

In the opinion of Orrick, Herrington & Sutcliffe LLP, Bond Counsel, based on an analysis of existing laws, regulations, rulings and court decisions, and assuming, among other matters, the accuracy of certain representations and compliance with certain covenants, interest on the 2006B Bonds and 2006C Bonds is excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986. In the further opinion of Bond Counsel, interest on the 2006B Bonds and 2006C Bonds is not a specific preference item for purposes of the federal individual or corporate alternative minimum taxes, although Bond Counsel observes that such interest is included in adjusted current earnings when calculating corporate alternative minimum taxable income. Bond Counsel is also of the opinion that interest on the 2006B Bonds and 2006C Bonds is exempt from State of California personal income taxes. Bond Counsel expresses no opinion regarding any other tax consequences related to the ownership or disposition of, or the accrual or receipt of interest on, the 2006B Bonds and 2006C Bonds. See "TAX MATTERS" herein.

## VERNON NATURAL GAS FINANCING AUTHORITY (CALIFORNIA)

### Variable Rate Revenue Bonds (Vernon Gas Project)

**\$115,440,000**  
**2006 Series B**

**\$115,405,000**  
**2006 Series C**

Dated: Date of Delivery

Price 100%

Due: August 1, 2021

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

The Vernon Natural Gas Financing Authority Variable Rate Revenue Bonds (Vernon Gas Project), 2006 Series B (the "2006B Bonds") and 2006 Series C (the "2006C Bonds") are being issued by the Vernon Natural Gas Financing Authority (the "Authority") pursuant to an Indenture of Trust, as supplemented by a First Supplemental Indenture of Trust (the "Indenture"), by and between the Authority and The Bank of New York Trust Company, N.A., as trustee (the "Trustee"). The 2006B Bonds and 2006C Bonds are special obligations of the Authority payable solely from and secured by the Trust Estate pledged under the Indenture, which consists primarily of payments to be made by the City of Vernon, California (the "City") pursuant to the Natural Gas Purchase Agreement (the "Gas Supply Agreement"), between the Authority and the City. Amounts to be paid by the City under the Gas Supply Agreement are special obligations payable solely from amounts in the Light and Power Fund as an Operating and Maintenance Expense, and the obligation of the City to make such payments from such amounts is absolute and unconditional. See "SECURITY AND SOURCES OF PAYMENT."

The 2006B Bonds and 2006C Bonds are being issued to provide funds to (i) finance a portion of the purchase by the Authority of a fifteen-year, prepaid supply of natural gas from Citigroup Energy Inc. (the "Gas Supplier") pursuant to an Agreement for Purchase and Sale of Natural Gas (the "Gas Purchase Agreement") between the Authority and the Gas Supplier; and (ii) pay the costs of issuing the 2006B Bonds and 2006C Bonds. All payment obligations of the Gas Supplier arising under the Gas Purchase Agreement are guaranteed by Citigroup Inc. (the "Guarantor") pursuant to a Guarantee (the "Guarantee") from the Guarantor to the Authority. See "PLAN OF FINANCE - Estimated Sources and Uses of Funds" and "GAS SUPPLY ACQUISITION".

The 2006B Bonds and 2006C Bonds will be issued in fully registered form, registered in the name of Cede & Co., as nominee of The Depository Trust Company ("DTC") under the book-entry only system maintained by DTC. While DTC is the securities depository for the 2006B Bonds and 2006C Bonds, principal of and interest on the 2006B Bonds and 2006C Bonds will be payable by the Trustee to DTC, which is obligated in turn to remit such payments to its DTC participants for subsequent disbursement to beneficial owners of the 2006B Bonds and 2006C Bonds, as more fully described herein.

The 2006B Bonds and 2006C Bonds will initially bear interest at a Weekly Interest Rate. The initial Weekly Interest Rate for the 2006B Bonds and 2006C Bonds will be determined by Citigroup Global Markets Inc. as Underwriter for the 2006B Bonds and the 2006C Bonds. Thereafter, the Weekly Interest Rate with respect to the 2006B Bonds and 2006C Bonds will be determined by Citigroup Global Markets Inc. as Remarketing Agent for the 2006B Bonds and the 2006C Bonds. The 2006B Bonds and 2006C Bonds will be subject to optional, extraordinary optional and mandatory redemption, and optional and mandatory tender for purchase, prior to maturity as described herein. See "THE 2006B BONDS AND 2006C BONDS-Redemption Provisions" and "Tender and Purchase of 2006B Bonds and 2006C Bonds" herein.

The Authority may elect to change the Interest Rate Period for the 2006B Bonds and/or the 2006C Bonds to another Interest Rate Period, as described herein and in Appendix D hereto. **This Official Statement describes the 2006B Bonds and 2006C Bonds in the Weekly Interest Rate Period only. Prospective purchasers of the 2006B Bonds or 2006C Bonds in an Interest Rate Period other than the Weekly Interest Rate Period should not rely on this Official Statement.**

MBIA Insurance Corporation (the "Insurer") will issue on the date of issuance and delivery of the 2006B Bonds and 2006C Bonds a financial guaranty insurance policy insuring the scheduled payments of principal of and interest on (but not premium on or purchase price of) the 2006B Bonds when due (the "2006B Policy") and a financial guaranty insurance policy insuring the scheduled payments of principal of and interest on (but not premium on or purchase price of) the 2006C Bonds when due (the "2006C Policy") and, together with the 2006B Policy, the "Policies").



Citibank, N.A. (the "Liquidity Provider") will provide on the date of issuance and delivery of the 2006B Bonds and 2006C Bonds a Standby Bond Purchase Agreement providing for the payment of the purchase price of 2006B Bonds tendered for purchase and not remarketed (the "2006B Liquidity Facility") and a Standby Bond Purchase Agreement providing for the payment of the purchase price of Series 2006C Bonds tendered for purchase and not remarketed (the "2006C Liquidity Facility") and, together with the 2006B Liquidity Facility, the "Liquidity Facilities". Each Liquidity Facility will expire, unless extended or terminated earlier in accordance with its terms, on June 27, 2009. The substantive terms of the Liquidity Facilities are identical.

#### Citibank, N.A.

UPON THE OCCURRENCE OF CERTAIN EVENTS OF DEFAULT UNDER THE RELATED LIQUIDITY FACILITY, THE LIQUIDITY PROVIDER'S OBLIGATION TO PURCHASE TENDERED 2006B BONDS OR 2006C BONDS MAY BE TERMINATED OR SUSPENDED AUTOMATICALLY. IN SUCH CASE, 2006B BONDS OR 2006C BONDS TENDERED WILL NOT BE PURCHASED UNDER THE RELATED LIQUIDITY FACILITY AND, THEREFORE, FUNDS MAY NOT BE AVAILABLE TO PURCHASE SUCH TENDERED 2006B BONDS OR 2006C BONDS. IN THE EVENT THE LIQUIDITY PROVIDER DOES NOT PURCHASE TENDERED 2006B BONDS OR 2006C BONDS FOR ANY REASON, NEITHER THE AUTHORITY NOR THE CITY HAS ANY OBLIGATION TO MAKE SUCH PAYMENT. THE POLICIES DO NOT PROVIDE FOR THE PAYMENT OF THE PURCHASE PRICE OF 2006B BONDS OR 2006C BONDS TENDERED FOR PURCHASE. SEE "THE LIQUIDITY FACILITIES."

At no time will any 2006B Bond or 2006C Bond bear interest at a Weekly Interest Rate that is in excess of the lesser of 12% per annum and the maximum rate of interest permitted by law. While bearing interest at a Weekly Rate, interest on the 2006B Bonds and 2006C Bonds is payable on the first Wednesday of each calendar month, commencing July 5, 2006, or if such Wednesday is not a Business Day, on the next succeeding Business Day. While the 2006B Bonds and 2006C Bonds bear interest at a Weekly Rate, the 2006B Bonds and 2006C Bonds will be available only in authorized denominations of \$100,000 and integral multiples of \$5,000 in excess thereof.

The 2006B Bonds and 2006C Bonds are special obligations of the Authority. The 2006B Bonds and 2006C Bonds are payable by the Authority solely from, and secured solely by a pledge of, the Trust Estate pursuant to Indenture. The 2006B Bonds and 2006C Bonds are not secured by a legal or equitable pledge of, or lien or charge upon, any property of the Authority or any of its income or receipts except the Trust Estate, which pledge is subject to the provisions of the Indenture permitting the application thereof for the purposes and on the terms and conditions set forth therein. Neither the faith and credit nor the taxing power of the State of California, the Authority, the City, or any other public agency is pledged to the payment of the 2006B Bonds or 2006C Bonds, and the issuance of the 2006B Bonds and 2006C Bonds shall not directly, indirectly or contingently obligate the Authority, the State of California or any political subdivision thereof, including the City, to levy or pledge any form of taxation or to make any appropriation for the payment of the 2006B Bonds or 2006C Bonds.

The 2006B Bonds and 2006C Bonds are offered when, as and if issued and delivered to the Underwriter, subject to the approval of legality by Orrick, Herrington & Sutcliffe LLP, Los Angeles, California, Bond Counsel, and certain other conditions. Certain legal matters will be passed upon for the Underwriter by King & Spalding LLP, New York, New York, for the Authority by Orrick, Herrington & Sutcliffe LLP, Los Angeles, California, Latham & Watkins LLP, Los Angeles, California, and Karns & Karabian, Los Angeles, California, and for the City by Karns & Karabian, Los Angeles, California, and Eric T. Fresch, City Attorney, Vernon, California. It is expected that the 2006B Bonds and 2006C Bonds will be available for delivery through the book-entry system of DTC in New York, New York on or about June 27, 2006.

