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9 UNITED STATES BANKRUPTCY COURT
 10 EASTERN DISTRICT OF CALIFORNIA
 11 SACRAMENTO DIVISION
 12

13 In re:
 14 CITY OF STOCKTON, CALIFORNIA,
 15 Debtor.

Case No. 2012-32118
 D.C. No. OHS-15
 Chapter 9

**EXHIBIT D-1 TO THE
 DECLARATION OF KENNETH
 DIEKER IN SUPPORT OF CITY'S
 SUPPLEMENTAL MEMORANDUM
 OF LAW IN SUPPORT OF
 CONFIRMATION OF FIRST
 AMENDED PLAN FOR THE
 ADJUSTMENT OF DEBTS OF CITY
 OF STOCKTON, CALIFORNIA
 (NOVEMBER 15, 2013)¹**

Date: May 12, 2014
 Time: 9:30 a.m.
 Dept: Courtroom 35
 Judge: Hon. Christopher M. Klein

24
 25
 26 ¹ Paragraph 13 of the Order Modifying Order Governing The Disclosure And Use Of Discovery Information And
 27 Scheduling Dates Related To The Trial In The Adversary Proceeding And Any Evidentiary Hearing Regarding
 28 Confirmation Of Proposed Plan Of Adjustment (Dkt. No. 1242, modifying Dkt. No. 1224) contemplates that the
 Parties will submit direct testimony declarations for their respective witnesses by April 21, 2014. Accordingly, the
 declarations submitted in support of this Supplemental Memorandum do not contain all of the information and do not
 attach all of the evidence that will be included in the direct testimony declarations that will be filed on April 21.

Exhibit D-1

NEW ISSUE-FULL BOOK-ENTRYRating: S&P: A
See "RATING" herein

In the opinion of Quint & Thimmig LLP, San Francisco, California, Bond Counsel, subject, however, to certain qualifications described in this Official Statement, under existing law, interest on the Bonds (i) is excludable from gross income of the owners thereof for federal income tax purposes, (ii) is not included as an item of tax preference in computing the federal alternative minimum tax for individuals and corporations, and (iii) is not taken into account in computing adjusted current earnings, which is used as an adjustment in determining the federal alternative minimum tax for certain corporations. In addition, in the opinion of Bond Counsel, interest on the Bonds is exempt from personal income taxation imposed by the State of California. See "TAX MATTERS" herein.

\$35,080,000
STOCKTON PUBLIC FINANCING AUTHORITY
LEASE REVENUE BONDS, 2009 SERIES A
(CAPITAL IMPROVEMENT PROJECTS)

Dated: Date of Delivery

Due: September 1, as shown on the inside cover

The Stockton Public Financing Authority (the "Authority") is issuing \$35,080,000 principal amount of Stockton Public Financing Authority Lease Revenue Bonds, 2009 Series A (Capital Improvement Projects) (the "2009 Bonds") to: (i) finance various capital improvements within the City of Stockton; (ii) fund a deposit into the Reserve Account in the amount of the Reserve Requirement (defined herein) as additional security for the 2009 Bonds; and (iii) pay certain costs associated with the issuance and sale of the 2009 Bonds. See "ESTIMATED SOURCES AND USES OF FUNDS" and "THE PROJECT."

The 2009 Bonds are limited obligations of the Authority payable solely from certain revenues of the Authority, consisting primarily of Lease Payments (as defined herein) to be made by the City to the Authority pursuant to a Lease Agreement dated as of September 1, 2009 (the "Lease Agreement"), pursuant to which the City will lease the Property (defined herein) from the Authority. The City covenants in the Lease Agreement to make the Lease Payments for its use and occupancy of the Property (defined herein) and to take such action as may be necessary to include Lease Payments in its annual budgets and to make necessary annual appropriations therefor. See "SECURITY AND SOURCES OF PAYMENT FOR THE 2009 BONDS."

The 2009 Bonds are issued pursuant to the terms of the Indenture of Trust dated as of September 1, 2009 (the "Indenture"), by and between the Authority and Wells Fargo Bank, National Association, as trustee (the "Trustee"). The principal of the 2009 Bonds is payable upon their respective stated maturities on September 1 of each year. Interest on the 2009 Bonds will be payable semiannually on March 1 and September 1, commencing March 1, 2010.

The 2009 Bonds will be issued in book-entry form, without coupons, initially registered in the name of Cede & Co., as nominee of The Depository Trust Company, New York, New York ("DTC"), who will act as securities depository for the 2009 Bonds. Ownership interests in the 2009 Bonds may initially be purchased, in denominations of \$5,000 or any integral multiple thereof, in book-entry only form as described herein. So long as Cede & Co is the registered owner of the 2009 Bonds, payments of principal and interest will be made to Cede & Co., as nominee for DTC. DTC is required in turn to remit such payments to DTC Participants for subsequent disbursements to Beneficial Owners. Disbursement of such payments to the DTC Participants is the responsibility of DTC, and disbursement of such payments to the Beneficial Owners is the responsibility of the DTC Participants and Indirect Participants as more fully described herein. See APPENDIX F—"DTC AND THE BOOK-ENTRY ONLY SYSTEM." **The 2009 Bonds are subject to optional, mandatory and extraordinary redemption as described herein. See "THE 2009 BONDS-Redemption Provisions."**

THE 2009 BONDS ARE 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 THE CITY OR ANY OF THEIR INCOME OR RECEIPTS, EXCEPT AS DESCRIBED HEREIN. NEITHER THE FAITH AND CREDIT NOR THE GENERAL TAXING POWER OF THE CITY, THE COUNTY OF SAN JOAQUIN, THE STATE OF CALIFORNIA, OR ANY POLITICAL SUBDIVISION THEREOF IS PLEDGED TO THE PAYMENT OF THE 2009 BONDS. THE OBLIGATION OF THE CITY TO MAKE LEASE PAYMENTS UNDER THE LEASE AGREEMENT DOES NOT CONSTITUTE A DEBT, LIABILITY OR OBLIGATION FOR WHICH THE CITY IS OBLIGATED TO LEVY OR PLEDGE ANY FORM OF TAXATION OR FOR WHICH THE CITY HAS LEVIED OR PLEDGED ANY FORM OF TAXATION. THE 2009 BONDS DO NOT CONSTITUTE AN INDEBTEDNESS WITHIN THE MEANING OF ANY CONSTITUTIONAL OR STATUTORY DEBT LIMITATION OR RESTRICTION. THE AUTHORITY HAS NO TAXING POWER.

This cover page contains information for quick reference only. It is *not* a complete summary of the 2009 Bonds. Investors should read the entire Official Statement to obtain information essential to the making of an informed investment decision. See "CERTAIN RISKS TO BOND OWNERS" for a discussion of factors that should be considered, in addition to the other matters set forth herein, in evaluating the investment quality of the 2009 Bonds.

The 2009 Bonds are offered when, as and if issued by the City and accepted by the Underwriter, subject to the approval of validity thereof by Quint & Thimmig LLP, San Francisco, California, Bond Counsel, and certain other conditions. Certain legal matters will be passed upon for the City and the Authority by the City Attorney, for the Authority and the City by Lofton & Jennings, San Francisco, California, Disclosure Counsel and for the Underwriter by Jones Hall, A Professional Law Corporation, San Francisco, California, Underwriter's Counsel. It is anticipated that the 2009 Bonds will be available for delivery in book-entry only form through the facilities of DTC on or about September 9, 2009.



RBC Capital Markets®

Dated: August 20, 2009

CTY206403

\$35,080,000
STOCKTON PUBLIC FINANCING AUTHORITY
LEASE REVENUE BONDS, 2009 SERIES A
(CAPITAL IMPROVEMENT PROJECTS)

MATURITY SCHEDULE

\$15,905,000 6.75% Term Bonds due September 1, 2029—Yield: 7.00%—Price 97.329%—CUSIP No.† 861394DA9
\$19,175,000 7.00% Term Bonds due September 1, 2038—Yield: 7.15%—Price 98.173%—CUSIP No.† 861394DB7

† Copyright 2009, American Bankers Association. CUSIP data herein is provided by Standard and 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 City, the Authority or the Underwriter take any responsibility for the accuracy of such CUSIP numbers. The CUSIP number for a specific maturity is subject to being changed after the issuance of the 2009 Bonds as a result of various subsequent actions including, but not limited to, a refunding in whole or in part of such maturity.

CITY OF STOCKTON
MAYOR AND CITY COUNCIL

Ann Johnston, *Mayor*
Katherine M. Miller, *Vice Mayor, District 2*
Elbert H. Holman, *Councilmember, District 1*
Leslie Baranco Martin, *Councilmember, District 3*
Diana Lowery, *Councilmember, District 4*
Susan Talamantes Eggman, *Councilmember, District 5*
Dale Fritchen, *Councilmember, District 6*

CITY STAFF

J. Gordon Palmer, Jr., *City Manager*
Mark Moses, *Chief Financial Officer*
Janet Salvetti, *Assistant Director of Administrative Services*
Kathleen VonAchen, *Finance Officer*
Joe Maestretti, *Budget Officer*
Richard E. Nosky, Jr. ("Ren"), *City Attorney*
Katherine Gong Meissner, *City Clerk*

STOCKTON PUBLIC FINANCING AUTHORITY

BOARD OF DIRECTORS

Ann Johnston, *Chair*
Katherine M. Miller, *Vice Chair*
Elbert H. Holman, *Member*
Leslie Baranco, *Member*
Diana Lowery, *Member*
Susan Talamantes Eggman, *Member*
Dale Fritchen, *Member*

SPECIAL SERVICES

BOND COUNSEL

Quint & Thimmig LLP
San Francisco, California

DISCLOSURE COUNSEL

Lofton & Jennings
San Francisco, California

TRUSTEE

Wells Fargo Bank, National Association
San Francisco, California

FINANCIAL ADVISOR

Del Rio Advisors, LLC
Modesto, California

No dealer, broker, salesperson or other person has been authorized by the Authority or the City to give any information or to make any representations other than those contained herein and, if given or made, such other information or representation may not be relied upon as having been authorized by the Authority or the City. This Official Statement does not constitute an offer to sell or a solicitation or an offer to buy nor will there be any sale of the 2009 Bonds by a person in any jurisdiction in which it is unlawful for such person to make such an offer, solicitation or sale.

Certain statements included or incorporated by reference in this Official Statement constitute “forward-looking” statements. Such statements are generally identifiable by the words “expects,” “forecasts,” “projects,” “intends,” “anticipates,” “estimates,” “assumes” and analogous expressions. The achievement of certain results or other expectations contained in such forward-looking statements are subject to a variety of risks and uncertainties that could cause actual results to differ materially from those that have been projected. No assurance is given that actual results will meet the forecasts of the City in any way, regardless of the optimism communicated in the information, and such statements speak only as of the date of this Official Statement. The Authority and the City disclaim any obligation or undertaking to release publicly any updates or revisions to any forward-looking statement contained herein to reflect any changes in the expectations of the Authority and the City with regard thereto or any change in events, conditions or circumstances on which any such statement is based.

All summaries of the Indenture, the Lease Agreement, the Site and Facility Lease (each as defined herein), and to other statutes and documents referred to herein do not purport to be comprehensive or definitive and are qualified in their entirety by reference to each such statute and document. This Official Statement including any amendment or supplement hereto is intended to be deposited with one or more depositories. This Official Statement does not constitute a contract between any Owner of a 2009 Bond and the Authority, the City or the Underwriter.

In connection with this offering, the Underwriter may overallocate or effect transactions that stabilize or maintain the market price of the 2009 Bonds at a level above that which might otherwise prevail in the open market. Such stabilizing, if commenced, may be discontinued at any time. The Underwriter may offer and sell the 2009 Bonds to certain dealers and dealer banks and banks acting as agent at prices lower than the public offering prices stated on the inside cover page, and said public offering prices may be changed from time to time by the Underwriter.

The issuance and sale of the 2009 Bonds have not been registered under the Securities Act of 1933 or the Securities Exchange Act of 1934, both as amended, in reliance upon exemptions provided thereunder by Sections 3(a)(2) and 3(a)(12), respectively, for the issuance and sale of municipal securities.

The City maintains a website. Unless specifically indicated otherwise, the information presented on that website is *not* incorporated by reference as part of this Official Statement and should not be relied upon in making investment decisions with respect to the 2009 Bonds.

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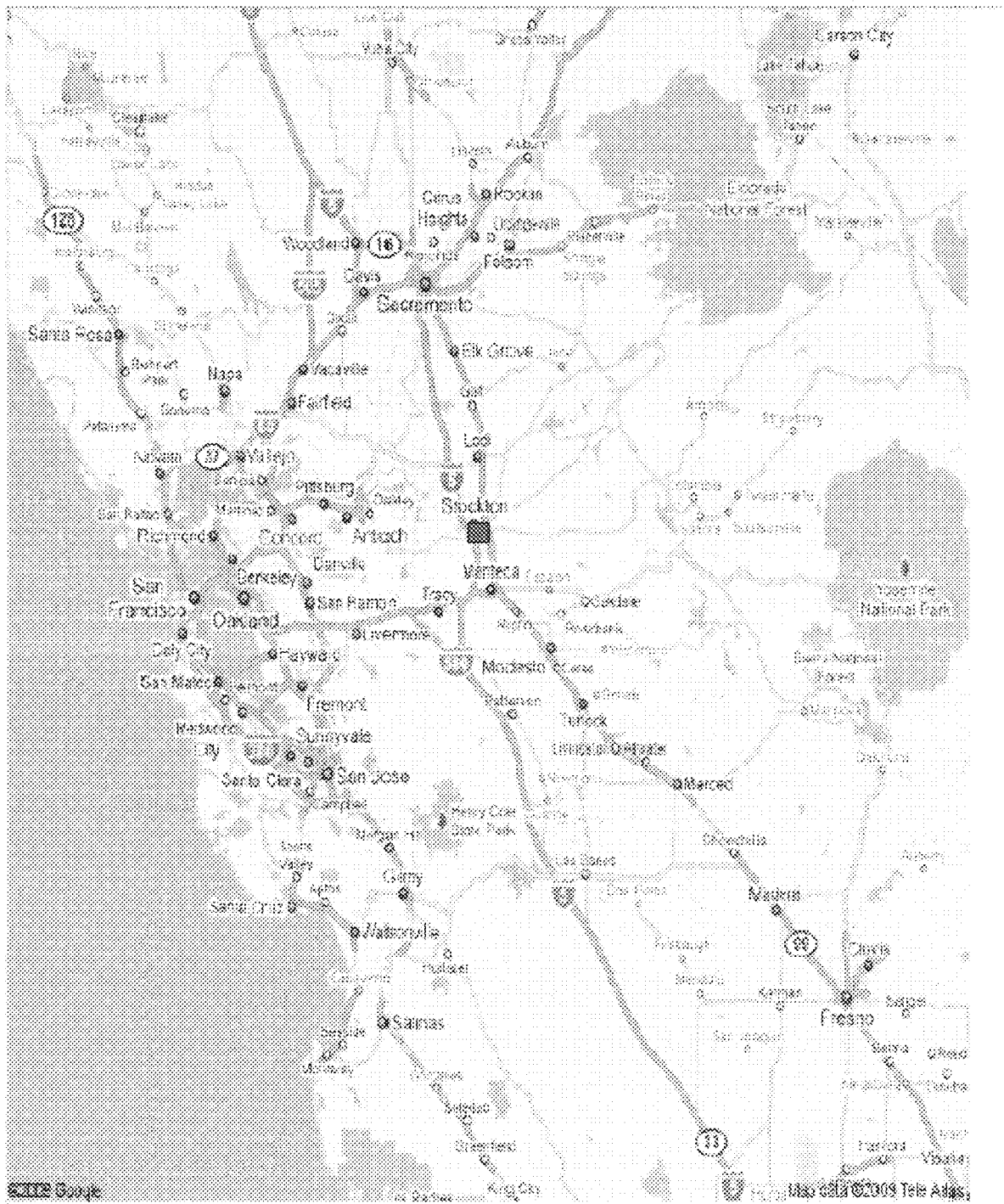
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REGIONAL MAP
City of Stockton
San Joaquin County, California



OFFICIAL STATEMENT

\$35,080,000

**STOCKTON PUBLIC FINANCING AUTHORITY
LEASE REVENUE BONDS, 2009 SERIES A
(CAPITAL IMPROVEMENT PROJECTS)**

INTRODUCTION

The descriptions of the Project, the 2009 Bonds, the Site and Facility Lease, the Lease Agreement, the Indenture and other documents described in this Official Statement do not purport to be definitive or comprehensive, and all references to those documents are qualified in their entirety by reference to the approved form of those documents, which documents are available at the principal corporate trust office of the Trustee in San Francisco, California. During the period of the offering of the 2009 Bonds, copies of such documents will also be available from the Underwriter named on the cover of this Official Statement. All capitalized terms used herein, unless noted otherwise, shall have the meanings given to such terms as set forth in the Indenture. See APPENDIX C—"SUMMARY OF CERTAIN PROVISIONS OF PRINCIPAL LEGAL DOCUMENTS—DEFINITIONS."

General

This Official Statement, including the cover page, the inside cover page and the Appendices hereto, is provided to furnish certain information in connection with the issuance and sale by the Stockton Public Financing Authority (the "Authority") of \$35,080,000 aggregate principal amount of Stockton Public Financing Authority Lease Revenue Bonds, 2009 Series A (Capital Improvement Projects) (the "2009 Bonds").

The 2009 Bonds are limited obligations of the Authority payable solely from Revenues (as defined herein) consisting primarily of certain payments (the "Lease Payments") made by the City of Stockton (the "City") to the Authority for the beneficial use and occupancy of the Property (as defined below). The City, as lessor, and the Authority, as lessee, will enter into a site and facility lease dated as of September 1, 2009 (the "Site and Facility Lease"), pursuant to which the City will lease to the Authority certain real property, and the facilities located thereon (collectively, the "Property"). See "THE PROPERTY." The Authority will pay to the City, as advance rental for the Property for the stated term of the Site and Facility Lease, the net proceeds of the 2009 Bonds. See APPENDIX C—"SUMMARY OF CERTAIN PROVISIONS OF THE PRINCIPAL LEGAL DOCUMENTS—LEASE AGREEMENT—Term of Lease."

The 2009 Bonds are being issued pursuant to Marks-Roos Local Bonds Pooling Act of 1985, as amended, constituting Articles 1 through 4 (commencing with Section 6500) of Chapter 5 of Division 7 of Title 1 of the Government Code of the State of California (the "Bond Law") and an Indenture of Trust dated as of September 1, 2009 (the "Indenture") by and between the Authority and Wells Fargo Bank, National Association, as trustee (the "Trustee"). Pursuant to the Indenture, the Authority will pledge to the Trustee, for the benefit of the Owners of the 2009 Bonds, all of the Revenues, consisting primarily of the Lease Payments.

Purpose

The City will lease the Property from the Authority pursuant to a Lease Agreement dated September 1, 2009 (the "Lease Agreement"), by and between the Authority, as lessor and the City, as lessee. The Lease Payments made by the City to the Authority under the Lease Agreement are equal to the scheduled debt service on the 2009 Bonds. The proceeds of the 2009 Bonds will be used to: (i) finance various capital improvements within the City of Stockton; (ii) fund a deposit into the Reserve Account in the amount of the Reserve Requirement (defined herein) as additional security for the 2009 Bonds; and (iii) pay certain costs associated with the issuance and sale of the 2009 Bonds.

Redemption

The 2009 Bonds are subject to optional, mandatory and extraordinary redemption prior to their respective stated maturities. See "THE 2009 BONDS—Redemption Provisions."

Security and Sources of Payment for the 2009 Bonds

General. Under the Indenture, the Authority will: (i) assign to the Trustee its interest under the Lease Agreement and (ii) pledge the Revenues and other amounts held under the Indenture to secure payment of debt service on the 2009 Bonds. The Authority's obligation to pay debt service on the 2009 Bonds is limited exclusively to the payments and other moneys and assets received by the Trustee on behalf of the Authority under the Lease Agreement and the amounts held pursuant to the Indenture. See "SECURITY AND SOURCES OF PAYMENT FOR THE 2009 BONDS—Pledge of Revenues."

Under the Lease Agreement, the City is required to pay to the Trustee the Lease Payments for the beneficial use and occupancy of the Property, which payments are scheduled in both time and amount to provide sufficient funds to pay, when due, the principal of and interest on the 2009 Bonds. See "SECURITY AND SOURCES OF PAYMENT FOR THE 2009 BONDS—Lease Payments."

Covenant to Budget and Appropriate. The City covenants under the Lease Agreement that so long as the Property is available for the City's use and occupancy, it will take such action as may be necessary to include all Lease Payments and Additional Payments in its annual budgets and to make the necessary annual appropriations therefor. See "SECURITY AND SOURCES OF PAYMENT FOR THE 2009 BONDS—Covenant to Budget and Appropriate."

Right of Substitution. Pursuant to the Lease Agreement, the City and the Authority may substitute other properties for the Property or portions thereof upon meeting certain conditions. See "SECURITY AND SOURCES OF PAYMENT FOR THE 2009 BONDS—Substitution of Property."

Abatement of Lease Payments. The obligation of the City to make Lease Payments under the Lease Agreement is subject to partial or complete abatement during any period in which, by reason of damage, destruction or condemnation of the Property or any portion thereof, there is substantial interference with the use and occupancy by the City of the Property or any portion thereof. See "CERTAIN RISKS TO BOND OWNERS" and "SECURITY AND SOURCES OF PAYMENT FOR THE 2009 BONDS—Pledge of Revenues." Abatement of Lease Payments under the Lease Agreement could result in Owners receiving less than the full amount of principal and interest on the 2009 Bonds, except to the extent proceeds of insurance (including rental interruption insurance) or condemnation awards or moneys in the Reserve Account (as defined herein) are available to make payments of principal of or interest on the 2009 Bonds (or the relevant portion thereof) during periods of abatement of Lease Payments. See also "SECURITY AND SOURCES OF PAYMENT FOR THE 2009 BONDS—Insurance" and "—Abatement."

The City may elect to use net insurance proceeds for repair, replacement or reconstruction of the Property or may apply such proceeds to the redemption of the 2009 Bonds. See APPENDIX C—"SUMMARY OF CERTAIN PROVISIONS OF PRINCIPAL LEGAL DOCUMENTS—LEASE AGREEMENT—Application of Net Proceeds."

Reserve Account

The Indenture establishes a Reserve Account, which is required to be funded in an amount equal to the Reserve Requirement. The Reserve Requirement is defined in the Indenture as the amount, equal to the least of: (i) maximum annual debt service on the 2009 Bonds, (ii) 125% of average annual debt service on the 2009 Bonds, and (iii) 10% of the par amount of the 2009 Bonds. The Indenture permits the City to satisfy the Reserve Account funding requirement by delivering a surety bond or letter of credit securing the amount of the Reserve Account Requirement to the Trustee. See "SECURITY AND SOURCES OF PAYMENT FOR THE 2009 BONDS—Reserve Account."

Risk Factors

Certain events could affect the ability of the City to pay debt service on the 2009 Bonds when due. See "CERTAIN RISKS TO BOND OWNERS" for a discussion of certain factors that should be considered, in addition to other matters set forth herein, in evaluating an investment in the 2009 Bonds.

Continuing Disclosure

The City has covenanted for the benefit of Owners and Beneficial Owners to provide certain financial information and operating data relating to the City not later than seven months after the end of each Fiscal Year, commencing with the Fiscal Year ending June 30, 2009 (the "Annual Report"), and to provide notices of the occurrence of certain enumerated events, if material. The Annual Report and the notices of material events will be filed with the Municipal Securities Rulemaking Board through its Electronic Municipal Market Access site. The specific nature of the information to be contained in the Annual Report or the notices of material events is set forth in APPENDIX D—"FORM OF CONTINUING DISCLOSURE CERTIFICATE." These covenants have been made in order to assist the Underwriter in complying with S.E.C. Rule 15c2-12(b)(5).

Availability of Documentation

This Official Statement contains brief descriptions of, among other things, the Bond Law, the 2009 Bonds, the security and sources of payment for the 2009 Bonds, the Indenture, the Site and Facility Lease, the Lease Agreement, the Continuing Disclosure Certificate and certain other documents. Such descriptions do not purport to be comprehensive or definitive and are qualified in their entirety by reference to such documents, and the descriptions herein of the 2009 Bonds are qualified in their entirety by the form thereof and the information with respect thereto included in such documents. The proposed form of legal opinion of Bond Counsel is set forth in APPENDIX E. The information set forth herein and in the Appendices hereto has been furnished by the City and includes information which has been obtained from other sources which are believed to be reliable but is not guaranteed as to accuracy or completeness by the City. Copies of documents referred to herein and information concerning the 2009 Bonds are available upon written request from the office of the City Clerk of the City of Stockton, City Hall, 425 North El Dorado Street, Stockton, California 95202; telephone: 209-937-8459. The City may impose a charge for copying, mailing and handling.

