NONCASH INVESTING, CAPITAL AND FINANCING</b>					
<b>ACTIVITIES:</b>					
Capital assets transferred in	\$ 862,587	\$ 45,682	\$ 749,502	\$ 1,657,771	\$ 318,634
Developer infrastructure contributions	264,477	2,591,935	370,166	3,226,578	

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

## APPENDIX D

### SUMMARY OF LEGAL DOCUMENTS

*Certain provisions of the Installment Purchase Contract and the Trust Agreement are summarized below. This summary does not purport to be complete or definitive and is qualified in its entirety by reference to the full terms of such documents .*

### DEFINITIONS

*All capitalized terms not defined below have the meanings set forth in the Trust Agreement or the Installment Purchase Contract.*

“Act” means the Joint Exercise of Powers Act, constituting Chapter 5 of Title 1 of Division 7 of the California Government Code (Sections 6500 et seq.) as amended and supplemented to the date of the Trust Agreement.

“Bond Insurer” means MBIA Insurance Corporation.

“Continuing Disclosure Agreement” means that certain Continuing Disclosure Agreement between the City of Modesto and the Trustee dated the date of issuance and delivery of the Water Bonds, as originally executed and as it may be amended from time to time in accordance with the terms thereof.

“Depository” means The Bank of New York Trust Company, N.A., as trustee, and its successors and assigns.

“Domestic Water Bonds” means the outstanding Modesto Irrigation District Financing Authority Domestic Water Project Revenue Bonds, Series 1998D and the Series F Water Bonds.

“Domestic Water Contract” means the 1998 Installment Purchase Contract, the Installment Purchase Contract, Domestic Water Swap Contracts and all contracts of the District authorized and executed by the District under and pursuant to the Law, the Domestic Water Installment Payments under which are on a parity with the Series F Domestic Water Installment Payments and are secured by a pledge of and lien on the Treatment and Delivery Revenues.

“Domestic Water Installment Payments” means: (1) the installment payments of interest and principal scheduled to be paid by the District, and (2) Domestic Water Swap Installment Payments, under and pursuant to the Domestic Water Contracts.

“Domestic Water Project Fund” means the Modesto Irrigation District Domestic Water project Fund, Series 2007, established pursuant to the Trust Agreement.

“Domestic Water Project Phase Two” means the acquisition of the Domestic Water System so described in the Installment Purchase Contract.

“Domestic Water Swap Installment Payments” means regularly scheduled payments and termination payments, if any, made to third-party counterparties pursuant to interest rate swap agreements, including but not limited to, the Series 2007F Swap Contract Payments.

“Domestic Water Swap Contracts” means all interest rate swap contracts entered into by the Authority and payable from Domestic Water Swap Installment Payments.

“Domestic Water System” means all facilities related to the treatment, transmission, storage, distribution and pumping and all other properties, structures or works for the treatment, transmission, storage, distribution and pumping of domestic water and all rights to obtain, control or receive domestic water services heretofore or

hereafter acquired or constructed by the District together with all additions, betterments, extensions or improvements to such facilities, properties, structures or works or any part thereof hereafter acquired and constructed.

“Domestic Water Service” means the treated water furnished, made available or sold by the Domestic Water System.

“Federal Securities” means any of the following:

1. Cash.
2. U.S. Treasury Certificates, Notes and Bonds (including State and Local Government Series “SLGs”)
3. Direct obligations of the Treasury which have been stripped by the Treasury itself, CATS, TIGRS and similar securities
4. Resolution Funding Corp. (REFCORP) Only the interest component of REFCORP strips which have been stripped by request of the Federal Reserve Bank of New York in book entry form are acceptable.
5. Pre-refunded municipal bonds rated “Aaa” by Moody’s and “AAA” by S&P. If however, the issue is only rated by S&P (i.e., there is no Moody’s rating), then the pre-refunded bonds must have been pre-refunded with cash, direct U.S. or U.S. guaranteed obligations, or AAA rated pre-refunded municipals to satisfy this condition.
6. Obligation issued by the following agencies which are backed by the full faith and credit of the U.S.
  - a. U.S. Export-Import Bank (Eximbank)  
Direct obligations or fully guaranteed certificates of beneficial ownership
  - b. Farmers Home Administration (FmHA)  
Certificates of beneficial ownership
  - c. Federal Financing Bank
  - d. General Services Administration  
Participation certificates
  - e. U.S. Maritime Administration  
Guaranteed Title XI financing
  - f. U.S. Department of Housing and Urban Development (HUD)  
Project Notes  
Local Authority Bonds  
New Communities Debentures – U.S. government guaranteed debentures

U.S. Public Housing Notes and Bonds – U.S. government guaranteed public housing notes and bonds

“Information Services” means Financial Information, Inc.'s "Daily Bond Service," 30 Montgomery Street, 10th Floor, Jersey City, New Jersey 07302, Attention: Editor; Kenny Information Services' "Called Bond Service," 55 Broad Street, 28th Floor, New York, New York 10004; Moody's "Municipal and Government," 99 Church Street, 8th Floor, New York, New York 10007, Attention: Municipal News Reports; and Standard and Poor's "Called Bond Record," 25 Broadway, 3rd Floor, New York, New York 10004; or, in accordance with then-current guidelines of the Securities and Exchange Commission, to such other addresses and/or such other services providing information with respect to called bonds, or no such services, as the Authority may designate in a Certificate of the Authority delivered to the Trustee.

“Installment Payments” means the installment payments of interest and principal and the prepayment premium, if any, payable by the District under and pursuant to the Installment Purchase Contract.

“Installment Purchase Contract” means the Installment Purchase Contract by and between the District and the Authority dated as of June 1, 2007, as originally executed and as it may from time to time be amended or supplemented in accordance with its terms.

“Interest Payment Date,” means the first Business Day of each March, June, September and December, commencing on September 4, 2007.

“Law” means the Irrigation District Law of the State of California (being Division 11 of the Water Code of the State of California, as amended) and all laws amendatory thereof or supplemental thereto.

“Maintenance and Operation Costs of the Domestic Water System” shall mean the costs set forth in Sections 14.2, 14.3, 14.4, 14.5, 14.6 and 14.7 of the Treatment and Delivery Agreement and similar costs related to the Domestic Water System.

“Maximum Annual Series F Domestic Water Installment Payments” means, as of any date of calculation, an amount equal to the greatest annual Series F Domestic Water Installment Payment payable in any year ending on September 1 during the period beginning with the then current year and ending with the year ending on September 1, 2037; provided that for purposes of such calculation the interest component of such Series F Domestic Water Installment Payment shall be calculated at rates equal to the fixed rates of interest to be paid by the Authority under the Series 2007F Swap Contract, namely 4.44% in the case of the notional amount of \$69,820,000 with respect to the Series F Water Bonds with a stated maturity of September 1, 2037 and 4.378% in the case of the notional amount of \$23,370,000 with respect to the Series F Water Bonds with a stated maturity of September 1, 2027

“Net Proceeds” means, when used with respect to any insurance or condemnation award, the proceeds from such insurance or condemnation award remaining after payment of all expenses (including attorneys' fees) incurred in the collection of such proceeds.

“Permitted Investments” means any of the following which at the time are legal investments under the laws of the State of California for moneys held under the Trust Agreement and then proposed to be invested therein:

A. Direct obligations of the United States (including obligations issued or held in book-entry form on the books of the Department of the Treasury, and CATS and TIGRS) or obligations the principal of and interest on which are unconditionally guaranteed by the United States.

B. Bonds, debentures, notes or other evidence of indebtedness issued or guaranteed by any of the following federal agencies and provided such obligations are backed by the full faith and credit of the United States (stripped securities are only permitted if they have been stripped by the agency itself):

1. United States Export-Import Bank

Direct obligations or fully guaranteed certificates of beneficial ownership

2. Farmers Home Administration

Certificates of beneficial ownership

3. Federal Financing Bank

4. Federal Housing Administration Debentures (“FHA”)

5. General Services Administration

Participation certificates

6. Government National Mortgage Association (“GNMA” or “Ginnie Mae”)

GNMA – guaranteed mortgage-backed bonds

GNMA – guaranteed pass-through obligations

7. United States Maritime Administration

Guaranteed Title XI financing

8. United States Department of Housing and Urban Development (“HUD”)

Project Notes

Local Authority Bonds

New Communities Debentures - United States government guaranteed debentures

U.S. Public Housing Notes and Bonds – U.S. government guaranteed public housing notes and bonds

C. Bonds, debentures, notes or other evidence of indebtedness issued or guaranteed by any of the following non-full faith and credit U.S. government agencies (stripped securities are only permitted if they have been stripped by the agency itself):

1. Federal Home Loan Bank System

Senior debt obligations

2. Federal Home Loan Mortgage Corporation (“FHLMC” or “Freddie Mac”)

Participation Certificates

Senior debt obligations

3. Federal National Mortgage Association (“FNMA” or “Fannie Mae”)

Mortgage-backed securities and senior debt obligations

4. Senior Loan Marketing Association (“SLMA” or “Sallie Mae”)

Senior debt obligations

5. Resolution Funding Corporation (“REFCORP”) obligations
6. Farm Credit System

Consolidated systemwide bonds and notes

D. Money market funds registered under the Federal Investment Company Act of 1940, whose shares are registered under the Federal Securities Act of 1933, and having a rating by S&P of “AAAm-G,” “AAA-m,” or “AA m” and if rated by Moody’s, rated “Aaa,” “Aa1” or “Aa2,” including funds for which the Trustee or any of its affiliates (including any holding company, subsidiaries, or other affiliates) provides investment advisory or other management services.

E. Certificates of deposit secured at all times by collateral described in (A) and/or (B) above. Such certificates must be issued by commercial banks (including affiliates of the Trustee), savings and loan associations or mutual savings banks. The collateral must be held by a third party and the Trustee must have a perfected first security interest in the collateral.

F. Certificates of deposit, savings accounts, deposit accounts or money market deposits (including those of the Trustee and its affiliates) which are fully insured by FDIC, including BIF and SAIF.

G. Investment Agreements, including Guaranteed Investment Contracts, Forward Purchase Agreements and Reserve Fund Put Agreements approved in writing by the applicable insurer or insurers of the Bonds.

H. Commercial paper rated, at the time of purchase, “Prime-1” by Moody’s and “A-1+” by S&P.

I. Bonds or notes issued by any state or municipality which are rated by Moody’s and S&P in one of the two highest rating categories assigned by such agencies.

J. Federal funds or bankers acceptances with a maximum term of one year of any bank which has an unsecured, uninsured and unguaranteed obligation rating of “Prime – 1” or “A3” or better by Moody’s and “A-1+” or “A” or better by S&P.

K. Repurchase agreements that provide for the transfer of securities from a dealer bank or securities firm (seller/borrower) to the Trustee (buyer/lender), and the transfer of cash from the Trustee to the dealer bank or securities firm with an agreement that the dealer bank or securities firm will repay the cash plus a yield to the Trustee in exchange for the securities at a specified date.

Repurchase Agreements must satisfy the following criteria:

a. Repos must be between the municipal entity and a dealer bank or securities firm

(1) Primary dealers on the Federal Reserve reporting dealer list which are rated A or better by Standard & Poor’s Ratings Group and Moody’s, or

(2) Banks rated “A” or above by Standard & Poor’s Ratings Group and Moody’s Investor Services.

b. The written repo contract must include the following:

(1) Securities which are acceptable for transfer are:

(a) Direct U.S. governments

(b) Federal agencies backed by the full faith and credit of the U.S. government (and FNMA & FHLMC)

(2) The term of the repo may be up to 30 days

(3) The collateral must be delivered to the municipal entity, trustee (if trustee is not supplying the collateral) or third party acting as agent for the trustee (if the trustee is supplying the collateral) before/simultaneous with payment (perfection by possession of certificated securities).

(4) The trustee has a perfected first priority security interest in the collateral.

(5) Valuation of Collateral

(a) The securities must be valued weekly, marked-to-market at current market price plus accrued interest

(b) The value of collateral must be equal to 104% of the amount of cash transferred by the municipal entity to the dealer bank or security firm under the repo plus accrued interest. If the value of securities held as collateral slips below 104% of the value of the cash transferred by municipality, then additional cash and/or acceptable securities must be transferred. If, however, the securities used as collateral are FNMA or FHLMC, then the value of collateral must equal 105%.

c. Legal opinion which must be delivered to the municipal entity:

Repo meets guidelines under state law for legal investment of public funds.

L. Any state administered pool investment fund in which the District is statutorily permitted or required to invest, including, but not limited to participation in the Local Agency Investment Fund (LAIF).

M. Any other investment approved by the Bond Insurer.

“Project Phase Two” means the acquisition, design, construction and installation of the Phase Two expansion to the domestic water treatment and delivery system of the District described in the Trust Agreement and all improvements and betterments related thereto.

“Revenues” means all Installment Payments and other payments made by the District and received by the Authority pursuant to the Installment Purchase Contract and all interest or other income from any investment of any money in any fund or account (other than the Rebate Fund) pursuant to the Trust Agreement.

“Series F Domestic Water Installment Payment Date” means the Interest Payment Date as that term is defined in the Trust Agreement.

“Series F Domestic Water Installment Payments” means (i) the Series F Domestic Water Installment Payments scheduled to be paid pursuant to the Installment Purchase Contract, and (ii) the Series 2007F Swap Contract Payments.

“Series 2007 Reserve Fund” means the Series 2007 Reserve Fund established pursuant to the Installment Purchase Contract.

“Series 2007 Reserve Fund Requirement” means, as of any date of calculation, an amount equal to the Maximum Annual Series F Domestic Water Installment Payments.