**Citigroup**

No dealer, broker, salesperson or other person has been authorized by the Authority or the Underwriter to give any information or to make any representations other than those contained herein and, if given or made, such other information or representation must not be relied upon as having been authorized by any of the foregoing. This Official Statement does not constitute an offer to sell or the solicitation of an offer to buy, nor shall there be any sale of the 2006B Bonds and 2006C Bonds by any person in any jurisdiction in which such offer, solicitation or sale would be unlawful prior to registration or qualification under the securities laws of such jurisdiction.

Statements contained in this Official Statement that include forecasts, estimates or matters of opinion, whether or not expressly stated as such, are intended solely as such and are not to be construed as representations of fact. The information set forth herein has been furnished by the Authority, the City, the Insurer, the Liquidity Provider, the Guarantor and other sources that are believed to be reliable, but is not guaranteed as to accuracy or completeness, and is not to be construed as a representation by the Underwriter. With respect to the information set forth under “BOND INSURANCE” and in Appendix G, no representation is made by the Authority, the City or the Underwriter as to the accuracy or adequacy of such information, or that any information referred to therein as being incorporated in this Official Statement by reference is correct. Such information has not been independently verified or confirmed by the Authority, the City or the Underwriter.

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

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

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CAUTIONARY STATEMENTS REGARDING  
FORWARD-LOOKING STATEMENTS IN  
THIS OFFICIAL STATEMENT

Certain statements included or incorporated by reference in this Official Statement and the Appendices hereto constitute “forward-looking statements.” Such statements are generally identifiable by the terminology used such as “plan,” “expect,” “estimate,” “budget” or other similar words. Such forward-looking statements include, but are not limited to, certain statements contained in Appendix A to this Official Statement under the captions “SUMMARY OF OPERATING RESULTS—Management’s Discussion of Operating Results,” “DEVELOPMENTS IN THE CALIFORNIA ENERGY MARKETS” and “RATE REGULATION.” Forward-looking statements in this Official Statement are subject to risks and uncertainties, including particularly those relating to natural gas costs and availability, wholesale and retail electric energy and capacity prices, federal and state legislation and regulations, competition and industry restructuring, and the economy of the service area of the City’s Electric System.

The achievement of any results or the realization of other expectations contained in such forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Neither the City nor the Authority plans to issue any updates or revisions to those forward-looking statements.

## **ADDRESSES OF PRINCIPAL PARTIES**

### **Authority**

Vernon Natural Gas Financing Authority  
4305 Santa Fe Avenue  
Vernon, California 90058  
Attention: Executive Director

### **Trustee and Tender Agent**

The Bank of New York Trust Company, N.A.  
700 S. Flower Street  
Los Angeles, California 90017  
Attention: Aurora Quiazon

### **Remarketing Agent**

Citigroup Global Markets Inc.  
390 Greenwich Street, 5<sup>th</sup> Floor  
New York, New York 10013  
Attention: Short-Term Tax-Exempt Trading

### **Liquidity Provider**

Citibank, N.A.  
390 Greenwich Street, 2<sup>nd</sup> Floor  
New York, New York 10013  
Attention: Manager, Short-Term Finance Group

### **Gas Supplier**

Citigroup Energy Inc.  
1301 Fannin Street, 23<sup>rd</sup> Floor  
Houston, Texas 77002  
Attention: Joe Toussaint

### **Financial Advisor**

Bond Logistix, LLC  
777 S. Figueroa Street, Suite 3200  
Los Angeles, California 90017  
Attention: A. Craig Underwood

### **Bond Insurer**

MBIA Insurance Corporation  
113 King Street  
Armonk, NY 10504  
Attention: Insured Portfolio Management - Global Utilities

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## OFFICIAL STATEMENT

### VERNON NATURAL GAS FINANCING AUTHORITY (CALIFORNIA)

#### Variable Rate Revenue Bonds (Vernon Gas Project)

**\$115,440,000**  
**2006 Series B**

**\$115,405,000**  
**2006 Series C**

### INTRODUCTION

*This Introduction is qualified in its entirety by reference to the more detailed information included and referred to elsewhere in this Official Statement. The offering of the 2006B Bonds and 2006C Bonds is made only by means of the entire Official Statement. Capitalized terms used in this Official Statement and not otherwise defined shall have the respective meanings assigned to them in Appendix C attached hereto.*

#### **Purpose of Official Statement**

The purpose of this Official Statement (which includes the cover page and the appendices attached hereto) is to provide information concerning the sale and delivery by the Vernon Natural Gas Financing Authority (the "Authority") of (i) \$115,440,000 in aggregate principal amount of its Variable Rate Revenue Bonds (Vernon Gas Project), 2006 Series B (the "2006B Bonds") and (ii) \$115,405,000 in aggregate principal amount of its Variable Rate Revenue Bonds (Vernon Gas Project), 2006 Series C (the "2006C Bonds").

THIS OFFICIAL STATEMENT DESCRIBES CERTAIN TERMS OF THE 2006B BONDS AND 2006C BONDS WHILE BEARING INTEREST IN A WEEKLY INTEREST RATE PERIOD. THERE ARE SIGNIFICANT DIFFERENCES IN THE TERMS OF THE 2006B BONDS AND 2006C BONDS IN OTHER INTEREST RATE PERIODS. THIS OFFICIAL STATEMENT IS NOT INTENDED TO PROVIDE INFORMATION WITH RESPECT TO THE 2006B BONDS OR 2006C BONDS IN ANY INTEREST RATE PERIOD OTHER THAN THE WEEKLY INTEREST RATE PERIOD.

#### **Authority for Issuance of the 2006B Bonds and 2006C Bonds**

The 2006B Bonds and 2006C Bonds are being issued by the Authority pursuant to (i) Article 4 of the Joint Exercise of Powers Act, constituting Chapter 5 of Division 7 of Title 1 of the California Government Code (the "Joint Powers Act"), and (ii) an Indenture of Trust, as supplemented by a First Supplemental Indenture of Trust, each dated as of June 1, 2006 (the "Indenture"), by and between the Authority and The Bank of New York Trust Company, N.A., as trustee (the "Trustee").

#### **Gas Supply Acquisition**

The Authority is purchasing a fifteen-year prepaid supply of natural gas (the "Gas Supply") from Citigroup Energy Inc. (the "Gas Supplier") pursuant to an Agreement for the Purchase and Sale of Natural Gas (the "Gas Purchase Agreement"), between the Authority and the Gas Supplier. The Authority's rights under the Gas Purchase Agreement, including the Gas Supply and the Guarantee (as described below under "-Guarantee of Gas Supplier Payment Obligations"), will be assigned, sold and transferred to the City, and purchased by the City, pursuant to the Natural Gas Purchase Agreement (the "Gas Supply Agreement") between the Authority and the City of Vernon, California (the "City"). As consideration for such assignment, sale and transfer, the City has agreed to make the Bond Payments, the Qualified Swap Payments, the Bank Payments and the Additional Gas Payments and to pay various other fees and expenses relating to the 2006 Bonds (as hereinafter defined). The City's payment obligations under the Gas Supply Agreement are special obligations payable solely from amounts in the Light and Power Fund and the obligations to make such payments from such amounts are absolute and unconditional, regardless of whether gas is actually provided to the City under the Gas Supply Agreement.

Upon receipt of Electric System Revenues, the City deposits all such amounts into the Light and Power Fund. The City has covenanted in the Gas Supply Agreement to apply the moneys in the Light and Power Fund to the payment of Operation and Maintenance Expenses then due and payable, which include the Bond Payments, the Qualified Swap Payments, the Bank Payments, the Additional Gas Payments and all other amounts due under the Gas Supply Agreement, before applying such moneys to any other purpose set forth in the City Bond Indenture.

**The amounts due from the City to the Authority, including the Bond Payments, the Qualified Swap Payments, the Bank Payments and the Additional Gas Payments, are not secured by a legal or equitable pledge of, or lien or charge upon, any property of the City or any of its income or receipts but are payable only from amounts in the Light and Power Fund. Neither the faith and credit nor the taxing power of the State of California (the "State"), the City or any other public agency is pledged to the payment of amounts due under the Gas Supply Agreement, and the execution and delivery of the Gas Supply Agreement do not directly, indirectly or contingently obligate the City, the State or any political subdivision thereof to levy or pledge any form of taxation or to make any appropriation for the payments due thereunder.**

For a further description of the City's obligations under the Gas Supply Agreement, see "SECURITY AND SOURCES OF PAYMENT - The Gas Supply Agreement."

#### **Use of Proceeds of the 2006B Bonds and 2006C Bonds**

The 2006B Bonds and 2006C Bonds are being issued to provide funds to (i) finance a portion of the prepayment for the Gas Supply required by the Gas Purchase Agreement; and (ii) pay the costs of issuing the 2006B Bonds and 2006C Bonds. See "PLAN OF FINANCE - Estimated Sources and Uses of Funds."

#### **Security and Sources of Payment**

The 2006B Bonds and 2006C Bonds are special obligations of the Authority payable solely from and secured solely by the Trust Estate pledged therefor under the Indenture, including primarily payments to be made by the City from amounts in the Light and Power Fund pursuant to the Gas Supply Agreement.

**The 2006B Bonds and the 2006C Bonds are special obligations of the Authority. The 2006B Bonds and the 2006C Bonds are payable by the Authority solely from, and secured solely by a pledge of, the Trust Estate pursuant to the Indenture. The 2006B Bonds and 2006C Bonds are not secured by a legal or equitable pledge of, or lien or charge upon, any property of the Authority or any of its income or receipts except the Trust Estate, which pledge is subject to the provisions of the Indenture permitting the application thereof for the purposes and on the terms and conditions set forth in the Indenture. Neither the faith and credit nor the taxing power of the State, the Authority, the City, or any other public agency is pledged to the payment of the 2006B Bonds or 2006C Bonds, and the issuance of the 2006B Bonds and 2006C Bonds shall not directly, indirectly or contingently obligate the Authority, the State or any political subdivision thereof, including the City, to levy or pledge any form of taxation or to make any appropriation for the payment of the 2006B Bonds or 2006C Bonds.**

For a further description of the security for and sources of payment of the 2006B Bonds and 2006C Bonds, see "SECURITY AND SOURCES OF PAYMENT."