THE 2009 BONDS

Description

The 2009 Bonds are limited obligations of the Authority payable solely from Revenues, consisting primarily of Lease Payments to be made by the City to the Authority under the Lease Agreement. See "SECURITY AND SOURCES OF PAYMENT FOR THE 2009 BONDS."

The 2009 Bonds will be issued in fully registered form, in denominations of \$5,000 each or any integral multiple thereof within a single maturity. The 2009 Bonds, when issued, will be registered in the name of Cede & Co., as nominee of The Depository Trust Company ("DTC"), New York, New York, which will act as securities depository for the 2009 Bonds. Individual purchases will be made in book-entry only form. Purchasers will not receive physical certificates representing their beneficial ownership interest in the 2009 Bonds. So long as the 2009 Bonds are registered in the name of the nominee, payment of principal of, premium, if any, and interest on the 2009 Bonds will be payable to DTC or its nominee. DTC in turn will remit such payments to DTC Participants for subsequent disbursement to the Beneficial Owners. See APPENDIX F—"DTC AND THE BOOK-ENTRY ONLY SYSTEM."

The 2009 Bonds will be dated the date of delivery, and will mature on the dates and in the principal amounts and will bear interest at the rates per annum set forth on the inside cover page of the Official Statement. Interest on the 2009 Bonds will be payable on March 1 and September 1 each year (each an "Interest Payment Date"), commencing March 1, 2010. Interest will be computed on the basis of a 360-day year consisting of twelve 30-day months.

Purpose

The 2009 Bonds are being issued to: (i) finance various capital improvements within the City of Stockton; (ii) fund a deposit into the Reserve Account in the amount of the Reserve Requirement (defined below) as additional security for the 2009 Bonds; and (iii) pay certain costs associated with the issuance and sale of the 2009 Bonds. See also "THE PROJECT."

Redemption Provisions

Optional Redemption. The 2009 Bonds maturing on or before September 1, 2019 are not subject to optional redemption prior to their respective stated maturities.

The 2009 Bonds are subject to redemption, in whole or in part, prior to their respective stated maturities at the option of the Authority upon 45 days written notice to the Trustee by the City of its intention to optionally prepay all or a portion of the Lease Payments, on any date on or after September 1, 2019 at a redemption price equal to 100% of the principal amount of 2009 Bonds called for redemption, plus accrued interest with respect thereto to the date fixed for redemption.

Sinking Fund Redemption. The 2009 Bonds maturing on September 1, 2029 (the "2029 Term Bonds") are subject to mandatory sinking fund redemption, in part, by lot on September 1 in each year commencing September 1, 2013, from sinking fund payments derived from scheduled Lease Payments made by the City, at a redemption price equal to 100% of the principal amount thereof to be redeemed, together with accrued interest to the date of redemption, without premium, as follows, *provided, however*, that if some but not all of the 2029 Term Bonds have been subject to optional redemption as described above, the total amount of all future sinking fund payments will be reduced by the aggregate principal amount of 2029 Term Bonds so redeemed, to be allocated among the sinking fund payments as are thereafter payable *pro rata* in integral multiples of \$5,000 to the extent possible in inverse order of maturity:

2029 Term Bonds

<u>Year</u> <u>(September 1)</u>	<u>Principal Amount</u>	<u>Year</u> <u>(September 1)</u>	<u>Principal Amount</u>
2013	\$525,000	2022	\$950,000
2014	565,000	2023	1,015,000
2015	600,000	2024	1,080,000
2016	640,000	2025	1,155,000
2017	685,000	2026	1,235,000
2018	730,000	2027	1,315,000
2019	780,000	2028	1,405,000
2020	835,000	2029 [†]	1,500,000
2021	890,000		

[†] Stated Maturity.

The 2009 Bonds maturing on September 1, 2038 (the “2038 Term Bonds”) are subject to mandatory sinking fund redemption, in part, by lot on September 1 in each year commencing September 1, 2030, from sinking fund payments derived from scheduled Lease Payments made by the City, at a redemption price equal to 100% of the principal amount thereof to be redeemed, together with accrued interest to the date of redemption, without premium, as follows, *provided, however*, that if some but not all of the 2038 Term Bonds have been subject to optional redemption as described above, the total amount of all future sinking fund payments will be reduced by the aggregate principal amount of 2038 Term Bonds so redeemed, to be allocated among the sinking fund payments as are thereafter payable *pro rata* in integral multiples of \$5,000 to the extent possible in inverse order of maturity:

2038 Term Bonds

<u>Year</u> <u>(September 1)</u>	<u>Principal Amount</u>	<u>Year</u> <u>(September 1)</u>	<u>Principal Amount</u>
2030	\$1,600,000	2035	\$2,245,000
2031	1,715,000	2036	2,400,000
2032	1,835,000	2037	2,570,000
2033	1,960,000	2038 [†]	2,750,000
2034	2,100,000		

[†] Final Maturity.

Purchase of Term Bonds in Lieu of Redemption. In lieu of redemption of the 2029 Term Bonds or the 2038 Term Bonds, amounts on deposit as sinking fund payments may also be used and withdrawn by the Trustee, at the written direction of the Authority, at any time for the purchase of the 2029 Term Bonds or the 2038 Term Bonds, as applicable, otherwise required to be redeemed on the following September 1 at private or public sale as and when and at such process (including brokerage and other charges and including accrued interest) as the Authority may in its discretion determine.

Special Mandatory Redemption from Insurance or Condemnation Proceeds. The 2009 Bonds are also subject to redemption prior to their respective stated maturities, as a whole or in part on any date from all amounts derived from any policy of casualty insurance or title insurance with respect to the Property, or the proceeds of any taking of the Property or any portion thereof in eminent domain proceedings (including sale under threat of such proceedings), to the extent remaining after payment therefrom of all expenses incurred in the collection and administration thereof (“Net Proceeds”) deposited in the Insurance and Condemnation Fund, as described in the Indenture, at a redemption price equal to 100% of the principal amount thereof plus interest accrued thereon to the date fixed for redemption,

without premium. See APPENDIX C—"SUMMARY OF CERTAIN PROVISIONS OF PRINCIPAL LEGAL DOCUMENTS—INDENTURE OF TRUST—Insurance and Condemnation Fund—*Application of Insurance Proceeds*" and "*Application of Eminent Domain Proceeds*."

Selection of Bonds for Redemption. If less than all of the 2009 Bonds of a particular maturity are to be redeemed at any one time, the Trustee is required to select the 2009 Bonds to be redeemed from all 2009 Bonds of such maturity or such given portion thereof not previously called for redemption, by lot in any manner which the Trustee in its sole discretions deems appropriate. For purposes of such selection, the Trustee will treat each 2009 Bond as consisting of separate \$5,000 portions and each such portion will be subject to redemption as if such portion were a separate 2009 Bond.

Notice of Redemption. Notice of redemption will be mailed by first class mail, postage prepaid, not less than 30 nor more than 60 days before any redemption date, to the respective Owners of any 2009 Bonds designated for redemption at their addresses appearing on the Registration Books, and to the Securities Depositories and to one or more of the Information Services by means acceptable to such institutions. Each notice of redemption is required to state the date of the notice, the redemption date, the place or places of redemption, whether less than all of the 2009 Bonds (or all 2009 Bonds of a single maturity) are to be redeemed, the CUSIP numbers and (if less than all of the 2009 Bonds within a maturity or maturities are called for redemption) Bond numbers of the 2009 Bonds to be redeemed, numbers of the 2009 Bonds to be redeemed, the maturity or maturities of the 2009 Bonds to be redeemed in part only, the respective portions of the principal amount thereof to be redeemed. Each such notice is also required to state that on the redemption date there will become due and payable on each of said 2009 Bonds the redemption price thereof, and that from and after such redemption date interest thereon shall cease to accrue, and shall require that such 2009 Bonds be then surrendered.

Neither the failure to receive any notice nor any defect therein will affect the proceedings for such redemption or the cessation of accrual of interest from and after the redemption date. Notice of redemption of Bonds will be given by the Trustee, at the expense of the Authority, for and on behalf of the Authority.

So long as Cede & Co., as nominee of DTC, continues to be the registered owner of the 2009 Bonds, any notices of redemption will be given only to Cede & Co., as nominee of DTC, and not to DTC, DTC Participants or Beneficial Owners. See APPENDIX F—"DTC AND THE BOOK-ENTRY ONLY SYSTEM."

The Authority has the right to rescind any option or special mandatory redemption by written notice to the Trustee on or prior to the date fixed for redemption. The Trustee is required to send such notice of rescission in the same manner as the notice of redemption was originally provided.

Effect of Redemption. If notice of redemption is given as provided in the Indenture and the amount necessary for the payment of the redemption price of, together with interest accrued to the date fixed for redemption on the 2009 Bond, or portions thereof, is held by the Trustee, then the 2009 Bonds, or portion thereof, designated for redemption will become due and payable, interest thereon will cease to accrue and the Owners of said 2009 Bonds will have no rights in respect thereof except to receive payment of the redemption price thereof.

ESTIMATED SOURCES AND USES OF FUNDS

The estimated sources and uses of funds with respect to the 2009 Bonds are set forth below.

**Table 1
Estimated Sources and Uses of Funds**

Sources:	
Principal Amount of the 2009 Bonds.....	\$35,080,000.00
Less: Original Issue Discount	<u>775,149.80</u>
TOTAL SOURCES	\$34,304,850.20
Uses:	
Deposit to Project Fund ⁽¹⁾	\$30,712,756.00
Deposit to Reserve Account.....	2,945,462.50
Costs of Issuance ⁽²⁾	<u>646,631.70</u>
TOTAL USES	\$34,304,850.20

⁽¹⁾ See "THE PROJECT."

⁽²⁾ Costs of issuance include Bond Counsel fees, Disclosure Counsel fees, Underwriter's discount, Trustee fees, Trustee's Counsel fees, Financial Advisor fees, rating agency fees, printing costs and other miscellaneous costs of issuance. For the details of Underwriter's discount, see "UNDERWRITING."

SECURITY AND SOURCES OF PAYMENT FOR THE 2009 BONDS

Pledge of Revenues

The 2009 Bonds are limited obligations of the Authority payable solely from the Revenues and other assets pledged under the Indenture. The term "Revenues" is defined in the Indenture to mean all Lease Payments, prepayments, insurance proceeds, condemnation proceeds, and subject to the provisions in the Indenture, all interest, profits or other income derived from the investment amounts in any fund or account established pursuant to the Indenture. As rental for the use and occupancy of the Property, the City covenants in the Lease Agreement to pay to the Authority the Lease Payments, subject to abatement, which are calculated to be sufficient to pay principal of and interest on the 2009 Bonds when due.

Pursuant to the Indenture, the Authority transfers in trust, grants a security interest in and assigns to the Trustee for the benefit of the Owners of 2009 Bonds all of the Revenues and all of the rights, title and interest of the Authority in the Lease Agreement (except for certain indemnification rights set forth therein) and in the Site and Facility Lease (except for certain indemnification rights set forth therein).

Lease Payments

Lease Payments are calculated on an annual basis for 12-month periods commencing on July 1 and ending on June 30, and each annual Rental Payment will be divided into two installments, an interest installment due on February 15 and a principal and interest installment due August 15 (each a "Lease Payment Date"), continuing to and including the date of termination of the Lease Agreement. Each annual Rental Payment will be for the use of the Property for the twelve-month period commencing on July 1 of the period in which such installments are payable (except the first rental period which commenced on the date of recording of the Lease Agreement).

The Indenture requires that Lease Payments be deposited in the Revenue Fund maintained by the Trustee. In accordance with the Indenture, the Trustee will transfer such amounts as are necessary to the Interest Account or the Principal Account, as the case may be, to pay principal of and interest on the 2009

Bonds as the same become due and payable. See APPENDIX C—"SUMMARY OF CERTAIN PROVISIONS OF PRINCIPAL LEGAL DOCUMENTS—INDENTURE OF TRUST—Allocation of Revenues."

Covenant to Budget and Appropriate

The City covenants in the Lease Agreement to take such action as may be necessary to include all Lease Payments due under the Lease Agreement in each of its annual budgets and to make the necessary annual appropriations therefor. The covenant to budget and appropriate are deemed to be covenants of the City imposed by law and it is the duty of each and every public official of the City to take such action and do such things as are required by law to carry out and perform the covenants and agreement of the City contained in the Lease Agreement. See also "CITY FINANCIAL INFORMATION—Direct and Overlapping Debt."

Deposit of Revenues; Funds and Accounts

The Trustee is required under the Indenture to deposit the Lease Payments as received into the Revenue Fund. All moneys in the Revenue Fund are held in trust for the benefit of the Owners and will be disbursed, allocated, and applied solely for the uses and purposes set forth in the Indenture.

Allocation of Moneys on Deposit in the Revenue Fund. Not later than the Business Day preceding each Interest Payment Date, the Trustee is required to transfer from the Revenue Fund and deposit into the following accounts, in the following order of priority, the requirements of each such account (including the making up of any deficiencies in any such account resulting from lack of Revenues sufficient to make any earlier required deposit) at the time of deposit to be satisfied before any transfer is made to an account subsequent in priority:

- First:* The Trustee is required to deposit in the Interest Account an amount required to cause the aggregate amount on deposit therein to be at least equal to the amount of interest becoming due and payable on such Interest Payment Date on all 2009 Bonds then Outstanding.
- Second:* The Trustee is required to deposit in the Principal Account an amount, if any, required to cause the aggregate amount on deposit therein to equal the principal amount of the 2009 Bonds coming due at maturity or upon sinking fund redemption and payable on such Interest Payment Date.
- Third:* The Trustee is required to deposit in the Reserve Account an amount, if any, required to cause the amount on deposit therein to equal the Reserve Requirement.
- Fourth:* If the then applicable Interest Payment Date is March 1, all remaining moneys are required to be held by the Trustee in the Revenue Fund and applied for the next succeeding September 1 Interest Payment Date deposits. If the then applicable Interest Payment Date is September 1, all remaining moneys are required to be transferred to the City for deposit in the General Fund.

Reserve Account

General. Under the Indenture, a Reserve Account is established and held by the Trustee and pledged to payment of the 2009 Bonds in the amount of the Reserve Requirement. The term "Reserve Requirement" means, as of any date of calculation, an amount equal to the least of (i) the maximum annual debt service on the 2009 Bonds; (ii) 125% of average annual debt service on the 2009 Bonds; and (iii) 10% of the par amount of the 2009 Bonds. On the date of delivery of the 2009 Bonds the Reserve

Requirement will be \$2,945,462.50, which is equal to the maximum annual debt service on the 2009 Bonds.

Use of Amounts in the Reserve Account. Moneys and/or Reserve Account Surety Bond on deposit in the Reserve Account will be used and withdrawn by the Trustee *solely* for the purpose of making transfers to the Interest Account and the Principal Account in such order of priority, in the event of any deficiency at any time in any such accounts or for the retirement of all of the Outstanding 2009 Bonds, except that so long as the Authority is not in default under the Indenture, any amount in excess of the Reserve Requirement will be withdrawn from the Reserve Account semiannually on or before the Business Day preceding each February 1 and August 1 and deposited in the Interest Account. See APPENDIX C—"SUMMARY OF CERTAIN PROVISIONS OF THE PRINCIPAL LEGAL DOCUMENTS—INDENTURE OF TRUST—*Application of Reserve Account.*"

Transfer of Excess Amounts. Any amounts remaining in the Reserve Account upon payment in full of all Outstanding 2009 Bonds, will be withdrawn by the Trustee and paid to the City as a refund of overpaid Lease Payments. Any amounts on deposit in the Reserve Account at any time in excess of the Reserve Requirement are required to be transferred to the Revenue Fund.

Insurance

Each insurance policy required to be maintained by the City pursuant to the Lease Agreement is required to name the Authority, the City and the Trustee as insureds and name the Trustee as loss payee so as to provide that all proceeds thereunder will be payable to the Trustee. All such policies are required to provide that the Trustee be given 30 days' notice prior to each expiration, any intended cancellation thereof or reduction of the coverage provided thereby; and must be provided by a commercial insurer rated in one of the two highest rating categories by Moody's and S&P (without regard to designations of plus or minus).

A summary of the insurance required by the Lease Agreement is described below.

Public Liability and Property Damage Insurance. The Lease Agreement requires the City to maintain or cause to be maintained, throughout the term of the Lease Agreement, comprehensive general insurance in protection of the Authority, City, and their respective members, officers, agents, employees and assigns. Such insurance is required to provide for indemnification of such parties against direct or contingent loss or liability for damages for bodily and personal injury, death or property damage occasioned by reason of the operation of the Property. Such public liability and property damage insurance is required to provide coverage in the minimum liability limits of \$1,000,000 for personal injury or death of each person, and \$3,000,000 for personal injury or deaths of two or more persons in each accident or event, and in a minimum amount of \$100,000 (subject to a deductible of not to exceed \$5,000) for damage to property resulting from each accident or event. Such insurance may, however, be in the form of a single limit policy in the amount of \$3,000,000 covering all such risks.

Such insurance may be maintained as part of or in conjunction with any other insurance coverage carried by the City, and may be maintained in whole or in part in the form of a program of self-insurance by the City, or in the form of the participation by the City in a joint powers authority or other program providing pooled insurance. The proceeds of such insurance is required to be applied by the City toward extinguishment or satisfaction of the liability with respect to which paid.

Fire and Extended Coverage Insurance. The City is required under the Lease Agreement to procure and maintain, or cause to be procured and maintained, throughout the term of the Lease Agreement, insurance against loss or damage to the improvements constituting the Property by fire and lightning, with extended coverage and vandalism and malicious mischief. Such fire and extended coverage insurance is required, as nearly as practicable, to cover loss or damage by explosion, windstorm,

riot, aircraft, vehicle damage, smoke and other such hazards as are normally covered by such insurance and is required to include earthquake coverage if such coverage is available at reasonable cost from reputable insurers as determined in the sole judgment of the City. Such insurance is required to be in an amount at least equal to the lesser of: (i) 100% of the replacement cost of all of the insured improvements, or (ii) the aggregate principal amount of the Outstanding 2009 Bonds.

Such insurance may be maintained as part of or in conjunction with any other insurance coverage carried by the City, and in the form of the participation by the City in a joint powers authority or other program providing pooled insurance. The Net Proceeds of such insurance is required to be applied as provided in the Lease Agreement.

Rental Interruption Insurance. The Lease Agreement requires the City to procure and maintain, or cause to be procured and maintained, throughout the term of the Lease Agreement, rental interruption or use and occupancy insurance to cover loss, total or partial, of the use of the Property, as a result of any of the hazards covered by fire and extended coverage insurance as required by the Lease Agreement, in an amount at least equal to the maximum Lease Payments coming due and payable during any future 24 month period.

Such insurance may be maintained as part of or in conjunction with any other insurance coverage carried by the City, and in the form of the participation by the City in a joint powers authority or other program providing pooled insurance; provided that such insurance may *not* be maintained by the City in the form of self-insurance. The proceeds of such insurance, if any, is required to be paid to the Trustee and deposited in the Revenue Fund, and credited towards the payment of the Lease Payments as the same become due and payable.

Title Insurance. On or before the Closing Date the City is required, at its expense, to obtain a CLTA policy of title insurance insuring the City's leasehold estate under the Lease Agreement, subject only to Permitted Encumbrances, in an amount at least equal to the aggregate principal amount of the 2009 Bonds.

All Net Proceeds received under said policy are required to be deposited with the Trustee in the Redemption Fund and applied to the redemption of the 2009 Bonds pursuant to the Indenture.

Self-Insurance. If any public liability and property damage insurance is provided in the form of self-insurance, the City is required to annually file with the Trustee within 90 days following the close of each Fiscal Year, a statement if the City risk manager, insurance consultant or actuary identifying the extent of such self-insurance and stating the determination that the City maintains sufficient reserves with respect thereto. If such insurance is provided in the form of self-insurance, the City is not obligated to make payment with respect to any insured event except from such reserves.

Additional Payments

The City is obligated under the Lease Agreement to pay when due, certain "Additional Payments," consisting of: (i) any fees and expenses incurred by the Authority in connection with or by reason of its leasehold estate in the Property, (ii) any amounts due to the Trustee for all services rendered under the Indenture, and for all reasonable fees and expenses, charges, costs, liabilities, legal fees and other disbursements incurred in and about the performance of its powers and duties under the Indenture; (iii) any reasonable fees and expenses of such accountants, consultants, attorneys and other experts as may be engaged by the Authority or the Trustee to prepare audits, financial statements, reports, opinions or provide such other services required under the Lease Agreement or the Indenture; and (iv) any reasonable out-of-pocket expenses of the Authority in connection with the execution and delivery of the Lease Agreement or the Indenture, or in connection with the issuance of the 2009 Bonds. Such costs and expenses will be payable as additional amounts of rental in consideration of the right of the City to the use

and occupancy of the Property. **Additional Payments are not pledged to the payment of debt service on the 2009 Bonds.**

Abatement

The Lease Payments will be abated during any period in which by reason of damage or destruction (other than by eminent domain) there is substantial interference with the use and occupancy by the City of the Property or any portion thereof. The amount of such abatement will be in an amount agreed upon by the City and the Authority so that the resulting Lease Payments represent fair consideration for the use and occupancy of the portions of the Property not damaged or destroyed and available for use and possession by the City. Abatement will continue for the period commencing with such damage or destruction and ending with the substantial completion of the work of repair or reconstruction or on the date the remaining portion of the Property is available for use and possession by the City. In the event of any such damage or destruction, the Lease Agreement will continue in full force and effect and the City waives any right to terminate the Lease Agreement by virtue of any such damage and destruction. There will be no abatement of Lease Payments to the extent that moneys derived from any person as a result of such damage or destruction are available to pay the amount that would otherwise be abated or if there is any money available in the Revenue Fund or the Reserve Account to pay the amount that would otherwise be abated. See "CERTAIN RISKS TO BOND OWNERS—Abatement of Lease Payments."

Eminent Domain

If all of the Property is taken permanently under the power of eminent domain or sold to a government threatening to exercise the power of eminent domain, the term of the Lease Agreement will cease as of the day possession is taken. If less than all of the Property is taken permanently, or if all of the Property or any part thereof is taken temporarily under the power of eminent domain: (i) the Lease Agreement will continue in full force and effect and will not be terminated by virtue of such taking and the parties waive the benefit of any law to the contrary, and (ii) there will be a partial abatement of Lease Payments in an amount to be agreed upon by the City and the Authority such that the resulting Lease Payments for the Property, represent fair consideration for the use and occupancy of the remaining usable portion of the Property.

Default

If the City defaults under the Lease Agreement, the Trustee as assignee under the Lease Agreement, may exercise any and all remedies available pursuant to law or granted pursuant to the Lease Agreement; *provided, however*, that notwithstanding anything in the Lease or in the Indenture to the contrary, there is no right under any circumstances to accelerate the Lease Payments or otherwise declare any Lease Payments not then in default to be immediately due and payable. The Authority and the Trustee (as assignee of the Authority) may terminate the Lease and re-lease all or any portion of the Property. See "CERTAIN RISKS TO BOND OWNERS—Limited Recourse on Default."

For a description of the events of default and permitted remedies of the Trustee (as assignee of the Authority) contained in the Lease and the Indenture, see APPENDIX C—"SUMMARY OF CERTAIN PROVISIONS OF THE PRINCIPAL LEGAL DOCUMENTS—LEASE AGREEMENT—Events of Default Defined" and "—Remedies on Default."

THE 2009 BONDS ARE 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 THE CITY OR ANY OF THEIR INCOME OR RECEIPTS, EXCEPT AS DESCRIBED HEREIN. NEITHER THE FAITH AND CREDIT NOR THE GENERAL TAXING POWER OF THE CITY, THE COUNTY OF SAN JOAQUIN, THE STATE OF

CALIFORNIA, OR ANY POLITICAL SUBDIVISION THEREOF IS PLEDGED TO THE PAYMENT OF THE 2009 BONDS. THE OBLIGATION OF THE CITY TO MAKE LEASE PAYMENTS UNDER THE LEASE AGREEMENT DOES NOT CONSTITUTE A DEBT, LIABILITY OR OBLIGATION FOR WHICH THE CITY IS OBLIGATED TO LEVY OR PLEDGE ANY FORM OF TAXATION OR FOR WHICH THE CITY HAS LEVIED OR PLEDGED ANY FORM OF TAXATION. THE 2009 BONDS DO NOT CONSTITUTE AN INDEBTEDNESS WITHIN THE MEANING OF ANY CONSTITUTIONAL OR STATUTORY DEBT LIMITATION OR RESTRICTION. THE AUTHORITY HAS NO TAXING POWER.