“Series 2007 Revenue Fund” means the Series 2007 Revenue Fund established pursuant to the Trust Agreement.

“Series 2007F Counterparty” means Bear Stearns Capital Markets.

“Series 2007F Interest Period” means each period commencing on and including an Interest Payment Date to but not including the next succeeding Interest Payment Date.

“Series 2007F Swap Contract” means, collectively, the ISDA Master Agreement, the two Confirmations, the Credit Support Annex and the Schedule, each dated June 5, 2007, and each between the Authority and Series 2007F Counterparty.

“Series 2007F Swap Contract Payments” means the regularly scheduled amounts periodically required to be paid by the Authority (excluding termination payments) to the Series 2007F Counterparty under the Series 2007F Swap Contract; provided that Series 2007F Swap Contract Payments shall only be payable from Treatment and Delivery Revenues.

“Series 2007F Swap Contract Receipts” means the amounts periodically required to be paid by the Series 2007F Counterparty to the Authority under the Series 2007F Swap Contract.

“Series F Water Bonds” means the Modesto Irrigation District Financing Authority Domestic Water Project Revenue Bonds, Series 2007F, issued pursuant to the Trust Agreement.

“Tax Certificate” means the Tax Certificate and Agreement, if any, delivered by the Authority and the District at the time of the issuance and delivery of the Series F Water Bonds, as the same may be amended or supplemented by its terms.

“Treatment and Delivery Agreement” means the Amended and Restated Treatment and Delivery Agreement, executed and delivered during 2005 by the District and the City of Modesto, as amended by the Financing Amendments to Amended and Restated Treatment and Delivery Agreement, dated as of June 1, 2007, by and between the District and the City of Modesto, as it may be further amended from time to time in accordance with its terms.

“Treatment and Delivery Revenues” means the Debt Service portion of the total sum to be paid by the City of Modesto as set forth in the Treatment and Delivery Agreement.

“Trust Agreement” means the Trust Agreement, dated as of June 1, 2007, by and among the Trustee, the District and the Authority, pursuant to which the Authority has issued its Series F Water Bonds.

## **SUMMARY OF INSTALLMENT PURCHASE CONTRACT**

### **Acquisition, Design and Construction of the Domestic Water Project, Phase Two**

Purchase of the Domestic Water Project Phase Two by the District. In consideration of the obligation of the District to pay the Purchase Price as provided in the Installment purchase Contract, the Authority sells, assigns and transfers to the District, and the District purchases from the Authority, all of the Authority’s right, title and interest in the Domestic Water Project Phase Two. Immediately upon completion of each separate component of the Domestic Water Project Phase Two, all right, title and interest in and to each such completed component of the Domestic Water Project Phase Two shall vest in the District without any further action by the District or the Authority.

Design, Acquisition and Construction of the Domestic Water Project Phase Two. The Authority agrees to design, acquire and construct the Domestic Water Project Phase Two for the District, and the Authority hereby appoints the District as its agent for the purpose of such design, acquisition and construction. The District agrees to enter into such engineering, design and construction contracts and purchase orders as may be necessary, as agent for the Authority, to provide for the complete design, acquisition and construction of the Domestic Water Project Phase Two. The District agrees that as such agent it will cause the acquisition and construction of the Domestic Water

Project Phase Two to be diligently completed after the deposit of funds in the Domestic Water Project Fund for such purpose pursuant to the Trust Agreement.

Notwithstanding the foregoing, it is expressly understood and agreed that the Authority shall be under no liability of any kind or character whatsoever for the payment of any costs or expenses incurred by the District (whether as agent for the Authority or otherwise) for the acquisition and construction of the Domestic Water Project Phase Two except from moneys in the Domestic Water Project Fund and that all such costs and expenses shall be paid by the District, regardless of whether the funds deposited in the Domestic Water Project Fund are sufficient to cover all such costs.

### **Domestic Water Installment Payments**

Purchase Price. (a) The Purchase Price to be paid under the Installment Purchase Contract by the District to the Authority is the sum of the aggregate principal amount of the District's obligations thereunder plus the interest to accrue on the unpaid balance of such principal amount from the effective date of the Installment Purchase Contract over the term thereof, subject to prepayment as provided therein.

(b) The principal amount of the Series F Domestic Water Installment Payments to be made by the District under Installment Purchase Contract is \$93,190,000.

(c) The interest to accrue on the unpaid balance of such principal amounts of Series F Domestic Water Installment Payments is as specified in the Installment purchase Contract and shall be paid by the District as and constitutes interest paid on the principal amount of the District's obligations thereunder.

Series F Domestic Water Installment Payments. The District shall, subject to any rights of prepayment provided in the Installment Purchase Contract, pay the Trustee, on behalf of the Authority, the Purchase Price in Series F Domestic Water Installment Payments on each Series F Domestic Water Installment Payment Date for the payment of principal of (whether at maturity or upon redemption or acceleration), redemption premium, if any, and interest on the Series F Water Bonds until the principal of, redemption premium, if any, and interest on the Series F Water Bonds shall have been fully paid or provision for the payment thereof have been made in accordance with the Trust Agreement, in immediately available funds, for deposit in the Series F Revenue Fund.

The interest components of the Series F Domestic Water Installment Payments shall be calculated for each interest payment period to be an amount equal to the amount of interest on the Series 2007F Bonds for such interest payment period, as specified in the Trust Agreement.

Each Series F Domestic Water Installment Payment shall be payable to the Authority on or before the 15th day of the month before its due date in lawful money of the United States of America. In the event the District fails to make any of the payments required to be made by it under the Installment Purchase Contract, such payment shall continue as an obligation of the District until such amount has been fully paid, and the District agrees to pay the same with interest accruing thereon at the rate or rates of interest then applicable to the remaining unpaid principal balance of the Series F Domestic Water Installment Payments if paid in accordance with its terms.

Obligation to Pay. The obligation of the District to make the Series F Domestic Water Installment Payments is absolute and unconditional, and until such time as the Purchase Price shall have been paid in full (or provision for the payment thereof shall have been made pursuant to the Installment Purchase Contract), the District will not discontinue or suspend any Series F Domestic Water Installment Payments required to be made by it under Installment Purchase Contract when due, whether or not the Domestic Water Project Phase Two or any part thereof is operating or operable or has been completed, or its use is suspended, interfered with, reduced or curtailed or terminated in whole or in part, and such payments shall not be subject to reduction whether by offset or otherwise and shall not be conditional upon the performance or nonperformance by any party of any agreement, including but not limited to the Treatment and Delivery Agreement, for any cause whatsoever; provided, however that in accordance with the Installment Purchase Contract, the District's obligation to so make the Series F Domestic Water Installment Payments is payable solely from Treatment and Delivery Revenues.

Authority Option to Repay. The Authority may, at any time, repay to the District an amount equal to that amount required to be deposited by the District to discharge its obligations under the Installment Purchase Contract, which amount, if so paid, the District shall so deposit in the time, form and manner specified thereunder.

## **Revenues**

All Treatment and Delivery Revenues are irrevocably pledged to the payment of the Domestic Water Installment Payments as provided in the Installment Purchase Contract, and the Treatment and Delivery Revenues shall not be used for any other purpose while any of the Domestic Water Installment Payments remain unpaid; provided, however, that out of the Treatment and Delivery Revenues there may be apportioned such sums for such purposes as are expressly permitted by the Installment Purchase Contract. This pledge shall constitute a first lien on the Treatment and Delivery Revenues for the payment of the Domestic Water Installment Payments and all other Domestic Water Contracts and Domestic Water Bonds in accordance with the terms of the Installment Purchase Contract; provided, however, that the foregoing pledge shall secure any portion of Domestic Water Swap Installment Payments that constitute termination payments under a Domestic Water Swap Contract on a second lien subordinate basis, and such security for such termination payments shall be junior to the pledge of Treatment and Delivery Revenues securing other Domestic Water Installment Payments.

Allocation of Treatment and Delivery Revenues. In order to carry out and effectuate the pledge and lien set forth in the Installment Purchase Contract, all Treatment and Delivery Revenues shall be deposited when and as available or received in the Modesto Irrigation District Domestic Water Project Revenue Fund, which fund has been previously established pursuant to the 1998 Installment Purchase Contract (the "Domestic Water Project Revenue Fund"), and which the District agrees and covenants to maintain so long as any Domestic Water Installment Payments remain unpaid, and all moneys in the Domestic Water Project Revenue Fund shall be so held in trust and applied and used solely as provided in the Installment Purchase Contract. All moneys in the Domestic Water Project Revenue Fund shall be set aside by the District at the following times in the following respective special funds (each of which is established under the Installment Purchase Contract and each of which is held by the District and each of which the District agrees and covenants to maintain so long as any Domestic Water Installment Payments remain unpaid) in the following order of priority:

- (i) Installment Payment Fund, including the Series F Domestic Water Installment Payment Account within such fund (to be held by the District); and
- (ii) Series 2007 Reserve Fund (to be held by the Depository).

All moneys in each of such funds shall be held in trust and shall be applied, used and withdrawn only for the purposes authorized in the Installment Purchase Contract.

Installment Payment Fund. On or before the last day of each month, the District shall, from the moneys in the Domestic Water Project Revenue Fund pay, without preference or priority, and in the event of any insufficiency of such moneys ratably without any discrimination or preference, for deposit in the Series F Domestic Installment Account, within the Installment Payment Fund, (i) the amount of 1/6 of the aggregate amount of interest (or, if applicable, the regularly schedule payment portion of the Series 2007F Swap Contract Payment) becoming due on the Series F Domestic Water Installment Payments during the next succeeding six months; and (ii) for deposit into such fund or account as may be provided therefor, in the case of Domestic Water Bonds or Domestic Water Installment Payments other than the Series F Domestic Water Installment Ppayments, a sum equal to the amount of 1/6 of the aggregate amount of interest becoming due on such Domestic Water Contracts and Domestic Water Bonds during the next succeeding six months, plus (iv) 1/12 of the aggregate amount of principal becoming due (due to maturity, mandatory sinking fund payment or mandatory prepayment or otherwise) on the Series F Domestic Water installment Payments, Domestic Water Contracts and Domestic Water Bonds during the next succeeding twelve months, but excluding from such amounts of principal any series or issue of such Domestic Water Bonds or Domestic Water Contracts having 25% or more of the aggregate principal amount of such series or issue due in any one year if such series or issue is secured by the proceeds of a letter of credit, revolving credit agreement or similar credit arrangement; provided, that, so long as the payments to be made by the Series 2007F Counterparty pursuant to the Series 2007F Swap Contract are being made on a full and timely basis, interest then accruing on the unpaid

balance of the principal amount of the Series F Domestic Water Installment Payments shall be assumed to the fixed rate of interest payable by the Authority under the Series 2007F Swap Contract

No deposit need be made in the Series F Domestic Water Installment Payment Account if each amount available and contained in each such account is at least equal to the amount of interest becoming due under the Installment Purchase Contract on the next succeeding Domestic Water Installment Payment Date (computed for purposes of this paragraph in the manner specified in the preceding paragraph), plus the amount of principal becoming due under the Installment Purchase Contract on the next succeeding Domestic Water Installment Payment Date for each such series.

All moneys in the Series F Domestic Water Installment Payment Account shall be withdrawn by the District solely for the purpose of paying the Series F Domestic Water Installment Payments to the Authority as they become due and payable in accordance with the Installment Purchase Contract; provided, however, that such amounts as the District determines in the Tax Certificate to be necessary to comply with the Installment Purchase Contract may be withdrawn by the District and transferred and applied pursuant thereto.

On the last day of each month, all remaining moneys in the Domestic Water Project Revenue Fund shall be applied, subject to the requirements of either the Trust Agreement or the Installment Purchase Contract relating to the use of surplus moneys in connection with any surety bonds, to pay the portion of the Series 2007 Public Finance Contract Payments constituting termination payments, if any, and thereafter as provided below.

Series 2007 Reserve Fund. The Authority, for the benefit of the District, shall cause to be deposited with the Depository into the Series 2007 Reserve Fund an amount, to be calculated by the District and filed with the Trustee, equal to the Series 2007 Reserve Fund Requirement. On or before the last day of each month, the District shall, from the remaining moneys in the Domestic Water Project Revenue Fund, thereafter transfer, without preference or priority, and in the event of any insufficiency of such moneys ratably without any discrimination or preference, to the Depository for deposit in the Series 2007 Reserve Fund in the case of the Series F Domestic Water Installment Payments (excluding any portion of Series 2007F Swap Contract Payments constituting termination payments) and deposit into such reserve fund or account as may be provided therefor, in the case of Domestic Water Bonds or Domestic Water Installment Payments other than the Series F Domestic Water Installment Payments, that sum, if any, equal to one-twelfth (1/12) of the amount necessary to restore the Series 2007 Reserve Fund to an amount equal to the Series 2007 Reserve Fund Requirement or such other reserve fund or account to an amount equal to the amount required to be maintained therein on the next succeeding September 1; provided, however, the District may provide for the Series 2007 Reserve Fund or such other fund or account by a policy of insurance issued by a municipal bond insurance company, the claims paying ability of which is rated in the highest rating category of Moody's and S&P, or by letter of credit or other credit facility issued by a bank or other financial institution the obligations of which are rated in not lower than the two highest rating categories of Moody's and S&P, in each case, if such rating agency is then rating obligations of the District.

No transfer need be made in the Series 2007 Reserve Fund if the amount available and contained therein is at least equal to the Series 2007 Reserve Fund Requirement.