#### **Guarantee of Gas Supplier Payment Obligations**

Under certain circumstances, the Gas Supplier may be obligated to make a payment to the Authority in lieu of gas required to be delivered under the Gas Purchase Agreement and upon the termination of the Gas Purchase Agreement prior to its stated termination date. All amounts payable by the Gas Supplier under the Gas Purchase Agreement, including any amount payable by the Gas Supplier upon any such early termination of the Gas Purchase Agreement, is guaranteed by Citigroup Inc. (the "Guarantor") pursuant to the Guarantee (the "Guarantee"), from the Guarantor to the Authority. See "PLAN OF FINANCE - Guarantee of Payment Obligations of the Gas Supplier."



## **Other 2006 Bonds**

The Authority also plans to issue concurrently with the issuance of the 2006B Bonds and 2006C Bonds its Variable Rate Revenue Bonds (Vernon Gas Project), 2006 Series A (the “2006A Bonds”), in an aggregate principal amount of \$200,000,000, for the purposes of paying the remaining cost of acquiring the Gas Supply and paying the costs of issuing the 2006A Bonds. For a more detailed description of the 2006A Bonds, see “PLAN OF FINANCE” herein. References herein to the “2006 Bonds” shall be mean, collectively, the 2006A Bonds, the 2006B Bonds and the 2006C Bonds, and references to the “Bonds” shall mean the 2006 Bonds together with any additional bonds issued pursuant to and secured on a parity with the 2006 Bonds under the Indenture, as it may be supplemented from time to time. See “APPENDIX D - SUMMARY OF CERTAIN PROVISIONS OF THE INDENTURE.”

## **The Authority**

The Joint Powers Act authorizes “public agencies” such as the City and the Redevelopment Agency of the City of Vernon (the “Redevelopment Agency”) to enter into an agreement to establish an agency to exercise any power common to the contracting parties. Pursuant to such authority, the City and the Redevelopment Agency have entered into the Joint Powers Agreement to create and establish the Authority. The Authority was created for the purpose of undertaking projects and programs that promote economic development within the City, including the promotion of opportunities for the creation or retention of employment, the stimulation of economic activity, and an increase of the tax base. Such projects and programs include assisting the City in procuring natural gas to be used as fuel for the City’s electric generating units which are part of the Electric System on terms and conditions approved by the City.

## **The City and the Electric System**

The City is a chartered city of the State of California, consisting of approximately 5.2 square miles and located in Los Angeles County, approximately four miles southeast of downtown Los Angeles. The City was established in 1905 with the objective of promoting industrial activity. There are approximately 1,260 businesses located in the City employing more than 45,000 persons. The City is almost exclusively industrial, with an estimated resident population of 110 as of January 1, 2006.

Pursuant to California law and its Charter, the City has established its Light and Power Department, which is responsible for the operation of the Electric System. The function of the Electric System is to supply electricity to the businesses, industries and residents of the City. The Electric System has been in operation since 1933. For the Fiscal Year ended June 30, 2005, the Electric System provided approximately 1,124 million kilowatt hours (“kWh”) of electricity to approximately 1,370 customers, almost all of which are commercial and industrial entities. See “APPENDIX A—CITY OF VERNON ELECTRIC SYSTEM.”

## **Bond Insurance**

Payment of the principal of and interest on the 2006B Bonds and 2006C Bonds when due will be insured by separate financial guaranty insurance policies (the “Policies”) to be issued by MBIA Insurance Corporation (the “Insurer”) simultaneously with the delivery of the 2006B Bonds and 2006C Bonds. See “BOND INSURANCE” herein.

## **Liquidity Facilities**

The purchase price of 2006B Bonds and 2006C Bonds that are tendered for purchase and not remarketed will be paid from amounts made available by the Liquidity Provider under the respective Liquidity Facility. Under each Liquidity Facility, the Liquidity Provider is obligated to make available to the Tender Agent an amount equal to the principal amount of the 2006B Bonds or 2006C Bonds, as applicable, which are tendered plus up to 35 days’ interest at an assumed interest rate of 12%. Each Liquidity Facility will expire on June 27, 2009 except as it may be extended or earlier terminated as described herein.

**Certain events of default may permit the Liquidity Provider to automatically terminate or suspend without notice its obligation to purchase tendered 2006B Bonds or 2006C Bonds. Upon the occurrence of**

**any such event, 2006B Bonds or 2006C Bonds tendered will not be purchased under the related Liquidity Facility and, therefore, funds may not be available to purchase such tendered 2006B Bonds or 2006C Bonds.** See “THE LIQUIDITY FACILITIES.”

### **Debt Service Reserve Fund**

Pursuant to the Indenture, the Debt Service Reserve Fund is required to be maintained in an amount equal to the Debt Service Reserve Requirement. Amounts on deposit in the Debt Service Reserve Fund will be applied to make up any deficiency in the Debt Service Fund for the payment when due of principal of or interest on the 2006 Bonds and any other Bonds issued under the Indenture. Initially, the Debt Service Reserve Fund will be funded with the Debt Service Reserve Fund Surety Bond (as hereinafter defined) issued by MBIA Insurance Corporation. See “SECURITY AND SOURCES OF PAYMENT - Debt Service Reserve Fund” and “- Debt Service Reserve Fund Surety Bond.”

### **Other Matters**

The summaries of and references to all documents, statutes, reports and other instruments referred to herein do not purport to be complete, comprehensive or definitive, and each such summary and reference is qualified in its entirety by reference to each document, statute, report or instrument.

Attached to this Official Statement as Appendix D are summaries of certain provisions of the Indenture. Copies of the Indenture, the Gas Supply Agreement and the Gas Purchase Agreement are available for inspection at the offices of the Trustee, and copies of the Indenture will be provided by the Trustee upon request and payment of duplication costs.

## **THE AUTHORITY**

The Authority is a publicly entity separate from its members, created pursuant to the Joint Powers Act and the Joint Exercise of Powers Agreement, dated as of April 1, 2006 (the “Joint Powers Agreement”), between the City and the Redevelopment Agency. The Authority was created for the purpose of undertaking projects and programs that promote economic development within the City, including the promotion of opportunities for the creation or retention of employment, the stimulation of economic activity, and an increase of the tax base. Such projects and programs include assisting the City in procuring natural gas for use as fuel for electric generating units which are part of the Electric System on terms and conditions approved by the City. Pursuant to the Joint Powers Act and the Joint Powers Agreement, the Authority has any and all powers necessary or convenient in accomplishing the aforementioned purposes for which it was created, which are authorized by law to each of the City and the Redevelopment Agency and separately to the Authority, including all powers which are incidental to express powers. Without limiting the generality of the preceding sentence, the Authority has the power to make and enter into contracts, including, but not limited to (i) agreements to purchase or sell natural gas, (ii) forward contracts, futures contracts, puts, calls, options or other contracts related to the purchase of natural gas, (iii) hedging agreements relating to bonds issued by the Authority or other investments, as authorized under California law, including, but not limited to, interest rate swap agreements, and (iv) contracts and agreements relating to credit enhancement and/or liquidity support for bonds, as well as the power to issue bonds and to pledge any Authority property or revenues as security for such bonds.

The business, activities and affairs of the Authority are managed and conducted by its Board of Directors. The Board of Directors consists of five directors. A vacancy in the office of a Director, whether by resignation or removal, is filled by the appointment of a successor by a resolution adopted by a majority vote of the remaining directors in office; however, no Director so appointed shall become a Director if the City Council of the City objects to such appointment within fifteen days of the receipt by the City Clerk of the City of the resolution appointing such Director. The present Directors and the expiration of their current terms of office are as follows:

<u>Name of Director</u>	<u>End of Term as Director</u>
Leonis C. Malburg	April 1, 2011
Thomas A. Ybarra	April 1, 2010
William J. Davis	April 1, 2009
Hilario Gonzales	April 1, 2008
W. Michael McCormick	April 1, 2007

## THE 2006B BONDS AND 2006C BONDS

### General

The 2006B Bonds and 2006C Bonds will bear interest initially at a Weekly Interest Rate as described below under “Determination of the Weekly Interest Rate” unless, at the direction of the Authority and upon compliance with the conditions set forth in the Indenture, the 2006B Bonds and 2006C Bonds are converted to bear interest at a Daily Interest Rate, Long-Term Interest Rate, Bond Interest Term Rate or Auction Rate (each, an “Interest Rate Period”).

**This Official Statement summarizes certain terms of the 2006B Bonds and 2006C Bonds only while such Bonds bear interest at a Weekly Interest Rate. Upon Conversion of the 2006B Bonds and 2006C Bonds to a different Interest Rate Period, the 2006B Bonds and/or 2006C Bonds will be subject to mandatory tender for purchase and, at that time, it is expected that a new official statement or other disclosure document will be prepared.**

The 2006B Bonds and 2006C Bonds will mature on August 1, 2021, subject to prior redemption as described herein under “Redemption Provisions”. The 2006B Bonds and 2006C Bonds will be dated the date of their delivery and bear interest from that date until paid. So long as the 2006B Bonds and 2006C Bonds bear interest at a Weekly Interest Rate, interest will be computed on the basis of a 365- or 366-day year for the actual days elapsed.

The 2006B Bonds and 2006C Bonds will be issued as fully registered Bonds in book-entry form only and when issued will be registered in the name of Cede & Co., as nominee of DTC. The 2006B Bonds and 2006C Bonds may be purchased only in denominations of \$100,000 and integral multiples of \$5,000 in excess of \$100,000 (each, an “Authorized Denomination”).