Substitution or Release of the Property

The City may or remove all or a portion of the Property provided that the City satisfies all of the following requirements prior to such substitution or release:

(i) the City files with the Authority and the Trustee an amended Exhibit A to the Site and Facility Lease adding a description of such substitute site and deleting the description of the former site or facility, as applicable;

(ii) the City files with the Authority and the Trustee an amended Exhibit A to the Lease Agreement adding a description of such substitute Site and deleting therefrom the description of the former site or facility, as applicable;

(iii) the City certifies in writing to the Authority and the Trustee that such substitute site serves the purposes of the City, constitutes property that is unencumbered (or the portion of such property to be substituted is encumbered) subject to Permitted Encumbrances, and constitutes property which the City is permitted to lease under the law of the State;

(iv) the City delivers to the Trustee and the Authority evidence that the substitute site or facility, as applicable (or the portions thereof to be substituted) is of equal or greater value than the site or facility (or the portions thereof) to be substituted;

(v) the City certifies the substitute site shall not cause the City to violate any of its covenants, representations and warranties made herein;

(vi) with respect to the substitution of any site, only, the City obtains an amendment to the title insurance policy required pursuant to the Site and Facilities Lease which adds thereto a description of the substitute site and deletes therefrom the description of the former site;

(vii) the City certifies that the substitute site is of the same or greater essentiality to the City as was the former site;

(viii) the City certifies that the substitute site has a useful life equal to or longer than the remaining term of the 2009 Bonds; and

(ix) the City provides notice of such substitution to any rating agency then rating the 2009 Bonds.

DEBT SERVICE SCHEDULE

Table 2 sets forth the estimated scheduled payments of principal and interest for the 2009 Bonds.

**Table 2
Debt Service Schedule**

<u>Date</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>	<u>Fiscal Year Debt Service</u>
March 1, 2010	-	\$1,154,233.47	\$1,154,233.47	\$1,154,233.47
September 1, 2010	-	1,207,918.75	1,207,918.75	-
March 1, 2011	-	1,207,918.75	1,207,918.75	2,415,837.50
September 1, 2011	-	1,207,918.75	1,207,918.75	-
March 1, 2012	-	1,207,918.75	1,207,918.75	2,415,837.50
September 1, 2012	-	1,207,918.75	1,207,918.75	-
March 1, 2013	-	1,207,918.75	1,207,918.75	2,415,837.50
September 1, 2013	\$525,000	1,207,918.75	1,732,918.75	-
March 1, 2014	-	1,190,200.00	1,190,200.00	2,923,118.75
September 1, 2014	565,000	1,190,200.00	1,755,200.00	-
March 1, 2015	-	1,171,131.25	1,171,131.25	2,926,331.25
September 1, 2015	600,000	1,171,131.25	1,771,131.25	-
March 1, 2016	-	1,150,881.25	1,150,881.25	2,922,012.50
September 1, 2016	640,000	1,150,881.25	1,790,881.25	-
March 1, 2017	-	1,129,281.25	1,129,281.25	2,920,162.50
September 1, 2017	685,000	1,129,281.25	1,814,281.25	-
March 1, 2018	-	1,106,162.50	1,106,162.50	2,920,443.75
September 1, 2018	730,000	1,106,162.50	1,836,162.50	-
March 1, 2019	-	1,081,525.00	1,081,525.00	2,917,687.50
September 1, 2019	780,000	1,081,525.00	1,861,525.00	-
March 1, 2020	-	1,055,200.00	1,055,200.00	2,916,725.00
September 1, 2020	835,000	1,055,200.00	1,890,200.00	-
March 1, 2021	-	1,027,018.75	1,027,018.75	2,917,218.75
September 1, 2021	890,000	1,027,018.75	1,917,018.75	-
March 1, 2022	-	996,981.25	996,981.25	2,914,000.00
September 1, 2022	950,000	996,981.25	1,946,981.25	-
March 1, 2023	-	964,918.75	964,918.75	2,911,900.00
September 1, 2023	1,015,000	964,918.75	1,979,918.75	-
March 1, 2024	-	930,662.50	930,662.50	2,910,581.25
September 1, 2024	1,080,000	930,662.50	2,010,662.50	-
March 1, 2025	-	894,212.50	894,212.50	2,904,875.00
September 1, 2025	1,155,000	894,212.50	2,049,212.50	-
March 1, 2026	-	855,231.25	855,231.25	2,904,443.75
September 1, 2026	1,235,000	855,231.25	2,090,231.25	-
March 1, 2027	-	813,550.00	813,550.00	2,903,781.25
September 1, 2027	1,315,000	813,550.00	2,128,550.00	-
March 1, 2028	-	769,168.75	769,168.75	2,897,718.75
September 1, 2028	1,405,000	769,168.75	2,174,168.75	-
March 1, 2029	-	721,750.00	721,750.00	2,895,918.75
September 1, 2029	1,500,000	721,750.00	2,221,750.00	-
March 1, 2030	-	671,125.00	671,125.00	2,892,875.00
September 1, 2030	1,600,000	671,125.00	2,271,125.00	-
March 1, 2031	-	615,125.00	615,125.00	2,886,250.00
September 1, 2031	1,715,000	615,125.00	2,330,125.00	-
March 1, 2032	-	555,100.00	555,100.00	2,885,225.00
September 1, 2032	1,835,000	555,100.00	2,390,100.00	-
March 1, 2033	-	490,875.00	490,875.00	2,880,975.00
September 1, 2033	1,960,000	490,875.00	2,450,875.00	-
March 1, 2034	-	422,275.00	422,275.00	2,873,150.00
September 1, 2034	2,100,000	422,275.00	2,522,275.00	-
March 1, 2035	-	348,775.00	348,775.00	2,871,050.00
September 1, 2035	2,245,000	348,775.00	2,593,775.00	-
March 1, 2036	-	270,200.00	270,200.00	2,863,975.00
September 1, 2036	2,400,000	270,200.00	2,670,200.00	-
March 1, 2037	-	186,200.00	186,200.00	2,856,400.00
September 1, 2037	2,570,000	186,200.00	2,756,200.00	-
March 1, 2038	-	96,250.00	96,250.00	2,852,450.00
September 1, 2038	2,750,000	96,250.00	2,846,250.00	-
March 1, 2039	-	-	-	2,846,250.00
TOTAL	\$35,080,000	\$48,637,264.72	\$83,717,264.72	\$83,717,264.72

THE PROPERTY

Description

The City will lease the Property described below to the Authority pursuant to the Site and Facility Lease, and the Authority will lease the Property back to the City pursuant to the Lease Agreement.

The Property consists of three separate properties, each of which is owned by the City, as further described below, and includes site development, landscaping, utilities, equipment, furnishings, improvements and appurtenant and related facilities located thereon.

Pursuant to the Lease Agreement, the City may substitute other real property for all or part of the Facilities from time to time upon making certain determinations as specified in the Lease Agreement. See "SECURITY AND SOURCES OF PAYMENT FOR THE 2009 BONDS—Substitution or Release of Property."

Oak Park. This Property is an approximately 61.2 acre park, bounded on the east by Union Pacific railroad tracks, on the north by East Fulton Street, on the south by East Alpine Street, and on the west by North Sutter and Alvarado Streets. This park features group picnic areas, 20 picnic tables, two tot lots, 15 barbecue pits, and four restrooms. In addition, Oak Park features 11 tennis courts, two regulation softball fields, the Billy Hebert Field, a 6,000 seat, regulation professional minor league baseball field, renovated in 2002; and a multi-use field, a community swimming pool complex with changing facilities, and an approximately 13,875 square foot ice rink facility with seating for 350. An approximately 5,000 square foot, one-story senior center, which is available for rental to the public, is also located at Oak Park.

Swenson Golf Course. This Property was opened in 1952 and is located on approximately 219 acres at 6803 Alexandria Place. Swenson Golf Course features a classic championship 18-hole, 72 par course, a nine-hole executive, par 3 course, a 15 station driving range, two putting greens and a practice bunker, paved cart paths. Also located on this Property is a clubhouse, an approximately 2,000 square foot pro shop, an approximately 5,000 square foot maintenance and storage facility and an approximately 2,500 square foot café with seating.

Van Buskirk Golf Course. This Property was opened in 1962 and is located on approximately 214.0 acres at 1740 Houston Avenue. Van Buskirk Golf Course features a classically designed par 72, 18-hole course, an all grass driving range with 15 stations, two practice greens and partially paved cart paths. Also located on this Property is a clubhouse, an approximately 2,000 square foot pro shop, an approximately 5,000 square foot maintenance and storage facility and an approximately 2,500 square foot cafe with seating.

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Summary of the Property; Terms under the Lease Agreement; Valuations

The following table sets forth certain details of the Property, including, among other things, terms under the Lease Agreement and valuations.

Table 3
Summary of the Property

<u>Facility</u>	<u>Address</u>	<u>Original Completion Date</u>	<u>Approx. Acreage of Site</u>	<u>Approx. Building Square Footage</u>	<u>Term Under the Lease Agreement (September 1)</u>	<u>Estimated Market Value[†]</u>
Oak Park	Alpine Avenue at Sutter Street	1953	61.2	20,000	2038	\$19,414,435
Swenson Golf Course	6803 Alexandria Place	1952	219.0	8,000	2038	8,612,686
Van Buskirk Golf Course	1740 Houston Avenue	1962	214.0	8,000	2038	<u>8,303,587</u>
TOTAL						\$36,330,708

[†] Based upon appraisals completed by American Appraisals, Inc. in June 2008.

Seismicity

Generally, within the State, some level of seismic activity occurs on a regular basis. Periodically, the magnitude of a single seismic event can cause significant ground shaking and potential for damage to property located at or near the center of such seismic activity. The Property was designed to the seismic standards existing at the later of the time of original construction or renovation. The Lease Agreement does not require the City to obtain earthquake insurance with respect to the Property. See also "CERTAIN RISKS TO BOND OWNERS—Abatement" and "—Risk of Earthquake and Other Natural Disasters."

THE PROJECT

The 2009 Bonds are being executed and delivered for the purpose of providing funds to acquire and develop various capital improvements throughout the City as described below (collectively, the "Project"):

Description

Fire Station Facilities Improvements. The City will use proceeds of the 2009 Bonds in the approximate amount of \$5.335 million to finance the costs of constructing and installing fire station facilities improvements, including modernizing and expanding Fire Station No 7, located in northern Stockton, from 3,800 square feet to 5,600 square feet; constructing and equipping an approximately 7,250 square foot Fire Station No. 13 in northeast Stockton; and developing a master plan study for fire station facilities within the City. Construction of this component of the Project commenced in January 2008 and is expected to be completed in December 2009.

Police Communication Center Expansion and Relocation. The City will use proceeds of the 2009 Bonds in the approximate amount of \$3.8 million to finance the costs of relocating and constructing an approximately 24,000 square foot Police Communications Center. This new facility will be located at 22 East Weber Street in the central area of the City. Construction of this component of the Project commenced in September 2008 and is expected to be completed in December 2009.

Park and Facility Improvements. The City will use proceeds of the 2009 Bonds in the approximate amount of \$11.120 million to finance the costs of acquiring land and constructing seven parks located throughout the City. This component of the Project commenced in January 2008 and is expected to be completed in September 2009.

Street Improvements. The City will use proceeds of the 2009 Bonds in the approximate amount of \$10.457 million to finance the costs of acquiring, constructing and installing various paving, bridge, widening, lighting, landscaping and other street improvements within the City. Construction of this component of the Project commenced in January 2008 and is expected to be completed in December 2009.

Environmental Matters and Land Use Approvals

Projects undertaken by the City, including the Project, are generally subject to the California Environmental Quality Act, as amended (Division 13 of the California Public Resources Code) ("CEQA"). Under CEQA, a public agency is required, following preparation of an initial assessment, to determine whether an environmental impact report (an "EIR"), a negative declaration or a mitigated negative declaration is required for a project. If there is substantial evidence that significant environmental effects may occur, an EIR is required to be prepared. The City Community Development, Building Division filed notices of exemption, prepared CEQA Environmental Assessments, or made mitigated negative declaration findings, as required, that were recorded with the County. All other land use approvals necessary to proceed with the Project components have been obtained or are expected to be received in due course.

CERTAIN RISKS TO BOND OWNERS

This section provides a general overview of certain risk factors which should be considered, in addition to the other matters set forth in this Official Statement, in evaluating an investment in the 2009 Bonds. This section is not meant to be a comprehensive or definitive discussion of the risks associated with an investment in the 2009 Bonds, and the order in which this information is presented does not necessarily reflect the relative importance of various risks. Potential investors in the 2009 Bonds are advised to consider the following factors, among others, and to review this entire Official Statement to obtain information essential to the making of an informed investment decision. Any one or more of the risk factors discussed below, among others, could lead to a decrease in the market value and/or in the marketability of the 2009 Bonds. There can be no assurance that other risk factors not discussed herein will not become material in the future.

Limited Obligation

The 2009 Bonds are not City debt and are limited obligations of the Authority. Neither the full faith and credit of the Authority nor the City is pledged for the payment of the interest on or principal of the 2009 Bonds nor for the payment of Lease Payments. The Authority has no taxing power. The obligation of the City to pay Lease Payments when due is an obligation payable from amounts in the General Fund of the City. The obligation of the City to make Lease Payments under the Lease Agreement does not constitute an obligation of the City for which the City is obligated to levy or pledge any form of taxation or for which the City has levied or pledged any form of taxation. Neither the 2009 Bonds nor the obligation of the City to make Lease Payments under the Lease Agreement constitute a debt or indebtedness of the Authority, the City, the State or any of its political subdivisions, within the meaning of any constitutional or statutory debt limitation or restrictions.

Lease Payments Not a Debt of the City

The Lease Payments due under the Lease Agreement (and insurance, payment of costs of repair and maintenance of the Property, taxes and other governmental charges and assessments levied against the Property) are not secured by any pledge of taxes or any other revenues of the City but are payable from any funds lawfully available to the City. The City may incur other obligations in the future payable from the same sources as the Lease Payments. In the event the City's revenue sources are less than its total

obligations, the City could choose to fund other municipal services before making Lease Payments. The same result could occur if, because of State constitutional limits on expenditures, the City is not permitted to appropriate and spend all of its available revenues. The City's appropriations, however, have never exceeded the limitations on appropriations under Article XIII B of the California Constitution. For information on the City's current limitations on appropriations, see "CONSTITUTIONAL AND STATUTORY LIMITATIONS ON TAXES, REVENUES AND APPROPRIATIONS—Article XIII B of the California Constitution."

Valid and Binding Covenant to Budget and Appropriate

Pursuant to the Lease Agreement, the City covenants to take such action as may be necessary to include Lease Payments due in its annual budgets and to make necessary appropriations for all such payments. Such covenants are deemed to be duties imposed by law, and it is the duty of the public officials of the City to take such action and do such things as are required by law in the performance of the official duty of such officials to enable the City to carry out and perform such covenants. A court, however, in its discretion may decline to enforce such covenants. Upon issuance of the 2009 Bonds, Bond Counsel will render its opinion (substantially in the form of APPENDIX E—"PROPOSED FORM OF BOND COUNSEL OPINION") to the effect that, subject to the limitations and qualifications described therein, the Lease Agreement constitutes a valid and binding obligation of the City. As to the Authority's practical realization of remedies upon default by the City, see "—Limitations on Remedies."

Abatement

In the event of loss or substantial interference in the use and occupancy of the Property by the City caused by damage or destruction or condemnation of the Property, Lease Payments will be subject to abatement. In the event that the Property or any component thereof, if damaged or destroyed by an insured casualty, could not be replaced during the period of time that proceeds of the City's rental interruption insurance will be available in lieu of Lease Payments plus the period for which funds are available from the Reserve Account or the Revenue Fund, or in the event that casualty insurance proceeds or condemnation proceeds are insufficient to provide for complete repair or replacement of the Property or such component of the Property or redemption of the 2009 Bonds, there could be insufficient funds to make payments to Owners in full. See APPENDIX C—"SUMMARY OF CERTAIN PROVISIONS OF PRINCIPAL LEGAL DOCUMENTS—LEASE AGREEMENT—Abatement of Lease Payments."

It is not possible to predict the circumstances under which such an abatement of rental may occur. In addition, there is no statute, case or other law specifying how such an abatement of rental should be measured. For example, it is not clear whether fair rental value is established as of commencement of the lease or at the time of the abatement. If the latter, it may be that the value of the Property is substantially higher or lower than its value at the time of the execution and delivery of the 2009 Bonds. Abatement, therefore, could have an uncertain and material adverse effect on the security for and payment of the 2009 Bonds.

Limited Recourse on Default

The enforcement of remedies provided in the Lease Agreement and the Indenture could be both expensive and time consuming. The Trustee has no interest in the Authority's title to the Property, and has no right to terminate the Lease Agreement or reenter or relet the Property. Upon the occurrence of one of the "events of default" described below, the City will be deemed to be in default under the Lease Agreement and the Authority may exercise any and all remedies available pursuant to law or granted pursuant to the Lease Agreement. Upon any such default, including a failure to pay Lease Payments, the Authority may either (1) terminate the Lease Agreement and seek to recover certain damages or (2) without terminating the Lease Agreement, (i) continue to collect rent from the City on an annual basis by seeking a separate judgment each year for that year's defaulted Lease Payments and/or (ii) reenter the Property and relet them. In the event of

default, there is no right to accelerate the total Lease Payments due over the term of the Lease Agreement, and the Trustee has no possessory interest in the Property and is not empowered to sell the Property.

Events of default under the Lease Agreement include: (i) the failure of the City to make any Lease Payment when the same become due and payable; (ii) the failure of the City to make any Additional Payment required under the Lease Agreement and such failure continues for 30 days; (iii) the failure of the City to observe or perform any covenant, condition or agreement of the Lease Agreement to be kept or performed by the City for a period of 30 days after notice of the same has been given to the City; and (iv) the filing of a voluntary petition in bankruptcy failure by the City to promptly lift any execution, garnishment or attachment, or adjudication of the City as a bankruptcy, or assignment by the City for the benefit of the creditors, or the entry by the City into an agreement of composition with creditors or the approval by a court of competent jurisdiction of a petition applicable to the City in any proceedings initiated under the provisions of applicable federal bankruptcy law, or under any similar costs thereafter enacted.

Upon a default, the Trustee may elect to proceed against the City to recover damages pursuant to the Lease Agreement. Any suit for money damages would be subject to statutory and judicial limitations on lessors' remedies under real property leases, other terms of the Lease Agreement and limitations on legal remedies against public agencies in the State, including a limitation on enforcement of judgments against funds needed to serve the public welfare and interest.

Limitations on Remedies

The rights of the Owners of 2009 Bonds are subject to the limitations on legal remedies against counties in the State, including applicable bankruptcy, insolvency, reorganization, moratorium and similar laws affecting the enforcement of creditors' rights generally, now or hereafter in effect, and to the application of general principles of equity, including concepts of materiality, reasonableness, good faith and fair dealing and the possible unavailability of specific performance or injunctive relief, regardless of whether considered in a proceeding in equity or at law.

Under Chapter 9 of the Bankruptcy Code (Title 11, United States Code), which governs the bankruptcy proceedings for public agencies such as the City, there are no involuntary petitions in bankruptcy. If the City were to file a petition under Chapter 9 of the Bankruptcy Code, the Owners of 2009 Bonds, the Trustee and the Authority could be prohibited from taking any steps to enforce their rights under the Lease Agreement, and from taking any steps to collect amounts due from the City under the Lease Agreement.

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

Risk of Earthquake and Other Natural Disasters

Earthquake. There are several active geological faults in the State that have potential to cause serious earthquakes that could result in damage within the City and to the Property, buildings, roads, bridges, and other property.

The City is located in a zone 3 seismic area. Seismic zones aid in identifying and characterizing certain geological conditions and the risk of seismic damage at a particular location, and are used in establishing building codes to minimize seismic damage. The five seismic zones are: zone 0 (no measurable damage), zone 1 (minor damage), zone 2 (moderate damage), zone 3 (major damage) and zone 4 (major damage and greater proximity than zone 3 to certain major fault systems). While the City is not located in any existing special study zone delineated by the State Division of Mines and Geology as an area of known active faults, it is possible that new geological faults could be discovered in the area and that

an earthquake occurring on such faults could result in damage of varying degrees of seriousness to property and infrastructure in the City, including the Property.

The Lease Agreement does not require the City to maintain insurance on the Property against earthquakes. See "SECURITY AND SOURCES OF PAYMENT FOR THE 2009 BONDS—Insurance" and APPENDIX A—"GENERAL, ECONOMIC AND DEMOGRAPHIC INFORMATION RELATING TO THE CITY OF STOCKTON—FINANCIAL INFORMATION—Risk Management."

Risk of Flooding. In accordance with the National Flood Insurance Reform Act (the "NFIRA") requiring, among other things, that the Federal Emergency Management Agency ("FEMA") assess its flood hazard map inventory at least once every five years. In 1995, the U.S. Army Corps of Engineers (the "Corps of Engineers") informed the City that updated flood insurance rate maps would be prepared. In the absence of the construction of flood improvements, FEMA indicated that all of metropolitan Stockton and the surrounding County areas would be located within the boundaries of a 100-year floodplain. A 100-year floodplain is an area expected to be inundated during a flood event of the magnitude for which there is a 1% (or 1-in-100) probability of occurrence in any year.

In response, the City, the County, and the San Joaquin County Flood Control and Water Conservation District formed the San Joaquin Area Flood Control Agency ("SJAFCA"), a Joint Powers Authority created in May 1995. SJAFCA officials convinced representatives of FEMA to delay issuing the maps until SJAFCA constructed a Flood Protection Restoration Project (the "FPRP") which also took into account full-buildout within the areas in accordance with then-existing general plans. The FPRP was completed in 1998 and consisted of flood wall and levee improvements along 40 miles of existing channel levees, 12 miles of levees, widening of the then-existing floodway with set-back levees and set-back benching, modifications to 24 bridges and the addition of two major detention basins. Updated flood insurance rate maps ("FIRMS") were issued on April 2, 2002, permitting development within all of metropolitan Stockton and surrounding areas without further restriction due to potential flood risk.

In the aftermath of Hurricane Katrina in August 2005, the Corps of Engineers delivered letters to agencies nationwide withdrawing certification of the flood hazard maps. As a result, FEMA implemented a Flood Map Modernization effort to update existing FIRMS, policies, regulations and procedures. In particular, FEMA has placed a high priority on reviewing, identifying and certifying levees and levee systems nationwide to verify whether such levees and levee systems provide adequate flood protection in areas currently designated as within a 100-year floodplain. To assure that levees shown on modernized FIRMS still provide that level of protection, FEMA is requiring that each levee in the country be inspected and accredited.

FEMA has completed inspection of the levees in the County. A preliminary FIRM was released by FEMA on May 9, 2008 (placing approximately 18,000 parcels within a 100-year floodplain) and a revised preliminary FIRM was released by FEMA on November 21, 2008 (reducing the number of parcels within the 100-year floodplain to approximately 4,000 parcels) as a result of FEMA giving the County additional time to demonstrate that levees guarding the Calaveras River and Bear Creek are adequate). The preliminary FIRM is an approximation of potential future flood plain areas and do not replace the existing official floodplain maps. Until final FIRMS are issued, the current FIRMS remain in effect. In addition, the State Department of Water Resources ("DWR") is in the process of evaluating and upgrading aging and deteriorating levees along the Sacramento and San Joaquin River Valleys and the San Joaquin Delta. DWR is evaluating more than 300 miles of urban project levees in these areas, with plans to later survey the entire 1,600 miles of project levees in the Central Valley. The final FIRMS become effective on October 16, 2009.

In addition, the State Department of Water Resources (the "DWR") is in the process of evaluating and upgrading aging and deteriorating levees along the Sacramento and San Joaquin River Valleys and the Delta. DWR is evaluating more than 300 miles of urban project levees in these areas, with plans to later survey the entire 1,600 miles of project levees in the Central Valley of the State.

The City makes no representation that the construction of the FPRP will guaranty that FEMA will accredit the levee improvements completed in 1998 or any of the other levees within the City or that FEMA will not issue revised a FIRM that place all or some of the City within the boundaries of a 100-year floodplain.

Hazardous Substances

In general, the owners and operators of real property may be required by law to remedy conditions of the property relating to releases or threatened releases of hazardous substances. The federal Comprehensive Environmental Response, Compensation and Liability Act of 1980, sometimes referred to as "CERCLA" or the "Superfund Act," is the most well-known and widely applicable of these laws, but State laws with regard to hazardous substances are also stringent and similar. Under many of these laws, the owner (or operator) of the property is obligated to remedy a hazardous substance condition whether or not the owner (or operator) has anything to do with creating or handling the hazardous substance. Further, such liabilities may arise not simply from the existence of a hazardous substance but from the method of handling it. All of these possibilities could significantly affect the finances of the City.