If at any time the amount available and contained in the Series 2007 Reserve Fund exceeds the Series 2007 Reserve Fund Requirement and if the District is not then in default under the Installment Purchase Contract, the Depository shall withdraw the amount of such excess from the Series 2007 Reserve Fund and shall deposit such amount in the Revenue Fund, and for this determination the Depository shall make a valuation of the Series 2007 Reserve Fund as often as it may deem appropriate, and in any event on or before September 1 in each year. Except for such withdrawals, all moneys in the Series 2007 Reserve Fund shall be used and withdrawn by the Depository solely for the purpose of making the Series F Domestic Water Installment Payments (excluding any portion of Series 2007F Swap Contract Payments constituting termination payments) in the event that no other moneys of the District are available therefor; provided, however, that such amounts may be withdrawn by the Depository and transferred to the District as the District determines in a written request of the District to the Depository to be necessary to fulfill the Rebate Requirement.

The Series 2007 Reserve Fund shall be replenished in the following priority: (i) principal and interest on a letter of credit, insurance policy, surety bond or other such funding instrument, if any, shall be paid from first

available Treatment and Delivery Revenues on a pro rata basis and in accordance with and to the extent permitted by the Installment Purchase Contract; (ii) after all such amounts are paid in full, amounts necessary to fund the Series 2007 Reserve Fund to the Series 2007 Reserve Fund Requirement, after taking into account the amounts available under the Surety Bond and any Additional Funding Instrument, shall be deposited from next available Treatment and Delivery Revenues.

Notwithstanding anything to the contrary contained in the Trust Agreement, at any time one or more surety bonds or insurance policies (collectively, "surety bonds") are on deposit in the Series 2007 Reserve Fund, the Trustee shall: (i) withdraw and use all cash, if any, on deposit in the Series 2007 Reserve Fund prior to using and withdrawing any amounts derived from payments under any surety bonds; and (ii) draw on all surety bonds on a pro rata basis based on the draw limit of each such surety bond, if there is more than one surety bond on deposit in the Series 2007 Reserve Fund.

On the last day of each month, all remaining moneys in the Domestic Water Project Revenue Fund shall be applied as directed by the District for the purposes set forth in the Treatment and Delivery Agreement.

Investments. Any moneys held by the District in the Domestic Water Project Revenue Fund and in the Installment Payment Fund shall be invested in Permitted Investments which will, as nearly as practicable, mature on or before the dates when such moneys are anticipated to be needed for disbursement under the Installment Purchase Contract. Any moneys held by the Depository in the Series 2007 Reserve Fund shall be invested by the Depository in Permitted Investments, upon the written request of the District or the Authority or upon telephone request of the District or the Authority promptly confirmed in writing; provided that absent directions as to investment of funds, the Depository shall invest in Permitted Investments described in clause (D) of the definition thereof. All investment earnings derived from the investment of funds on deposit in (i) the Series 2007 Reserve Fund shall be applied in accordance with the Trust Agreement; and (ii) any other fund or account created under the Installment Purchase Contract shall be retained in such fund or account, or otherwise applied in accordance with the Written Request of the District or the Authority.

### **Covenants of the District**

Compliance with Installment Purchase Contract and Ancillary Agreements. The District will punctually pay the Series F Domestic Water Installment Payments in strict conformity with the terms of the Installment Purchase Contract, and will faithfully observe and perform all the agreements, conditions, covenants and terms contained therein required to be observed and performed by it, and will not terminate the Installment Purchase Contract for any cause including, without limiting the generality of the foregoing, any acts or circumstances that may constitute failure of consideration, destruction of or damage to the Domestic Water Project Phase Two, commercial frustration of purpose, any change in the tax or other laws of the United States of America or of the State of California or any political subdivision of either or any failure of the Authority to observe or perform any agreement, condition, covenant or term contained in the Installment Purchase Contract required to be observed and performed by it, whether express or implied, or any duty, liability or obligation arising out of or connected therewith or the insolvency, or deemed insolvency, or bankruptcy or liquidation of the District or any force majeure, including acts of God, tempest, storm, earthquake, war, rebellion, riot, civil disorder, acts of public enemies, blockade or embargo, strikes, industrial disputes, lock outs, lack of transportation facilities, fire, explosion, or acts or regulations of governmental authorities.

The District will faithfully observe and perform all the agreements, conditions, covenants and terms contained in the Trust Agreement and the Treatment and Delivery Agreement required to be observed and performed by it, and it is expressly understood and agreed by and among the parties to the Installment Purchase Contract, the Treatment and Delivery Agreement and the Trust Agreement that, subject to the Installment Purchase Contract, each of the agreements, conditions, covenants and terms contained in each such contract and agreement is an essential and material term of the purchase of and payment for the Domestic Water Project Phase Two by the District pursuant to, and in accordance with, and as authorized under the Law.

Against Encumbrances. The District will not make any pledge of or place any lien on the Treatment and Delivery Revenues except as may be required to complete the Domestic Water Project Phase Two. The foregoing shall not limit the District in connection with the posting of collateral pursuant to the Series 2007F Swap Contract.

Against Sale or Other Disposition of Property. The District will not sell, lease or otherwise dispose of the Domestic Water System or any part thereof essential to the proper operation of the Domestic Water System or to the maintenance of the Treatment and Delivery Revenues. The District will not enter into any agreement or lease which impairs the operation of the Domestic Water System or any part thereof necessary to secure adequate Treatment and Delivery Revenues for the payment of the Domestic Water Installment Payments, or which would otherwise impair the rights of the Authority with respect to the Treatment and Delivery Revenues or the operation of the Domestic Water System. Any real or personal property which has become nonoperative or which is not needed for the efficient and proper operation of the Domestic Water System, or any material or equipment which has become worn out, may be sold at not less than the market value thereof if such sale will not reduce the Treatment and Delivery Revenues and if the proceeds of such sale are deposited in the Revenue Fund. The foregoing shall not limit the District in connection with the posting of collateral pursuant to the Series 2007F Swap Contract.

Against Competitive Facilities. The District will not, to the extent permitted by law, acquire, construct, maintain or operate and will not, to the extent permitted by law and within the scope of its powers, permit any other public or private agency, corporation, district or political subdivision or any person whomsoever to acquire, construct, maintain or operate within the District any water system competitive with the Domestic Water System.

Against Federal Income Taxation. The District will not directly or indirectly use or permit the use of any proceeds of the obligation provided in the Installment Purchase Contract or any other funds of the District or take or omit to take any action that would cause such obligation to be an "arbitrage bond" within the meaning of Section 148(a) of the Code or a "federal-guaranteed obligation" within the meaning of Section 149(b) of the Code or a "private activity bond" as described in Section 141 of the Code. The District will not allow 10% or more of the proceeds of the obligations provided in the Installment Purchase Contract to be used in the trade or business of any nongovernmental units and will not loan 5% or more of the proceeds of the obligations provided therein to any nongovernmental units.

To that end, as long as any Series F Domestic Water Installment Payments are unpaid, the District will comply with all requirements of such sections of the Code to the extent applicable to the obligations provided in the Installment Purchase Contract. In the event that at any time the District is of the opinion that it is necessary to restrict or to limit the yield on the investment of any moneys held by the District under the Installment Purchase Contract or by the Trustee under the Trust Agreement, the District shall so instruct the Trustee in writing, and the Trustee, as appropriate, shall act in accordance with such instructions.

The District and the Authority covenant that they will at all times do and perform all acts necessary or desirable in order to assume that the interest component of the Series F Domestic Water Installment Payments will not be included in gross income of the holders of the Certificates for federal income tax purposes and will take no action that would result in such interest being so included. The District covenants to abide by all of the covenants, terms and conditions relating to the District set forth in the Trust Agreement.

Notwithstanding any provision of the Installment Purchase Contract, if the District receives an opinion of Bond Counsel that any specified action required under the tax covenants of the Installment Purchase Contract is no longer required or that some further or different action is required to maintain the exclusion from gross income for federal income tax purposes of interest with respect to the Series F Domestic Water Installment Payments or the Series F Water Bonds, the District may conclusively rely on such opinion in complying with the requirements of tax covenants of the Installment Purchase Contract, and the covenants thereunder shall be deemed to be modified to that extent.

Prompt Acquisition and Construction. The District will take all necessary and appropriate steps as agent of the Authority to acquire and construct the Domestic Water Project Phase Two with all practicable dispatch and in an expeditious manner and in conformity with law so as to complete the same as soon as possible.

Maintenance and Operation of the Domestic Water System; Budgets. The District will maintain and preserve the Domestic Water System in good repair and working order at all times and will operate the Domestic Water System in an efficient and economical manner and will pay all Maintenance and Operation Costs of the Domestic Water System as they become due and payable. On or before the first date of each Fiscal Year (commencing January 1, 2008), the District will adopt and file with the Authority a budget approved by the Board of

Directors of the District setting forth the estimated Maintenance and Operation Costs of the Domestic Water System. Any budget may be amended at any time during any Fiscal Year and such amended budget shall be filed by the District with the Authority.

Payment of Claims. The District will pay and discharge any and all lawful claims for labor, materials or supplies which, if unpaid, might become a lien on the Treatment and Delivery Revenues or any part thereof or on any funds in the hands of the District prior or superior to the lien of the Domestic Water Installment Payments or which might impair the security of the Domestic Water Installment Payments.

Compliance with Contracts. The District will comply with, keep, observe and perform all agreements, conditions, covenants and terms, express or implied, required to be performed by it contained in all contracts for the use of the Domestic Water System and all other contracts affecting or involving the Domestic Water System to the extent that the District is a party thereto.

Insurance. (a) The District will procure and maintain or cause to be procured and maintained insurance on the Domestic Water System with responsible insurers in such amounts and against such risks (including accident to or destruction of the Domestic Water System) as are usually covered in connection with domestic water systems similar to the Domestic Water System so long as such insurance is available at reasonable costs from reputable insurance companies. In the event of any damage to or destruction of the Domestic Water System caused by the perils covered by such insurance, the Net Proceeds thereof shall be applied to the reconstruction, repair or replacement of the damages or destroyed portion of the Domestic Water System. The District shall begin such reconstruction, repair or replacement promptly after such damage or destruction shall occur, and shall continue and properly complete such reconstruction, repair or replacement as expeditiously as possible, and shall pay out of such Net Proceeds all costs and expenses in connection with such reconstruction, repair or replacement so that the same shall be completed and the Domestic Water System shall be free and clear of all claims and liens.

If such Net Proceeds, to the extent such Net Proceeds are derived from a loss or claim with respect to the Domestic Water System, exceed the costs of such reconstruction, repair or replacement, then the excess Net Proceeds shall be applied in part to the prepayment of Installment Payments as provided the Installment Purchase Contract and in part to such other fund or account as may be appropriate and used for the retirement of Domestic Water Contracts in the same proportion that the aggregate unpaid principal balance of Installment Payments then bears to the aggregate unpaid principal amount of such Domestic Water Contracts. If such Net Proceeds, to the extent such Net Proceeds are derived from a loss or claim with respect to the Domestic Water System, are sufficient to enable the District to retire the entire obligation evidenced by the Installment Purchase Contract prior to the final due date of the Installment Payments as well as the entire obligations evidenced by Domestic Water Contracts then remaining unpaid prior to their final respective due dates, the District may elect not to reconstruct, repair or replace the damaged or destroyed portion of the Domestic Water System, and thereupon such Net Proceeds shall be applied to the prepayment of Installment Payments as provided in the Installment Purchase Contract and to the retirement of such Domestic Water Contracts.

(b) If the conditions set forth in subparagraph (a) above are not met, then such Net Proceeds, to the extent such Net Proceeds are derived from a loss or claim with respect to the Domestic Water System, shall be applied in part to the prepayment of the Series F Domestic Water Installment Payments as provided in the Installment Purchase Contract, and in part to such other fund or account as may be appropriate and used for the retirement of the Domestic Water Bonds and Domestic Water Contracts in the same proportion that the aggregate unpaid principal balance of such Domestic Water Bonds and Domestic Water Contracts then bears to the aggregate unpaid principal balance of the Series F Domestic Water Installment Payments.

(c) The District will procure and maintain such other insurance which it shall deem advisable or necessary to protect its interests and the interests of the Authority, which insurance shall afford protection in such amounts and against such risks as are usually covered in connection with domestic water systems similar to the Domestic Water System; provided that any insurance required pursuant to the Installment Purchase Contract may be maintained under a self-insurance program so long as such self-insurance is maintained in the amounts and manner usually maintained in connection with domestic water systems similar to the Domestic Water System.

All policies of insurance required to be maintained in the Installment Purchase Contract shall provide that the Authority will be given 30 days' written notice of any intended cancellation thereof or reduction of coverage provided thereby.

Accounting Records; Financial Statements and Other Reports. (a) District will keep appropriate accounting records in which complete and correct entries shall be made of all transactions relating to the Domestic Water System, which records shall be available for inspection by the Authority at reasonable hours and under reasonable conditions.

(b) The District will prepare and file with the Trustee and the Authority annually within 120 days after the close of each Fiscal Year (commencing with the Fiscal Year ending December 31, 2007): (1) Financial statements of the District for the preceding Fiscal Year prepared in accordance with generally accepted accounting principles, together with an Accountant's Report thereon and a special report prepared by the Independent Certified Public Accountant who examined such financial statements stating that nothing came to their attention in connection with such examination that caused them to believe that the District was not in compliance with any of the financial agreements or financial covenants contained in the Installment Purchase Contract; and (2) a certificate of insurance as to all insurance policies maintained and self-insurance programs maintained by the District with respect to the Domestic Water System as of the close of such Fiscal Year, including the names of the insurers which have issued the policies and the amounts thereof and the property or risks covered thereby and that such insurance satisfies the requirements of the Installment Purchase Contract.