While the 2006B Bonds and 2006C Bonds bear interest at a Weekly Interest Rate, interest on the 2006B Bonds and 2006C Bonds will be payable monthly in arrears on the first Wednesday of each month, commencing July 5, 2006 (each, an “Interest Payment Date”), or the next succeeding Business Day if any such Wednesday is not a Business Day. If a payment date is not a Business Day at the place of payment, the payment will be made at that place on the next succeeding Business Day, with the same force and effect as if made on the payment date, and, in the case of such payment, no interest will accrue for the intervening period.

Interest on the 2006B Bonds and 2006C Bonds will be payable for the period commencing on the first Wednesday of the preceding month and ending on the Tuesday immediately preceding the Interest Payment Date (or, if sooner, the last day of the Weekly Interest Rate Period). In any event, interest on the 2006B Bonds and 2006C Bonds will accrue during the final Interest Rate Period to the date on which the 2006B Bonds and 2006C Bonds have been paid in full.

At no time will any 2006B Bond or 2006C Bond bear interest at a Weekly Interest Rate that is in excess of the lesser of 12% per annum and the maximum rate of interest permitted by applicable law.

Principal of and interest on the 2006B Bonds and 2006C Bonds will be paid by the Trustee from moneys in the Debt Service Fund. So long as records of ownership of the 2006B Bonds and 2006C Bonds are maintained through the Book-Entry Only System described below, all payments to the Beneficial Owners of the 2006B Bonds and 2006C Bonds, including payments of principal and interest, will be made in accordance with the procedures described below under "BOOK-ENTRY ONLY SYSTEM."

In the event the Book-Entry Only System is discontinued, principal of the 2006B Bonds and 2006C Bonds would be payable upon presentation of the 2006B Bonds and 2006C Bonds to the Trustee at its Principal Office by the Owners thereof, and interest on the 2006B Bonds and 2006C Bonds would be payable on each Interest Payment Date by the Trustee by check mailed on the date on which interest is due to the Owners of the 2006B Bonds and 2006C Bonds at the close of business on the Record Date in respect of such Interest Payment Date at the registered addresses of Owners as they appear on the registration books maintained by the Trustee.

The Record Date with respect to any Interest Payment Date for the 2006B Bonds and 2006C Bonds (whether or not the 2006B Bonds or 2006C Bonds are in a Book-Entry Only System) is the Business Day immediately preceding such Interest Payment Date.

Concurrently with the issuance of the 2006B Bonds and 2006C Bonds, the Authority will enter into a Remarketing Agreement with Citigroup Global Markets Inc., as Remarketing Agent for the 2006B Bonds and 2006C Bonds. Under the terms of the Remarketing Agreement, the Remarketing Agent will agree to determine the Weekly Interest Rate on each of the 2006B Bonds and 2006C Bonds and use its best efforts to remarket the 2006B Bonds and 2006C Bonds which are subject to optional and mandatory tender for purchase.

#### **Determination of the Weekly Interest Rate**

During each Weekly Interest Rate Period, the 2006B Bonds and 2006C Bonds will bear interest at the Weekly Interest Rate, which will be determined by the Remarketing Agent for such Series by 5:00 p.m., New York City time, on Tuesday of each week during such Weekly Interest Rate Period, or if such day is not a Business Day, then on the next succeeding Business Day. The initial Weekly Interest Rate for each Weekly Interest Rate Period will apply to the period commencing on the effective date of such Weekly Interest Rate Period and ending on the next succeeding Tuesday. Each Weekly Interest Rate thereafter will apply to the period commencing on Wednesday and ending on the next succeeding Tuesday (a "Calendar Week"), unless such Weekly Interest Rate Period will end on a day other than Tuesday, in which event the last Weekly Interest Rate for such Weekly Interest Rate Period will apply to the period commencing on and including Wednesday preceding the last day of such Weekly Interest Rate Period and ending on and including the last day of such Weekly Interest Rate Period.

The Weekly Interest Rate applicable to the 2006B Bonds and Series 2006C Bonds for each Weekly Interest Rate Period will be the rate of interest per annum determined by the Remarketing Agent (based on the examination of tax-exempt obligations comparable in the judgment of the Remarketing Agent to the 2006B Bonds or 2006C Bonds, as the case may be, and known by the Remarketing Agent to have been priced or traded under then prevailing market conditions) to be the minimum interest rate which, if borne by the 2006B Bonds or 2006C Bonds, would enable the Remarketing Agent to sell such 2006B Bonds or 2006C Bonds on such date of determination at a price (without regarding accrued interest) equal to the principal amount thereof.

In the event the Remarketing Agent fails to establish a Weekly Interest Rate for any Calendar Week, then the Weekly Interest Rate for such week will be the same as the Weekly Interest Rate for the immediately preceding Calendar Week if the Weekly Interest Rate for such preceding Calendar Week was determined by the Remarketing Agent. In the event that the Weekly Interest Rate for the immediately preceding Calendar Week was not determined by the Remarketing Agent, or in the event that the Weekly Interest Rate determined by the Remarketing Agent is held to be invalid or unenforceable by a court of law, then the interest rate for such week will be equal to 110% of the BMA Index, or if such index is no longer made available, 85% of the interest rate on 30-day high grade unsecured commercial paper notes sold through dealers by major corporations as reported in The Wall Street Journal on the day the Weekly Interest Rate would otherwise be determined as provided in the Indenture.

## **Conversion of Interest Rate Period for 2006B Bonds or 2006C Bonds**

*Conversion from Weekly Interest Rate.* The Authority may direct that the interest rate on the 2006B Bonds or 2006C Bonds bearing interest at a Weekly Interest Rate be converted to a Daily Interest Rate, a Long-Term Interest Rate, Bond Interest Term Rates or ARS Rates upon satisfaction of certain conditions set forth in the Indenture.

If the Interest Rate Period for the 2006B Bonds or the 2006C Bonds is to be converted from the Weekly Interest Rate Period, then the 2006B Bonds or 2006C Bonds, as the case may be, will be subject to mandatory tender for purchase on the effective date of the Conversion to another Interest Rate Period, at a purchase price equal to the principal amount thereof, without premium, plus accrued interest (if any) to the effective date of the Conversion. The Indenture provides that the Trustee is required to give notice of any Conversion to another Interest Rate Period to the Owners of the 2006B Bonds or 2006C Bonds, as the case may be, not less than 30 days prior to the proposed effective date of such Conversion.

*Certain Conditions to Conversion of Interest Rate Period.* In connection with any Conversion of the Interest Rate Period for the 2006B Bonds or 2006C Bonds, the Authority will cause to be provided to the Trustee, the Liquidity Facility Provider, the Insurer and the Remarketing Agent a Favorable Opinion of Bond Counsel on the effective date of such Conversion. In the event that a Favorable Opinion of Bond Counsel is not delivered on any such date, then the Interest Rate Period will not be converted, and the 2006B Bonds or 2006C Bonds, as the case may be, will continue to bear interest at a Weekly Interest Rate as in effect immediately prior to such proposed Conversion of the Interest Rate Period.

In any event, if notice of a Conversion has been mailed to the Owners of the 2006B Bonds and 2006C Bonds, and a Favorable Opinion of Bond Counsel is not delivered on the effective date of the proposed Conversion, the 2006B Bonds and 2006C Bonds will continue to be subject to mandatory tender for purchase on the date which would have been the effective date of such Conversion as provided in the Indenture.

The Authority may rescind its election to convert the Interest Rate Period for the 2006B Bonds or 2006C Bonds from the Weekly Rate Period by delivering a rescission notice to the Trustee, the Remarketing Agent, the Tender Agent, the Liquidity Facility Provider and the Insurer on or prior to 10:00 a.m. on the second Business Day preceding the proposed effective date of the Conversion. However, if a notice of the proposed Conversion has been given to the Owners of the 2006B Bonds or 2006C Bonds, then such 2006B Bonds or 2006C Bonds nevertheless will still be subject to mandatory tender for purchase on the date which would have been the effective date of the Conversion, regardless of the rescission.

If, at any time, the Interest Rate Period for the 2006B Bonds or 2006C Bonds is to be changed from one Interest Rate Period to another, such change must apply to all of the 2006B Bonds or 2006C Bonds. On or prior to the date the Authority changes the Interest Rate Period for the 2006B Bonds or 2006C Bonds, the Authority is required to deliver to the Trustee written confirmation of the new ratings from each Rating Agency then rating the 2006B Bonds or 2006C Bonds.

## **Tender and Purchase of 2006B Bonds and 2006C Bonds**

THE INDENTURE PROVIDES THAT SO LONG AS CEDE & CO. IS THE SOLE REGISTERED OWNER OF THE 2006B BONDS AND 2006C BONDS, ALL TENDERS AND DELIVERIES OF 2006B BONDS AND 2006C BONDS UNDER THE PROVISIONS OF THE INDENTURE SHALL BE MADE PURSUANT TO DTC'S PROCEDURES AS IN EFFECT FROM TIME TO TIME, AND NONE OF THE AUTHORITY, THE TRUSTEE, THE INSURER OR THE REMARKETING AGENT SHALL HAVE ANY RESPONSIBILITY FOR OR LIABILITY WITH RESPECT TO THE IMPLEMENTATION OF SUCH PROCEDURES.

*Tender for Purchase Upon Election of Owner During Weekly Interest Rate Period.* During any Weekly Interest Rate Period, any 2006B Bond or 2006C Bond may be tendered by the Owner (so long as the 2006B Bonds and 2006C Bonds are in a Book-Entry Only System, by the Beneficial Owner through its Participant in the Securities Depository) for purchase in whole (or in part if both the amount to be purchased and the amount remaining unpurchased will consist of Authorized Denominations) at the option of the Owner on any Business Day

at the applicable Purchase Price, upon delivery to the Tender Agent at its Principal Office, to the Trustee at its Principal Office and to the Remarketing Agent of an irrevocable written notice which states the principal amount of such 2006B Bond or 2006C Bond and the date on which the same will be purchased, which date must be a Business Day at least seven days after the date of the delivery of such notice. Any notice delivered to the Tender Agent after 4:00 p.m., New York City time, will be deemed to have been received on the next succeeding Business Day.