Further, it is possible that liabilities may arise in the future resulting from the existence on the Property of a substance presently classified as hazardous but which has not been released or the release of which is not presently threatened, or may arise in the future resulting from the existence of a substance not presently classified as hazardous but which may in the future be so classified. Such liabilities may arise not simply from the existence of a hazardous substance but from the method of handling it.

Although the City handles, uses and stores and will handle, use and store certain hazardous substances, including but not limited to, solvents, paints, certain other chemicals on or near the Property, the City knows of no existing hazardous substances which require remedial action on or near the Property. However, it is possible that such substances do currently or potentially exist and that the City is not aware of them.

Limited Liability of Authority to the Owners

Except as expressly provided in the Indenture, the Authority will not have any obligation or liability to the Owners of the 2009 Bonds with respect to the payment when due of the Lease Payments by the City, or with respect to the performance by the City of other agreements and covenants required to be performed by it contained in the Lease Agreement or the Indenture, or with respect to the performance by the Trustee of any right or obligation required to be performed by it contained in the Indenture.

Risk of Tax Audit

In December 1999, as a part of a larger reorganization of the Internal Revenue Service (the "IRS"), the IRS commenced operation of its Tax Exempt and Government Entities Division (the "TE/GE Division"), as the successor to its Employee Plans and Exempt Organizations division. The new TE/GE Division has a subdivision that is specifically devoted to tax-exempt bond compliance. Public statements by IRS officials indicate that the number of tax-exempt bond examinations (which would include the issuance of securities such as the 2009 Bonds) is expected to increase significantly under the new TE/GE Division. There is no assurance that if an IRS examination of the 2009 Bonds was undertaken that it would not adversely affect the market value of the 2009 Bonds. See "TAX MATTERS."

The City has not been contacted by the IRS regarding the examination of any of its bond transactions.

Reliance on State Budget

Approximately 49.7% of the City's General Fund revenues for Fiscal Year 2007-08 consisted of payments collected by the State and passed-through to local governments or collected by the County and allocated to local governments by State law. Approximately 47.2% of the City's General Fund revenues for Fiscal Year 2008-09 and approximately 47.0% of the City's General Fund revenues for Fiscal Year 2009-10 are expected to come from such sources. There can be no assurance that current or future State budget difficulties will not adversely affect the City's revenues or its ability to make payments under the Lease Agreement. See "CITY FINANCIAL INFORMATION--State Budgets."

Secondary Markets and Prices

The Underwriter will not be obligated to repurchase any of the 2009 Bonds, and no representation is made concerning the existence of any secondary market for the 2009 Bonds. No assurance can be given that any secondary market will develop following the completion of the offering of the 2009 Bonds, and no assurance can be given that the initial offering prices for the 2009 Bonds will continue for any period of time.

Changes in Law

There can be no assurance that the electorate of the State will not at some future time adopt additional initiatives or that the Legislature will not enact legislation that will amend the laws or the Constitution of the State resulting in a reduction of the general fund revenues of the City and consequently, having an adverse effect on the security for the 2009 Bonds.

THE CITY

For certain general, economic and demographic information with respect to the City, see APPENDIX A--"GENERAL, ECONOMIC AND DEMOGRAPHIC INFORMATION RELATING TO THE CITY OF STOCKTON."

CITY FINANCIAL INFORMATION

Financial Statements

All governmental funds are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Government funds consist of the General Fund, special revenue funds, debt service funds, capital project funds and permanent funds.

Property taxes are recognized as revenue in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met. The governmental fund revenues of the City are recognized when they become measurable and available as net current assets.

Expenditures are generally recorded when the liability is incurred, as under accrual accounting. However, debt service expenditures, as well as those related to compensated absences and claims and judgments, are recorded only when payment is due.

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting, as are the proprietary fund financial statements. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

Proprietary funds distinguish operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of the proprietary funds are charges to customers for sales and services. Operating expenses for the proprietary funds include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses. See APPENDIX B—"CITY OF STOCKTON COMPREHENSIVE ANNUAL FINANCIAL REPORT FOR FISCAL YEAR ENDED JUNE 30, 2008."

The audited financial statements for the City, which includes the General Fund, are attached as APPENDIX B. The audited Comprehensive Annual Financial Reports of the City are also available upon request directed to the City Clerk's Office, City Clerk of the City of Stockton, City Hall, 425 North El Dorado Street, Stockton, California 95202. The audited financial statements may also be viewed online or downloaded at <http://www.stocktongov.com/adminservices/reports/financialreports.cfm>.

City Budget Process

The Fiscal Year of the City begins on the first day of July of each year and ends on the thirtieth day of June of the following year.

The City Charter requires that the City Manager submit a budget for the ensuing Fiscal Year to the City Council at least 30 days prior to the beginning of such Fiscal Year, or such earlier date as specified by the City Council. The City Council is required to adopt the budget at a public hearing and may make such amendments to the proposed budget as it deems desirable. The budget may be amended by vote of the City Council at any time during the Fiscal Year.

All appropriations approved by the City Council lapse at the end of the Fiscal Year to the extent they have not been expended or encumbered, except as otherwise provided in the City Charter or where the City Council has by resolution provided for the continuance of an appropriation beyond such Fiscal Year.

In the event the City Council fails to adopt the budget by the beginning of the Fiscal Year, the various amounts contained in the proposed budget shall be deemed appropriated until the final budget is adopted.

The City has enacted its budget in a timely manner in each of the last three Fiscal Years.

City Revised Budget. The annual budget serves as the foundation for the City's financial planning and control. In accordance with the provisions of the City Charter, the City Manager prepares and the City Council adopts a budget prior to June 30, for each subsequent Fiscal Year. Each City department is given expenditure targets based on projected General Fund resources, and is required to develop operational plans within these targets to accomplish the goals articulated each Fiscal Year by the City Council.

In early 2008, the City Council developed goals and objectives believed to best represent the priorities of City government. In July 2008, the City concluded that the level of the declining revenue base coupled with slim General Fund balances required a significant revision to the Fiscal Year 2008-09 General Fund Budget adopted on May 20, 2008. As a result, the City Council directed Budget staff to

develop a revision to the Fiscal Year 2008-09 original budget that allocated limited General Fund resources in a manner to achieve the goals articulated by the City Council. The budgets of the City are developed using a common method of base expenditures calculations plus targets in order to match revenue estimates for the budgeted appropriations for such Fiscal Year. This same expenditure target budget process was used to address the revenue shortfalls for the Fiscal Year 2008-09 Revised Budget.

Recent City General Fund Budgets

Fiscal Year 2007-08. The budget for Fiscal Year 2007-08, adopted by the City Council on May 22, 2007, included a reduction of the General Fund balance in the amount of \$3.2 million. Due to declining tax revenues, mid-year General Fund expenditure target reductions were announced to City departments in January of 2008 as part of the Fiscal Year 2008-09 original budget development process. These expenditure target reductions were not formally adopted by the City Council in the form of a mid-year budget amendment resolution, but were administratively complied with by the City's departments. The mid-year targets resulted in reductions of \$2.5 million in General Fund expenditure appropriations to assist in addressing the estimated revenue shortfall of \$6.5 million. The mid-year revenue and expenditure reductions were estimated to result in a Fiscal Year 2007-08 General Fund operating performance of a negative \$7.2 million compared to the \$3.2 million deficit originally adopted for the General Fund.

Actual audited revenues for the City's General Fund for Fiscal Year 2007-08 closely matched the revised revenue estimates. Additionally, actual audited General Fund expenditures were below the mid-year targeted reduction level. This reduced expenditure level resulted in a Fiscal Year 2007-08 General Fund operating performance of a negative \$5.9 million, rather than the negative \$7.2 million that was anticipated.

Fiscal Year 2008-09. The budget for Fiscal Year 2008-09 was adopted by the City Council on May 20, 2008. The original adopted Fiscal Year 2008-09 budget estimated a negative operating performance for the General Fund of \$3.3 million. On July 10th and July 24th, budget officials made presentations to the Budget/Finance/Economic Development Committee expressing an early warning that the revenue projections of which the original budget was adopted would likely not be realized. As a result of these presentations, the City Manager directed an examination of the adopted Fiscal Year 2008-09 General Fund budget. The Budget Office analysis concluded that the level of the declining revenue base coupled with slim General Fund balances required a significant revision to the City's current year General Fund budget. During August and September, revenue estimates were evaluated and revised. During this time a variety of presentations regarding the fiscal health of the General Fund were made to the Budget/Finance/Economic Development Committee and the City Council as a whole. City Council members were actively engaged in revising the current year budget and committed to preserving the fiscal health of the City's General Fund.

The final evaluation performed by Budget staff concluded that in order to match expenditures to revenues for Fiscal Year 2008-09 and end the Fiscal Year with the same fund balance with which it began, the City Council needed to approve \$19.2 million in expenditure and transfers out reductions. The service reduction was based on revised revenue estimates, as well as contractual and other potential legal obligations not reflected in the original adopted budget appropriations. The service reduction projections reflected the difference between the mid-summer economic downturn condition's impact on tax revenues and a worsening of the economy that could potentially be experienced later in the Fiscal Year. On the expenditure side, the service reductions reflected potential adverse contractual and legal judgments which were then pending, including any judgment rendered in connection with the emergency communications access fee. See also "CONSTITUTIONAL AND STATUTORY LIMITATIONS ON TAXES, REVENUES AND APPROPRIATIONS—Proposition 218—*Emergency Communications System Access Fee Litigation.*"

In reaction to this significant General Fund budget funding gap, on November 6, 2008 the City Council approved \$19.2 million in General Fund expenditure and transfers out reductions to match an estimated revenue and transfers in shortfall of \$15.8 million. Expenditure reductions impacted all City General Fund departments and included savings resulting from a hiring freeze instituted at the beginning of the fiscal year; a new voluntary separation incentive program; 10 days of furloughs; and other services and program reductions. Public safety department expenditure reductions amounted to two-thirds of the total \$19.2 million in General Fund expenditure and transfers out reductions. After adoption of the revised budget, the City Manager directed all City departments to implement the revised budget reduction measures approved by the City Council. The revised budget resolution gave the City Manager the authority to use administrative measures to ensure implementation of the budget reduction measures to meet the reduced department appropriation levels, including the layoff of all City civilian and public safety personnel.

The Revised Budget for Fiscal Year 2008-09 also reduced appropriations in the Library Fund, Recreation Fund, Measure W Fund and various other operating funds. Under the resolution, the Council also amended the fee schedule and increased specific parking civil penalties to more closely coincide with penalties for similar violations in comparable cities. The revised budget balanced estimated revenues with revised expenditure appropriations and retained available fund balances at the prior Fiscal Year level. The Council's above adopted actions included a reduction of Internal Service Fund benefit charge rates to affect a net reduction of costs in the General Fund of an estimated \$4.0 million and a reduction of equipment rental rates by 10%.

As a measure to ensure compliance with the adopted revised budget, on February 6, 2009, the City Manager announced the layoff of 29 police officers and three department directors (Information Technology, Economic Development and Library Services) and the reorganization of those three departments as part of the implementation of the Fiscal Year 2008-09 revised budget. In addition, the number of Deputy City Manager positions was reduced from four to two and those employees were reassigned to other City departments. These actions were aimed at streamlining City functions and reducing costs. As a result of the reorganization, the Information Technology department became part of the renamed Administrative Services department (formerly, the Financial Management department); the Economic Development department merged with Housing and Redevelopment; and Library Services became part of the Community Services department (formerly the Parks and Recreation department). City Management stated that this was the first step in many changes expected to come, of which changes were made as the City continued to consolidate and reduce costs for the Fiscal Year 2009-10 budget.

The layoffs of the police officers, which were effective for February 28, 2009, were in response to, at the time, the inability of the City and the Associations to agree on the furloughs or furlough-equivalent pay reductions approved by the City Council that were part of the Fiscal Year 2008-09 revised budget. The only remedy available to the City to address departmental budget non-compliance, aside from negotiation, was to implement layoffs. Subsequently, a concession was reached with the police officers unit to avoid these 29 layoff, including waiver of uniform allowance and benefit payments through Fiscal Year 2008-09 in exchange for a promise by the administration to retain the 29 police officers through June 30, 2009.

Fiscal Year 2009-10. The budget for Fiscal Year 2009-10 was adopted by the Stockton City Council on June 23, 2009. The adopted General Fund budget balanced estimated revenues/transfers of \$162.7 million with proposed expenditure/transfers appropriations of \$162.7 million and retained available fund balances at the prior year budgeted level. It was determined that the economic downturn would continue to impact the City's tax revenues. As a result, the adopted budget represents reductions of \$22.8 million to revenue/transfer estimates and \$22.8 million in reduced expenditure/transfer appropriations.

Taxes and other revenues were reduced by \$17.9 million, reflecting significant declines in general economic indicators including declining property tax revenue of 13.2% and sales tax revenue of 14% compared to the revised budget revenue estimates. Property tax revenues are estimated at \$27.5 million, a reduction of \$4.2 million. Sales and use tax revenues are estimated at \$34.4 million, a reduction of \$5.6 million. Motor vehicle in lieu revenues are estimated at \$19.35 million, a reduction of \$3.65 million. Transfers-in were reduced by \$4.9 million primarily due to a change in the accounting treatment of Gas Tax revenues. Gas Tax revenues and corresponding public works street maintenance expenditures were approved to be moved to the Gas Tax Fund, with the State required level of General Fund maintenance of effort found in the transfers out line.

Expenditure reductions were approved of \$3.5 million in general government, \$5.9 million in the public safety, \$3.88 million in the previous public safety contingency line, and \$10.8 million in public works. Transfers-out were increased by \$1.4 million reflecting both reduced General Fund subsidy funding of \$1.0 million to the Recreation Services and Library Services funds and an additional transfer of \$2.4 million for the Gas Tax state required General Fund maintenance of effort for street maintenance. Street maintenance costs were moved from the General Fund Public Works Department to the Gas Tax Fund. The budgeted beginning available fund balance estimate for Fiscal Year 2009-10 remained at prior year levels reflecting the efforts of City Administration to implement a balanced budget.

In addition to continuing the hiring freeze for all City departments and extending the furlough program from 10 to 12 days, the adopted Fiscal Year 2009-10 Budget includes the layoff of employees across City departments. Twenty-seven non-public safety employees were laid off effective June 30, 2009. Additionally, 55 layoff notices were issued to police officers to be effective for June 30, 2009 as the City Manager acted to reach the cost reductions necessary for the Police Department to reach its Fiscal Year 2009-10 budget target. Due to ongoing discussions that were taking place, the effective date of these 55 layoff notices was moved to July 18, 2009. As discussed above, successful resolution of the Stockton Police Officers' Association salary implementation dispute and agreement on additional concessions that achieve the required budget reductions of the Police Department budget were achieved on July 15, 2009, resulting in the City Manager's rescission of the 55 police officer layoff notices. The police officer staffing level remains below the original budget of Fiscal Year 2008-09 as a result of the City-wide hiring freeze, which continues to be in place for Fiscal Year 2009-10 for all City departments including public safety personnel. See "*Labor Relations—Recent Developments Regarding the Potential Layoff of City Police Officers.*"

Budgeted full-time City employees number 1,584 for Fiscal Year 2009-10. Of the total, 558 are assigned to the Police Department and 296 to the Fire Department. This total for Fiscal Year 2009-10 is down from the 1,886 full-time positions authorized in the original budget for Fiscal Year 2008-09. The reduction of 302 full-time positions is attributable to 27 laid off employees; 194 retirements under the City's voluntary separate program; and the CalPERS two-year service credit "Golden Handshake" incentive program and 75 full-time vacant positions due to normal attrition which have been left unfilled and unfunded due to the hiring freeze which remains in place through Fiscal Year 2009-10.

Set forth in Table 4 on the following page is a summary statement of the City of Stockton's adopted General Fund Budget for Fiscal Year 2007-08, the adopted original General Fund Budget for Fiscal Year 2008-09 and the adopted revised General Fund Budget for Fiscal Year 2008-09 (with a variance between the original and the revision) and the adopted General Fund Budget for Fiscal Year 2009-10. The Fiscal Year 2007-08 data summarizes the final adopted budgets as such information is presented in the annual financial statements of the City "*—Schedule of Revenues, Expenditures and Changes in Fund Balance—Budget and Actual—On a Budgetary Basis—General Fund,*" for each such Fiscal Year.

Table 4
City of Stockton
General Fund Budget†
Fiscal Years 2007-08, 2008-09 and 2009-10
(\$ in 000's)

	2007-08 Actual Budget	2008-09 Budget		Variance	Adopted 2009-10 Budget
		Original Adopted Budget	Adopted Revised Budget		
REVENUES:					
Taxes:					
Property	\$37,460	\$39,075	\$31,714	(\$7,361)	\$27,525
Utility	32,439	31,850	30,735	(1,115)	30,055
In Lieu of Sales	11,551	10,469	9,823	(646)	8,297
Other	26,050	25,454	24,185	(1,269)	23,935
License and Permits	364	369	369	0	398
Federal Grants and Subsidies	0	0	0	0	0
Sales and Use Tax - Levied by State	35,273	33,789	30,202	(3,587)	26,113
Other Governmental	24,546	25,668	23,601	(2,067)	19,817
Charges for Services	9,611	10,455	10,084	(371)	9,688
Fines and Forfeitures	3,898	3,766	4,346	580	3,972
Use of Money and Property	2,096	2,099	3,702	1,603	2,652
Investment Income:					
Interest Income	690	1,115	715	(400)	635
Net increase (decrease) in fair value of investments	0	0	0	0	0
Refunds and Reimbursements	3,328	3,265	2,990	(275)	1,840
Miscellaneous	<u>5,724</u>	<u>7,735</u>	<u>7,401</u>	<u>(334)</u>	<u>6,998</u>
TOTAL REVENUES	193,030	195,109	179,867	(15,242)	161,924
EXPENDITURES:					
Current:					
General Government	16,661	17,636	15,525	(2,111)	12,022
Public Safety	146,969	150,088	133,586	(16,502)	127,649
Public Works	13,993	13,307	18,820	5,513	8,064
Parks and Recreation	9,428	8,853	109	(8,744)	62
Public Safety Contingent	0	0	3,880	3,880	0
Capital Outlay	86	86	86	0	0
Debt Service - Costs of Issuance	<u>30</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
TOTAL EXPENDITURES	187,167	189,970	172,006	(17,964)	147,797
EXCESS OF REVENUE OVER EXPENDITURES	5,863	5,139	7,861	(2,722)	14,127
Other Financing Sources (Uses):					
Transfers In	6,245	6,270	5,654	(616)	775
Transfers Out	(17,037)	(14,726)	(13,528)	1,198	(14,901)
Sales of Fixed Assets	0	13	13	0	0
Proceeds of Long-Term Debt	0	0	0	0	0
Discounts on Debt Issuances	<u>(24)</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
TOTAL OTHER FINANCING SOURCES (USES)	(10,816)	(8,443)	(7,861)	582	(14,127)
NET CHANGE IN FUND BALANCES	(4,953)	(3,304)	0	3,304	0
FUND BALANCES, BEGINNING OF YEAR	28,078	23,125	23,125	0	23,125
Prior Period Adjustment	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
FUND BALANCES (DEFICIT), END OF YEAR	<u>\$23,125</u>	<u>\$19,821</u>	<u>\$23,125</u>	<u>\$3,304</u>	<u>\$23,125</u>

† Budgeted figures represent final adopted budgets from each Fiscal Year from the Comprehensive Annual Financial Report, Schedule of Revenues, Expenditures and Changes in Fund Balance - Budget and Actual - On a Budgetary Basis General Fund.
Source: City of Stockton.

Discussions regarding Concerns of the City's General Fund Solvency

On February 20, 2009, it was reported in *The Record*, a newspaper of general circulation within the City, under the headline "City Could Consider Bankruptcy" that the City Council's Budget/Finance/Economic Development Committee called for the City to at least consider filing for bankruptcy protection, and that the City's General Fund deficit was expected to reach \$30 million by June 2010 and further service reductions and layoffs are all but certain. At least two facts in the article were inaccurate.

On February 19, 2009, during the Budget/Finance/Economic Development Committee (the "Budget Committee") meeting, Dale Fritchen, Chair of the Committee requested that the City Attorney's Office give or cause to be given an informational presentation on municipal bankruptcy. The informational presentation by the City Attorney's office was not prepared or scheduled.

A transcript of the discussion from the Committee meeting to which *The Record* article refers is set forth below:

"I have been receiving also an increased number of members of the public who bump into me, and two or three last night, and everyday there's individuals who bump into me and tell me 'why doesn't the City just go bankrupt.' I'm not one who is afraid, who will stick my head in the sand and be afraid of finding out more information. I think it would be prudent and it would be wise for the Budget Committee to have someone come and report about what the effects of bankruptcy would be; the pros and the cons. I know I have seen a number of reports, on emails, blogs and elsewhere that talks about, that the City would have to give up its assets if it declares bankruptcy. So last night I went on the computer, and went on the internet and found out that city assets are not part of a Chapter 9, I think, municipal bankruptcy. So there is a lot of misinformation out there, that I think would be. . . also good to clear the air. So that I'm not afraid of education, I'm not afraid of information being out there. So I was wondering if it would be possible for the City Attorney's office to either give a presentation about the pros and cons of it or if there is somebody that you know in the community that could come and give that presentation, whenever it be, in one of our future Budget meetings. I don't know what the Committee thinks about that. And if they're okay with finding out more information about that as an option."

The estimated \$30 million General Fund deficit figure reported in *The Record* references information provided by Budget Office staff to the Budget/Finance/Economic Development Committee on January 13, 2009 in a "budget primer" prepared for the benefit of the five new City Council members who took office effective January 1, 2009. The budget primer presented a worst case scenario of the fiscal situation of the City over an 18-month time horizon (January 2009 through June 2010). This estimated \$30.0 million budget gap includes an assumption that Fiscal Year 2008-09 General Fund actual expenditures would exceed by \$3.5 million the revised budget expenditure reduction target, and that no further actions to reduce cost would be undertaken by management. Annualizing the Fiscal Year 2008-09 \$3.5 million in needed reductions into the Fiscal Year 2009-10 projected budget amounts to an additional deficit in Fiscal Year 2009-10 of \$7.0 million, for a total between the two Fiscal Years of \$10.5 million in related cuts that had been authorized by the previous City Council. As a result of this "budget primer" presentation, the Budget/Finance/Economic Development Committee and the City Council expressed their full support of management in undertaking actions to realize the Fiscal Year 2008-09 revised budget. As previously discussed, following January 13, 2009 the City Manager directed the layoff of 29 police officers, three department heads and reorganization of the deputy city management staff. See also "–Labor Relations–Recent Developments regarding the Potential Layoff of City Police Officers."

As a result of management actions taken after January 13, 2009, the preliminary estimate of the 18-month (January 2009 through June 2010) deficit was revised to \$22.8 million (\$30.0 million *less* the \$10.5 million discussed above, plus \$3.3 million in other subsequent net adjustments to revenue estimates and other reductions). The Budget Office provided each General Fund department with a Fiscal Year 2009-10 expenditure target required to close the funding gap. Since mid-January 2009, the Budget/Finance/Economic Development Committee were provided with weekly presentations by each department regarding operational plans to meet these required cost reductions. The City Council expressed its strong support for maintaining a fiscally sustainable cost structure that results in an available fund balance in the General Fund similar to prior year levels at the end of Fiscal Year 2009-10 and that fiscal solvency is the only option for the City.

On May 8, 2009, it was reported in *The Bond Buyer*, a newspaper of national circulation dedicated to reporting municipal credit market activity, under the headline "Bankruptcy Rumor Mill: In California, Some Cities Eye the Example of Vallejo" that the City of Stockton was one of the California cities in which bankruptcy rumors were "self-inflicted" rather than "justified". Further the City Finance Officer, Kathleen VonAchen, was quoted as stating "[W]e're not declaring bankruptcy," and further emphasized that solvency was the only option being pursued by the City. As summarized in the paragraph above describing the budget development process for Fiscal Year 2009-10, measures undertaken by the City administration to balance the budget have proven this solvency statement to be correct.

City Financial Management Policies

The City Council has adopted a comprehensive set of financial management policies to provide for: (i) establishing targeted General Fund reserves; (ii) the prudent investment of City funds; and (iii) establishing parameters for issuing and managing debt supported by the General Fund, Enterprise Funds and any other related funding entity of the City.

General Fund Reserve Policy. In May of 2006, the City Council adopted a General Fund Reserve Policy that established the goal of achieving reserve available fund balances of 5% of appropriations for catastrophic events and 5% of appropriations for budgetary/economic uncertainty. Appropriations from these reserves require approval by the City Council. At the time of adoption of this reserve policy the City Council voiced a commitment to fund these reserve levels over the subsequent future years.