(c) The District will prepare annually not more than 120 days after the close of each Fiscal Year (commencing with the Fiscal Year ending December 31, 2007) a summary report showing in reasonable detail the Treatment and Delivery Revenues and the Maintenance and Operation Costs of the Domestic Water System for such Fiscal Year and containing a general statement of the physical condition of the Domestic Water System. The District will furnish copies of such summary reports to the Trustee, the Authority and to any investment bankers, security dealers and others interested in the Domestic Water Installment Payments requesting copies thereof.

(d) The District shall keep, and shall cause the Trustee to keep proper books of record and account in accordance with the Trustee's standards in which complete and correct entries shall be made of all transactions relating to the receipt, investment, disbursement, allocation and application of the Domestic Water Installment Payments and the proceeds of the obligations provided in the Installment Purchase Contract. Such records shall specify the account or fund to which each investment (or portion thereof) held pursuant to the Installment Purchase Contract and the Trust Agreement is to be allocated and shall set forth, in the case of each Permitted Investment, (i) its purchase price, (ii) identifying information, including par amount, coupon rate, and payment dates, (iii) the amount received at maturity or its sale price, as the case may be, (iv) the amounts and dates of any payments made with respect thereto, and (v) such other documentation as the District deems necessary.

Such records shall be open to inspection by the Authority at any reasonable time during regular business hours on reasonable notice. The Trustee shall furnish to the District regular reports on such dates and containing such information as the District shall require, covering the activities and responsibilities of the Trustee.

Protection of Security and Rights of the Authority. The District will preserve and protect the security of the Installment Purchase Contract and the rights of the Authority to the Series F Domestic Water Installment Payments thereunder and will warrant and defend such rights against all claims and demands of all persons.

Payment of Taxes and Compliance with Governmental Regulations. The District will pay and discharge all taxes, assessments and other governmental charges which may be lawfully imposed upon the Domestic Water System or any part thereof or the Treatment and Delivery Revenues when the same shall become due. The District will duly observe and conform with all valid regulations and requirements of any governmental authority relative to the operation of the Domestic Water System or any part thereof, but the District shall not be required to comply with any regulations or requirements so long as the validity or application thereof shall be contested in good faith.

Amount of Rates and Charges. The District will fix, prescribe and collect rates and charges for the Domestic Water Service which are reasonably fair and nondiscriminatory and which, together with all other lawfully available funds of the District, will be at least sufficient to yield during each Fiscal Year an amount not less than the

sum of: (i) the Maintenance and Operation Costs of the Domestic Water System for such Fiscal Year; (ii) debt service on all Domestic Water Bonds and all Domestic Water Installment Payments for such Fiscal Year, in each case only to the extent they are then unpaid or are not discharged in accordance with their respective terms; and (iii) to the extent not included in clause (ii), any amounts due and payable by the Authority under the Series 2007F Swap Contract.

Special Appropriation. In the event that Revenues (as defined in the Trust Agreement) are insufficient to pay in full any amount then due and payable with respect to the Bonds, an Authorized District Representative (as defined in the Trust Agreement) shall submit to the Board of Directors of the District a special budget item requesting a special appropriation from the Board of Directors of the District of the amount of such insufficiency; provided, however, that the Board of Directors of the District shall have absolute discretion in determining whether such a special appropriation shall be made, and a determination not to make a special appropriation shall not in and of itself constitute an Event of Default.

Eminent Domain Proceeds. If all or any part of the Domestic Water System shall be taken by eminent domain proceedings, the Net Proceeds thereof shall be applied as follows:

(a) If (1) the District obtains and files with the Authority an Engineer's Report showing (i) the estimated loss of annual Treatment and Delivery Revenues, if any, suffered or to be suffered by the District by reason of such eminent domain proceedings, (ii) a general description of the additions, betterments, extensions or improvements to the Domestic Water System proposed to be acquired and constructed by the District from such Net Proceeds, and (iii) an estimate of the additional annual Treatment and Delivery Revenues to be derived from such additions, betterments, extensions or improvements, and (2) the District, on the basis of such Engineer's Report filed with the Authority, determines that the estimated additional annual Treatment and Delivery Revenues will sufficiently offset the estimated loss of annual Treatment and Delivery Revenues resulting from such eminent domain proceedings so that the ability of the District to meet its obligations under the Installment Purchase Contract will not be substantially impaired (which determination shall be final and conclusive) then the District shall promptly proceed with the acquisition and construction of such additions, betterments, extensions or improvements substantially in accordance with such Engineer's Report and such Net Proceeds shall be applied for the payment of the costs of such acquisition and construction, and any balance of such Net Proceeds not required by the District for such purpose shall be deposited in the Domestic Water Project Revenue Fund.

(b) If the conditions set forth in paragraph (a) above are not met, then such Net Proceeds shall be applied in part to the prepayment of Domestic Water Installment Payments as provided in the Installment Purchase Contract and in part to such other fund or account as may be appropriate and used for the retirement of Domestic Water Bonds and Domestic Water Contracts in the same proportion which the aggregate unpaid principal balance of Domestic Water Installment Payments then bears to the aggregate unpaid principal amount of such Domestic Water Bonds and Domestic Water Contracts.

Assignment of Authority's Rights. As security for the payment of the Domestic Water Bonds, the Authority will assign to the Trustee the Authority's rights under the Installment Purchase Contract, including the right to receive payments thereunder, and the Authority directs the District to make the payments required thereunder directly to the Trustee. The District consents to such assignment and agrees to make payments directly to the Trustee without defense or set-off by reason of any dispute between the District and the Authority or the Trustee.

Continuing Disclosure. The District covenants and agrees in the Installment Purchase Contract that it will comply with and carry out all of the provisions of the Continuing Disclosure Agreement. Notwithstanding any other provision of the Installment Purchase Contract, failure of the District to comply with the Continuing Disclosure Agreement shall not be considered an Event of Default; however, the Trustee may (and, at the request of any Participating Underwriter or the Owners of at least 25% aggregate principal amount of Outstanding Water Bonds, shall) or any Owner may take such actions as may be necessary and appropriate, including seeking specific performance by court order, to cause the District to comply with its obligations concerning continuing disclosure under the Installment Purchase Contract.

Series 2007F Swap Contract. In order to manage its interest expense under the Series F Water Bonds, the Authority has entered into the Series 2007F Swap Contract with the consent and approval of the District and the

City. The City is obligated to include in its payments of Debt Service, as that term is defined in the Treatment and Delivery Agreement, payments with respect to the amounts due from the Authority under the Series 2007F Swap Contract. The District agrees to include in its Series F Domestic Water Installment Payments all such amounts paid by the City.

### **Events of Default and Remedies of the Authority**

Events of Default and Acceleration of Maturities. If one or more of the following Events of Default shall happen, that is to say:

(1) if default shall be made in the due and punctual payment of any Domestic Water Installment Payment or any Domestic Water Contract or Domestic Water Bond when and as the same shall become due and payable;

(2) if default shall be made by the District in the performance of any of the other agreements or covenants required in the Installment Purchase Contract to be performed by it, and such default shall have continued for a period of 60 days after the District shall have been given notice in writing of such default by the Authority; or

(3) if the District shall file a petition or answer seeking arrangement or reorganization under the federal bankruptcy laws or any other applicable law of the United States of America or any state therein, or if a court of competent jurisdiction shall approve a petition filed with or without the consent of the District seeking arrangement or reorganization under the federal bankruptcy laws or any other applicable law of the United States of America or any state therein, or if under the provisions of any other law for the relief or aid of debtors any court of competent jurisdiction shall assume custody or control of the District or of the whole or any substantial part of its property;

then and in each and every such case during the continuance of such Event of Default specified in clause (1) above, the Authority shall, and for any other such Event of Default the Authority may, by notice in writing to the District, declare the entire principal amount of the unpaid Domestic Water Installment Payments and the accrued interest thereon to be due and payable immediately, and upon any such declaration the same shall become immediately due and payable, anything contained in the Installment Purchase Contract to the contrary notwithstanding. The Installment Purchase Contract, however, is subject to the condition that if at any time after the entire principal amount of the unpaid Domestic Water Installment Payments and the accrued interest thereon shall have been so declared due and payable and before any judgment or decree for the payment of the moneys due shall have been obtained or entered the District shall deposit with the Authority a sum sufficient to pay the unpaid principal amount of the Domestic Water Installment Payments or the unpaid payment of any other Domestic Water Contract or Domestic Water Bond referred to in clause (1) above due prior to such declaration and the accrued interest thereon, with interest on such overdue installments, at the rate or rates applicable to the remaining unpaid principal balance of the Domestic Water Installment Payments or such Domestic Water Contract or Domestic Water Bond if paid in accordance with their terms, and the reasonable expenses of the Authority, and any and all other defaults known to the Authority (other than in the payment of the entire principal amount of the unpaid Domestic Water Installment Payments and the accrued interest thereon due and payable solely by reason of such declaration) shall have been made good or cured to the satisfaction of the Authority or provision deemed by the Authority to be adequate shall have been made therefor, then and in every such case the Authority, by written notice to the District, may rescind and annul such declaration and its consequences; but no such rescission and annulment shall extend to or shall affect any subsequent default or shall impair or exhaust any right or power consequent thereon.

Application of Funds Upon Acceleration. All moneys in the Series F Domestic Water Installment Payment Account of the Installment Payment Fund upon the date of the declaration of acceleration by the Authority as provided in the Installment Purchase Contract and all Treatment and Delivery Revenues thereafter received shall be applied in the following order:

First, to the payment, without preference or priority, and in the event of any insufficiency of such moneys ratably without any discrimination or preference, of the fees, costs and expenses of the Trustee, if any, in carrying out the provisions of the Installment Purchase Contract, including reasonable compensation to its accountants and counsel; and

Second, to the payment of (i) the entire principal amount of the unpaid Domestic Water Installment Payments (other than Domestic Water Swap Installment Payments), the unpaid principal amount of all Domestic Water Bonds and Domestic Water Contracts and the accrued interest thereon, with interest on the overdue installments at the rate or rates of interest applicable to the Domestic Water Installment Payments and such Domestic Water Bonds and Domestic Water Contracts if paid in accordance with their respective terms, and (ii) regularly scheduled Domestic Water Swap Installment Payments.

Third, to the payment of the portion of Domestic Water Swap Installment Payments constituting termination payments, if any.

Other Remedies of the Authority. The Authority shall have the right:

(a) by mandamus or other action or proceeding or suit at law or in equity to enforce its rights against the District or any director, officer or employee thereof, and to compel the District or any such director, officer or employee to perform and carry out its or such person's duties under the Law and the agreements and covenants required to be performed by it or such person contained in the Installment Purchase Contract;

(b) by suit in equity to enjoin any acts or things which are unlawful or violate the rights of the Authority; or

(c) by suit in equity upon the happening of an Event of Default to require the District and its directors, officers and employees to account as the trustee of an express trust.

Non-Waiver. Nothing in the Installment Purchase Contract shall affect or impair the obligation of the District, which is absolute and unconditional, to pay the Domestic Water Installment Payments to the Authority at the respective due dates or upon prepayment from the Treatment and Delivery Revenues and the other funds in the Installment Purchase Contract pledged for such payment, or shall affect or impair the right of the Authority, which is also absolute and unconditional, to institute suit to enforce such payment by virtue of the contract embodied therein.

A waiver of any default or breach of duty or contract by the Authority shall not affect any subsequent default or breach of duty or contract or impair any rights or remedies on any such subsequent default or breach of duty or contract. No delay or omission by the Authority to exercise any right or remedy accruing upon any default or breach of duty or contract shall impair any such right or remedy or shall be construed to be a waiver of any such default or breach of duty or contract or an acquiescence therein, and every right or remedy conferred upon the Authority by the Law or by the Installment Purchase Contract may be enforced and exercised from time to time and as often as shall be deemed expedient by the Authority.

If any action, proceeding or suit to enforce any right or exercise any remedy is abandoned or determined adversely to the Authority, the District and the Authority shall be restored to their former positions, rights and remedies as if such action, proceeding or suit had not been brought or taken.

Remedies Not Exclusive. No remedy in the Installment Purchase Contract conferred upon or reserved to the Authority is intended to be exclusive of any other remedy, and each such remedy shall be cumulative and shall be in addition to every other remedy given thereunder or now or hereafter existing in law or in equity or by statute or otherwise and may be exercised without exhausting and without regard to any other remedy conferred by the Law or any other law.