*Mandatory Tender for Purchase Upon Change to a Different Interest Rate Period.* The 2006B Bonds and/or 2006C Bonds will be subject to mandatory tender for purchase, at the applicable Purchase Price, on the effective date of a change to a different Interest Rate Period for such 2006B Bonds or 2006C Bonds (or on the day which would have been the effective date of such a change to a new Interest Rate Period if the conditions to such change set forth in the Indenture have not been satisfied).

*Mandatory Tender for Purchase upon Substitution, Termination or Expiration of a Liquidity Facility; Mandatory Standby Tender.* If at any time the applicable Liquidity Provider is not in default under the Liquidity Facility for a Series of the 2006B Bonds or 2006C Bonds and the Trustee gives notice that the purchase price of the 2006B Bonds or 2006C Bonds will on the date specified in such notice cease to be payable from amounts made available under the applicable Liquidity Facility as a result of (i) the substitution, termination or expiration of the term, as extended, of such Liquidity Facility, including, but not limited to, a termination at the option of the Authority in accordance with the terms of such Liquidity Facility, or (ii) the occurrence of a Mandatory Standby Tender (as hereinafter defined), then each such 2006B Bond or 2006C Bond, as the case may be, shall be purchased or deemed purchased at the applicable Purchase Price. In the event that funds from the remarketing of the 2006B Bonds or 2006C Bonds, as the case may be, are not sufficient to pay the purchase price of all such 2006B Bonds or 2006C Bonds subject to mandatory tender, funds for such purchase will be drawn under the applicable Liquidity Facility. In the event such mandatory tender for purchase is required as a result of the substitution of an Alternate Liquidity Facility for the Liquidity Facility then in effect with respect to the 2006B Bonds or 2006C Bonds, as the case may be, the purchase price of 2006B Bonds or 2006C Bonds so tendered and not remarketed will be purchased from amounts made available under such Liquidity Facility rather than such Alternate Liquidity Facility.

Any purchase of a 2006B Bond or 2006C Bond under the circumstances described in the preceding paragraph will occur on the Business Day preceding any substitution, expiration or termination of a Liquidity Facility, including any termination as a result of a Mandatory Standby Tender. "Mandatory Standby Tender" means the mandatory tender of the 2006B Bonds or 2006C Bonds upon receipt by the Trustee of written notice from the Liquidity Facility Provider that an event with respect to its Liquidity Facility has occurred which requires or gives the Liquidity Facility Provider the option to terminate its Liquidity Facility upon notice and requires that all Outstanding 2006B Bonds or 2006C Bonds secured by such Liquidity Facility be tendered for purchase. A Mandatory Standby Tender does not include circumstances in which the Liquidity Facility Provider may suspend or terminate its obligations to purchase 2006B Bonds or 2006C Bonds without notice, in which case there will be no mandatory tender of the 2006B Bonds or 2006C Bonds. See "THE LIQUIDITY FACILITIES."

The Trustee is required to give notice by mail to the Owners of the 2006B Bonds or 2006C Bonds (i) on or before the 30th day preceding the substitution, termination or expiration of the related Liquidity Facility (except in the case of a termination resulting from an event resulting in the immediate termination or suspension of the obligation of the Liquidity Facility Provider to purchase the 2006B Bonds or 2006C Bonds, as the case may be, under the terms of the related Liquidity Facility) in accordance with its terms, or (ii) in the case of any Mandatory Standby Tender under such Liquidity Facility, as soon as reasonably possible following the receipt by the Trustee of notice of the Mandatory Standby Tender. The notice must be accompanied by directions for the purchase of the 2006B Bonds or 2006C Bonds, as the case may be. Among other things, the notice must state the date of the termination or expiration of the affected Liquidity Facility and in the case of substitution the date of the proposed substitution of an Alternate Liquidity Facility (if any), and state that the 2006B Bonds or 2006C Bonds will be purchased as a result of such substitution, termination or expiration, including any termination as a result of a Mandatory Standby Tender and the date on which such purchase will occur, and will also provide any other information required in the notice to the Owners of the 2006B Bonds or 2006C Bonds.

*Irrevocable Notice Deemed to be Tender of 2006B Bonds or 2006C Bonds.* The giving of notice by an Owner of a 2006B Bond or 2006C Bond of its election to have such 2006B Bond or 2006C Bond purchased during

a Weekly Interest Rate Period will constitute the irrevocable tender for purchase of such 2006B Bond or 2006C Bond with respect to which such notice has been given, regardless of whether such 2006B Bond or 2006C Bond is delivered to the Tender Agent for purchase on the relevant purchase date. If any Owner of a 2006B Bond or 2006C Bond who has given notice of tender for purchase as described in the preceding sentence (or, so long as the 2006B or 2006C Bonds, as applicable, are in the Book-Entry Only System, the Owner authorizes and directs its Participant to make entries on the books of the Participant in the Securities Depository transferring the beneficial ownership of its 2006B Bond or 2006C Bond) fails to deliver such 2006B Bond or 2006C Bond to the Tender Agent at the place and on the applicable date and at the time specified, or fails to deliver such 2006B Bond or 2006C Bond properly endorsed, such 2006B Bond or 2006C Bond will constitute an Undelivered Bond.

*Undelivered 2006B Bonds or 2006C Bonds.* If funds in the amount of the purchase price of the Undelivered Bonds are available for payment to the Owner thereof on the date and at the time specified, from and after the date and time of that required delivery, (i) each Undelivered Bond will be deemed to be purchased and will no longer be deemed to be Outstanding under the Indenture; (ii) interest will no longer accrue thereon; and (iii) funds in the amount of the purchase price of each such Undelivered Bond will be held by the Tender Agent for the benefit of the Owner thereof (provided that the Owner will have no right to any investment proceeds derived from such funds), to be paid on delivery (and proper endorsement) of such Undelivered Bond to the Tender Agent at its Principal Office. Any funds held by the Tender Agent as described in clause (iii) of the preceding sentence will be held uninvested and not commingled. The Tender Agent may refuse to accept delivery of any 2006B Bonds or 2006C Bonds for which a proper instrument of transfer has not been provided; such refusal, however, will not affect the validity of the purchase of such 2006B Bonds or 2006C Bonds as described in the Indenture.

*Payment of Purchase Price.* For payment of the purchase price of any 2006B Bond required to be purchased as provided in the Indenture on the purchase date specified in the applicable notice, such 2006B Bond must be delivered, at or prior to 10:00 a.m., New York City time, on the date specified in such notice, to the Tender Agent at its Principal Office, accompanied by an instrument of transfer thereof, in form satisfactory to the Tender Agent, executed in blank by the Owner thereof or his duly authorized attorney, with such signature guaranteed by a commercial bank, trust company or member firm of the New York Stock Exchange.

*Delivery Address for Tender Notices and Tendered 2006B Bonds and 2006C Bonds.* Notices in respect of tenders for purchase at the election of Owners during a Weekly Interest Rate Period must be delivered to the Tender Agent and the Remarketing Agent.

*Book-Entry Tender and Delivery Procedures.* Notwithstanding anything to the contrary contained in the Indenture, for so long as DTC's nominee is the sole registered owner of the 2006B Bonds and 2006C Bonds, all tenders for purchase and deliveries of 2006B Bonds and 2006C Bonds tendered for purchase or subject to mandatory tender under the provisions of the Indenture will be made pursuant to the DTC's procedures as in effect from time to time and neither the Authority, the Tender Agent, the Trustee, the Insurer nor the Remarketing Agent will have any responsibility for or liability with respect to the implementation of such procedures.

#### **Source of Funds for Purchase of 2006B Bonds and 2006C Bonds**

On the date on which 2006B Bonds and 2006C Bonds are to be purchased pursuant to the Indenture, the Tender Agent will purchase such 2006B Bonds and 2006C Bonds from the Owners thereof at the purchase price thereof. Funds for the payment of such purchase price will be derived solely from the following sources in the order of priority indicated:

- (a) proceeds of the sale of the 2006B Bonds or 2006C Bonds, as the case may be, remarketed by the Remarketing Agent;
- (b) moneys received from draws on the related Liquidity Facility; and
- (c) any funds provided to the Tender Agent by the City for such purpose in its sole discretion (there being no obligation of the City to provide any funds).

UPON THE OCCURRENCE OF CERTAIN EVENTS OF DEFAULT UNDER THE RELATED LIQUIDITY FACILITY, THE LIQUIDITY PROVIDER'S OBLIGATION TO PURCHASE TENDERED 2006B

BONDS OR 2006C BONDS MAY BE TERMINATED OR SUSPENDED AUTOMATICALLY. IN SUCH CASE, 2006B BONDS OR 2006C BONDS TENDERED WILL NOT BE PURCHASED UNDER THE RELATED LIQUIDITY FACILITY AND, THEREFORE, FUNDS MAY NOT BE AVAILABLE TO PURCHASE SUCH TENDERED 2006B BONDS OR 2006C BONDS. IN THE EVENT THE LIQUIDITY PROVIDER DOES NOT PURCHASE TENDERED 2006B BONDS OR 2006C BONDS FOR ANY REASON, NEITHER THE AUTHORITY NOR THE CITY HAS ANY OBLIGATION TO MAKE SUCH PAYMENT. THE POLICY DOES NOT PROVIDE FOR THE PAYMENT OF THE PURCHASE PRICE OF 2006B BONDS OR 2006C BONDS TENDERED FOR PURCHASE. SEE “THE LIQUIDITY FACILITIES.”