Copies of the General Fund Reserve Policy may be obtained by contacting the Director of Administrative Services, City Hall, 425 North El Dorado Street, Stockton, California 95202.

Investment Policy. The investment of funds of the City (except pension and retirement funds), including those held under the Trust Agreement and in the Enterprise Funds, are made in accordance with the City's Investment Policy, as amended in June 2009 (the "Investment Policy") and Section 53600 *et seq.* of the California Government Code. The Investment Policy is subject to revision at any time and is reviewed at least annually to ensure compliance with the stated objectives of safety, liquidity, yield, and current laws and financial trends. All amounts held under the Trust Agreement are invested at the direction of the City in Investment Securities, as defined in the Trust Agreement, and are subject to certain limitations contained therein. See APPENDIX C—"SUMMARY OF CERTAIN PROVISIONS OF THE PRINCIPAL LEGAL DOCUMENTS—TRUST AGREEMENT—Investments."

The objective of the Investment Policy is to assist the City in accurately monitoring and forecasting expenditures and revenues to enable the City to invest funds to the fullest extent possible while obtaining the highest yield, provided such investments satisfy the criteria established for safety and liquidity.

All funds of the City (except retirement funds) and investment activities are governed by the Investment Policy, which sets forth the following primary objectives, in order of priority:

Safety. The safety of principal is the foremost objective of the investment program. The investments of the City are to be undertaken in a manner which seeks to ensure preservation of the capital in the overall of the portfolio. To attain this objective, diversification is required in order that potential losses on individual securities do not exceed the income generated from the remainder of the portfolio.

Liquidity. Requires that the investment portfolio of the City remain sufficiently liquid to enable the City to meet all operating requirements that might be reasonably anticipated.

Yield. Requires that the investment portfolio be designed with the objective of attaining a market rate of return throughout budgetary and economic cycles, taking into account the investment risk constraints of the City and the cash flow characteristics of the portfolio.

The City strives to maintain the level of investment of all funds as near 100% as possible, through daily and projected cash flow determinations. The basic premise underlying the City's investment philosophy is, and continues to be, to insure that funds remain safe and available as needed.

Copies of the Investment Policy may be obtained by contacting the Director of Administrative Services, City Hall, 425 North El Dorado Street, Stockton, California 95202.

Debt Management Policy. In 2006, the City adopted a written Capital Financing and Debt Management Policy, as amended May 20, 2008 (the "Debt Management Policy") that establishes parameters for issuing debt and managing a debt portfolio encompassing the specific capital improvement needs of the City and its ability to repay financial obligations utilizing a long range financial approach. The Debt Management Policy, which includes an Interest Rate Risk Mitigation Policy (the "Swap Policy"), is intended to guide decisions related to debt supported by the General Fund and any other related funding entities.

Goals and Objectives. Specifically, the goals of the Debt Management Policy are to (i) evaluate critical debt issuance options; (ii) promote sound financial management, utilizing long range financial planning; (iii) provide accurate and timely information on financial conditions; (iv) maintain appropriate capital assets for present and future needs; (v) protect and enhance the credit rating of the City; (vi) ensure the legal and prudent use of the bonding authority of the City through an effective system of financial security and internal controls; (vii) promote cooperation and coordination with other public entities and the private sector in the financing and delivery of services; and (viii) use debt financing where appropriate to match projected revenue streams with facility needs.

The Debt Management Policy is reviewed annually by a committee comprised of the Deputy City Manager, the Chief Financial Officer, the Finance Officer, a representative from the City Attorney's Office, the Budget Officer and the Budget Analyst assigned to the Capital Improvement Program (the "CIP"). Any revisions to Debt Management Policy are submitted to the Budget/Finance/Economic Development Committee (comprised of three members of the City Council) for review and then to the full City Council for approval.

Approach to Financing Long-Term Debt. The Debt Management Policy integrates pay-as-you-go project financing with projects financed through the issuance of long-term debt. The Capital Improvement Program utilizes this combined approach to fund the City's capital projects. Therefore, the Debt Management Policy is integrated with long range financial plans and the capital improvement

program of the City. Debt issuance for capital projects should not be considered unless such issuance has been incorporated into the Capital Improvement Program.

The Debt Management Policy promotes the use of debt only in those cases where public policy, equity, and economic efficiency favor debt over cash (*i.e.*, pay-as-you-go) financing.

Debt Management and Capacity. The General Fund is permitted to be used to provide back-up liquidity to improve the credit rating of a self-supported debt issue (*i.e.* an obligation that is expected to be paid from a specific revenue source), but *only if* the General Fund *is not* exposed to a significant risk of loss of assets or impairment of liquidity. The Debt Management Policy prohibits the City from using the General Fund to provide financial support for assessment, Mello-Roos or redevelopment obligations. The City may use the General Fund to provide credit support for redevelopment obligations.

General Purpose Debt Capacity. The City monitors its levels of general-purpose debt. In evaluating debt capacity, general purpose supported debt service will not exceed seven percent of total General Fund budgeted expenditures and transfers out.

Enterprise Fund Debt Capacity. The City sets enterprise fund rates at levels needed to fully cover debt service and coverage requirements, operations and maintenance, administration and capital improvement costs. The ability to afford new debt for enterprise operations will be evaluated as an integral part of the City's rate review and setting process.

Inter-fund Loans among City Funds. Inter-fund loans among City funds are considered to finance high priority needs on a case-by-case basis, only when the fund making the loan would not be negatively impacted. Inter-fund borrowing may also be used when it would reduce costs of interest, debt issuance, and/or administration. Inter-fund loans require a written and signed loan agreement between the two City entities that includes a repayment schedule with interest paid at the current borrowing rate of the term of the loan. The repayment term of inter-fund loans is limited to five years.

Swap Policy. The Debt Policy Committee will recommend the use of rate risk mitigation products only in accordance with the purposes specified in Government Code Section 5922(a). A summary of certain of the provisions of the Swap Policy is set for the below:

Purpose. The City is permitted to execute swap agreements if the transaction is expected to result in the following:

- (i) A reduction in exposure to changes in interest rate in the context of a particular financing or the overall asset/liability management of the City.
- (ii) A lower net cost of borrowing with respect to the City's debt.
- (iii) Management of variable rate exposure consistent with prudent policies.

Form of Swap Agreements. The Swap Policy requires that all interest rate swap agreements entered into by the City contain the terms and conditions as set forth in the International Swap and Derivatives Association, Inc. ("ISDA") Master Agreement.

Prohibited Uses. The Swap Policy prohibits the City from entering into interest rate swaps, caps, collars and floors, options with respect thereto and other similar instruments, on either a current or forward basis (collectively, "Swaps") that are for speculative purposes.

Qualified Swap Counterparties. The City is authorized to enter into Swaps only with qualified swap counterparties. Qualified swap counterparties must be rated at least “Aa3” or “AA-” or equivalent by any two of the nationally recognized rating agencies (*i.e.* Moody’s, Standard & Poor’s or Fitch); or have an “AAA” subsidiary rated by at least one nationally recognized credit rating agency. In addition, the counterparty is required to have a demonstrated record of successfully executing swap transactions and a minimum capitalization of at least \$150 million.

The City is permitted to negotiate or competitively bid an interest rate swap transaction based upon a determination by the Debt Policy Committee of the method that will result in the lowest risk and cost to the City.

Term and Notional Amount of Swap Agreement. The Swap Policy permits the City to determine the appropriate term for an interest rate swap agreement on a case by case basis and prohibits the City from entering into a swap agreement with a term that extends beyond the final maturity date of existing debt or the final maturity date of refunding bonds.

Swap Counterparty Credit Exposure Limits. The Swap Policy requires the City to diversify its Swap counterparty credit risk to limit the City’s credit exposure to any one counterparty. The limits are established for each counterparty based upon the credit rating of the counterparty as well as the relative level of risk associated with each existing swap transaction. The risk measure is calculated based upon a mark-to-market sensitivity of each transaction to an assumed shift in interest rates. Assuming a 25 basis point movement in the swap rate, the maximum net exposure (*i.e.* termination payment) per counterparty is not permitted to exceed the following amounts:

<u>Counterparty Credit Ratings</u>	<u>25 Basis Point Shift in the Yield Curve</u>
Fully Collateralized	\$5,000,000
AAA Category	\$4,000,000
AA Category	\$3,000,000

The calculation of net interest rate sensitivity per counterparty will take into consideration multiple transactions, some of which may offset market interest rate risk thereby reducing overall exposure to the City. Additional exposure provisions are as follows: (i) the sum total notional amount per swap counterparty may not exceed 40% of the City’s total bonded indebtedness; and (ii) the appropriate collateral amount will be determined on a case by case basis and approved by the Debt Policy Committee.

If the sensitivity limit is exceeded by a counterparty, the City is required to conduct a review of the exposure sensitivity limit calculation of the counterparty. The Debt Policy Committee is required to evaluate appropriate strategies to mitigate the exposure.

Collateral Requirements. If the credit rating of a counterparty or parent falls below the “AA” category, the City may require the counterparty to post collateral. Additional collateral for further decreases in credit rating are required to be posted. Additional collateral for further decreases in credit ratings of each counterparty is required to be posted by each such counterparty in accordance with the provisions contained in the collateral support agreements to each swap agreement. Collateral is required to consist of cash, non-callable direct obligations or obligations unconditionally guaranteed by the United States Treasury, or non-callable senior debt obligations of Freddie Mac, FannieMae or the Federal Home Loan Banks. The aggregate total notional amount for each counterparty may not exceed 25% of the total revenue bond indebtedness of the City.

A complete copy of the Debt Management Policy may be obtained by contacting the Director of Administrative Services, City Hall, 425 North El Dorado Street, Stockton, California 95202.

The City has not entered into any Swaps.

Current Investments

As of June 30, 2009, the investment portfolio of the City, excluding funds held by fiscal agents, had a weighted average maturity of 1.8 years and a current average coupon of 3.19%. The assets of the investment portfolio are shown in Table 5:

Table 5
Investment Portfolio of the City
(As of June 30, 2009)

Type of Security	Par Value	Book Value		Market Value	Market Value Plus Accrued Interest
		Amount	Percent		
Federal Agency Securities	\$85,450,000.00	\$86,984,436.22	35.04%	\$90,854,980.54	\$91,766,408.50
U.S. Treasury Bills and Notes	31,150,000.00	31,551,855.10	12.29	33,579,477.20	33,830,453.77
FDIC Insured Corporate Notes	31,570,000.00	31,848,848.04	12.04	31,905,052.11	31,965,388.96
Corporate Commercial Paper	10,000,000.00	9,998,041.67	3.89	9,998,041.67	9,998,475.20
Corporate Notes	23,550,000.00	23,927,482.49	9.32	24,144,320.77	24,506,895.91
Corporate Repurchase Agreement	23,779,427.89	23,779,427.89	9.26	23,779,427.89	23,779,493.94
Money Market Accounts	8,683,355.77	8,683,355.77	3.38	8,683,355.17	8,683,355.77
Local Agency Investment Fund (LAIF)	<u>39,997,807.36</u>	<u>39,997,807.36</u>	<u>15.58</u>	<u>39,997,807.36</u>	<u>40,104,836.59</u>
Total	\$254,180,591.20	\$256,771,254.54	100.00%	\$262,942,462.71	\$264,633,308.64

† Includes Corporate Repurchase Agreements and Short-Term Corporate Notes.
Source: City of Stockton.

Principal Sources of General Fund Revenues

Property taxes were the single largest revenue source to the General Fund in Fiscal Year 2007-08, representing approximately 19.8% of revenues; followed by sales taxes representing approximately 17.0% and utility users taxes representing approximately 16.5%. These three sources represented an aggregate of approximately 53.3% of the General Fund revenues for Fiscal Year 2007-08, an aggregate of approximately 51.5% of General Fund revenues of the Fiscal Year 2008-09 Adopted Revised Budget and an aggregate of approximately 51.7% of General Fund revenues of the Fiscal Year 2009-10 Adopted Budget. For a discussion of potential State Budget impacts on General Fund Revenues, see “–State Budgets.” For a discussion of sales tax revenues and property taxes, see “–Sales Tax” and “–Ad Valorem Property Taxation.”

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General Fund Revenues and Expenditures

Table 6 summarizes the general fund balance sheet of the City as of June 30 for the past four Fiscal Years and the estimated balance for the Fiscal Year ending June 30, 2009. The City's Fiscal Year ends on June 30. Table 7 summarizes revenues and expenditures for the General Fund for Fiscal Years 2004-05 through 2007-08 and estimated revenues and expenditures for the General Fund for Fiscal Year 2008-09.

The fluctuation in asset balances is primarily related to economic conditions in recent fiscal years. In Fiscal Year 2005-06, General Fund revenues exceeded estimates by approximately \$15.5 million. In Fiscal Year 2006-07, General Fund revenues exceeded estimates by approximately \$8.7, a decrease of \$6.8 million. The revenue decrease combined with the 2006-07 transfer out of \$5.991 to close out the Emergency Medical Transportation Fund is responsible for the majority of the decline in General Fund Assets in Fiscal Year 2006-07. In Fiscal Year 2007-08, actual General Fund revenues were below what was anticipated in the budget as expenditures continued to increase, further decreases in net assets resulted. For Fiscal Year 2008-09, available fund balances are estimated to remain at the same level as in Fiscal Year 2007-08.

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Table 6
City of Stockton
General Fund Balance Sheet
(For Fiscal Years 2004-05 through 2007-08[†] and Estimated Fiscal Year 2008-09)
(\$ in thousands)

	<u>2004-05</u>	<u>2005-06</u>	<u>2006-07[†]</u>	<u>2007-08[†]</u>	<u>Estimated 2008-09[†]</u>
ASSETS					
Assets:					
Cash and investments	\$2,796	\$8,966	\$3,959	\$3,463	\$5,059
Cash and investment with fiscal agents	1,059	1,096	0	0	0
Receivables:					
Interest	69	104	116	378	200
Taxes and special assessments	9	9	9	9	9
Accounts and other receivables	14,335	16,989	16,700	21,380	21,140
Allowance for uncollectibles	(4,179)	(5,326)	(7,311)	(8,187)	(7,900)
Due from other funds	9,743	6,975	8,599	1,238	890
Due from other governments	8,436	12,023	8,729	8,394	8,300
Allowance for uncollectibles	(16)	(16)	(16)	(16)	(16)
Due from other agencies	364	371	523	619	650
Prepaid items	0	0	1,007	738	765
Inventory of supplies	1,072	158	174	176	175
Advances to other funds	<u>3,498</u>	<u>4,083</u>	<u>9,769</u>	<u>9,770</u>	<u>1,426</u>
TOTAL ASSETS	37,186	45,432	42,258	37,962	30,698
LIABILITIES AND FUND BALANCES					
Liabilities:					
Accounts payable	1,308	1,575	2,092	2,057	2,000
Accrued payroll and benefits	3,133	3,451	3,729	4,277	4,500
Due to other agencies	108	235	116	111	120
Deposits and other liabilities	203	241	791	359	500
Deferred Revenue	<u>8,970</u>	<u>8,462</u>	<u>6,538</u>	<u>8,033</u>	<u>7,500</u>
TOTAL LIABILITIES	13,722	13,964	13,266	14,837	14,620
Fund Balances (deficit)					
Reserved [†]	6,958	8,352	13,231	13,498	4,838
Unreserved:					
Designated	<u>16,506</u>	<u>23,116</u>	<u>15,761</u>	<u>9,627</u>	<u>11,240</u>
TOTAL FUND BALANCES[†]	23,464	31,468	28,992	23,125	16,078
TOTAL LIABILITIES AND FUND BALANCES[†]	\$37,186	\$45,432	\$42,258	\$37,962	\$30,698

[†] In Fiscal Year 2007-08, a prior year audit adjustment was made to reflect the outstanding balance of funds owed to the General Fund by the Development Services Fund. As a result, the prior year balances in "Advances to other funds" were restated; in the amount of \$9.062 million for Fiscal Year 2006-07; and in the amount of \$8.062 million for Fiscal Year 2007-08. Corresponding adjustments are also reflected in "Total Assets," "Reserved Fund Balances," "Total Fund Balances," and "Total Liabilities and Fund Balances." In Fiscal Year 2008-09, a settlement agreement with the Building Industry Association of the Delta included a forgiveness of the \$8.062 million loan advance. For a description of this matter, see "LITIGATION."

Source: City of Stockton.

Table 7 summarizes the revenues and expenses of the City's General Fund for the last five Fiscal Years.

Table 7
City of Stockton
General Fund
Comparable Statement of Revenues, Expenditures and Changes in Fund Balance
(For Fiscal Years 2004-05 through 2007-08 and Estimated for Fiscal Year 2008-09)
(\$ in thousands)

	<u>2004-05</u>	<u>2005-06</u>	<u>2006-07⁽¹⁾</u>	<u>2007-08⁽¹⁾</u>	Estimated <u>2008-09</u>
REVENUES					
Taxes					
Property	\$26,676	\$32,418	\$35,497	\$37,077	\$33,125
In Lieu of Sales Tax ⁽²⁾	8,750	9,274	11,090	10,164	9,823
Utility ⁽³⁾	34,908	34,313	30,101	30,861	30,429
Franchise	9,812	10,333	10,817	11,537	11,618
Business License	8,873	11,149	10,198	10,134	9,500
Hotel/Motel Room	2,160	2,171	2,180	2,287	1,800
Document Transfer (Real Estate)	2,036	2,010	1,187	686	680
Other	0	3	6	2	1
Licenses and Permits	337	346	337	377	667
Federal Grants and Subsidies	0	0	8	0	0
Sales and Use Tax—Levied by State ⁽²⁾⁽⁴⁾	31,889	37,725 ⁽⁵⁾	32,388	31,900	27,377
Other Governmental	16,196	18,857	24,059	24,872	25,335
Charges for Services	10,545	10,821	9,226	10,213	11,000
Fines and Forfeitures	3,214	3,900	3,292	3,302	4,200
Use of Money and Property	791	537	2,134	2,462	3,600
Investment Income:					
Interest Income	1,053	586	1,616	1,316	1,000
Net increase (decrease) in fair value of investments	38	65	163	302	—
Refunds and Reimbursements	5,254	4,020	6,837 ⁽⁶⁾	3,709	3,300
Miscellaneous	<u>4,860</u>	<u>4,784</u>	<u>5,359</u>	<u>6,086</u>	<u>7,800</u>
TOTAL REVENUES	167,392	183,312	186,476	187,287	181,255
EXPENDITURES					
Current:					
General Government	13,444	14,110	14,776	15,089	14,511
Public Safety	121,460	131,689	138,283	143,955	138,596
Public Works	13,426	13,334	14,050	13,936	18,536
Parks and Recreation	7,676	8,027	8,827	8,904	112
Public Safety Contingent	0	0	0	0	2,750
Capital Outlay	101	6	521	86	—
Debt Service - Costs of Issuance	<u>0</u>	<u>0</u>	<u>31</u>	<u>30</u>	<u>99</u>
TOTAL EXPENDITURES	156,107	167,166	176,488	182,000	174,604
EXCESS OF REVENUES OVER EXPENDITURES	\$11,285	\$16,146	\$9,988	\$5,287	\$6,651
Other Financing Sources (Uses)					
Transfers In	10,633	10,848	6,466	5,845	7,383
Transfers Out	(16,303)	(18,992)	(26,997) ⁽⁷⁾	(17,019)	(13,128)
Sales of Fixed Assets	2	2	5	44	109
Proceeds of Long-Term Debt	0	0	0	0	0
Discounts on Debt Issuances	<u>0</u>	<u>0</u>	<u>0</u>	<u>(24)</u>	<u>0</u>
TOTAL OTHER FINANCE SOURCES (USES)	(5,668)	(8,142)	(20,526)	(11,154)	(5,636)
SPECIAL ITEMS					
Legal Settlement with BIA ⁽⁸⁾	0	0	0	0	(8,062)
NET CHANGE IN FUND BALANCES ⁽¹⁾	5,617	8,004	(10,538)	(5,867)	(7,047)
FUND BALANCES, BEGINNING OF YEAR ⁽¹⁾	17,847	23,464	31,468	28,992	23,125
Prior Period Adjustment ⁽¹⁾	<u>0</u>	<u>0</u>	<u>8,062</u>	<u>0</u>	<u>0</u>
FUND BALANCES (DEFICIT), END OF YEAR ⁽¹⁾	23,464	\$31,468	\$28,992	\$23,125	\$16,078
Restricted Reserves	\$6,958	\$8,354	\$13,229	\$13,498	\$4,838
Unreserved – Available for Designations	\$16,506	\$23,114	\$15,763	\$9,627	\$11,240

(Footnotes appear on the following page.)

(Footnotes to Table 7)

- (1) In Fiscal Year 2007-08, a prior year audit adjustment was made to reflect the outstanding balance of funds owed to the General Fund by the Development Services Fund. As a result, Fund Balances, Beginning of Year, have been restated to reflect the outstanding balance of the advance receivable from the Development Services Fund in the amount of \$8.062 million for Fiscal Year 2007-08. Corresponding changes are also reflected in "Fund Balances (Deficit), End of Year."
- (2) Effective with Fiscal Year 2005-06, In Lieu of Sales Tax has been segregated from Sales and Use Tax Levied by the State. The accounting presentation for Fiscal Years 2004-05 has been revised for consistency with this presentation.
- (3) Commencing with Fiscal Year 2004-05 revenue from Utility Users Tax has been declining as a result of a City Council approved rate reduction. Rates were reduced from 8% to 7.75% for Fiscal Year 2004-05. Additional reductions of 0.75% and 1% were effective for Fiscal Years 2005-06 and 2006-07, respectively.
- (4) Effective with Fiscal Year 2006-07, Sales and Use Tax has been reclassified as Intergovernmental Revenue - Sales and Use Tax Levied by the State. The presentation of Sales and Use Tax for Fiscal Years 2004-05 and 2005-06 has been revised for consistency with this presentation. The City no longer reports any Sales and Use Tax Levied by the City in the General Fund.
- (5) In Fiscal Year 2005-06, revenues for Sales and Use Tax - Levied by the State reflect 13 months of collections as a one-time accounting adjustment was made to properly reflect the modified accrual practice. The effect of this was to report additional revenue of \$4.43 million in Fiscal Year 2005-06.
- (6) Refunds and reimbursements revenues reflect a one-time increase in Fiscal Year 2006-07 due to a \$3.7 million payment for State Mandated Cost (SB-90) reimbursements. This was \$3.4 million higher than Fiscal Year 2005-06. State Mandated Cost reimbursements for Fiscal Year 2007-08 total \$138,000.
- (7) In Fiscal Year 2006-07, transfers out reflect a one-time amount of \$5.99 million due to the close out of the Emergency Medical Transportation Fund.
- (8) As of June 30, 2008, the City reported an advance from the General Fund to the Other Governmental Development Services fund in the amount of \$8,062,120 (the "Development Services Loan"). As part of a lawsuit filed in May 2008, the Building Industry Association of Delta challenged the validity of the Development Services Loan. In a settlement agreement dated July 7, 2009, the City agreed to write-off the \$8.062 million remaining balance of the Development Services Loan. See "LITIGATION."

State Budgets

Approximately 47.0% (consisting of the sales tax, property tax and the motor vehicle license fee) of the City's Fiscal Year 2009-10 General Fund Revised Budget consists of payments collected by the State and passed-through to local governments or collected by the County and allocated to local governments by State law. The financial condition of the State has an impact on the level of these revenues. In past years the State has reduced revenues to cities and counties to help solve the State's budget problems.

The level of intergovernmental revenues that the City received from the State in Fiscal Year 2009-10 and in subsequent Fiscal Years are affected by the financial condition of the State.

The following information concerning the State's 2007-08 Fiscal Year budget, the Fiscal Year 2008-09 Budget and the Fiscal Year 2009-10 Budget has been obtained from publicly available information on the State Department of Finance, the State Treasurer and the California Legislative Analyst Office websites. The estimates and projections provided below are based upon various assumptions, which may be affected by numerous factors, including future economic conditions in the State and the nation, and there can be no assurance that the estimates will be achieved. For further information and discussion of factors underlying the State's projections, see the aforementioned websites. The City believes such information to be reliable, however, the City takes no responsibility as to the accuracy or completeness thereof and has not independently verified such information.

Fiscal Year 2007-08. The 2007-08 Budget Act (the "2007 State Budget Act") was adopted by the Legislature on August 21, 2007 and signed by the Governor, after using his line item veto authority to reduce State General Fund appropriations by \$703 million, on August 24, 2007. The 2007 State Budget projected \$102.3 billion in budget-year revenues, an increase of 6.5% from Fiscal Year 2006-07; authorized expenditures of an equal amount (an increase of 0.6% from Fiscal Year 2006-07); and left the State General Fund with a year-end reserve of \$4.1 billion (the same as assumed for Fiscal Year 2006-07), comprised of \$2.6 billion in the State's Special Fund for Economic Uncertainties and \$1.5

billion in the Budget Stabilization Account, which Account was established when voters approved Proposition 58 in March 2004.