## **Discharge of Obligations**

Discharge of Obligations. When

(a) all or any portion of not less than \$100,000 of the Domestic Water Installment Payments shall have become due and payable in accordance with the Installment Purchase Contract or a written notice of the District to prepay all or any portion of not less than \$100,000 of the Domestic Water Installment Payments shall have been filed with the Trustee; and

(b) there shall have been deposited with the Trustee at or prior to the Domestic Water Installment Payment Date (or dates) specified for prepayment, in trust for the benefit of the Authority or its assigns and irrevocably appropriated and set aside to the payment of all or any portion of not less than \$100,000 of the Domestic Water Installment Payments sufficient moneys and Permitted Investments, issued by the United States of America and described in clause (i) of the definition thereof, the principal of and interest on which when due will provide money sufficient to pay all principal, prepayment premium, if any, and interest of such Domestic Water Installment Payments to their respective Domestic Water Installment Payment Dates or to their prepayment date or dates as the case may be; and

(c) provision shall have been made for paying all fees and expenses of the Trustee so long as such Domestic Water Installment Payments shall remain unpaid,

then and in that event, if an opinion of Special Counsel is filed with the Trustee to the effect that the actions authorized by and taken pursuant to the Installment Purchase Contract shall not adversely affect the exclusion of the interest portion of the Domestic Water Installment Payments from gross income for federal income tax purposes, the right, title and interest of the Authority in the Installment Purchase Contract and the obligations of the District thereunder shall, with respect to all or such portion of the Domestic Water Installment Payments as have been so provided for, thereupon cease, terminate, become void and be completely discharged and satisfied (except for the right of the Trustee and the obligation of the District to have such moneys and such Permitted Investments applied to the payment of such Domestic Water Installment Payments). In such event, upon request of the District, the Trustee shall cause an accounting for such period or periods as may be requested by the District to be prepared and filed with the District and shall execute and deliver to the District all such instruments as may be necessary to evidence such total or partial discharge and satisfaction, as the case may be, and, in the event of a total discharge and satisfaction, the Trustee shall pay over to the District, as an overpayment of Domestic Water Installment Payments, all such moneys or such Permitted Investments held by it pursuant to the Installment Purchase Contract other than such moneys and such Permitted Investments as are required for the payment or prepayment of the Domestic Water Installment Payments, which moneys and Permitted Investments shall continue to be held by the Trustee in trust for the payment of the Domestic Water Installment Payments and shall be applied by the Trustee to the payment of the Domestic Water Installment Payments of the District.

## SUMMARY OF THE TRUST AGREEMENT

### Revenues

Pledge of Revenues. Pursuant to the Trust Agreement, all Revenues and any other amounts (including proceeds of the sale of the Water Bonds) held by the Trustee in any fund or account established thereunder (other than amounts on deposit in the Rebate Fund are irrevocably pledged to the payment of the interest on and principal of the Water Bonds as provided therein, and the Revenues shall not be used for any other purpose while any of the Water Bonds remain Outstanding; provided, however, that out of the Revenues and other moneys there may be applied such sums for such purposes as are permitted under the Trust Agreement. Such pledge shall constitute a first pledge of and charge and lien upon the Revenues and all other moneys on deposit in the funds and accounts established under the Trust Agreement (other than amounts on deposit in the Rebate Fund) for the payment of the interest on and principal of the Water Bonds in accordance with the terms of the Trust Agreement.

Receipt and Deposit of Revenues. (a) The Authority agrees and covenants that all Revenues when and as received shall be received by the Authority in trust for the benefit of the Holders and shall be deposited when and as received by the Authority in the Series 2007 Revenue Fund. All Revenues shall be accounted for through and held in trust in the Series 2007 Revenue Fund, and the Authority shall have no beneficial right or interest in any of the Revenues except only as provided in the Trust Agreement. All Revenues shall be allocated, applied and disbursed solely for the purposes and uses set forth in the Trust Agreement, and shall be accounted for separately and apart from all other accounts, funds, money or other resources of the Authority.

(b) Subject to the Installment Purchase Contract and the Trust Agreement, all money in the Series 2007 Revenue Fund shall be set aside by the Trustee in the following respective special accounts within the Series 2007 Revenue Fund in the following order of priority:

(i) Interest Account, including the Capitalized Interest Subaccount therein. The Trustee on or before the Interest Payment Date shall deposit in the Interest Account an amount of money which, together with any money contained therein, is equal to the aggregate amount of interest coming due and payable on all Outstanding Water Bonds of each series on such Interest Payment Date. Except as provided the Installment Purchase Contract and Trust Agreement, moneys in the Interest Account shall be used and withdrawn by the Trustee solely for the purpose of paying the interest on the Water Bonds when due and payable. In addition if so directed by the Authority, the Trustee shall deposit into the Interest Account, Series 2007F Swap Contract Receipts of the Authority and shall pay from the Interest Account, Series 2007F Swap Contract Payments on behalf of the Authority.

(ii) Principal Account. The Trustee on or before September 1 of each year shall deposit in the Principal Account an amount of money which, together with any money contained therein, is equal to the aggregate principal amount of all Outstanding Water Bonds becoming due and payable on such September 1, plus the aggregate amount of all sinking fund payments required to be made with respect to the Water Bonds that are term bonds. Except as provided in the Installment Purchase Contract and the Trust Agreement, moneys in the Principal Account shall be used and withdrawn by the Trustee solely for the purpose of paying the principal of the Water Bonds when due and payable, provided that all sinking fund payments deposited into the Principal Account shall be used and withdrawn by the Trustee solely for the purpose of redeeming or paying at maturity the Water Bonds for which such sinking fund payment was made.

(iii) Redemption Account. The Trustee, on the date specified in the Written Request of the District filed with the Trustee pursuant to the Installment Purchase Contract at the time that any prepaid Installment Payment is paid to the Trustee, shall deposit in the Redemption Account that amount of money representing the portion of the Installment Payments designated as prepaid Installment Payments. Except as provided in the Installment Purchase Contract and Trust Agreement, moneys in the Redemption Account shall be used and withdrawn by the Trustee solely for the purpose of paying the principal of, redemption premiums, if any, and interest on the Water Bonds to be redeemed.

(iv) Surplus Account. The Trustee, on or before September 1 of each year, beginning on September 1, 2010, shall deposit in the Surplus Account all money remaining in the Series 2007 Revenue Fund after the deposits, if any, required by the Installment Purchase Contract and the Trust Agreement and subsections (i), (ii) and (iii) of this section have been made. On September 2 of each year, beginning on September 2, 2010, the Trustee, if the District is not then in default under the Trust Agreement and the Installment Purchase Contract, shall disburse the money in the Surplus Account to satisfy any unpaid amounts due and payable by the Authority under the Series 2007F Swap Contract and thereafter to the District unless the Trustee, in its discretion, shall determine that any money in the Surplus Account is or will be required for the payment of the principal of or interest on the Water Bonds on the next succeeding Interest Payment Date (assuming for the purpose of such determination that the District shall pay when due all Installment Payments required by the Installment Purchase Contract), in which event such money shall be held in the Surplus Account for such purpose.

## **Project Fund**

The Trustee shall establish and maintain the Modesto Irrigation District Domestic Water Project Fund, Series 2007. The moneys in the Project Fund shall be held by the Trustee in trust and applied to the payment of the costs of issuance of the Water Bonds, fees and premiums for any surety bond, bond insurance or other credit enhancement, the initial fees and expenses of the Trustee, printing costs, legal, accounting and engineering fees and other costs incidental therewith.

Before any payment is made from the Project Fund by the Trustee, there shall be filed with the Trustee a requisition signed by an Authorized District Representative conforming with the requirements of the Trust Agreement, stating with respect to each payment to be made: (1) the requisition number; (2) the name and address of the person to whom payment is due; (3) the purpose for which such payment is to be made; (4) the amount to be paid; (5) that each obligation mentioned therein has been properly incurred and is a proper charge against the Project Fund; and (6) that none of the items for which payment is requested has been previously reimbursed from the Project Fund.

Each such requisition shall be sufficient evidence to the Trustee of the facts stated therein. Upon receipt of each such requisition, the Trustee shall pay the amount set forth in the Trust Agreement as directed by the terms thereof.

When all costs payable from the Project Fund have been paid, the District shall deliver to the Trustee a Certificate of the District stating that all such costs have been paid (or that all of such costs have been paid less specified claims which are subject to dispute and for which a retention in the Project Fund is to be maintained in the full amount of such claims until such dispute is resolved). Upon the receipt of such certificate, the Trustee shall transfer any remaining balance in the Project Fund (but less the amount of any such retention) in accordance with a Written Request of the District to be deposited in the Domestic Water Project Revenue Fund established under the Installment Purchase Contract, and the Trustee shall thereupon close the Project Fund.

### **Investment of Moneys**

Subject to the limitations in of the Trust Agreement, any moneys in any of the funds and accounts to be established by the Trustee pursuant to the Trust Agreement shall be invested by the Trustee in Permitted Investments upon the Written Request of the District or upon telephone request of the District promptly confirmed in writing. Moneys in any fund or account (other than the Rebate Fund) shall be invested in Permitted Investments with respect to which payments of principal thereof and interest thereon are scheduled or otherwise payable not later than the date on which it is estimated that such moneys will be required by the Trustee.

For the purpose of determining the amount in any fund, all Permitted Investments credited to such fund shall be valued at the lower of cost (inclusive of all interest accrued but not paid) or market value.

### **Assignment to Trustee; Enforcement of Obligations**

Pursuant to the Trust Agreement, the Authority transfers, assigns and sets over to the Trustee all of the Installment Payments and other Revenues and any and all rights and privileges it has under the Installment Purchase Contract including, without limitation, the right to collect and receive directly all of the Installment Payments and the right to hold and enforce any security interest, and any Installment Payments collected or received by the Authority shall be deemed to be held, and to have been collected or received, by the Authority as the agent of the Trustee, and shall forthwith be paid by the Authority to the Trustee. The Trustee also shall take all steps, actions and proceedings required to be taken as provided in any opinion of Bond Counsel delivered to it, reasonably necessary to maintain in force for the benefit of the Owners of the Water Bonds the Trustee's rights in and priority to the following security granted to it for the payment of the Water Bonds: (i) the Trustee's rights as assignee of the Installment Payments and other Revenues and (ii) all other rights and privileges under the Installment Purchase Contract and as beneficiary of any other rights to security for the Water Bonds which the Trustee may receive in the future.

### **Covenants of the Authority and the Trustee**

Punctual Payment and Performance. The Authority will punctually pay out of the Revenues the interest on and the principal of and redemption premiums, if any, to become due on every Water Bond issued under the Trust Agreement in strict conformity with the terms of the Trust Agreement and of the Water Bonds, and will faithfully observe and perform all of the agreements and covenants to be observed or performed by the Authority contained in the Trust Agreement and in the Water Bonds.

Compliance with Installment Purchase Contract and Treatment and Delivery Agreement. The District and the Authority will faithfully comply with, keep, observe and perform all the agreements, conditions, covenants and terms contained in the Installment Purchase Contract and in the Treatment and Delivery Agreement required to be complied with, kept, observed and performed by the District and the Authority, and the Trustee will, to the extent required under the Trust Agreement, enforce such document against the District in accordance with its terms.

The Authority will not alter, amend or modify the Installment Purchase Contract without the prior written consent of the Trustee. Such consent of the Trustee shall be given only (i) if the Trustee receives an opinion of

Bond Counsel which states that such alterations, amendments or modifications will not result in any material impairment of the security given or intended to be given for the payment of the Installment Payments, or (ii) if the Trustee first obtains the written consents of the Bond Insurer and the Owners of at least 60% in aggregate principal amount of the Water Bonds then Outstanding to such alterations, amendments or modifications; provided, however, that the tax covenants of the Installment Purchase Contract may be amended upon receipt of an opinion of Bond Counsel that any specified action required thereunder is no longer required, or some further or different action is required, to maintain the exclusion from federal income tax of interest on the Water Bonds.

The District will not alter, amend or modify the Treatment and Delivery Agreement without the prior written consent of the Trustee. Such consent of the Trustee shall be given only (i) if the Trustee receives a Certificate of the District to the effect that such alterations, amendments or modifications will not result in any material impairment of the security given or intended to be given for the payment of the Installment Payments, or (ii) if the Trustee first obtains the written consent of the Bond Insurer and the Owners of at least 60% in aggregate principal amount of the Water Bonds then Outstanding to such alterations, amendments or modifications.

Observance of Laws and Regulations. The Authority and the Trustee will faithfully comply with, keep, observe and perform all valid and lawful obligations or regulations now or hereafter imposed on them by contract, or prescribed by any law of the United States of America or of the State of California, or by any officer, board or commission having jurisdiction or control, as a condition of the continued enjoyment of each and every franchise, right or privilege now owned or hereafter acquired by them, including their right to exist and carry on their respective businesses, to the end that such franchises, rights and privileges shall be maintained and preserved and shall not become abandoned, forfeited or in any manner impaired.

Tax Covenants. The District and the Authority each covenant that it will not take any action, or fail to take any action, if any such action or failure to take such action would adversely affect the exclusion from gross income of the interest on the Water Bonds under Section 103 of the Code.

Against Encumbrances. So long as any Water Bonds are Outstanding, the Authority will not create or suffer to be created any pledge of or lien on the Installment Payments or other Revenues other than the pledge and lien of the Trust Agreement, and will not issue any bonds, notes or obligations payable from the Installment Payments or other Revenues or secured by a pledge of or charge or lien upon the Installment Payments or other Revenues except the Water Bonds.

Prosecution and Defense of Suits. The Authority will defend against every action, suit or other proceeding at any time brought against the Trustee or any Owner upon any claim arising out of the receipt, deposit or disbursement of any of the Installment Payments or other Revenues or involving the rights of the Trustee or any Owner under the Trust Agreement; provided, however, that the Trustee or any Owner at its or such Owner's election may appear in and defend any such action, suit or other proceeding. The Authority will indemnify and hold harmless the Trustee and the Owners against any and all liability claimed or asserted by any person arising out of any such receipt, deposit or disbursement, and will indemnify and hold harmless the Owners against any attorneys' fees or other expenses which any of them may incur in connection with any litigation or otherwise in connection with the foregoing to which any of them may become a party in order to enforce their rights under the Trust Agreement or under the Water Bonds, provided that such litigation shall be concluded favorably to such Owners' contentions in the Trust Agreement.