**Redemption Provisions**

*Mandatory Sinking Fund Redemption.* The 2006B Bonds and 2006C Bonds are subject to mandatory sinking fund redemption, in part, by lot, from Sinking Fund Installments on each date set forth below, at a redemption price equal to the respective principal amount of the 2006B Bonds or 2006C Bonds to be redeemed, without premium. Sinking Fund Installments for the 2006B Bonds or 2006C Bonds shall be due on the following dates and in the following amounts:

<u>2006B Sinking Fund Installment Due Date</u>	<u>Sinking Fund Installment</u>	<u>2006C Sinking Fund Installment Due Date</u>	<u>Sinking Fund Installment</u>
8/1/2007	\$5,710,000	8/1/2007	\$5,710,000
8/6/2008	5,965,000	8/6/2008	5,965,000
8/5/2009	6,180,000	8/5/2009	6,180,000
8/4/2010	6,430,000	8/4/2010	6,425,000
8/3/2011	6,640,000	8/3/2011	6,635,000
8/1/2012	7,020,000	8/1/2012	7,015,000
8/7/2013	7,275,000	8/7/2013	7,270,000
8/6/2014	7,575,000	8/6/2014	7,575,000
8/5/2015	7,895,000	8/5/2015	7,895,000
8/3/2016	8,195,000	8/3/2016	8,190,000
8/2/2017	8,565,000	8/2/2017	8,565,000
8/1/2018	8,925,000	8/1/2018	8,920,000
8/7/2019	9,290,000	8/7/2019	9,285,000
8/5/2020	9,705,000	8/5/2020	9,705,000
8/1/2021	10,070,000	8/1/2021	10,070,000

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In the event any 2006B Bonds or 2006C Bonds have been purchased by the City or the Authority and surrendered for cancellation or redeemed at the option of the Authority, the remaining Sinking Fund Installments for such 2006B Bonds or 2006C Bonds shall be reduced, in an aggregate amount equal to the principal amount of such 2006B Bonds or 2006C Bonds so surrendered and redeemed, as directed in writing by the City, and in the absence of such direction, as proportionately as possible in integral multiples of the applicable Authorized Denominations.

*Optional Redemption.* The 2006B Bonds and 2006C Bonds bearing interest at a Weekly Interest Rate are subject to optional redemption by the Authority, in whole or in part, at any time on any Business Day, at a Redemption Price equal to the principal amount thereof to be redeemed, plus accrued but unpaid interest to the redemption date. In the event of an optional redemption of 2006B Bonds or 2006C Bonds, (i) 2006B Bonds or 2006C Bonds which are Bank Bonds shall be redeemed prior to any other 2006B Bonds or 2006C Bonds which are to be redeemed and which are not Bank Bonds; and (ii) the notional amount of the interest rate swap transaction relating to the 2006B Bonds and 2006C Bonds must be reduced by an amount corresponding to the principal amount of the 2006B Bonds or 2006C Bonds optionally redeemed.

*Notice of Redemption.* In the event any 2006B Bonds or 2006C Bonds are called for redemption, the Trustee shall give notice, in the name of the Authority, of the redemption of such 2006B Bonds or 2006C Bonds, which notice shall be mailed, by first class mail, postage prepaid, not more than sixty (60) nor less than thirty (30) days before the redemption date to the Owners of the 2006B Bonds or 2006C Bonds to be redeemed (in whole or in part) at their addresses appearing in the Bond Register. Such notice shall specify the maturity date of the 2006B Bonds or 2006C Bonds to be redeemed, the redemption date and the place or places where amounts due upon such redemption shall be payable and, if less than all of the 2006B Bonds or 2006C Bonds of any maturity are to be redeemed, the letters and numbers or other distinguishing marks of such 2006B Bonds or 2006C Bonds to be so redeemed, and, in the case of 2006B Bonds or 2006C Bonds to be redeemed in part only, such notice shall also specify the respective portions of the principal amount thereof to be redeemed. Such notice shall further state that on the date scheduled for redemption and provided sufficient funds are deposited with the Trustee therefor, interest on the 2006B Bonds or 2006C Bonds shall cease to accrue and be payable.

Receipt of such notice shall not be a condition precedent to the redemption of 2006B Bonds and 2006C Bonds and failure of any Owner of a 2006B Bond or 2006C Bond to receive any such notice or any insubstantial defect in such notice shall not affect the validity of the proceedings for the redemption of 2006B Bonds or 2006C Bonds. Any defect in such notice given to the Owners of less than all of the 2006B Bonds or 2006C Bonds to be redeemed shall not affect the validity of the proceedings for the redemption of the 2006B Bonds or 2006C Bonds as to which the notice of redemption did not contain such defect.

*Conditional Redemption.* In the event funds required to pay the redemption price of the 2006B Bonds or 2006C Bonds are not on deposit with the Trustee at the time notice of any optional redemption of 2006B Bonds or 2006C Bonds is given, such notice shall state that such redemption is conditional upon the receipt by the Trustee, on or prior to the date fixed for such redemption, of moneys sufficient to pay the redemption price of the 2006B Bonds or 2006C Bonds to be redeemed, and that if such moneys shall not have been so received said notice shall be of no force and effect and the Authority shall not be required to redeem such 2006B Bonds or 2006C Bonds. In the event a notice of redemption of 2006B Bonds or 2006C Bonds contains such a condition and such moneys are not so received, the redemption of 2006B Bonds or 2006C Bonds as described in the conditional notice of redemption shall not be made and the Trustee shall, within a reasonable time after the date on which such redemption was to occur, give notice to the Persons and in the manner in which the notice of redemption was given that such moneys were not so received and that there shall be no redemption of 2006B Bonds or 2006C Bonds pursuant to the conditional notice of redemption.

*Partial Redemption of 2006B Bonds or 2006C Bonds.* If less than all of the Outstanding 2006B Bonds or 2006C Bonds shall be called for redemption, and subject to the procedures of DTC with respect to selection of 2006B Bonds and 2006C Bonds for redemption as described under "BOOK-ENTRY ONLY SYSTEM", the particular 2006B Bonds or 2006C Bonds or portions thereof to be redeemed shall, subject to any limitations with respect thereto contained in the Indenture, be selected at random by the Trustee in such manner as the Trustee in its discretion may deem fair and appropriate; provided, however, that 2006B Bonds and 2006C Bonds shall be redeemed in the following order of priority (and by lot within each priority): first, any 2006B Bonds or 2006C Bonds which are Bank Bonds, and second, any other 2006B Bonds or 2006C Bonds; provided further, that the

portion of any 2006B Bond or 2006C Bond of a denomination greater than the minimum Authorized Denomination for the 2006B Bonds and 2006C Bonds shall be redeemed in part only in a principal amount such that the portion of such 2006B Bond or 2006C Bond which is not redeemed shall be in an Authorized Denomination and that, in selecting portions of 2006B Bonds or 2006C Bonds for redemption, the Trustee shall treat each 2006B Bond or 2006C Bond as representing that number of 2006B Bonds or 2006C Bonds of the minimum Authorized Denomination which is obtained by dividing the principal amount of such 2006B Bond or 2006C Bond by the minimum Authorized Denomination.

SO LONG AS THE ONLY REGISTERED OWNER OF THE 2006B BONDS AND 2006C BONDS IS CEDE & CO., AS NOMINEE OF DTC, SUCH SELECTION WILL, HOWEVER, BE MADE BY DTC. If a portion of a 2006B Bond or 2006C Bond is called for redemption, a new 2006B Bond or 2006C Bond of the same series in a principal amount equal to the unredeemed portion thereof will be issued to the Owner upon surrender thereof.

### **BOOK-ENTRY ONLY SYSTEM**

The Depository Trust Company (“DTC”), New York, NY, will act as securities depository for the 2006B Bonds and 2006C Bonds (within this section, the “Securities”). The Securities will be issued as fully-registered securities registered in the name of Cede & Co. (DTC’s partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully-registered Security certificate will be issued for each maturity of the Securities, and will be deposited with DTC.

DTC, the world’s largest depository, is a limited-purpose trust company organized under the New York Banking Law, a “banking organization” within the meaning of the New York Banking Law, a member of the Federal Reserve System, a “clearing corporation” within the meaning of the New York Uniform Commercial Code, and a “clearing agency” registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for over 2 million issues of U.S. and non-U.S. equity issues, corporate and municipal debt issues, and money market instruments from over 85 countries that DTC’s participants (“Direct Participants”) deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities, through electronic computerized book-entry transfers and pledges between Direct Participants’ accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation (“DTCC”). DTCC, in turn is owned by a number of Direct Participants of DTC and Members of the National Securities Clearing Corporation, Government Securities Clearing Corporation, MBS Clearing Corporation, and Emerging Markets Clearing Corporation, (NSCC, GSCC, MBSCC, and EMCC, also subsidiaries of DTCC), as well as by the New York Stock Exchange, Inc., the American Stock Exchange, LLC, and the National Association of Securities Dealers, Inc. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, and trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant either directly or indirectly (“Indirect Participants”). DTC has Standard & Poor’s highest rating: AAA. The DTC Rules applicable to its Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at [www.dtcc.com](http://www.dtcc.com).