The 2007 State Budget Act proposed a major redirection of transportation funds, reductions in social services, and a variety of other actions to eliminate a significant shortfall in Fiscal Year 2007-08, including among other things, (i) increases in funding for county Medi-Cal administration costs; (ii) a partial repayment of Proposition 42 transportation suspensions that occurred in Fiscal Years 2003-04 and 2004-05 as required by Proposition 1A of 2004 (defined herein); (iii) an assumption that \$1 billion in one-time revenues from the sale of EdFund, the State's nonprofit student loan guaranty agency will be received; and (iv) a suspension of a California Work Opportunity and Responsibility to Kids cost-of-living adjustment (a "COLA") for one year and permanently delays the State Supplemental Security income/State Supplementary Program COLA for five months.

Based on the policies contained in the 2007 State Budget Act, according the State Legislative Analyst's Office, the nonpartisan fiscal and policy advisor to the State, the State would face operating shortfalls of more than \$5 billion in both Fiscal Year 2008-09 and Fiscal Year 2009-10 because many of the solutions enacted in the 2007 State Budget Act were of a one-time nature.

Fiscal Year 2008-09. The 2008-09 Budget Act (the "2008 State Budget Act") was adopted by the Legislature on September 16, 2008 and signed by the Governor on September 23, 2008, reflecting a reduction of \$850 million from the proposed budget bill adopted by the Legislature due to the line item veto by the Governor of \$510 million in State General Fund appropriations and \$340 million in State General Fund savings due to the delay in enacting the 2008 State Budget Act and the effect of Executive Order S-09-08 (which terminated the services of temporary employees and reduced overtime).

The 2008-Budget Act reported that the State General Fund began Fiscal Year 2008-09 with a balance of \$4 billion. The 2008 State Budget Act projected State General Fund revenues and transfers for Fiscal Year 2008-09 of \$102 billion, a decrease of approximately 1% from the anticipated revenues and transfers for Fiscal Year 2007-08, and State General Fund expenditures of \$103.4 billion, an increase of approximately 0.06% above the anticipated expenditures for Fiscal Year 2007-08. The 2008 State Budget Act projected ending Fiscal Year 2008-09 with a State General Fund balance of \$2.6 billion, of which \$885 million would be reserved for the liquidation of encumbrances and \$1.7 billion would be deposited in a reserve for economic uncertainties.

The Governor's economic forecasts for Fiscal Year 2008-09 reflected weaker economic performance throughout the country and the State. The 2008 State Budget Act addressed a projected \$24.3 billion budget shortfall which was identified in the Governor's May Revision to the Proposed 2008-09 Budget with a combination of cuts in expenditures and projections of increased revenues. The 2008 State Budget Act included vetoes on behalf of the Governor in the amount of \$510 million of spending approved by the State legislature. The 2008 State Budget Act included a proposal to increase the Budget Stabilization Account (the "BSA") from 5% of State General Fund expenditures to 12.5%. In addition, the 2008 State Budget Act proposed an annual transfer to the BSA of 3% of the General Fund and the elimination of the ability to suspend such annual transfers. The State would only be permitted to transfer funds from the BSA if (1) actual revenues during such fiscal year are below a specified level and (2) funds transferred from the BSA to the State General Fund are appropriated in a stand-alone bill.

Certain of the features of the 2008 State Budget Act affecting local governments included the following:

1. The 2008 State Budget Act proposed to fully fund the Proposition 1A of 2004 loan repayment for Fiscal Year 2008-09 in the amount of \$83 million and the Proposition 42 transfer in the amount of \$1.4 billion, which allocation included \$573 million to the State Transportation Improvement Program and \$286 million to the Public Transportation Account.

2. The Highway Safety, Traffic Reduction, Air Quality, and Port Security Bond Act of 2006 (“Proposition 1B”) authorized \$19.92 billion over the next nine years to fund existing and new Statewide transportation-related infrastructure programs and projects. Such amount included appropriations in Fiscal Year 2008-09 of \$350 million for local transit, \$250 million for local streets and roads, \$201 million for the State & Local Partnership Program and \$21 million for local seismic funding. In addition, AB 1252, enacted in June 2008, provided \$149 million from Proposition 1B to accelerate funding for local streets and roads projects.

3. Chapter 72 of the Statutes of 2005 requires the payment of mandated costs incurred prior to Fiscal Year 2004-05 to begin in Fiscal Year 2006-07 and paid over a term of fifteen years. The 2008 State Budget Act included the elimination of \$75 million in estimated reimbursement claims. The 2008 State Budget Act delayed the third payment of these claims by one year. The 2008 State Budget Act projected that the mandated costs incurred prior to 2004-05 is \$956 million.

4. The 2008 State Budget Act included a veto from the Governor reducing proposed Department of Social Services funding for the California Work Opportunity and Responsibility to Kids (“CalWORKs”) program in the amount of \$70 million. Prior to this veto, such funding would have been available to counties as part of their single allocation and available for county administration, employment services, and child care.

5. The 2008 State Budget Act permanently suspended provision of the June 2008 and June 2009 State Supplementary Payment program cost of living adjustment (“COLA”). The 2008 State Budget Act provided the State Director of Finance with mid-year authority to freeze the COLA, rate increases or increases in State participation in local costs for up to 120 days and require the Governor to submit urgency legislation to permanently suspend the COLA and other rate increases; provided, however, if the Governor fails to act within 120 days, or the State legislature fails to adopt the suspension, the COLA and other rate increases are reinstated.

6. The 2008 State Budget Act reflected savings to the State of \$107.2 million, of which \$53.4 million was attributed to the General Fund, in funding for counties to determine eligibility for Medi-Cal services.

7. The 2008 State Budget Act included \$1.49 billion in Mental Health Services Act (“MHSA”) funds for Proposition 63, of which \$100 million was committed by counties to the MHSA Housing Program. This funding was in addition to \$300 million identified by counties in Fiscal Year 2007-08. This program makes funding available through the California Housing Finance Agency to develop permanent supportive housing serving persons with serious mental illness who are homeless or at risk of homelessness.

8. The 2008 State Budget Act included a veto from the Governor, which reduced proposed funding for the Department of Social Services for County Administration and Automation Projects to \$1,192,736,000 from \$1,194,774,000. By eliminating funding for the Work Incentive Nutritional Supplement program in the amount of by \$2,038,000, the Governor delayed implementation of this program for one year in order to allow the Department of Social Services to study this program and ensure it is consistent with federal rules.

9. The 2008 State Budget Act included a veto from the Governor reducing proposed Department of Corrections funding for Adult Corrections and Rehabilitation Operations by approximately \$28 million to approximately \$4.9 billion.

Fiscal Year 2009-10. On February 20, 2009, the Governor signed into law the budget for Fiscal Year 2009-10 (the “2009 State Budget Act”). The 2009 State Budget Act proposes to address the State’s projected \$41 billion deficit and contains mid-year reductions to the 2008 State Budget Act.

The following are some of the major impacts of the 2009 State Budget Act on local governments throughout the State, including the City:

1. The 2009 State Budget Act includes deferrals of payments to counties for social services and transportation. For February, March and April 2009, monthly transfers of fuel excise tax allocations to cities and counties will be deferred. Payments are scheduled to resume and deferred payments will be paid in May 2009. The 2009 State Budget Act also authorizes two-month deferrals of health and social services payments to counties from July and August to September 2009. Counties are scheduled to receive deferred payments from the State by September 30, 2009. Counties with populations under 40,000 persons are exempt from the deferral of payments for social services.

2. The 2009 State Budget Act increases personal income tax liability by 0.25% in each personal income tax bracket, although the rate will drop to 0.125% if revenues from the ARRA reach \$10 billion.

3. The 2009 State Budget Act increases the VLF rate from 0.65% to 1.15%, 0.15% of which will be dedicated to local public safety programs. The remaining 0.35% of the increase will be deposited into the State's General Fund. The 2009 State Budget Act also imposes a 0.65% rate on commercial vehicles effective May 19, 2009 through July 1, 2011 with a possible two-year extension under certain circumstances. See "--Motor Vehicle License Fees."

4. Under the 2009 State Budget Act, the State's portion of the sales and use taxes would increase by 1%, beginning April 1, 2009 through July 1, 2011, with a possible one-year extension under certain circumstances.

5. Generation of approximately \$6 billion in revenues for Fiscal Year 2009-10 based on voter approval of three propositions on the ballot for the May 19, 2009 special election, including a proposed \$5 billion borrowing from future lottery revenues (Proposition 1C). Each of these measures was defeated.

Impact of the American Recovery and Reinvestment Act of 2009 on the State. The 2009 State Budget Act also includes a number of reductions and revenues tied to the ARRA. Certain reductions to Cal WORKS grants, Medi-Cal benefits and reimbursements, SSI/SSP grants, in-home support services ("IHSS"), the judicial branch and higher education are scheduled to be enacted in statute and could be suspended if expected revenues from the ARRA are certified by the Department of Finance to equal \$10 billion, including revenues anticipated to be received by June 30, 2010. If revenues from the ARRA are not sufficient to meet the \$10 billion target, the reductions would be permanent. If revenues from the ARRA reach \$10 billion, the reductions would not go into effect. A future statute would be required to enact the reductions should they become necessary. On March 4, 2009, the Department of Finance released a preliminary estimate that the State would receive approximately \$8 billion in federal economic stimulus funds, \$2 billion short of what is required to prevent the cuts. The Department of Finance and the State Treasurer's Office are working with various interested entities to analyze the Department of Finance's preliminary estimates.

May Revision to the 2009 State Budget Act. On May 14, 2009, the Governor released the May Revision to the 2009 State Budget Act (together with the contingency proposals referenced therein, the "2009 May Revision"). The 2009 May Revision projected a budget gap of \$21.3 billion through the remainder of Fiscal Year 2008-09 and Fiscal Year 2009-10 due to continued shortfalls in revenue collections and increased costs and the failure of five budget-related propositions included in the May 19, 2009 special election, which the 2009 May Revision proposed to address through program reductions and additional borrowings. The 2009 May Revision estimated Fiscal Year 2008-09 revenues and transfers of \$85.95 billion, total expenditures of \$91.89 billion and a year-end deficit of \$3.63 billion, which includes a \$2.31 billion prior-year State General Fund balance, a \$4.71 billion withdrawal from the reserve for

economic uncertainties and an allocation of \$1.08 billion to the reserve for the liquidation of encumbrances. The 2009 May Revision projected Fiscal Year 2009-10 revenues and transfers of \$92.22 billion, total expenditures of \$85.46 billion and a year-end surplus of 53.13 billion (net of the \$3.63 billion deficit from Fiscal Year 2008-09), of which \$1.08 billion would be reserved for the liquidation of encumbrances and \$2.05 billion would be deposited in a reserve for economic uncertainties. The 2009 May Revision indicated that the State's economic outlook included negative growth for calendar year 2009, followed by weak growth in calendar year 2010 and increased growth in calendar year 2011.

Features of the 2009 May Revision affecting local government included the following:

1. The 2009 May Revision proposed to reduce program expenditures by approximately \$2.64 billion in Fiscal Year 2008-09 and \$6.36 billion in Fiscal Year 2009-10, primarily through reductions in education funding and health and social services programs, including in-home support services, CalWORKS, immigrant assistance programs, child welfare services and SSI/SSP.

2. The 2009 May Revision proposed that the State borrow 8% of property tax revenues from counties, cities and special districts for Fiscal Year 2009-10, totaling approximately \$2 billion, which amount would be repaid within three years, all in accordance with Proposition 1A of 2004. The manner in which the borrowing would be allocated (*i.e.*, the amount to be borrowed from particular local agencies), and whether the property taxes paid to local agencies by the State in-lieu of vehicle license fees and in-lieu of sales tax, remained subject to determination. The 2009 May Revision proposed to create a joint powers entity to allow local agencies to borrow against the State repayment as a group.

3. The 2009 May Revision proposed \$750 million in reductions to the federal Medi-Cal program, subject to receipt of a federal waiver.

4. The 2009 May Revision proposed to redirect \$60 million in cigarette and tobacco products surtax revenues from county health programs.

5. The 2009 May Revision proposed to change sentencing options for low-level offenders such that an offense that could be charged as a misdemeanor or felony would be punishable only by a term in county jail. The 2009 May Revision estimated that the State would save approximately \$100 million from such shift. The potential impact of this proposal on counties is currently unknown as the details of the proposal have not yet been disclosed.

LAO May Overview of the 2009 May Revision. On May 21, 2009, the Legislative Analyst's Office, the State's nonpartisan fiscal and policy advisor (the "LAO") released an analysis of the 2009 May Revision entitled Overview of the 2009-10 May Revision (the "LAO 2009 May Overview"). The LAO 2009 May Overview stated that the economic and revenue forecasts and assessments of the State's budgetary problems set forth in the 2009 May Revision were generally reasonable in light of the effects of the economic slowdown throughout the United States, but indicated that State General Fund expenditures across Fiscal Year 2008-09 and Fiscal Year 2009-10 could exceed revenues by approximately \$3 billion more than the amount estimated in the 2009 May Revision.

The LAO 2009 May Overview stated that the 2009 May Revision relied on a number of proposals that could return the budget to balance and result in a State General Fund reserve at the end of Fiscal Year 2009-10 of \$2.1 billion, but that the largest proposals carried the largest risks. The LAO also noted that many of the proposals contained in the 2009 May Revision were one-time in nature and recommended that the State Legislature reduce its reliance on one-time measures, which could contribute to long-term negative effects for taxpayers and programs. The LAO 2009 May Overview set forth several budget recommendations for the State Legislature, including eliminating certain duplicative, inefficient, ineffective or over-budgeted education programs, borrowing additional transportation funds, increasing community college fees, reconsidering the dedication of certain vehicle license fees to local public safety

programs, implementing additional user fees for government services, modifying the proposed property tax revenues borrowing to target specific agencies and reconsidering the use of revenue anticipation warrants for budget balancing and reserve building purposes, which, according to the LAO, sets a bad precedent and presents serious legal concerns.

The LAO 2009 May Overview stated that the State Legislature would face a significant challenge to address the projected budget deficit in Fiscal Year 2008-09 and projected revenue shortfalls in Fiscal Year 2009-10 and must pay particular attention to closing the State's ongoing structural mismatch between revenues and spending for future years. The LAO 2009 May Overview reiterated that the State Legislature should avoid proposed solutions that do not prioritize program reductions, add additional borrowing or debt and lead to a diminution of the State Legislature's authority.

Governor's Update to the 2009 May Revision. On May 26, 2009 and May 29, 2009, the Governor released updates to the 2009 May Revision (collectively, the "2009 May Revision Update"). The 2009 May Revision Update projected a budget deficit of \$3.10 billion through the remainder of Fiscal Year 2008-09 due to shortfalls in revenue collections and increased costs and the failure of five of the six budget-related propositions included in the May 19, 2009 special election ballot. The 2009 May Revision Update estimated Fiscal Year 2008-09 General Fund revenues and transfers of \$85.95 billion, total General Fund expenditures of \$91.35 billion and a year-end deficit of \$3.10 billion, which included a \$2.31 billion prior-year State General Fund balance and an allocation of \$1.08 billion to the reserve for the liquidation of encumbrances. The 2009 May Revision Update projected Fiscal Year 2009-10 revenues and transfers of \$92.22 billion, total expenditures of \$83.52 billion and a year-end surplus of \$5.60 billion (net of the \$3.10 billion deficit from Fiscal Year 2008-09), of which \$1.08 billion would be reserved for the liquidation of encumbrances and \$4.52 billion would be deposited in a reserve for economic uncertainties. The 2009 May Revision and the 2009 May Revision Update collectively included proposals to reduce State General Fund spending in the amount of \$3.12 billion during the remainder of Fiscal Year 2008-09 and \$20.85 billion during Fiscal Year 2009-10. The 2009 May Revision Update withdrew the Governor's 2009 May Revision proposal to issue revenue anticipation warrants in the amount of \$5.6 billion to address a portion of the State General Fund deficit.

Features of the 2009 May Revision Update affecting local governments include the following:

1. The 2009 May Revision Update proposed to eliminate CalWORKS, which was expected to reduce State General Fund spending by approximately \$1.31 billion in Fiscal Year 2009-10. In the event the State eliminated CalWORKS, federal matching funds for the program would be eliminated.
2. The 2009 May Revision Update proposed to eliminate General Fund expenditures for county programs relating to the Healthy Families Programs, Maternal, Child, and Adolescent Health, Mental Health Managed Care Services and the Early and Periodic Screening, Diagnosis, and Treatment Services program. The proposals were expected to reduce General Fund expenditures by \$424.2 million.
3. The 2009 May Revision Update proposed to reduce the local share of the gasoline tax from \$1.05 billion to \$300 million. Pursuant to this proposal, the State would apply the \$750 million to pay current and prior year debt service on highway bonds.

Issuance of Registered Warrants. On June 24, 2009, the State Controller announced that the State would issue registered warrants ("IOUs") beginning July 2, 2009 to local governments for social services, private contractors, State vendors, taxpayers entitled to income and corporate tax refunds, and for payments for other State operations if immediate budget and cash solutions were not quickly adopted by the Governor and the State Legislature. The City has not determined the impact of the issuance of IOUs on the financial condition of the City at this time.

Amendment of the 2009 State Budget Act. On July 23, 2009 through July 24, 2009, State Legislature voted on, and passed, a majority of the budget solutions amending the 2009 State Budget Act to address the combined \$60 billion budget deficit over Fiscal Years 2008-09 and 2009-10 that resulted from the deepening recession. The amendments included spending cuts, borrowing, redirecting revenues from local governments, accounting maneuvers, and a \$921 million reserve.

On July 28, 2009, the Governor signed an amendment to the 2009 State Budget Act (the "Amended 2009 State Budget Act") to include an additional \$24.2 billion in budget solutions to address the further deterioration of the fiscal situation of the State identified in the 2009 May Revision. Because the State Legislature did not adopt budget solutions that eliminated the entire projected deficit, the Governor used his veto power to eliminate an additional \$489 million in spending, leaving the State with a \$500 million reserve.

The \$24.2 billion in budget solutions contained in the Amended 2009 State Budget include: (i) expenditure reductions of \$8.5 billion from K-14 education and additional cuts to the State colleges and university systems (just under \$2 billion total for Fiscal Year 2008-09 and Fiscal Year 2009-10); \$785 million from the Department of Corrections, with specific program reforms to be determined upon the return of the State Legislature in August 2009, \$1.7 billion from General Government, by suspending COLAs; leveraging State assets, consolidating and reorganizing boards and commissions (\$50 million in Fiscal Year 2009-10) and IT procurement reform (\$100 million); \$820 million from State Employee Compensation by adopting third furlough day (\$425 million), eliminating rural health care, and scoring health care savings; \$3.0 billion from Health and Human Services by adopting long-term reforms to CalWORKs (\$510 million in Fiscal Year 2009-10), changes and improvements to Medi-Cal eligibility and improved care coordination (\$1.4 billion); reducing In-Home Supportive Services (IHSS) services for all but the most severely disabled and implementing anti-fraud initiatives (\$264 million), funding to counties for Child Welfare Services (\$80 million), changes to eligibility in the Healthy Families program and freezing of COLAs for IHSS and the Department of Developmental Services long-term care providers (\$76 million) and elimination of funding for the Williamson Act Program which backfills property tax revenues that local governments forego when property is preserved for agriculture or open space uses; (ii) \$1.0 billion in fund shifts, including a shift of redevelopment agency funds to schools (\$1.7 billion) with the same amount of base school property tax shifted to the county-level Supplemental Revenue Augmentation Funds, from which \$850 million will be used to fund courts, prisons, Medi-Cal, hospital, and K-12 school bond expenses that would otherwise be funded from the State General Fund and the remaining \$850 million used to fund K-12 school costs offsetting Proposition 98 State General Fund costs; (iii) \$3.5 billion in revenue augmentations, including optional personal income tax withholding changes; tax enforcement; permitting the State Compensation Insurance Fund (the "SCIF") to invest in bonds issued by the State Treasurer to raise cash, and special fund transfers; (iv) \$2.2 billion in borrowing, including suspension of Proposition 1A of 2004 (\$1.9 billion), a loan from the State Highway Account (\$135 million) and various loans and fund shifts to keep State parks open; and (v) pushing the last State worker payday of the Fiscal Year from June 30, 2010, to July 1, 2010, the start of the next Fiscal Year (\$1.4 billion).

The Amended 2009 State Budget Act reflects the harsh reality of diminished resources forced by the recession and the impact of the cuts are across the board. It is expected that there will be a number of lawsuits by local governments resulting from the passage of the Amended 2009 State Budget Act over the suspension of Prop 1A of 2004, the redevelopment fund shift, securitization and other issues.

On July 28, 2009, the Governor announced that he will call a special session in late September for legislators to consider the recommendations of the Commission on the 21st Century Economy for overhauling the State's tax system.

City Responses to the Amended 2009 State Budget Act. Pursuant to Proposition 1A of 2004 approved by the voters of the State in November 2004, the State may shift up to eight percent of local government property tax revenues to schools and community colleges during severe State financial hardship. Because the State choose to shift local government property tax revenues as allowed by Proposition 1A of 2004, the City will likely experience a reduction in its revenues in Fiscal Year 2009-10, as discussed below.

The City has estimated the potential effect of the State budget adopted in July, particularly the Proposition 1A of 2004 borrowing proposal. The City currently projects that up to approximately \$5.2 million of its General Fund revenues in Fiscal Year 2009-10 may be subject to State suspension of Proposition 1A of 2004:

Table 8
City of Stockton
General Fund Revenues Subject to State Suspension of Proposition 1A of 2004
Fiscal Year 2009-10

<u>Component</u>	<u>Amount</u>
8% Property Tax	\$2,575,913
Sales Tax Triple Flip	785,815
Property Tax in Lieu of VLF	<u>1,820,000</u>
TOTAL	\$5,181,728

Disruptions in payments to the City from the State, whether temporary or permanent, may require adjustments in the General Fund budget. Deferrals in State payments may jeopardize the City's ability to maintain core discretionary programs that could require suspension of such programs. As a result, the City's strategy to mitigate the \$5.2 million impact related to the Proposition 1A of 2004 suspension/borrowing is two-fold, either: (i) enter into a City Council approved loan agreement between the City's General Fund and an alternate General Fund-related fund (*i.e.*, internal services funds or special revenue fund) to be structured with the same terms/length as the State's repayment commitment, or (ii) participate in a statewide pool bond issue under those same terms as discussed in the State's July adopted budget.

The City cannot predict the extent of the budgetary problems the State will encounter in this or in any future Fiscal Year, and, it is not clear what measures would eventually be taken by the State to balance its budget, as required by law. Accordingly, the City cannot predict the final outcome of future State budget negotiations, the impact that such budgets will have on its finances and operations or the actions to be taken in the future.

Sales Tax

A sales tax is imposed on retail sale or consumption of personal property. Sales tax revenues are determined by the total taxable transactions within a jurisdiction and distributed by the State Board of Equalization to the jurisdiction where the sale took place. Sales taxes collected from merchants with no permanent place of business (*i.e.*, manufacturers, construction contractors, etc.) are accumulated to a Countywide or State-wide (out-of-state businesses) pool and distributed to cities and counties in proportion to their collections from all sales taxpayers.

In 1955, the State Legislature enacted the Bradley Burns Act which established a statewide rate for sales tax, allowed counties to enact sales taxes, capped cities' taxes at 1% and provided for collection by the State Board of Equalization. The City's 1% sales tax has historically been an important local revenue source.

The value and volume of these taxable transactions are in turn dependent on economic and other factors which will influence the City. Such factors include the level of inflation affecting the price of goods and services subject to the sales tax, the rate of population growth in the general area, the characteristics of retail developments, including the relative size of market service areas, the sensitivity of the types of businesses within the City to changes in the economy, and competing retail establishments outside the City. A deterioration of economic and other factors influencing taxable sales generated in the City would reduce the level of taxable sales generated in the City, thereby reducing sales tax revenues. Table 9 shows historical retail sales for certain businesses in the City.