Payment Pursuant to the Municipal Bond Insurance Policy. As long as the Municipal Bond Insurance Policy shall be in full force and effect, the Authority and the Trustee agree to comply with the provisions of the Trust Agreement and the Installment Purchase Contract and any provision expressly recognizing or granting rights in or to the Bond Insurer shall not be amended in any manner which affects the rights of the Bond Insurer thereunder without the prior written consent of the Bond Insurer.

The Bond Insurer's consent shall be required in addition to Owner consent when required for the following purposes: (i) execution and delivery of any amendment, supplement or change to or modification of the Trust Agreement or the Installment Purchase Contract; (ii) removal of the Trustee and selection and appointment of any successor trustee; and (iii) initiation or approval of any action not described in (i) or (ii) above which requires Owner consent.

Continuing Disclosure. The Authority shall have no responsibility or liability to the Owners of the Water Bonds or any other person with respect to the continuing disclosure requirements contained in the Continuing Disclosure Agreement. The Trustee covenants and agrees in the Trust Agreement that it will comply with and carry out all of the provisions applicable to the Trustee of the Continuing Disclosure Agreement and the Installment Purchase Contract. Notwithstanding any other provision of the Trust Agreement, failure of the City or the Trustee to comply with the Continuing Disclosure Agreement shall not be considered an Event of Default; however, the Trustee (and, at the request of any Participating Underwriter or the Owners of at least 25% aggregate principal amount of Outstanding Water Bonds, shall) or any Owner may take such actions as may be necessary and appropriate, including seeking mandate or specific performance by court order, to cause the City to comply with its obligations under the Continuing Disclosure Agreement or to cause the Trustee to comply with its obligations under the Trust Agreement.

### **Events of Default and Remedies**

Events of Default and Acceleration of Maturities. If one or more of the following events (in the Trust Agreement called “Events of Default”) shall happen, that is to say:

(a) if default shall be made in the due and punctual payment of the interest on any Water Bond when and as the same shall become due and payable;

(b) if default shall be made in the due and punctual payment of the principal of or redemption premium, if any, on any Water Bond when and as the same shall become due and payable, whether at maturity as therein expressed or by proceedings for redemption;

(c) if default shall be made by the Authority in the performance of any of the other agreements or covenants required in to be performed by the Authority, and such default shall have continued for a period of 30 days after the Authority shall have been given notice in writing of such default by the Trustee;

(d) if an Event of Default (as that term is defined in the Installment Purchase Contract) shall happen;  
or

(e) if the Authority shall file a petition or answer seeking arrangement or reorganization under the federal bankruptcy laws or any other applicable law of the United States of America or any state therein, or if a court of competent jurisdiction shall approve a petition filed with or without the consent of the Authority seeking arrangement or reorganization under the federal bankruptcy laws or any other applicable law of the United States of America or any state therein, or if under the provisions of any other law for the relief or aid of debtors any court of competent jurisdiction shall assume custody or control of the Authority or of the whole or any substantial part of its property;

then and in each and every such case during the continuance of such Event of Default the Trustee may, with the consent of the Bond Insurer and shall, at the direction of the Bond Insurer or the Owners of not less than a majority in aggregate principal amount of the Water Bonds then Outstanding with the consent of the Bond Insurer, by notice in writing to the Authority and the Bond Insurer, declare the principal of all Water Bonds then Outstanding and the interest accrued thereon to be due and payable immediately, and upon any such declaration the same shall become due and payable, anything contained in the Trust Agreement or in the Water Bonds to the contrary notwithstanding. The Trustee shall promptly notify all Owners and the Bond Insurer of any such Event of Default which is continuing. Such notice shall include a reference to or a summary of the rights and remedies available to the Owners as set forth in the Trust Agreement..

This provision, however, is subject to the condition that if at any time after the principal of the Water Bonds then Outstanding shall have been so declared due and payable and before any judgment or decree for the payment of the money due shall have been obtained or entered the Authority shall deposit with the Trustee a sum sufficient to pay all matured interest on all the Water Bonds and all principal of the Water Bonds matured prior to such declaration, with interest at the rate borne by such Water Bonds on such overdue interest and principal, and the reasonable fees and expenses of the Trustee (including but not limited to the fees and expenses of its attorneys), and

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

Institution of Legal Proceedings by Trustee. If one or more of the Events of Default shall happen and be continuing, the Trustee in its discretion may with the consent of the Bond Insurer, and shall, at the direction of the Bond Insurer or the Owners of a majority in aggregate principal amount of the Water Bonds then Outstanding with the consent of the Bond Insurer, and upon being indemnified to its satisfaction therefor, proceed to protect or enforce its rights or the rights of the Owners of Water Bonds under the Trust Agreement by a suit in equity or action at law, either for the specific performance of any covenant or agreement contained in the Trust Agreement, or in aid of the execution of any power granted in the Trust Agreement, or by mandamus or other appropriate proceeding for the enforcement of any other legal or equitable remedy as the Trustee shall deem most effectual in support of any of its rights and duties under the Trust Agreement.

Actions by Trustee as Attorney-in-Fact. Any action, proceeding or suit which any Owner shall have the right to bring to enforce any right or remedy under the Trust Agreement may be brought by the Trustee for the equal benefit and protection of all Owners, whether or not the Trustee is an Owner, and the Trustee is appointed by the Trust Agreement (and the successive Owners, by taking and holding the Water Bonds issued thereunder, shall be conclusively deemed to have so appointed it) the true and lawful attorney-in-fact of the Owners for the purpose of bringing any such action, proceeding or suit and for the purpose of doing and performing any and all acts and things for and on behalf of the Owners as a class or classes as may be advisable or necessary in the opinion of the Trustee as such attorney-in-fact.

Limitation on Owners' Right to Sue. No Owner of any Water Bond issued under the Trust Agreement shall have the right to institute any suit, action or proceeding at law or equity, for any remedy under or upon the Trust Agreement, unless (a) such Owner shall have previously given to the Trustee written notice of the occurrence of an Event of Default; (b) the Owners of at least a majority in aggregate principal amount of all the Water Bonds then Outstanding shall have made written request upon the Trustee to exercise the powers granted in the Trust Agreement or to institute such suit, action or proceeding in its own name; (c) said Owners shall have tendered to the Trustee reasonable security or indemnity against the costs, expenses and liabilities to be incurred in compliance with such request; and (d) the Trustee shall have refused or omitted to comply with such request for a period of 60 days after such request shall have been received by, and said tender of indemnity shall have been made to, the Trustee.

No Liability by the District to the Owners. Except for the payment when due of the Installment Payments and the performance of the other agreements and covenants required to be performed by it contained in the Installment Purchase Contract or in the Trust Agreement, the District shall not have any obligation or liability to the Owners with respect to the Trust Agreement or the preparation, issuance, execution, delivery or transfer of the Water Bonds or to the disbursement of the Revenues by the Trustee to the Owners, or with respect to the performance by the Trustee of any right or obligation required to be performed by it contained in the Trust Agreement.

No Liability by the Trustee to the Owners. Except as expressly provided in the Trust Agreement, the Trustee shall not have any obligation or liability to the Owners with respect to the payment when due of the Installment Payments by the District or with respect to the performance by the District of the other agreements and covenants required to be performed by it contained in the Installment Purchase Contract or in the Trust Agreement.

## **The Trustee**

Duties, Immunities and Liabilities of Trustee. The Trustee shall, prior to an Event of Default, and after the curing of all Events of Default which may have occurred, perform such duties and only such duties as are specifically set forth in the Trust Agreement. The Trustee shall, during the existence of any Event of Default (which

has not been cured), exercise such of the rights and powers vested in it by the Trust Agreement, and use the same degree of care and skill in their exercise, as prudent persons would exercise or use under the circumstances in the conduct of their own affairs.

No provision of the Trust Agreement shall be construed to relieve the Trustee from liability for its own negligent action or its own negligent failure to act, except that:

(a) Prior to such an Event of Default under the Trust Agreement and after the curing of all Events of Default which may have occurred,

(1) the duties and obligations of the Trustee shall be determined solely by the express provisions of the Trust Agreement, and the Trustee shall not be liable except for the performance of such duties and obligations as are specifically set forth in the Trust Agreement, and no implied covenants or obligations shall be read into the Trust Agreement against the Trustee; and

(2) in the absence of bad faith on the part of the Trustee, the Trustee may conclusively rely, as to the truth of the statements and the correctness of the opinions expressed in the Trust Agreement, upon any certificate or opinion furnished to the Trustee conforming to the requirements of the Trust Agreement; but in the case of any such certificate or opinion which by any provision thereof is specifically required to be furnished to the Trustee, the Trustee shall be under a duty to examine the same to determine whether or not it conforms to the requirements of the Trust Agreement; and

(b) At all times, regardless of whether or not any Event of Default shall exist,

(1) the Trustee shall not be liable for any error of judgment made in good faith by a responsible officer or officers of the Trustee unless it shall be proved that the Trustee was negligent in ascertaining the pertinent facts; and

(2) The Trustee shall not be liable with respect to any action taken or omitted to be taken by it in good faith in accordance with the direction of the Owners of not less than a majority, or such larger percentage as may be required under the Trust Agreement, in aggregate principal amount of the Water Bonds at the time outstanding relating to the time, method and place of conducting any proceeding for any remedy available to the Trustee or exercising any trust or power conferred upon the Trustee under the Trust Agreement.

None of the provisions contained in the Trust Agreement shall require the Trustee to expend or risk its own funds or otherwise incur individual financial liability in the performance of any of its duties or in the exercise of any of its rights or powers.

Qualifications of Trustee. There shall at all times be a trustee under the Trust Agreement which shall be a bank, trust company or national association organized and doing business under the laws of the United States or of a state thereof, authorized under such laws to exercise corporate trust powers, having a combined capital and surplus of at least \$75,000,000, and subject to supervision or examination by federal or state authority. If such corporations or banking associations publish reports of condition at least annually, pursuant to law or to the requirements of any supervising or examining authority above referred to, then for the purposes of the Trust Agreement the combined capital and surplus of such corporations or banking associations shall be deemed to be their combined capital and surplus as set forth in their most recent reports of conditions so published. In case at any time the Trustee shall cease to be eligible in accordance with the provisions of the Trust Agreement, the Trustee shall resign immediately in the manner and with the effect specified therein.

Resignation and Removal of Trustee and Appointment of Successor Trustee. (a) The Trustee may at any time resign by giving written notice to the Authority and the Bond Insurer and by giving to the Owners Notice by Mail. Upon receiving such notice of resignation, the Authority, with the advice and consent of the District and the Bond Insurer, shall promptly appoint a successor trustee by an instrument in writing. If no successor trustee shall have been so appointed and have accepted appointment within 30 days after the giving of such notice of resignation,

the resigning trustee may petition any court of competent jurisdiction for the appointment of a successor trustee or any Owner who has been a bona fide Owner of a Water Bond for at least six months may, on behalf of itself and others similarly situated, petition any such court for the appointment of a successor trustee. Such court may thereupon, after such notice, if any, as it may deem proper and may prescribe, appoint a successor trustee.

(b) In case at any time either of the following shall occur:

(1) the Trustee shall cease to be eligible in accordance with the provisions the Trust Agreement and shall fail to resign after written request therefor by the Authority or by any Owner who has been a bona fide Owner of a Water Bond for at least six months, or

(2) the Trustee shall become incapable of acting, or shall be adjudged a bankrupt or insolvent, or a receiver of the Trustee or of its property shall be appointed, or any public officer shall take charge or control of the Trustee or of its property or affairs for the purpose of rehabilitation, conservation or liquidation,

then, in any such case, the Authority may remove the Trustee and appoint a successor trustee by an instrument in writing, or any Owner who has been a bona fide Owner of a Water Bond for at least six months may, on behalf of itself and all others similarly situated, petition any court of competent jurisdiction for the removal of the Trustee and the appointment of a successor trustee. Such court may thereupon, after such notice, if any, as it may deem proper and may prescribe, remove the Trustee and appoint a successor trustee.

(c) The Authority or Owners of a majority in aggregate principal amount of the Water Bonds at the time Outstanding may at any time remove the Trustee and appoint a successor trustee by an instrument or concurrent instruments in writing signed by the Authority or such Owners, as the case may be. The Bond Insurer may remove the Trustee for breach of its obligations under the Trust Agreement and in such event the Authority shall appoint a successor trustee by an instrument in writing.

### **Modification of Trust Agreement**

Amendment or Supplement of Trust Agreement. The Trust Agreement and the rights and obligations of the Authority, the District, the Owners and the Trustee thereunder may be amended or supplemented at any time by an amendment thereof or supplement thereto which shall become binding when the written consents of the Bond Insurer and the Owners of 60% in aggregate principal amount of the Water Bonds then Outstanding, exclusive of Water Bonds disqualified as provided in the Trust Agreement, are filed with the Trustee. No such amendment or supplement shall (1) extend the stated payment date of any Water Bond, or reduce the rate of interest thereon, or extend the time of payment of such interest, or reduce the amount of principal thereof, or reduce any redemption premium thereon, without the prior written consent of the Owner of the Water Bond so affected, or (2) reduce the percentage of Owners whose consent is required for the execution of any amendment or supplement to the Trust Agreement, or (3) modify any of the rights or obligations of the Trustee without its prior written consent thereto.

The Trust Agreement and the rights and obligations of the Authority, the District, the Owners and the Trustee thereunder may also be amended or supplemented at any time by an amendment thereof or supplement thereto which shall become binding upon execution without the consent of any Owners or the Bond Insurer, but only to the extent permitted by law and after receipt of an approving opinion of Bond Counsel and only for any one or more of the purposes set forth in the Trust Agreement.