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

To facilitate subsequent transfers, all Securities deposited by Direct Participants with DTC are registered in the name of DTC’s partnership nominee, Cede & Co or such other name as may be requested by an authorized

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

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

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

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

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

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

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

THE AUTHORITY, THE UNDERWRITER AND THE TRUSTEE WILL HAVE NO RESPONSIBILITY OR OBLIGATION TO ANY DIRECT PARTICIPANT, ANY INDIRECT PARTICIPANT OR ANY BENEFICIAL OWNER, OR ANY OTHER PERSON NOT SHOWN ON THE REGISTRATION BOOKS OF THE TRUSTEE AS BEING A REGISTERED OWNER OF THE 2006B BONDS OR 2006C BONDS, WITH RESPECT TO: (1) THE ACCURACY OF ANY RECORDS MAINTAINED BY DTC OR ANY DIRECT PARTICIPANT OR INDIRECT PARTICIPANT; (2) THE PAYMENT OF ANY AMOUNT DUE BY DTC TO ANY DIRECT PARTICIPANT, BY ANY DIRECT PARTICIPANT TO ANY INDIRECT PARTICIPANT, OR BY ANY DIRECT OR INDIRECT PARTICIPANT TO ANY BENEFICIAL OWNER IN RESPECT OF THE PRINCIPAL AMOUNT OF OR INTEREST ON THE 2006B BONDS OR 2006C BONDS; (3) THE DELIVERY OF ANY NOTICE BY DTC TO ANY DIRECT PARTICIPANT, BY ANY DIRECT PARTICIPANT TO ANY INDIRECT PARTICIPANT, OR BY ANY DIRECT OR INDIRECT PARTICIPANT TO ANY BENEFICIAL OWNER WHICH IS REQUIRED OR PERMITTED TO BE GIVEN TO REGISTERED OWNERS UNDER THE TERMS OF THE INDENTURE; (4) THE SELECTION OF THE BENEFICIAL OWNERS TO RECEIVE PAYMENT IN THE EVENT OF ANY PARTIAL REDEMPTION OF THE 2006B BONDS OR 2006C BONDS; OR (5) ANY CONSENT GIVEN OR ACTION TAKEN BY DTC AS REGISTERED OWNER.

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

## PLAN OF FINANCE

### General

The proceeds of the 2006B Bonds and 2006C Bonds will be used by the Authority to (i) finance a portion of the cost of acquiring the Gas Supply from the Gas Supplier pursuant to the Gas Purchase Agreement, and (ii) pay the costs of issuing the 2006B Bonds and 2006C Bonds. Contemporaneously with the issuance of the 2006B Bonds and 2006C Bonds, the Authority expects to issue and sell the 2006A Bonds under the Indenture in an aggregate principal amount of \$200,000,000, for the purposes of paying the remaining cost of acquiring the Gas Supply and paying the costs of issuing the 2006A Bonds. The 2006A Bonds are expected to bear interest in an ARS Interest Rate Period, and the scheduled payments of principal of and interest on the 2006A Bonds are expected to be insured by a financial guaranty insurance policy issued by the Insurer containing the same terms and conditions as the Policies. The 2006A Bonds represent a special obligation of the Authority secured by a lien on the Trust Estate on a parity with the lien thereon securing the 2006B Bonds and 2006C Bonds. Each Series of the 2006 Bonds is cross-defaulted against every other Series of the 2006 Bonds.

### Acquisition and Delivery of Gas Supply

*General.* Under the terms of the Gas Purchase Agreement, the Authority is acquiring an aggregate of approximately 89,441,000 MMBtu of natural gas to be delivered by the Gas Supplier in specified Monthly Quantities for each month for fifteen years, commencing August 1, 2006 (the "Contract Term"). The Monthly Quantity of gas for each month will be delivered by the Gas Supplier ratably each day of such month (the "Daily Quantities") to the Delivery Point on the pipeline facilities of the Southern California Gas Company (the "Transporter").

*Assignment of Rights by the Authority to the City.* Pursuant to the Gas Supply Agreement and in consideration of the obligations of the City to make certain payments thereunder, including the Bond Payments, the Qualified Swap Payments, the Bank Payments and the Additional Gas Payments, the Authority has assigned to the City all of its rights and interests in and to the Gas Supply and Gas Purchase Agreement, and all rights and interests of the Authority in and to the Guarantee. Consequently, references in this section to "Purchaser" shall be deemed to be references to the City, as assignee of the Authority. See "The Gas Supply Agreement" in this section.

*Delivery Obligation.* Each day during the term of the Gas Purchase Agreement, the Gas Supplier is required to schedule and deliver on a Firm basis the Daily Contract Quantity for such day to the Delivery Point. In the event the Gas Supplier fails to deliver such quantity of gas, including for reasons of *Force Majeure*, and to the extent such quantity of gas is not otherwise delivered as an Additional Interval Quantity under the terms of the Gas Purchase Agreement, the Gas Supplier is required to pay to the Purchaser the Replacement Cost (as defined in the Gas Purchase Agreement) in respect thereof.

*Delivery Points.* Except as may otherwise agreed to by the Gas Supplier and the Purchaser under the terms of the Gas Purchase Agreement, the Delivery Point for gas delivered under the Gas Purchase Agreement shall be any existing or future Southern California border receipt points into Transporter's system. In the event that Transporter establishes any City Gas Tariff Delivery Restriction, the parties may agree to provide for the least disproportionate economic impact on each party of such City Gas Tariff Delivery Restriction (the "Mitigation Measures"). If the parties fail, after good faith efforts, to reach agreement as to the Mitigation Measures, the Gas Supplier may elect to terminate the Gas Purchase Agreement unless the Purchaser agrees to assume all such additional costs. See "Early Termination of the Gas Purchase Agreement" in this section.

*Early Termination of the Gas Purchase Agreement.* The Purchaser may, by written notice to the Gas Supplier, terminate the Gas Purchase Agreement prior to the end of the Contract Term in the event that (a) any amount due and owing to the Purchaser by the Gas Supplier under the Gas Purchase Agreement is not paid on or before ten (10) Days after notice of such failure is given by the Purchaser, (b) the Gas Supplier fails to deliver the Daily Contract Quantity for a cumulative total of thirty (30) or more days in a 12-month period (excluding any period during which such delivery failure is caused by *Force Majeure*), (c) any Seller Bankruptcy or Guarantor

Bankruptcy occurs and is continuing, or (d) the Gas Supplier fails to provide to the Purchaser an Alternate Guarantee or other credit support as and when required under the terms of the Gas Purchase Agreement. In addition to the foregoing, the Gas Purchase Agreement may be terminated by the Gas Supplier following the adoption of any City Gas Tariff Delivery Restriction and the failure by the Gas Supplier and the Purchaser to agree to restrictions on the use of certain border receipt points on Transporter's system and/or other measures to mitigate the additional cost thereof, or for Purchaser to agree to bear all such costs.

*Payment Due Upon Early Termination.* In connection with any early termination of the Gas Purchase Agreement as described above, the Gas Supplier shall pay to the Purchaser on the date of such termination the Replacement Cost (determined as provided in the Gas Purchase Agreement) for prepaid gas, if any, not delivered prior to the termination of the Gas Purchase Agreement, plus an amount equal to the remaining value of the Gas Purchase Agreement. Such amount shall constitute liquidated damages for all gas not delivered under the Gas Purchase Agreement.

*Guarantee of Gas Supplier's Payment Obligations.* All payment obligations of the Gas Supplier under the Gas Purchase Agreement, including the amount payable by the Gas Supplier upon early termination thereof as described above, are guaranteed by the Guarantor under the Guarantee. See "Guarantee of Payment Obligations of the Gas Supplier" in this section. The Gas Supplier may substitute an Alternate Guarantee upon approval by the Purchaser and the Insurer, and shall provide an Alternate Guaranty or other credit support for its payment obligations under the Gas Purchase Agreement as described in the Gas Purchase Agreement in the event the Credit Ratings of the Guarantor are withdrawn or reduced below the minimum levels specified in the Gas Purchase Agreement.

#### **Guarantee of Payment Obligations of the Gas Supplier**

*Obligations Guaranteed.* All payment obligations of the Gas Supplier under the Gas Purchase Agreement are guaranteed by the Guarantor pursuant to a Guarantee. In case of the failure of the Gas Supplier punctually to pay any such amounts due, the Guarantor has agreed upon written demand by the Purchaser to cause any such payment to be made when and as the same become due and payable, as if such payment were made by the Gas Supplier. Subject to the City's rights with respect thereto pursuant to the Gas Supply Agreement, the Guarantee and all rights of the Purchaser thereunder have been assigned to the Trustee under the Indenture as part of the Trust Estate.

*Nature of Guarantor's Obligations.* The Guarantee is an irrevocable, unconditional, continuing obligation of the Guarantor, irrespective of the validity, regularity or enforceability of the obligations of the Gas Supplier under the Gas Purchase Agreement, the absence of any action to enforce the same, any waiver or consent by the Purchaser with respect to any provisions thereof, the rendering of any judgment against the Gas Supplier or any action to enforce the same or any other matter which would release a guarantor. The Guarantor has waived diligence, presentment, demand of payment (except as described in the foregoing paragraph), any right to require a proceeding against the Gas Supplier, protest or notice with respect to the obligations of the Gas Supplier or the amounts payable by the Gas Supplier under the Gas Purchase Agreement and all demands whatsoever, and has covenanted that the Guarantee will not be discharged except by complete payment of the obligations of the Gas Supplier. The Guarantee shall continue to be effective or be reinstated, as the case may be, if at any time any payment made by the Gas Supplier to the Purchaser is rescinded or must otherwise be restored or returned by the Purchaser upon the insolvency, bankruptcy or reorganization of the Gas Supplier, all as though such payment had not been made.

*Certain Information Regarding the Guarantor.* Citigroup Inc. is a Delaware holding company whose wholly-owned subsidiaries include Citigroup Energy Inc. For further information regarding Citigroup Inc., reference is made to (i) the Annual Report on Form 10-K of Citigroup, Inc. and its subsidiaries for the year ended December 31, 2005, filed by Citigroup Inc. with the Securities and Exchange Commission (the "SEC"), (ii) the Quarterly Report on Form 10-Q of Citigroup, Inc. and its subsidiaries for the quarter ended March 31, 2006, filed by Citigroup Inc. with the SEC, and (iii) the Form 8-Ks filed by Citigroup Inc. with the SEC on March 31, April 4, April 13, April 17, April 25, April 26, April 27, April 28, April 28, May 12, May 19, June 9, June 15 of 2006. Further information regarding Citigroup Inc. subsequent to December 31, 2005, will be included in the Form 10-Qs (quarterly), Form 10-Ks (annually), and any Form 8-Ks subsequently filed by Citigroup Inc. with the SEC. Copies

of such material may be obtained, upon payment of a duplicating fee, by writing to the SEC at 100 F Street, N.E., Washington, D.C. 20549. In addition, such reports are available at the SEC's web site (<http://www.sec.gov>).