Table 9
City of Stockton
Taxable Retail Sales Data
Calendar Years 2003 to 2007[†]
(\$ in 000's)

	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007[†]</u>
RETAIL STORES					
Apparel Stores	\$86,994	\$105,950	\$117,760	\$119,153	\$299,377
General Merchandise	450,383	490,497	537,946	552,730	415,529
Food Stores	158,262	171,071	180,598	186,432	163,156
Eating & Drinking Places	233,674	248,648	266,869	278,050	297,703
Home Furnishings and Appliances	83,672	96,848	104,559	94,714	141,372
Building Materials and Farm Implements	381,828	525,053	538,219	499,491	461,560
Auto Dealers and Auto Supplies	594,426	622,387	662,421	622,487	529,777
Service Stations	151,314	161,981	184,740	211,870	398,106
Other Retail Stores	<u>370,721</u>	<u>406,687</u>	<u>454,893</u>	<u>475,585</u>	<u>368,106</u>
TOTAL RETAIL STORES	2,511,274	2,829,122	3,048,005	3,040,512	3,004,940
All Other Outlets	<u>566,255</u>	<u>637,707</u>	<u>692,632</u>	<u>735,748</u>	<u>684,579</u>
TOTAL ALL OUTLETS	\$3,077,529	\$3,466,829	\$3,740,637	\$3,776,260	\$3,689,519
Percentage Change	7.85%	12.65%	7.90%	0.95%	(2.30%)

[†] Most recent annual data available.

Source: State Board of Equalization for calendar years 2003 through 2006 and The HdL Companies for calendar year 2007.

The City's original budget for Fiscal Year 2008-09 projected a 5% growth in sales tax revenues. HdL Companies performed a study that evaluated new businesses coming into the City against business closures and projected a 10.6% decline in the sales tax base. As a result of the deepening economic downturn, the City revised its original revenue estimates for Fiscal Year 2008-09 sales and use taxes to reflect a 10.6% decrease from Fiscal Year 2007-08 receipts. Budgeted estimates for sales and use tax receipts in Fiscal Year 2009-10 reflect an approximately 14.0% decline compared to the Prior Fiscal Year.

In August 2003, the State adopted legislation which cut the sales tax revenue to cities by half and redirected those revenues to repay State bonds issued to fund the State deficit (Triple Flip) (AB 7X, Revenue and Taxation Code §§7203, 6051.5). The legislation includes a requirement to repay the lost sales tax revenue with subsequent payments from local property taxes taken to establish the Education Revenue Augmentation Fund (the "ERAF").

The Triple Flip statute provides that the cities will later receive an additional amount of property tax equal to the reduction in sales tax revenues. The sales tax reduction will be 0.25% of the 1% the City now receives pursuant to the language included in the voter approved Proposition 57, which authorized the issuance of State deficit bonds.

Utility Users Tax

Pursuant to Ordinance 2570C.S., effective November 1, 1974, as amended, the City imposes a tax on all telecommunication, electric, gas, water and video service delivered to users within the City (collectively, the "Utility Users Tax"). The Utility Users Tax is imposed at rates established by the Ordinance. The rate for Fiscal Year 2005-06 was 7% and for Fiscal Year 2006-07 and thereafter is set at 6%. Table 10 sets forth the utility users tax received by the City for the last five Fiscal Years and the estimated amounts for Fiscal Year 2008-09 and Fiscal Year 2009-10.

Table 10
City of Stockton
Utility Users Taxes
Fiscal Years 2004-05 through 2007-08 and Estimated for Fiscal Years 2008-09 and 2009-10
(\$ in thousands)

<u>Fiscal Year</u>	<u>Utility Users In Lieu Fee</u>
2004-05	\$34,908
2005-06	34,313
2006-07	30,101
2007-08	30,861
2008-09	30,429
2009-10 [†]	30,055

[†] Estimated.

Source: City of Stockton.

Property Taxes

Ad Valorem Property Taxes

Tax Levies, Collections and Delinquencies. Property Taxes are levied by the County for each fiscal year on taxable real and personal property which is situated in the County. Property taxes collected in advance are recorded as deferred revenue and recognized as revenue in the year they become available. The County levies, bills and collects property taxes for the City. Property taxes paid to the City by the County within 60 days after the end of the Fiscal Year are "available" and are, therefore, recognized as revenue.

For assessment and collection purposes, property is classified either as "secured" or "unsecured" and is listed accordingly on separate parts of the assessment roll. The "secured roll" is that part of the assessment roll containing State/assessed public utilities property and property the taxes on which are a lien on real property sufficient, in the opinion of the County Assessor, to secure payment of the taxes. Other property is assessed on the "unsecured roll."

Secured and unsecured property taxes are levied based on the assessed value as of January 1, the lien date, of the preceding Fiscal Year. Secured property tax is levied on October 1 and due in two installments, on November 1 and March 1. Collection dates are December 10 and April 10 which are also the delinquent dates. At that time, delinquent accounts are assessed a penalty of 10%. Accounts that remain unpaid on June 30 are charged an additional 1.5 % per month. Such property may thereafter be redeemed by payment of a penalty of 1.5% per month to the time of redemption, plus costs and a redemption fee. If taxes are unpaid for a period of five years or more, the property is deeded to the State and then is subject to sale by the County Treasurer.

Unsecured property tax is levied on July 1 and due on July 31, and has a collection date of August 31 which is also the delinquent date. A 10% penalty attaches to delinquent unsecured taxes. If unsecured taxes are unpaid at 5:00 p.m. on October 31, an additional penalty of 1.5% attaches to them on the first day of each month until paid. The taxing authority has four ways of collecting delinquent unsecured personal property taxes: (1) bringing a civil action against the taxpayer; (2) filing a certificate in the office of the County Clerk specifying certain facts in order to obtain a lien on certain property of the taxpayer; (3) filing a certificate of delinquency for record in the County Clerk and County Recorder's office in order to obtain a lien on certain property of the taxpayer; and (4) seizing and selling personal property, improvements, or possessory interests belonging or assessed to the assessee.

Teeter Plan. The City is located within a county that is following the "Teeter Plan" (defined below) with respect to property tax collection and disbursement procedures. Under this plan, a county can implement an alternate procedure for the distribution of certain property tax levies on the secured roll pursuant to Chapter 3, Part 8, Division 1 of the Revenue and Taxation Code of the State of California (comprising Section 4701 through 4717, inclusive), commonly referred to as the "Teeter Plan."

Generally, the Teeter Plan provides for a tax distribution procedure by which secured roll taxes and assessments are distributed to taxing agencies within a county included in the Teeter Plan on the basis of the tax levy, rather than on the basis of actual tax collections. The County then receives all future delinquent tax payments, penalties and interest, and a complex tax redemption distribution system for all taxing agencies is avoided. In connection with the Teeter Plan, a county can advance to the participating taxing agencies an amount equal to 95% of the total then-prior years' delinquent secured property taxes and 100% of the total then-prior years' delinquent secured assessments, including the associated penalties and interest, and 100% of the then-current year's secured roll levy.

The Board of Supervisors of the County may discontinue the procedures under the Teeter Plan altogether, or with respect to any tax or assessment levying agency in the County, if the rate of secured tax and assessment delinquency in that agency in any year exceed 3% of the total of all taxes and assessment levied on the secured rolls for that agency.

Thus, so long as the County maintains its policy of collecting taxes pursuant to said procedures and the City meets the Teeter Plan requirements, the City will receive 100% of the annual installments levied without regard to actual collections in the City. There is no assurance, however, that the County Board of Supervisors will maintain its policy of apportioning taxes pursuant to the aforementioned procedures.

Assessed Valuation. All property is assessed using full cash value as defined by Article XIII A of the State Constitution. State law provides exemptions from ad valorem property taxation for certain classes of property such as churches, colleges, nonprofit hospitals and charitable institutions.

Future assessed valuation growth allowed under Article XIII A (new construction, certain changes of ownership, 2% inflation) will be allocated on the basis of "situs" among the jurisdictions that serve the tax rate area within which the growth occurs. Local agencies and schools will share the growth of "base" revenues from the tax rate area. Each year's growth allocation becomes part of each agency's allocation in the following year. The availability of revenue from growth in tax bases to such entities may be affected by the establishment of redevelopment agencies which, under certain circumstances, may be entitled to revenues resulting from the increase in certain property values.

The passage of Assembly Bill 454 in 1987 changed the manner in which unitary and operating nonunitary property is assessed by the State Board of Equalization. The legislation deleted the formula for the allocation of assessed value attributed to such property and imposed a State-mandated local program requiring the assignment of the assessment value of all unitary and operating non-unitary property in each county of each State assessee other than a regulated railway company. The legislation

established formulas for the computation of applicable county-wide rates for such property and for the allocation of property tax revenues attributable to such property among taxing jurisdictions in the county beginning in Fiscal Year 1988-89. This legislation requires each County to issue each State assessee, other than a regulated railway company, a single tax bill for all unitary and operating nonunitary property.

Assessment Appeals. Property tax values determined by the County Assessor may be subject to appeal by property owners. Assessment appeals are annually filed with the Assessment Appeals Board for a hearing and resolution. The resolution of an appeal may result in a reduction to the County Assessor's original taxable value and a tax refund to the applicant/property owner.

Each assessment appeal could result in a reduction of the taxable value of the real property, personal property or possessory interest of the property which is the subject of the appeal. Alternatively, an appeal may be withdrawn by the applicant or the Assessment Appeals Board may deny or modify the appeal at a hearing or by stipulation.

Effect of Delinquencies and Foreclosures on Property Tax Collections. As described above under "The Teeter Plan," once an installment of property tax becomes delinquent, penalties are assessed commencing on the applicable delinquency date until the delinquent installment(s) and all assessed penalties are paid. In the event of foreclosure and sale of property by a mortgage holder, all past due property taxes, penalties and interest is required to be paid before the property can be transferred to a new owner.

Based on information provided by an independent data collection service, for calendar year 2008, mortgage holders had sent 8,763 notices of default with respect to properties located within the City compared to 6,009 during calendar year 2007, and 6,455 trustee deeds had been recorded (indicating that the property has been lost to foreclosure) during calendar year 2008 compared to 2,310 during calendar year 2007. During the first half (January through June) of calendar year 2009, mortgage holders sent 4,952 notices of default and recorded 3,177 trustee deeds compared to 4,167 notices of default sent and 1,980 trustee deeds recorded during the first half calendar year 2008. These events are related to the collapse of the subprime sector of the mortgage market that is impacting certain homeowners nationwide. In California, the greatest impacts to date are in regions of the Central Valley (such as San Joaquin County) and the Inland Empire in Southern California, where the largest number of new mortgages were originated as growth occurred within the County.

A summary of the notices of default sent and trustee deeds recorded for the City and the County for calendar years 2006 through 2008 is set forth in Table 11.

Table 11
City of Stockton and San Joaquin County
Summary of Foreclosure Activity
Calendar Years 2006 – 2008

	Notices of Default					Trustee Deeds (Foreclosures)				
	2007		2008			2007		2008		
	2006	Number	Change	Number	Change	2006	Number	Change	Number	Change
City	1,790	6,009	235.7%	8,763	45.8%	261	2,310	785.1%	6,455	179.4%
County	3,235	11,051	241.6	16,410	28.5	451	3,971	780.5	11,625	192.7

Source: MDA DataQuick Information.

The level of default and foreclosure activity is related to the collapse of the subprime sector of the mortgage market that is impacting certain homeowners nationwide and has resulted in downward pressure on home prices in the affected areas. Within the State, the greatest impacts to date are in regions of the Central Valley, including the City, the Inland Empire, and other areas in the State where the large numbers of new mortgages were originated in more affordable areas.

The increased level of default and foreclosure activity has resulted in downward pressure on home prices in the affected areas. In response, the City has continued to implement its aggressive collection activities that include mailing timely demand letters to delinquent property owners with follow up by a foreclosure attorney, if required. See “–Recent City General Fund Budgets–Fiscal Year 2008-09.”

In 1978, the voters of the State passed Proposition 8, a constitutional amendment to Article XIII A that allows a *temporary* reduction in assessed value when real property suffers a decline in value. A decline in value occurs when the current market value of real property is less than the current assessed (taxable) factored base year value as of the lien date, January 1.

In April 2008, the County Assessor announced that approximately 58,000 properties within the County that were transferred between January 1, 2004 and December 31, 2008 were to be reassessed, representing an aggregate reduction in assessed value of approximately \$3.5 billion. The City represents approximately 33.3% of the assessed value within the County.

The County Assessor informed the City that it had evaluated approximately 27% of the property within the City for Proposition 8 temporary reassessments. In the Fiscal Year 2008-09 General Fund Revised Budget, the City assumed that assessed value would decrease with respect to 73% of the property within the City at a rate equal to only 1.3% over the Fiscal Year 2007-08 assessed value. For Fiscal Year 2009-10 the County Assessor undertook a comprehensive reassessment of the entire County, resulting in estimated assessed values that are 12.9% below the City’s assessed value level for the prior Fiscal Year. See also “CONSTITUTIONAL AND STATUTORY LIMITATIONS ON TAXES AND APPROPRIATIONS–Article XIII A of the California Constitution.”

Table 12 shows assessed valuations in the City since Fiscal Year 2004-05.

Table 12
City of Stockton
Assessed Full Cash Value of all Taxable Property
Fiscal Years 2004-05 to 2009-10
(\$ in Thousands)

<u>Fiscal Year</u>	<u>Land</u>	<u>Improvements</u>	<u>Personal Property</u>	<u>Gross Assessed Value</u>	<u>Less Exemptions</u>	<u>Net Assessed Value</u>	<u>Percent Change</u>
2004-05	\$4,104,660	\$10,509,572	\$816,308	\$15,430,540	(\$1,111,509)	\$14,319,031	14.8%
2005-06	4,811,339	12,251,910	960,438	18,003,687	(1,185,310)	16,818,377	17.5
2006-07	5,992,555	14,034,608	1,006,872	21,034,035	(1,238,271)	19,795,764	17.7
2007-08	6,661,962	15,092,621	1,006,432	22,761,015	(1,302,249)	21,458,766	8.4
2008-09	6,387,373	14,984,980	1,209,963	22,582,316	(1,398,902)	21,183,414	(1.3)
2009-10	4,810,514	13,909,815	1,259,076	19,968,568	(1,514,454)	18,454,114	(12.9)

Source: San Joaquin County Assessor’s Office.

Neighborhood Stabilization Program. The City received notice from the United States Department of Housing and Urban Development (“HUD”) that it would be receiving approximately \$12.1 million through the Neighborhood Stabilization Program (the “NSP”) developed by HUD to implement a portion of H.R. 3221, the “Housing and Economic Recovery Act of 2008” (“HERA”), signed into law on July 30, 2008. The City expects to allocate approximately \$7 million of the NSP funds for the acquisition, rehabilitation and resale of vacant, foreclosed or abandoned homes within the City to owner-occupants with household incomes of no more than 120% of area median income. Under HERA, NSP funds are required to be obligated within 18 months following receipt of funds from HUD and are subject to numerous federal and local regulations.

In order to stabilize neighborhoods significantly impacted by the foreclosure crisis and place families in homes as quickly as possible, the City issued a Notice of Funding Availability to non-profit housing developers with experience in constructing and/or rehabilitating housing projects within the City for participation in the NSP. Only residential properties within the City constructed after 1978 that were foreclosed upon or abandoned are eligible for participation in the NSP. The deadline for submitting proposals was November 7, 2008.

City Housing Department Staff reviewed the proposals and submitted recommendations for the award of funding to the City Council for approval. The City Council reviewed and approved the proposals of four non-profit housing developers for participation in the NSP in early 2009. Under HERA, each successful applicant is required to enter into an NSP subrecipient agreement with the sponsor entity specifying the amount of funds provided, timelines, project requirements, regulations and authorized use of funds. Following approval of the NSP subrecipient agreements by the City Council, such agreements were executed. The City executed an agreement with HUD and environmental review of each project was completed during the first quarter of 2009.

The NSP is expected to make a positive impact in neighborhoods targeted in the plan, affecting approximately 80 homes targeted in the \$75,000 to \$200,000 range. The City does not expect the effects of this program to have a material impact on property tax revenues.

Table 13 shows a history of the City’s secured tax levies and delinquencies.

Table 13
City of Stockton
Secured Property Tax Levies and Collections
Fiscal Years 2003-04 through 2007-08 and Estimated for Fiscal Year 2008-09
(\$ Amounts in Thousands)

<u>Fiscal Year</u>	<u>Total Tax Levy</u>	<u>Current Tax Collections</u>	<u>Percent of Levy Collected⁽¹⁾</u>	<u>Total Tax Collections</u>	<u>Percent of Total Collections to Levy</u>
2003-04	\$23,498	\$23,498	100.00%	\$23,498	100.00%
2004-05	26,685	26,685	100.00	26,685	100.00
2005-06	30,661	30,661	100.00	30,661	100.00
2006-07	33,891	33,891	100.00	33,891	100.00
2007-08	33,633	33,633	100.00	33,633	100.00
2008-09 ⁽²⁾	30,952	N/A	N/A	N/A	N/A

(1) Pursuant to an agreement with San Joaquin County, the County provides the City with 100% of the amount owed to the City for secured properties regardless of collection status. In exchange the County is entitled to 100% of revenues collected for interest and penalties. This agreement is commonly referred to as the Teeter Plan.

(2) Estimated.

Source: San Joaquin County Auditor/Controller’s Office.

Principal Taxpayers. Table 14 sets forth the principal secured property taxpayers in the City of Stockton as of Fiscal Year 2007-08, the most current information available.

Table 14
City of Stockton
Principal Secured Property Taxpayers
(\$ in thousands)
Fiscal Year 2007-08*

<u>Taxpayer</u>	<u>Nature of Business</u>	<u>2007-08[†]</u> <u>Assessed</u> <u>Valuation</u>	<u>Percentage of</u> <u>Assessed</u> <u>Valuations</u>
Levine Investments Ltd. PTP	Retail Center	\$80,623	0.4%
Corn Products Inc.	Food Processing	64,845	0.3
Simpson Manufacturing Co., Inc.	Manufacturing	59,834	0.3
Diamond Walnut Growers Inc.	Food Processing	59,244	0.2
FR Net Lease Co-Invest Prog 10 LLC	Warehouse	43,000	0.2
Sherwood Mall LLC	Retail Center	42,088	0.2
WTM Glimcher LLC	Retail Center	41,524	0.2
Pavillions Apartments LP	Apartment Rentals	39,229	0.2
Inland Western Stockton Airport Way LLC	Warehouse	37,776	0.2
TRU Properties Inc.	Warehouse	<u>37,691</u>	<u>0.2</u>
SUBTOTAL		505,854	2.5
Other Secured Taxpayers		<u>19,755,440</u>	<u>97.5</u>
TOTAL -NET OF EXEMPTIONS [†]		\$20,261,294	100.0%

[†] Most recent data available. Exemptions relative to the Fiscal Year 2007-08 secured tax roll are homeowners (\$269,059) and other (\$990,099).

Sources: San Joaquin County Auditor/Controller's Office and San Joaquin County Assessor's Office.

Motor Vehicle License Fees

Vehicle license fees are assessed in the amount of 2% of a vehicle's depreciation market value for the privilege of operating a vehicle on California's public highways. A program to offset (or reduce) a portion of the vehicle license fees ("VLF") paid by vehicle owners was established by Chapter 322, Statutes of 1998. Beginning January 1, 1999, a permanent offset of 25% of the VLF paid by vehicle owners became operative. Various pieces of legislation increased the amount of the offset in subsequent years to the existing statutory level of 67.5% of 2% (resulting in the current effective rate of 0.65%). This level of offset was estimated to provide tax relief of \$3.95 billion in the Fiscal Year 2003-04. Beginning in Fiscal Year 2004-05, the State-local agencies agreement permanently reduced the VLF rate to 0.65% and eliminated the General Fund offset program.

In connection with the offset of the VLF, the Legislature authorized appropriations from the State General Fund to "backfill" the offset so that the local governments, which receive all of the vehicle license fee revenues, would not experience any loss of revenues. The legislation that established the VLF offset program also provided that if there were insufficient General Fund moneys to fully "backfill" the VLF offset, the percentage offset would be reduced proportionately (*i.e.*, the license fee payable by drivers would be increased) to assure that local governments would not be disadvantaged. In June 2003, the Director of Finance under the Davis Administration ordered the suspension of VLF offsets due to a determination that insufficient General Fund moneys would be available for this purpose, and, beginning in October 2003, VLF paid by vehicle owners were restored to the 1998 level. However, the offset suspension was rescinded by Governor Schwarzenegger on November 17, 2003, and offset payments to local governments resumed. Local governments received "backfill" payments totaling \$3.80 billion in

Fiscal Year 2002-03. "Backfill" payments totaling \$2.65 billion were expected to be paid to local governments in Fiscal Year 2003-04. The State-local agreement also provided for the repayment in August 2006 of approximately \$1.2 billion that was not received by local governments during the time period between the suspension of the offsets and the implementation of higher fees. This repayment obligation was codified by Proposition 1A of 2004, which was approved by the voters in the November 2004 General Election and was repaid early by the State in August 2005. For a description of Proposition 1A of 2004, see "CONSTITUTIONAL AND STATUTORY LIMITATIONS ON TAXES, REVENUES AND APPROPRIATIONS—Proposition 1A of 2004." In March 2005, the City was a participant in the California Statewide Communities Development Authority ("CSCDA") VLF Securitization Program, pursuant to which the City sold its VLF receivable to CSCDA in exchange for an aggregate payment in the amount of \$4,352,425 in Fiscal Year 2004-05.

Table 15 sets forth the Motor Vehicle in Lieu Fees received by the City for the last five Fiscal Years and the estimated amount to be received in Fiscal Year 2009-10.

Table 15
City of Stockton
Motor Vehicle in Lieu Fees
Fiscal Years 2004-05 through 2008-09 and Estimated for Fiscal Year 2009-10

<u>Fiscal Year</u>	<u>Motor Vehicle In Lieu Fee</u>
2004-05	\$14,538,044 ⁽¹⁾
2005-06	18,173,205
2006-07	22,660,542
2007-08	24,050,659
2008-09	23,290,000
2009-10	19,360,000 ⁽²⁾

(1) Reflects receipt of \$2,539,000 received as a result of the CSCDA VLF Securitization Program.

(2) Adopted Budget.

Source: City of Stockton.

Labor Relations

Under the terms of the Meyers-Milius-Brown Act (State Government Code Section 3500 *et seq.*), the City is required to meet and confer with its employees on all matters concerning wage, hours and working conditions.

City employees are represented in seven bargaining units by nine labor organizations. The agreements with all of these labor organizations, except for the Operations and Maintenance Supervisory Local 3, generally have a four year term commencing July 1, and provide for a minimum costs of living adjustment of 2.5% and not greater than 6%, based on a percentage of the consumer price index or prior year revenue growth of key General Fund sources.

Recent Developments Regarding the Salary Implementation Contract Disputes with the City. The Stockton Police Officers' Association (the "SPOA") and the Stockton Police Management Association (the "SPMA" and together, the "Associations"), each have a provision in their existing labor agreement providing for a salary increase, effective July 1, 2008, based on market data. On July 1, 2008, the City provided a 9.5% salary increase (the amount budgeted in anticipation of the salary survey results). At that time, the position of the Associations was that an increase between 15.35% and 22% was owed based upon their interpretation of the labor agreements regarding three specific data points. The estimated additional cost would have resulted in a payment of an additional \$3.5 million to \$8 million in

Fiscal Year 2008-09. The position of the City was that based upon the data points, at most, an additional 1.85% (representing approximately \$988,000) was owed.

The dispute was handled through the grievance process described in the labor agreements. The Associations also filed a claim with the office of the City Attorney for damages against the City for back salary and interest, which claim was denied. The subsequent step in the grievance process, before submitting to final and binding arbitration, was presentation before an adjustment review board consisting of three members selected by the City Council and three members selected by the Associations. The City offered to submit the matter to mediation for resolution. Mediation efforts between the city and each of the SPOA and SPMA were terminated in March 2009 and resolution of these disputes was the subject of binding arbitration.

Subsequent to March 2009, negotiations between the SPOA and SPMA and the City administration resumed. On July 15, 2009, the SPOA membership approved a tentative agreement negotiated with the City's management. The tentative agreement was approved by the City Council in a closed session on July 7, 2009 and was returned to the City Council at a public meeting for ratification on July 21, 2009. The agreement ends the salary survey implementation dispute regarding salary increases, and the 9.5% increase authorized since July 2008; increases the raise retroactively by an additional 5.5%, to a total of 15%; and extends the contracts for the SPOA and SPMA two years to 2012. The 5.5% increase for Fiscal Year 2008-09 will be implemented with a 2% base salary increase, retroactive payment (in the amount of \$1.1 million) and a reduction in work-hours equivalent to 3.5% of base pay. The prior year 2% base rate increase will continue into Fiscal Year 2009-10, but reduced work-hours equivalent to 3% of base salary will be implemented. Further, SPOA agreed to waive the 2.5% cost of living adjustment contained in the prior contract that would have been in effect July 1, 2009 and agreed to receive a 3% salary increase on January 1, 2011. Police officers in return would make about \$7.3 million in concessions (of which \$4 million are in Fiscal Year 2009-10), to include increased health care contributions by employees, the suspension of a partial uniform allowance, among other concessions. Upon the City Council's formal ratification of the agreement on July 21, 2009, all policy layoff notices were rescinded.