### **Defeasance**

Discharge of the Trust Agreement. When the obligations of the District under the Installment Purchase Contract shall cease pursuant to the Installment Purchase Contract (except for the right of the Trustee and the obligation of the District to have the money and Permitted Investments mentioned in the Trust Agreement applied to the payment of Installment Payments as therein set forth), then and in that case the obligations created by the Trust Agreement shall thereupon cease, terminate and become void except for the right of the Owners and the obligation of the Trustee to apply such moneys and Permitted Investments to the payment of the Water Bonds as set forth in the

Trust Agreement and the right of the Trustee to collect any fees or expenses due thereunder, and the Trustee shall turn over to the District, as an overpayment of Installment Payments, any surplus in the Series 2007 Revenue Fund or the Project Fund and all balances remaining in any other funds or accounts other than moneys and Permitted Investments held for the payment of the Water Bonds at maturity or on redemption, which moneys and Permitted Investments shall continue to be held by the Trustee in trust for the benefit of the Owners and shall be applied by the Trustee to the payment, when due, of the principal and interest and premium, if any, represented by the Water Bonds, and after such payment, the Trust Agreement shall become void.

**APPENDIX E**

**PROPOSED FORM OF OPINION OF BOND COUNSEL**

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[closing date]

Modesto Irrigation District Financing Authority  
Modesto, California

Modesto Irrigation District Financing Authority  
Domestic Water Project Revenue Bonds, Series 2007F  
(Final Opinion)

Ladies and Gentlemen:

We have acted as bond counsel to the Modesto Irrigation District Financing Authority (the “Issuer”) in connection with the issuance of \$93,190,000 aggregate principal amount of Modesto Irrigation District Financing Authority Domestic Water Project Revenue Bonds, Series 2007F (the “Bonds”), issued pursuant to the provisions of the Joint Exercise of Powers Act (constituting Chapter 5 of Title 1 of Division 7 of the California Government Code) and a trust agreement, dated as of June 1, 2007 (the “Trust Agreement”), by and among the Issuer, the Modesto Irrigation District (the “District”) and The Bank of New York Trust Company, N.A., as trustee (the “Trustee”). Capitalized terms not otherwise defined herein shall have the meanings ascribed thereto in the Trust Agreement.

In such connection, we have reviewed the Trust Agreement, the Installment Purchase Contract, the Tax Certificate, dated the date hereof (the “Tax Certificate”), certificates of the Issuer, the District, the Trustee, and others, opinions of counsel to the Issuer, the District and the Trustee, and such other documents, opinions and matters to the extent we deemed necessary to render the opinions set forth herein.

The opinions expressed herein are based on an analysis of existing laws, regulations, rulings and court decisions and cover certain matters not directly addressed by such authorities. Such opinions may be affected by actions taken or omitted or events occurring after the date hereof. We have not undertaken to determine or to inform any person, whether any such actions are taken or omitted or events do occur or any other matters come to our attention after the date hereof. Accordingly, this opinion is not intended to, and may not, be relied upon in connection with any such actions, events or matters. We disclaim any obligation to update this letter. We have assumed the genuineness of all documents and signatures presented to us (whether as originals or as copies) and the due and legal execution and delivery thereof by, and

validity against, any parties other than the Issuer. We have assumed, without undertaking to verify, the accuracy of the factual matters represented, warranted or certified in the documents, and of the legal conclusions contained in the opinions, referred to in the second paragraph hereof. Furthermore, we have assumed compliance with all covenants and agreements contained in the Trust Agreement, the Installment Purchase Contract and the Tax Certificate, including (without limitation) covenants and agreements compliance with which is necessary to assure that future actions, omissions or events will not cause interest on the Bonds to be included in gross income for federal income tax purposes. We call attention to the fact that the rights and obligations under the Bonds, the Trust Agreement, the Installment Purchase Contract and the Tax Certificate and their enforceability 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 the limitations on legal remedies against public entities in the State of California. We express no opinion with respect to any indemnification, contribution, penalty, choice of law, choice of forum, choice of venue, waiver or severability provisions contained in the foregoing documents nor do we express any opinion with respect to the state or quality of title to or interest in any of the real or personal property described in or as subject to the lien of the Installment Purchase Contract or the accuracy or sufficiency of the description contained therein of, or the remedies available to enforce liens on, any such property. Finally, we undertake no responsibility for the accuracy, completeness or fairness of the Official Statement or other offering material relating to the Bonds and express no opinion with respect thereto.

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

1. The Bonds constitute the valid and binding limited obligations of the Issuer. The Bonds are payable from certain amounts payable by the District under the Installment Purchase Contract and certain other moneys described in the Trust Agreement (as more particularly defined in the Trust Agreement, the "Revenues").

2. The Trust Agreement has been duly executed and delivered by, and constitutes the valid and binding obligation of, the Issuer. The Trust Agreement creates a valid pledge, to secure the payment of the principal of and interest on the Bonds, of the Revenues and any other amounts (including certain proceeds of the sale of the Bonds) held by the Trustee in any fund or account established pursuant to the Trust Agreement, except the Rebate Fund, subject to the provisions of the Trust Agreement permitting the application thereof for the purposes and on the terms and conditions set forth in the Trust Agreement.

3. The Bonds are not a debt, liability or obligation of the District or of any other public agency who is a party to the joint powers agreement creating the Issuer. The obligation of the District to make payments pursuant to the Installment Purchase Contract is

limited to the Treatment and Delivery Revenues. Neither the faith and credit nor the taxing powers of the District, the State of California nor any political subdivision thereof is pledged to such payments or the payment of principal of or interest on the Bonds.

4. The Installment Purchase Contract has been duly executed and delivered by, and constitutes the valid and binding obligation of, the Issuer and the District, respectively.

5. Interest on the Bonds is excluded from gross income for federal income tax purposes under section 103 of the Internal Revenue Code of 1986 and is exempt from State of California personal income taxes. Interest on the Bonds is not a specific preference item for purposes of the federal individual or corporate alternative minimum taxes, although we observe that it is included in adjusted current earnings when calculating corporate alternative minimum taxable income. We express no opinion regarding other tax consequences relating to the ownership or disposition of, or the accrual or receipt of interest on, the Bonds.

Faithfully yours,

ORRICK, HERRINGTON & SUTCLIFFE LLP

per

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**APPENDIX F**

**SCHEDULE OF INSTALLMENT PAYMENTS**

<b>Period Ending (June 30)</b>	<b>Series 1998D Installment Payments</b>	<b>Series 2007 Installment Payments<sup>1</sup></b>	<b>Total Installment Payments<sup>2</sup></b>	<b>Parity Debt Service</b>	<b>Total Debt Service<sup>2</sup></b>
2007	\$ 6,687,444	–	\$ 6,687,444	\$ 2,993,683	\$ 9,681,127
2008	6,681,894	\$ 2,806,030	9,487,924	3,666,954	13,154,878
2009	6,672,406	4,123,147	10,795,553	3,911,482	14,707,034
2010	6,681,894	4,123,147	10,805,040	3,929,632	14,734,672
2011	6,670,769	4,123,147	10,793,915	3,919,387	14,713,302
2012	6,670,894	4,123,147	10,794,040	3,911,317	14,705,357
2013	6,666,644	4,123,147	10,789,790	3,930,042	14,719,832
2014	6,655,159	4,123,147	10,778,306	3,920,036	14,698,342
2015	6,655,553	4,123,147	10,778,700	3,935,847	14,714,547
2016	6,644,672	4,123,147	10,767,818	3,923,293	14,691,112
2017	6,645,038	4,123,147	10,768,184	3,804,630	14,572,814
2018	6,636,288	4,123,147	10,759,434	3,662,216	14,421,650
2019	6,630,163	4,123,147	10,753,309	3,672,963	14,426,272
2020	6,632,938	4,123,147	10,756,084	3,659,703	14,415,787
2021	6,629,575	4,123,147	10,752,722	3,652,344	14,405,065
2022	6,618,269	4,123,147	10,741,415	3,665,048	14,406,463
2023	6,613,425	4,123,147	10,736,572	3,677,398	14,413,970
2024	–	8,304,567	8,304,567	3,659,460	11,964,027
2025	–	8,293,467	8,293,467	3,677,970	11,971,437
2026	–	8,289,159	8,289,159	3,693,000	11,982,159
2027	–	8,315,438	8,315,438	3,680,130	11,995,568
2028	–	8,316,756	8,316,756	3,689,070	12,005,826
2029	–	8,321,460	8,321,460	3,694,530	12,015,990
2030	–	8,309,258	8,309,258	3,720,930	12,030,188
2031	–	8,325,956	8,325,956	3,718,560	12,044,516
2032	–	8,320,888	8,320,888	3,737,130	12,058,018
2033	–	8,343,388	8,343,388	3,726,930	12,070,318
2034	–	8,347,679	8,347,679	3,737,670	12,085,349
2035	–	8,353,539	8,353,539	3,744,060	12,097,599
2036	–	8,365,191	8,365,191	3,746,100	12,111,291
2037	–	8,362,191	8,362,191	3,768,210	12,130,401
2038	–	12,133,514	12,133,514	–	12,133,514

<sup>1</sup> Assumes an interest rate based upon the Domestic Water Swap Agreement fixed interest rate of (i) 4.378% on the Series 2007 Water Bonds with the stated maturity of September 1, 2027 and (ii) 4.440% on the Series 2007 Water Bonds with the stated maturity of September 1, 2037.

<sup>2</sup> Totals may not add up because of rounding.

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## APPENDIX G

### DTC AND THE BOOK-ENTRY ONLY SYSTEM

#### General

The Series 2007 Water Bonds will be delivered in book-entry only form. The Depository Trust Company (“DTC”) will act as securities depository for the Series 2007 Water Bonds. The Series 2007 Water 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 securities certificate will be issued for each maturity of the Series 2007 Water Bonds, each in the aggregate principal amount of such maturity, and will be deposited with DTC.

DTC, the world’s largest depository, is a limited-purpose trust company organized under the New York Banking Law, a “banking organization” within the meaning of the New York Banking Law, a member of the Federal Reserve System, a “clearing corporation” within the meaning of the New York Uniform Commercial Code, and a “clearing agency” registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for over 2.2 million issues of U.S. and non-U.S. equity, 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](http://www.dtcc.com) and [www.dtc.org](http://www.dtc.org).

Purchases of the Series 2007 Water Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Series 2007 Water Bonds on DTC’s records. The ownership interest of each actual purchaser of each Series 2007 Water 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 Series 2007 Water 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 the Series 2007 Water Bonds, except in the event that use of the book-entry system for the Series 2007 Water Bonds is discontinued.

To facilitate subsequent transfers, all Series 2007 Water Bonds deposited by Direct Participants with DTC are registered in the name of DTC’s partnership nominee, Cede & Co., or such other name as may be requested by an authorized representative of DTC. The deposit of Series 2007 Water Bonds with DTC and their registration in the name of Cede & Co. or such other DTC nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Series 2007 Water Bonds; DTC’s records reflect only the identity of the Direct Participants to whose accounts such Series 2007 Water 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 Series 2007 Water Bonds are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such issue to be redeemed.

Neither DTC nor Cede & Co. will consent or vote with respect to the Series 2007 Water Bonds unless authorized by a Direct Participant in accordance with DTC's Procedures. Under its usual procedures, DTC mails an Omnibus Proxy to the Authority 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 Series 2007 Water Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Principal, premium, if any, and interest payments on the Series 2007 Water Bonds will be made to DTC. DTC's practice is to credit Direct Participants' accounts, upon DTC's receipt of funds and corresponding detail information from the Authority or the Trustee, on 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 customer 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 nor its nominee, the Trustee, the Authority or the City, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of principal, premium, if any, and interest to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the Authority or the Trustee, disbursement of such payments to Direct Participants shall be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners will be responsibility of Direct and Indirect Participants.

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

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

**The Authority, the District, the City and the Trustee cannot and do not give any assurance that DTC, DTC Participants or others will distribute payments of principal, interest or any premium with respect to the Series 2007 Water Bonds paid to DTC or its nominee as the registered owner, or any prepayment or other notices, to the Beneficial Owner, or that they will do so on a timely basis or will serve and act in the manner described in this Official Statement. The Authority, the District, the City and the Trustee are not responsible or liable for the failure of DTC or any DTC Participant to make any payment or give any notice to a Beneficial Owner with respect to the Series 2007 Water Bonds or any error or delay relating thereto.**

The foregoing description of the procedures and record-keeping with respect to beneficial ownership interest in the Series 2007 Water Bonds, payment of principal, premium, if any, interest and other payments on the Series 2007 Water Bonds to DTC Participants or Beneficial Owners, confirmation and transfer of beneficial ownership interests in such Series 2007 Water Bonds and other related transactions by and between DTC, the DTC Participants and the Beneficial Owners is based solely on information provided by DTC. Accordingly, no representations can be made concerning these matters and neither the DTC Participants nor the Beneficial Owners should rely on the foregoing information with respect to such matters, but should instead confirm the same with DTC or the DTC Participants, as the case may be.

#### **Discontinuance of DTC Services**

In the event that (a) DTC determines not to continue to act as securities depository for the Series 2007 Water Bonds or (b) the Authority determines to remove DTC from its functions as a depository, DTC's role as

securities depository for the Series 2007 Water Bonds and use of the book-entry system will be discontinued. If the Authority fails to select a qualified securities depository to replace DTC, the Authority will execute and deliver new Series 2007 Water Bonds in fully registered form in such denominations and numbered in the manner determined by the Trustee and registered in the names of such persons as are requested in a written request of the Authority. The Trustee shall not be required to deliver such new Series 2007 Water Bonds within a period of less than 60 days from the date of receipt of such written request of the Authority. Upon such registration, such persons in whose names the Series 2007 Water Bonds are registered will become the registered owners of the Series 2007 Water Bonds for all purposes.

In the event that the book-entry system is discontinued, the following provisions would also apply: (a) Series 2007 Water Bonds may be exchanged for an equal aggregate principal amount of such Series 2007 Water Bonds in other authorized denominations and of the same maturity, upon surrender thereof at the corporate trust office of the Trustee; (b) the transfer of any Series 2007 Water Bond may be registered on the books maintained by the Trustee under the Trust Agreement for such purpose only upon the surrender thereof to the Trustee together with a duly executed written instrument of transfer in a form approved by the Trustee; (c) for every exchange or transfer of Series 2007 Water Bonds, the Trustee shall require the payment by any owner requesting such transfer or exchange of any tax or other governmental charge that may be imposed with respect to such exchange or registration of transfer; (d) no transfer or exchange of Series 2007 Water Bonds shall be required to be made during the 15-day period prior to any interest payment date or during the period established by the Trustee for selection of Series 2007 Water Bonds for redemption; (e) all interest payments on the Series 2007 Water Bonds will be made by clearinghouse check or draft mailed on the interest payment dates therefor as provided in the Trust Agreement to the person appearing on the registration books maintained by the Trustee; and (f) all payments of principal and any premium on the Series 2007 Water Bond, will be made upon surrender thereof at the corporate trust office of the Trustee.

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**APPENDIX H**

**SPECIMEN FINANCIAL GUARANTY INSURANCE POLICY**

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# FINANCIAL GUARANTY INSURANCE POLICY

**MBIA Insurance Corporation  
Armonk, New York 10504**

Policy No. [NUMBER]

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

[PAR]  
[LEGAL NAME OF ISSUE]

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

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

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

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

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

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

**MBIA Insurance Corporation**

\_\_\_\_\_  
President

Attest:

\_\_\_\_\_  
Assistant Secretary

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## APPENDIX I

### FORM OF CONTINUING DISCLOSURE AGREEMENT

This CONTINUING DISCLOSURE AGREEMENT (the “Disclosure Agreement”) is executed and delivered by the CITY OF MODESTO (the “City”) and THE BANK OF NEW YORK TRUST COMPANY, N.A., in its capacity as Dissemination Agent (the “Dissemination Agent”), in connection with the issuance by the Modesto Irrigation District Financing Authority (the “Authority”) of its \$93,190,000 Domestic Water Project Revenue Bonds, Series 2007F (the “Bonds”). The Bonds are being issued pursuant to a Trust Agreement (the “Trust Agreement”), dated as of June 1, 2007, by and among the Authority, the Modesto Irrigation District (the “District”) and The Bank of New York Trust Company, N.A., as trustee (the “Trustee”). The City and the Dissemination Agent covenant and agree as follows:

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

**SECTION 2. Definitions.** In addition to the definitions set forth in the Trust Agreement, which apply to any capitalized term used in this Disclosure Agreement unless otherwise defined in this Section 2, the following terms shall have the following meanings:

“Annual Report” shall mean any Annual Report provided by the City pursuant to, and as described in, Sections 3 and 4 of this Disclosure Agreement.

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

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

“Disclosure Representative” shall mean the City Manager or Finance Director of the City, or their designee, or such other officer or employee as the City shall designate in writing to the Trustee and the Dissemination Agent from time to time.

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

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

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

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

“National Repository” shall mean any Nationally Recognized Municipal Securities Information Repository for purposes of the Rule. The internet address listing for the National Repositories is set forth on Exhibit A hereto.

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

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

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

“State” shall mean the State of California.

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

### SECTION 3. Provision of Annual Reports.

(a) The City shall, or shall cause the Dissemination Agent to, not later than 270 days after the end of the City’s Fiscal Year (presently March 31 of the subsequent year following the end of the City’s Fiscal Year), commencing with the report for the end of the 2006-07 Fiscal Year, prepare an Annual Report which is consistent with the requirements of Section 4 of this Disclosure Agreement. The Annual Report may be submitted as a single document or as separate documents comprising a package, and may include by reference other information as provided in Section 4 of this Disclosure Agreement; *provided* that the audited financial statements of the City may be submitted separately from the balance of the Annual Report, and later than the date required above for the filing of the Annual Report if not available by that date. If the City’s Fiscal Year changes, the City shall give notice of such change in the same manner as for a Listed Event under Section 5(f).

(b) Not later than fifteen (15) Business Days prior to the date specified in subsection (a) for providing the Annual Report to Repositories, the City shall provide the Annual Report to the Dissemination Agent (if other than the City) and the Trustee. If by fifteen (15) Business

Days prior to such date, the Dissemination Agent has not received a copy of the Annual Report from the City, the Dissemination Agent shall contact the City to determine if the City is in compliance with subsection (a). The City reserves the right to make this filing through the Central Post Office.

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

(d) The Dissemination Agent shall:

- (i) determine each year prior to the date for providing the Annual Report the name and address of each National Repository and the State Repository, if any; and;
- (ii) to the extent the City has provided the Dissemination Agent with the Annual Report, file a report with the City and (if the Dissemination Agent is not the Trustee, the Trustee) certifying that the Annual Report has been provided pursuant to this Disclosure Agreement, stating the date it was provided and listing all the Repositories to which it was provided. The Dissemination Agent shall have no responsibility for the content of any Annual Report.

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

- (i) the Annual Budget of the City;
- (ii) the Comprehensive Annual Financial Report of the City and, to the extent not contained in said Report or if said Report is no longer being prepared, the audited financial statements of the City's Municipal Water System for the prior Fiscal Year, prepared in accordance with generally accepted accounting principles as promulgated to apply to governmental entities from time to time by the Government Accounting Standards Board. If the audited financial statements of the City's Municipal Water System are not available by the time the Annual Report is required to be filed pursuant to Section 3(a), the Annual Report shall contain unaudited financial statements, and the audited financial statements shall be filed in the same manner as the Annual Report when they become available;
- (iii) the principal amount of the Bonds and any other Parity Debt outstanding,
- (iv) to the extent not included in the City's audited financial statements, an update for the prior Fiscal Year of the financial information and operating data with respect to the City and the Municipal Water Utility System of the following type (or information and data comparable thereto) included

in the Official Statement relating to the Bonds, dated June \_\_\_\_, 2007 (the “Official Statement”):

- (a) the table entitled “CITY WATER UTILITY SYSTEM STATISTICS”;
- (b) the table entitled “CITY WATER UTILITY SYSTEM – Service Area Total Production”;
- (c) the table entitled “CITY WATER UTILITY SYSTEM – Sale of Water”;
- (d) the table entitled “CITY WATER UTILITY SYSTEM – Ten Largest Customers”;
- (e) the table entitled “CITY WATER UTILITY SYSTEM – Monthly Single Family Residential Flat Water Rates”;
- (f) the table entitled “CITY WATER UTILITY SYSTEM – Water Rates and Charges Commercial Accounts”;
- (g) the table entitled “CITY WATER UTILITY SYSTEM – Connection Fees for All Users Except Multiple Family Units”;
- (h) the table entitled “CITY WATER UTILITY SYSTEM – Comparison of Average Monthly Water Rates Flat Rate (1” Service)”;
- (i) the table entitled “CITY WATER UTILITY SYSTEM – Historical Debt Service Coverage”; and
- (j) the table entitled “CITY WATER UTILITY SYSTEM – Projected Operating Results).”

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

#### SECTION 5. Reporting of Significant Events.

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

1. principal and interest payment delinquencies;

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

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

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

(d) If the City determines that the Listed Event would not be material under applicable federal securities laws, the City shall so notify the Dissemination Agent in writing and instruct the Dissemination Agent not to report the occurrence pursuant to subsection (e).

(e) If the Dissemination Agent has been instructed by the City to report the occurrence of a Listed Event, the Dissemination Agent shall file a notice of such occurrence with the Municipal Securities Rulemaking Board or the Repositories with a copy to the City. Notwithstanding the foregoing, notice of Listed Events described in subsections (a)(4) and (5) need not be given under this subsection any earlier than the notice (if any) of the underlying event is given to the Holders of affected Bonds pursuant to the Trust Agreement.

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

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

SECTION 7. Dissemination Agent. The City may, from time to time, appoint or engage a Dissemination Agent to assist it in carrying out its obligations under this Disclosure Agreement, and may discharge any such Dissemination Agent, with or without appointing a successor Dissemination Agent. The Dissemination Agent shall not be responsible in any manner for the content of any notice or report prepared by the City pursuant to this Disclosure Agreement. If at any time there is not any other designated Dissemination Agent, the Trustee shall be the Dissemination Agent. The initial Dissemination Agent shall be The Bank of New York Trust Company, N.A.. The Dissemination Agent shall be entitled to compensation for its services as Dissemination Agent and reimbursement for its out-of-pocket expenses, attorney's fees, costs and advances made or incurred in the performance of its duties under this Disclosure Agreement in accordance with its written fee schedule provided to the City, as such fee schedule may be amended from time to time in writing.

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

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

In the event of any amendment or waiver of a provision of this Disclosure Agreement, the City shall describe such amendment in the next Annual Report, and shall include, as applicable, a narrative explanation of the reason for the amendment or waiver and its impact on the type (or, in the case of a change of accounting principles, on the presentation) of financial information or operating data being presented by the City. In addition, if the amendment relates to the

accounting principles to be followed in preparing financial statements, (i) notice of such change shall be given in the same manner as for a Listed Event under Section 5, and (ii) the Annual Report for the year in which the change is made should present a comparison (in narrative form and also, if feasible, in quantitative form) between the financial statements as prepared on the basis of the new accounting principles and those prepared on the basis of the former accounting principles.

SECTION 9. Additional Information. Nothing in this Disclosure Agreement shall be deemed to prevent the City from disseminating any other information, using the means of dissemination set forth in this Disclosure Agreement or any other means of communication, or including any other information in any Annual Report or notice of occurrence of a Listed Event, in addition to that which is required by this Disclosure Agreement. If the City chooses to include any information in any Annual Report or notice of occurrence of a Listed Event in addition to that which is specifically required by this Disclosure Agreement, the City shall not have any obligation under this Disclosure Agreement to update such information or include it in any future Annual Report or notice of occurrence of a Listed Event.

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

In accepting the appointment under this Disclosure Agreement, the Dissemination Agent is not acting in a fiduciary capacity to the Holders or Beneficial Owners of the Bonds, the City, the Participating Underwriters or any other party or person.

No provision of this Disclosure Agreement shall require the Dissemination Agent to risk or advance or expend its own funds or incur any financial liability.

SECTION 11. Duties, Immunities and Liabilities of Dissemination Agent. The Dissemination Agent shall have only such duties as are specifically set forth in this Disclosure Agreement, and the City agrees to indemnify and save the Dissemination Agent, its officers, directors, employees and agents, harmless against any loss, expense and liabilities which it may incur arising out of or in the exercise or performance of its powers and duties hereunder, including the costs and expenses (including attorneys fees) of defending against any claim of liability, but excluding liabilities due to the Dissemination Agent's negligence or willful misconduct. The Dissemination Agent shall have the right to resign from its duties as Dissemination Agent upon thirty (30) days notice to the City and the Trustee. The obligations of the City under this Section shall survive resignation or removal of the Dissemination Agent and payment of the Bonds.

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

To the City: City of Modesto  
1010 10<sup>th</sup> Street, P.O. Box 642  
Modesto, California 95353  
Attention: Finance Director  
Telephone: (209) 577-5369  
Facsimile: (209) 571-5128

To the Dissemination Agent: The Bank of New York Trust Company, N.A.  
700 S. Flower Street, 5th Floor  
Los Angeles, CA 90017  
Attention: Corporate Trust Department  
Telephone: (213) 630-6231  
Facsimile: (213) 630-6215

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

SECTION 13. Beneficiaries. This Disclosure Agreement shall inure solely to the benefit of the City, the Dissemination Agent, the Participating Underwriter and Holders and Beneficial Owners from time to time of the Bonds, and shall create no rights in any other person or entity.

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SECTION 14. Signature. This Disclosure Agreement has been executed by the undersigned on the date hereof, and such signature binds the City and the Dissemination Agent to the undertaking herein provided.

Dated: \_\_\_\_\_, 2007

CITY OF MODESTO

By: \_\_\_\_\_  
Director of Finance

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

By: \_\_\_\_\_  
Authorized Officer

## **EXHIBIT A**

An updated list of Nationally Recognized Municipal Securities Information Repositories approved by the Securities and Exchange Commission may be found at the following internet address: <http://www.sec.gov/info/municipal/nrmsir.htm>

**EXHIBIT B**

**NOTICE TO REPOSITORIES OF FAILURE TO FILE ANNUAL REPORT**

Name of Obligated Party: CITY OF MODESTO

Name of Issue: DOMESTIC WATER PROJECT REVENUE BONDS, SERIES 2007E  
AND SERIES 2007F

Date of Delivery: \_\_\_\_\_, 2007

NOTICE IS HEREBY GIVEN that the City has not provided an Annual Report with respect to the above-named Bonds as required by Section 3 of the Continuing Disclosure Agreement, dated \_\_\_\_\_, 2007, between the City and The Bank of New York Trust Company, N.A., as Dissemination Agent. The City has informed the undersigned that it anticipates that the Annual Report will be filed by \_\_\_\_\_.

Dated: \_\_\_\_\_

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

By: \_\_\_\_\_  
Authorized Officer

cc: City of Modesto