Recent Developments regarding the Potential Layoff of City Police Officers. To ensure compliance with the adopted revised budget for Fiscal Year 2008-09, on February 6, 2009, the City Manager announced the layoff of 29 police officers. The layoffs of the police officers, which were effective for February 28, 2009, were in response to, at the time, the inability of the City and the Associations to agree on the furloughs or furlough-equivalent pay reductions approved by the City Council that were part of the Fiscal Year 2008-09 revised budget. The only remedy available to the City to address departmental budget non-compliance, aside from negotiation, was to implement layoffs. Subsequently, a concession was reached with the police officers unit to avoid the layoffs, including waiver of uniform allowance and benefit payments through Fiscal Year 2008-09 in exchange for a promise by the administration to retain the 29 police officers through June 30, 2009.

Additionally, 55 layoff notices were issued to police officers to be effective for June 30, 2009 as the City Manager's measured action to reach the cost reductions necessary for the Police Department to reach its Fiscal Year 2009-10 budget target. Due to ongoing discussions that were taking place, the effective date of these layoff notices was moved to July 18, 2009. As discussed above, successful resolution of the SPOA salary implementation dispute and agreement by SPOA to additional concessions that achieved the required Police Department budget reductions on July 21, 2009 resulted in the City Manager's rescission of the layoff notices. The police officer staffing level remains below the original budget of Fiscal Year 2008-09 as a result of the City-wide hiring freeze, which continues to be in place for Fiscal Year 2009-10 for all City departments including public safety personnel.

The following is a list of the bargaining units, recognized employee organizations, number of active employees and the expiration dates of current agreements as of July 1, 2009.

Table 16
City of Stockton
Summary of Employee Contracts

<u>Employee Organization</u>	<u>Bargaining Unit</u>	<u>Active Employees</u>	<u>Expiration Date</u>
Stockton Police Officers' Association	Police Officers	365	06/30/2012 ⁽¹⁾
Stockton City Employees' Association	Miscellaneous Workers	445	06/30/2014
Operating Engineers' Local 3	Miscellaneous Workers	135	06/30/2008 ⁽²⁾
Stockton Firefighters' Local 456	Firefighters	233	06/30/2010 ⁽³⁾
Mid-Management/Supervisory Level Unit	Miscellaneous Workers	131	06/30/2010 ⁽²⁾
Stockton Police Management Association	Police Officers	21	06/30/2012 ⁽¹⁾
Stockton Fire Management Unit	Firefighters	8	06/30/2010 ⁽³⁾
Operations and Maintenance Local 3	Miscellaneous Workers	112	12/31/2008 ⁽²⁾
Operations and Maintenance Supervisory Local 3	Miscellaneous Workers	8	12/31/2008 ⁽²⁾
TOTAL		1,458	

- (1) As described above, a dispute existed relative to implementation of a July 1, 2008 salary increase. The City reached a tentative agreement with the Stockton Police Officers Association that settles the salary survey dispute and also provides for concessions of approximately \$7.1 million over a three-year period. The vote of the membership approved the agreement on July 15, 2009. The tentative agreement was approved by the City Council on July 21, 2009.
- (2) The employees represented by this bargaining unit continue working at the City pursuant to the terms of the expired agreement. Negotiations are in progress and discussions regarding salary and benefit changes.
- (3) The City reached a tentative agreement with the Stockton Firefighters' Local 456 and Stockton Fire Management Unit that provides for savings of approximately \$7.4 million in Fiscal year Fiscal Year 2009-10 and restructures a prior Letter of Understanding that provided for restoration of previous concessions. The restructure is estimated to save an additional \$5.0 million in Fiscal Year 2009-10 over current obligations.

Health and Medical Insurance

The City provides health benefits to certain employees and their dependents for medical, dental and vision care. For Fiscal Years 2005-06, 2006-07 and 2007-08, the City paid claims in the amount of \$23.817 million, \$21.999 million and \$27.012 million, respectively. Each employee and dependent is covered by a life insurance policy and the employee also is covered by a long-term disability policy.

The life insurance and long-term disability benefits are based upon the bargaining unit to which the employee is associated. Life insurance benefits following retirement are continued at the same benefit level and conditions as active employees except that after age 65 a reduction to 65% is instituted. In Fiscal Years 2005-06, 2006-07 and 2007-08, the City paid premiums in the amount of \$1.120 million, \$1.167 million and \$1.234 million, respectively.

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Retirement Programs

The following information concerning the California Public Employees' Retirement System ("PERS") is excerpted from publicly available sources, which the City believes to be accurate. PERS is not obligated in any manner for payment of debt service on the 2009 Bonds and the assets of PERS are not available for such payment. PERS should be contacted directly at CalPERS, Lincoln Plaza Complex, 400 Q Street, Sacramento, California 95814, Telephone: 888-225-7377 for other information, including information relating to its financial position and investments.

General. The City provides retirement benefits to all regular City employees scheduled to work over 1,000 hours in a plan year through a contract with PERS, a multiple-employer public sector employee defined benefit pension plan. PERS provides service and disability retirement benefits, annual cost-of-living adjustments and death benefits to PERS members and beneficiaries. PERS acts as a common investment and administrative agent for participating public entities within the State. PERS is a contributory plan deriving funds from employee contributions as well as from employer contributions and earnings from investments.

PERS maintains two pension plans for the City, a Safety Plan (the "Safety Plan") and a Miscellaneous Plan (the "Miscellaneous Plan" and, together with the Safety Plan, the "PERS Plans"). The City contributes to PERS amounts equal to the recommended rates for the PERS Plans multiplied by the payroll of those employees of the City who are eligible under PERS.

Funding Policy. The staff actuaries at PERS prepare annually an actuarial valuation which covers a Fiscal Year ending approximately 15 months before the actuarial valuation is prepared (thus, the actuarial valuations delivered to the City in fall 2008 with respect to both the Safety Plan and the Miscellaneous Plan, covered PERS' Fiscal Year ended June 30, 2007). The actuarial valuations express the required contribution rates for the City in percentages of payroll, which percentages the City contributes in the Fiscal Year immediately following the Fiscal Year in which the actuarial valuation is prepared (thus, the City's contribution rates derived from the actuarial valuation as of June 30, 2007, which was prepared in fall 2008, will be in effect during the City's Fiscal Year 2009-10). PERS rules require the City to implement the actuary's recommended rates.

In calculating the annual required contribution rates, the PERS actuary calculates on the basis of certain assumptions the actuarial present value of benefits that PERS will fund under the PERS Plans, which includes two components, the normal cost and the unfunded accrued actuarial liability (the "UAAL"). The normal cost represents the actuarial present value of benefits that the City will fund under the PERS Plans that are attributed to the current year, and the UAAL represents the actuarial present value of benefits that the City will fund that are attributed to past years. The UAAL represents an estimate of the actuarial shortfall between assets on deposit at PERS and the present value of the benefits earned through the valuation date by retirees and active employees. The UAAL is based on several assumptions such as, among others, the rate of investment return, life expectancy, age of retirement, inflation, salary increases and disabilities. In addition, the UAAL includes certain actuarial adjustments such as, among others, the actuarial practice of smoothing losses and gains over multiple years (which is described in more detail below). As a result, prospective investors are encouraged to consider the UAAL as an estimate of the unfunded actuarial present value of the benefits that the City will fund under the PERS Plans to retirees and active employees upon their retirement and not as a fixed or hard expression of the liability the City owes to PERS under the PERS Plans.

In each actuarial valuation, the PERS actuary calculates the actuarial value of the assets (the "Actuarial Value") of the PERS Plans at the end of the Fiscal Year (which assumes, among other things, that the actuarial rate of return during that Fiscal Year equaled the applicable assumed rate of return of 7.75%). The PERS actuary uses a smoothing technique to determine Actuarial Value that is calculated

based on certain policies. As described below, these policies were significantly changed in April 2005, thus affecting the Actuarial Value calculations for Fiscal Year 2006-07 and thereafter.

On April 21, 2004, the PERS Board approved a change in the inflation assumption used in the actuarial valuations that set employer contribution rates. The inflation assumption was changed from 3.5% to 3%. The change impacted the inflation component of the annual investment return assumption, the long term payroll growth assumption and the individual salary increase assumptions as follows:

- The annual assumed investment return has decreased from 8.25% to 7.75%.
- The long term salary increase assumption has decreased from 3.75% to 3.25%.
- The inflation component of individual salary scales has decreased from 3.75% to 3.25%.

In April 2005, the PERS Board approved changes in its actuarial to help reduce volatility in employer contributions rates. The changes included amortizing gains and losses over a rolling 30-year period; moving from a three-year to a 15-year smoothing methodology; revising the expected value “corridor” limit for establishing the actuarial value of assets to not less than 80% or more than 120%; and creation of a stabilization fund.

Complete updated inflation and actuarial assumptions can be obtained by contacting PERS at the address shown above.

Pursuant to PERS actuarial policies, the City combined all amortization bases into a single base equal to the aggregate unfunded liability/surplus of the City (a “Fresh Start”). Under this policy, the Fresh Start base is determined by the Chief Actuary of PERS in a manner that best satisfies PERS policy to provide for the elimination of unfunded liabilities or amortization of surpluses in a manner that maintains security for the members of PERS while minimizing substantial variations in employer contribution rates.

On June 16, 2004, PERS approved the request of the City for a Fresh Start 25-year amortization of the PERS unfunded liability for the Safety Plan. Application of the Fresh Start amortization resulted in the contribution rates of the City being reduced from 39.500% to 32.870% for the Safety Plan.

Funding Status. An actuarial valuation of assets differs from a market valuation of assets in that an actuarial valuation reflects so-called smoothing adjustments which smooth the impact of gains and losses over multiple years. As of June 30, 2007, the actuarial value of the assets in each of the Safety Plan and the Miscellaneous Plan was approximately \$592.3 million and \$434.9 million, respectively. As a result, even if the market rate of return of the assets in the PERS Plans is above the actuarial assumed rate of 7.75% in future Fiscal Years, the actuarial practice of smoothing losses over several years may cause the investment rate of return for actuarial purposes to be less than the market rate of return. If the market rate of return is lower than the assumed rate, the PERS Plans will realize a loss for actuarial purposes, but, ordinarily, this actuarial loss will be smoothed such that the PERS Plans would only be impacted by one-fifteenth of that loss in one Fiscal Year. However, PERS has a policy that the difference between market value and actuarial value cannot exceed 120%.

The investment return in Fiscal Year 2006-07 was -2.5%.

Recent Developments—PERS - Decline in Investment Return. Recent developments in the financial markets have resulted in a decline in investment return for Fiscal Year 2007-08. As indicated above, in calculating the UAAL in an actuarial valuation, the PERS actuary assumes an investment return equal to 7.75%. The actual investment return for Fiscal Year 2007-08, net of expenses, was negative 5.1%. Employer contribution rates are affected by the investment return in a given Fiscal Year in the third Fiscal Year that follows. Therefore, the negative 5.1% return for Fiscal Year 2007-08 will first be reflected in employer contribution rates applicable for Fiscal Year 2010-11. However, PERS had

achieved investment returns in each of the four fiscal years prior to Fiscal Year 2007-08 which exceeded the assumed rate of investment return. Through PERS smoothing of investment returns, these previous positive returns will cushion the impact that the losses will have on employer contribution rates in the Fiscal Year 2010-11. As of June 30, 2007, with the asset smoothing method, PERS had set aside approximately 14% of the stabilization fund created by PERS in 2005. The negative 5.1% return for Fiscal Year 2007-08, approximately 12.9% less than the 7.75% expected rate of return, utilizes most of the stabilization fund. Therefore, investment returns lower than the 7.75% expected rate of return in subsequent Fiscal Years will produce a significantly greater impact on employer contribution rates in subsequent Fiscal Years. However, the extent of such impact is not yet known.

Historical Funding Status. The City's labor contracts require it to pay the entire amount of its employees' contribution rate, including the annual contribution of 7% and to PERS for safety employees. The labor contracts for miscellaneous employees reduce the City's payment of the employee's retirement contribution by a percent equal to the cost of the 2.0% at 55 retirement program.

PERS determines contribution requirements under the Entry Age Normal Method. Under this method, the City's total normal benefit cost for each employee from date of hire to date of retirement is expressed as a level percentage of the related total payroll cost. Normal benefit cost under this method is the level amount the employer must pay annually to fund an employee's projected retirement benefit. This level percentage of payroll method is used to amortize any unfunded actuarial liabilities. The actuarial assumptions used to compute contribution requirements are also used to compute the actuarial accrued liability. The City does not have a net pension obligation since it pays these actuarially required contributions monthly.

Table 17A and 17B set forth the UAAL, and the total employer contributions made by the City, for the Safety Plan and the Miscellaneous Plan, respectively, for Fiscal Years 2005-06 through 2009-10 based upon the PERS Actuarial Reports prepared as of June 30, 2003 through June 30, 2007.

Table 17A
PERS Historical Funding Status
(Safety Plan)

Actuarial Valuation Date	UAAL	Affects City Contribution for Fiscal Year	City Contribution Amount ⁽¹⁾
June 30,			
2003	\$92,355,897	2005-06	\$17,894,450
2004	103,265,334	2006-07	15,374,953 ⁽²⁾
2005	107,568,000	2007-08	10,979,501 ⁽²⁾
2006	117,558,558	2008-09	11,932,433 ⁽²⁾
2007	27,500,863	2009-10	12,726,682

(1) Indicated amounts are those amounts paid by the City to PERS in the indicated years and do not reflect all amounts paid by the City under the Safety Plan or otherwise.

(2) Reflects a discount since the payment was made to PERS between July 1 and July 15 of the respective Fiscal Years.

Sources: PERS Actuarial Reports for June 30, 2003 through 2007.

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Table 17B
PERS Historical Funding Status
(Miscellaneous Plan)

<u>Actuarial Valuation Date</u> <u>June 30,</u>	<u>UAAL</u>	<u>Affects City Contribution for Fiscal Year</u>	<u>City Contribution Amount⁽¹⁾</u>
2003	\$39,054,293	2005-06	\$9,132,312
2004	44,512,738	2006-07	8,786,651 ⁽²⁾
2005	48,280,430	2007-08	6,735,567 ⁽²⁾
2006	51,298,297	2008-09	7,331,594 ⁽²⁾
2007	18,631,995	2009-10	8,226,273

(1) Indicated amounts are those amounts paid by the City to PERS in the indicated years and do not reflect all amounts paid by the City under the Miscellaneous Plan or otherwise.

(2) Reflects a discount since the payment was made to PERS between July 1 and July 15 of the respective Fiscal Years.

Sources: PERS Actuarial Reports for June 30, 2003 through 2007.

Table 18 sets forth the actuarially required contributions by the City for the five most recent Fiscal Years.

Table 18
PERS Schedule of Required Employer Contributions

<u>Fiscal Year</u>	<u>Safety Plan</u>	<u>Miscellaneous Plan</u>	<u>Total</u>
2005-06	\$17,894,450	\$9,132,312	\$27,026,762
2006-07	15,374,953 ⁽¹⁾	8,786,651 ⁽¹⁾	24,161,604 ⁽¹⁾
2007-08	10,979,501 ⁽¹⁾	6,735,567 ⁽¹⁾	17,715,068 ⁽¹⁾
2008-09	11,932,433 ⁽¹⁾	7,331,594 ⁽¹⁾	19,264,027 ⁽¹⁾
2009-10 ⁽²⁾	12,726,682 ⁽²⁾	8,226,273 ⁽²⁾	20,952,955 ⁽²⁾

(1) Reflects discounts since the payments were made to PERS between July 1 and July 15 of the respective Fiscal Years.

(2) Estimated based upon projected payroll as of the date of the Actuarial Report.

Sources: PERS Actuarial Reports for June 30, 2003 through 2007.

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Table 19A and Table 19B show the employer contribution rates to PERS or each of the plans for Fiscal Year 2005-06 through Fiscal Year 2009-10, as determined by the annual actuarial valuations for the years ended June 30, 2003 through June 30, 2007, and the percentage projected for Fiscal Year 2010-11 assuming a -2.5% investment rate of return, no future amendments and no liability gains or losses (*i.e.* from larger than expected pay increases, higher levels of retirement, etc.) to satisfy its retirement funding obligations.

Table 19A
PERS Schedule of Employer Contribution Rates
(Safety Plan)

<u>Actuarial Report for Year Ended</u>	<u>Affects Contribution Rate for Fiscal Year</u>	<u>Employer Normal Cost</u>	<u>Unfunded Rate</u>	<u>Total Employer Contribution Rate</u>
6/30/2003	2005-06	19.208	15.506%	34.714%
6/30/2004	2006-07	19.412	12.726	32.138
6/30/2005	2007-08	19.364	2.062	21.426 ⁽¹⁾
6/30/2006	2008-09	19.289	2.232	21.521
6/30/2007	2009-10	19.053	2.308 ⁽¹⁾	21.361 ⁽¹⁾
6/30/2007	2010-11	N/A	N/A	21.200 ⁽²⁾

Table 19B
PERS Schedule of Employer Contribution Rates
(Miscellaneous Plan)

<u>Actuarial Report for Year Ended</u>	<u>Affects Contribution Rate for Fiscal Year</u>	<u>Employer Normal Cost</u>	<u>Unfunded Rate</u>	<u>Total Employer Contribution</u>
6/30/2003	2005-06	10.817%	6.708%	17.525%
6/30/2004	2006-07	10.846	5.529	16.375
6/30/2005	2007-08	10.868	1.510 ⁽¹⁾	16.605
6/30/2006	2008-09	10.825	2.065 ⁽¹⁾	12.890 ⁽¹⁾
6/30/2007	2009-10	10.871	2.213 ⁽¹⁾	13.084 ⁽¹⁾
6/30/2007	2010-11	N/A	N/A	12.900 ⁽²⁾

(1) Reflects the deposit with PERS of \$125,675,000 aggregate amount from the proceeds of the City of Stockton 2007 Taxable Pension Obligation Bonds to prepay the City's UAAL for the PERS Plans, \$89,535,711 with respect to the Safety Plan and \$34,139,289 with respect to the Miscellaneous Plan.

(2) Projected.

Sources: PERS Actuarial Reports for June 30, 2003 through 2007.

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Set forth in Table 20A and Table 20B is five year historical funding progress information for each of the Plans. The values presented below represent actuarial values (which differs from market value).

Table 20A
PERS Funding History
(Safety Plan)

Valuation Date (June 30)	Entry Age Accrued Liability (a)	Actuarial Value of Assets (b)	Unfunded (Overfunded) Liability (a-b)	Funded Ratios		Annual Covered Payroll (c)	Unfunded (Overfunded) Liability as % of Payroll (a-b/c)
				Actuarial Asset Value (b/a)	Market Value		
2003	\$473,038,190	\$380,682,293	\$92,355,897	80.5%	73.2%	\$43,816,129	210.8%
2004	504,302,910	401,037,576	103,265,334	79.5	78.4	45,115,799	228.9
2005	536,142,694	428,574,694	107,568,000	79.9	82.7	48,325,899	222.6
2006	579,610,838	462,052,280	117,558,558	79.7	85.0	52,289,374	224.8
2007	619,816,290	592,315,427	27,500,863	95.6	109.4	54,127,744	50.8

Table 20B
PERS Funding History
(Miscellaneous Plan)

Valuation Date (June 30)	Entry Age Accrued Liability (a)	Actuarial Value of Assets (b)	Unfunded (Overfunded) Liability (a-b)	Funded Ratios		Annual Covered Payroll (c)	(Overfunded) Liability as % of Payroll (a-b/c)
				Actuarial Asset Value (b/a)	Market Value		
2003	\$344,933,214	\$305,878,921	\$39,054,293	88.7%	80.6%	\$54,241,063	72.0%
2004	366,460,118	321,947,380	44,512,738	87.9	86.5	50,602,143	88.0
2005	393,457,559	345,177,129	48,280,430	87.7	90.4	51,317,103	94.1
2006	421,341,956	370,043,659	51,298,297	87.8	93.3	53,640,119	95.6
2007	453,621,297	434,989,302	18,631,995	95.9	110.4	57,119,972	32.6

Sources: PERS Actuarial Reports for June 30, 2003 through June 30, 2007.

On April 5, 2007 the City issued its 2007 Taxable Pension Obligation Bonds in the aggregate principal amount of \$125,310,000 to refinance the City's UAAL in the amount of \$125,310,000.

Prospects. From June 30, 2000 to June 30, 2003, as a result of lower-than-expected rates of investment returns, PERS has experienced significant losses. In the actuarial valuation as of June 30, 2002, which was used for the required contribution rates for Fiscal Year 2004-05, the full effect of these actuarial losses was not reflected in the City's required contribution rates because asset losses were smoothed, substantially reducing the impact of the low investment return. But as of June 30, 2003, the actuarial loss had increased to such a level that the City was required to pay the entire normal cost payment plus a portion of the UAAL that resulted.

Beginning with the June 30, 2004 actuarial valuation rate stabilization methodologies were implemented to reduce rate volatility due to actual gains and losses by approximately 50%.

The PERS actuary, in the June 30, 2007 actuarial valuation, determined that the City contribution rate under the Safety Plan for the Fiscal Year 2009-10 will be 21.361%, reflecting normal costs equal to 19.053% and amortization of a portion of the UAAL equal to 2.308%. PERS also projected that the Fiscal Year 2010-11 contribution rate will be approximately 21.2% assuming there are no amendments to

the plan and no liability gains or losses (such as larger than expected pay increases, higher retirements, etc.). There have been no projections completed by PERS beyond Fiscal Year 2010-11 and the City makes no representations as to the level of future contribution rates.

The PERS actuary, in the June 30, 2007 actuarial valuation, determined that the City's contribution rate under the Miscellaneous Plan for the Fiscal Year 2009-10 will be 13.084%, reflecting normal costs equal to 10.871% and amortization of a portion of the UAAL equal to 2.213%. PERS also projected that the Fiscal Year 2010-11 contribution rate will be approximately 12.9% assuming there are no amendments to the plan and no liability gains or losses (such as larger than expected pay increases, higher retirements, etc.). There have been no projections completed by PERS beyond Fiscal Year 2010-11 and the City makes no representations as to the level of future contribution rates.

Risk Management

The City maintains three internal service funds to account for and finance its uninsured risk of loss related to general liability, workers' compensation and health benefits insurance. Under the City's risk management program, the City retains risk for up to \$1 million for each general liability claim, \$500,000 for each workers' compensation claim and \$210,000 for each medical plan member under the health benefits program. The City also manages risk by participating in two joint powers authorities organized for the purpose of pooling self-insured losses and by purchasing commercial insurance for claims in excess of the coverage provided by the funds and for all other risks of loss for health benefit claims. The workers' compensation and health benefits programs are administered by third party administrators. The general liability program is self-administered by the City.

General Liability Insurance. In 1986, the City joined with other municipalities and regional municipal joint powers authorities to form the California Joint Powers Risk Management Authority (the "CJPRMA"), a public entity risk pool currently operating as a general liability risk management and insurance program for 22 member entities. The City's self-insured retention (the "SIR") is \$1 million. Losses above the City's SIR are pooled up to \$5 million per occurrence, with reinsurance in place above the \$5 million up to \$40 million. Specific coverage includes comprehensive and general automotive liability, personal injury, contractual liability, errors and omissions and certain other coverage.

The CJPRMA governing board is comprised of a representative from each member entity. All members have a single vote for policy and charter changes. An executive committee of seven is elected to handle administration. Members are assessed annual contributions based on actuarially determined rates. CJPRMA retroactively adjusts premium deposits for any excess or deficiency in deposits related to paid claims and reserves. Financial statements for CJPRMA for the fiscal year ended June 30, 2007 can be obtained from CJPRMA at 2333 San Ramon Valley Boulevard, Suite 250, San Ramon, California 94583-4456.

Workers' Compensation Insurance. In July 2003, in an effort to stabilize and control its costs of access to workers' compensation coverage, the City joined the California Public Entity Insurance Authority ("CPEIA"), a public entity risk pool which currently operates an Excess Workers Compensation ("EWC") Program. CPEIA has since merged into an existing authority known as California State Association of Counties Excess Insurance Authorities (CSACEIA). The City's self-insured retention is currently set at \$500,000 per occurrence. Losses above the City's SIR are pooled up to \$5 million per occurrence. Reinsurance is in place in layers above the \$5 million up to \$50 million, with an additional \$150 million in limits purchased by the EWC Program, for a combined total of \$200 million per occurrence.

CSACEIA was formed in 1979 by 29 counties in the State for the purpose of pooling risk and providing a viable and cost effective solution for the counties' insurance and risk management needs. It has since expanded to allow admittance from cities and other entities and currently includes 93% of the