### **Swap Agreement**

Contemporaneously with the issuance of the 2006 Bonds, the Authority is entering into an interest rate swap agreement in the form of an ISDA Master Agreement, dated as of June 27, 2006, including the Schedule and Credit Support Annex thereto (the "Master Agreement") with Citibank, N.A., New York (the "Swap Counterparty"). Pursuant to the Master Agreement, the Authority will enter into five separate interest rate swap transactions with the Swap Counterparty (four relating to the 2006A Bonds, i.e., one relating to each Subseries, and one relating to the 2006B Bonds and 2006C Bonds). Each such transaction will be evidenced by a Confirmation entered into under and governed by the Master Agreement (the Master Agreement, together with each such Confirmation, the "Swap Agreement"), with the notional amount and term of each such transaction being the same as the principal amount and term of the related Series of 2006 Bonds. The Authority will be required to make periodic payments thereunder based on a fixed rate and such notional amount, and in return, the Swap Counterparty will be required to make periodic payments based on a variable rate of interest equal to a percentage of one-month LIBOR and such notional amount. The amounts payable by each party on any date under the Swap Agreement will be netted against any payments to be received from the other party thereunder on the same date. The Swap Agreement is a Qualified Swap Agreement under the Indenture. All amounts due from the Authority under the Swap Agreement, including Net Payments and Termination Payments, are payable from Revenues deposited to the Qualified Swap Payments Fund in the order of priority set forth in the Indenture and described below under "SECURITY AND SOURCES OF PAYMENT—Application of Amounts in the Revenue Fund."

### **Sale of Gas to the City**

*General.* Pursuant to the Gas Supply Agreement, the Authority has assigned, transferred and sold to the City all of its right, title and interest in and to the Gas Purchase Agreement, including the Gas Supply purchased thereunder, and the Guarantee. The City will take delivery of such gas in accordance with the Gas Purchase Agreement and shall take title to each MMBtu of such gas at the Delivery Point. The City will have sole responsibility for transporting the purchased gas from the Delivery Point, including arranging for such transportation and paying all costs associated therewith. So long as no event of default exists with respect to the Gas Supply Agreement, the City will exercise all of the rights of the Authority under the Gas Purchase Agreement and the Guarantee.

*Consideration for Gas.* In consideration for the assignment by the Authority to the City of all of the Authority's right, title and interest in and to the Gas Purchase Agreement and the Guarantee, the City has agreed under the Gas Supply Agreement to make the Bond Payments, the Qualified Swap Payments, the Bank Payments and the Additional Gas Payments, and to pay various other fees and expenses relating to the 2006 Bonds. Such payments shall be made by the City solely from amounts on deposit in the City's Light and Power Fund.

*Unconditional Obligations.* The Gas Supply Agreement provides that the obligations of the City to make the payments required thereunder, including the Bond Payments, the Qualified Swap Payments, the Bank Payments and the Additional Gas Payments, and to perform and observe the other agreements on its part contained therein, are absolute and unconditional, irrespective of any defense or any rights of setoff, recoupment or counterclaim it might otherwise have against the Purchaser or any other person, and that the City shall pay absolutely net the payments required by the Gas Supply Agreement as prescribed therein, free of any deductions and without abatement, diminution or setoff. See "SECURITY AND SOURCES OF PAYMENT - The Gas Supply Agreement."

*Grant of Security Interest to Trustee.* Pursuant to the Indenture and subject to the priorities established thereunder, the Authority granted to the Trustee for the benefit of the Owners and the other parties secured under the Indenture a security interest in and to the Authority's right, title and interest in and to (i) the Gas Supply Agreement (other than the Reserved Rights), including the right to receive the Bond Payments, the Qualified Swap Payments, the Bank Payments and the Additional Gas Payments from the City, and (ii) all amounts paid by the Guarantor under and pursuant to the Guarantee.

*Use of Gas by the City in the Electric System.* The City will use the Gas Supply primarily as fuel for the generation of electricity at the Malburg Generating Station. The acquisition of the Gas Supply is the principal component of a long term natural gas procurement program for the Malburg Generating Station and the H. Gonzales Station consisting of approximately 70% fixed priced gas and approximately 30% indexed price gas. The Gas Supply will provide approximately 87% of the fuel requirements for the Malburg Generating Station when running as a base load unit in average climatic conditions. The remaining 13% of fuel requirements for the Malburg Generation Station, and the fuel requirements for the H. Gonzales Station gas turbines, will be met primarily through a partial requirements contract with Citigroup Energy Inc. In connection with the acquisition of the Gas Supply, the City will enter into a commodity price hedge relating to approximately 25% of the Monthly Quantities required to be delivered by the Gas Supplier (the "Commodity Price Hedge"). The Commodity Price Hedge will effectively convert the fixed price of the portion of the Gas Supply to which the Commodity Hedge relates to a variable market index price determined monthly.

For a description of the Electric System, including further information with respect to the use of gas by the City, the City's gas procurement program, and its monitoring and hedging of gas prices, see APPENDIX A - "CITY OF VERNON ELECTRIC SYSTEM."

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## ESTIMATED SOURCES AND USES OF FUNDS

### Sources of Funds:

Principal Amount of the 2006B Bonds and 2006C Bonds .....	\$ 230,845,000
<b>Total Sources of Funds</b> .....	<b>\$ 230,845,000</b>

### Use of Funds:

Cost of Acquiring a Portion of the Gas Supply .....	\$ 227,074,475
Costs of Issuance <sup>(1)</sup> .....	3,770,525
<b>Total Use of Funds</b> .....	<b>\$ 230,845,000</b>

<sup>(1)</sup> Includes legal fees, fees of the Trustee, rating agency fees, financial and consulting fees, bond insurance and debt service reserve surety premiums, printing costs and other miscellaneous expenses for the 2006B Bonds and 2006C Bonds.

Concurrently with the issuance of the 2006B Bonds and 2006C Bonds, the Authority also plans to issue the 2006A Bonds in the aggregate principal amount of \$200,000,000. The net proceeds of the 2006A Bonds will be used to: (i) pay the portion of the cost of acquiring the Gas Supply not being paid with the proceeds of the 2006B Bonds and 2006C Bonds; and (ii) pay the cost of issuance of the 2006A Bonds.

## SECURITY AND SOURCES OF PAYMENT

### Pledge Effected by the Indenture

*Trust Estate.* The 2006B Bonds and 2006C Bonds are special obligations of the Authority. The principal of and interest on the 2006B Bonds and 2006C Bonds are payable solely from and secured solely by a lien on and security interest in the Trust Estate pledged therefor under the Indenture, which consists of: (i) the Revenues; (ii) all amounts on deposit in the Funds and Accounts held by the Trustee under the Indenture, other than the Rebate Fund, including the investments, if any, thereof; (iii) all of the Authority’s right, title and interest in and to the Gas Supply Agreement, other than Reserved Rights; and (iv) subject to the rights of the City in the Gas Purchase Agreement and the Guarantee pursuant to the Gas Supply Agreement, all of the Authority’s right, title and interest in and to the Gas Purchase Agreement and the Guarantee. The pledge of the Trust Estate in the Indenture is subject to the provisions of the Indenture permitting the application thereof for the purposes and on the terms and conditions set forth therein. The pledge of the Trust Estate pursuant to the Indenture secures the 2006B Bonds and 2006C Bonds, the 2006A Bonds and any other Bonds which the Authority may issue on a parity basis under the Indenture.

For a summary of certain provisions of the Indenture, see “APPENDIX D—SUMMARY OF CERTAIN PROVISIONS OF THE INDENTURE.”

*Revenues.* “Revenues” is defined in the Indenture to mean (i) all Bond Payments, Bank Payments and all Qualified Swap Payments paid by the City pursuant to the Gas Supply Agreement; (ii) all Net Payments and Termination Payments paid by the Swap Counterparty to the Authority pursuant to each Qualified Swap Agreement, which Termination Payments are not used to fund a replacement Qualified Swap Agreement; (iii) subject to the rights of the City under the Gas Supply Agreement prior to the occurrence of an Event of Default thereunder, all amounts paid by the Gas Supplier pursuant to the Gas Purchase Agreement; and (iv) all amounts paid by Guarantor or any other Person pursuant to, or in connection with, the Guarantee.

**The 2006B Bonds and 2006C Bonds are special obligations of the Authority. The 2006B Bonds and 2006C Bonds are payable by the Authority solely from, and secured solely by a pledge of, the Trust Estate pursuant to the Indenture. The 2006B Bonds and 2006C Bonds are not secured by a legal or equitable pledge of, or lien or charge upon, any property of the Authority or any of its income or receipts except the Trust Estate, which pledge is subject to the provisions of the Indenture permitting the application thereof for**



**the purposes and on the terms and conditions set forth therein. Neither the faith and credit nor the taxing power of the State, the Authority, the City or any other public agency is pledged to the payment of the 2006B Bonds or 2006C Bonds, and the issuance of the 2006B Bonds and 2006C Bonds shall not directly, indirectly or contingently obligate the Authority, the State or any political subdivision thereof, including the City, to levy or pledge any form of taxation or to make any appropriation for the payment of the 2006B Bonds or 2006C Bonds.**

*Bond Payments, Bank Payments and Swap Payments.* The City has covenanted pursuant to the Gas Supply Agreement to pay to the Trustee, as assignee of the Authority, as a Bond Payment on or before each date provided in or pursuant to the Indenture for the payment of principal of (whether at maturity or upon redemption or acceleration), and/or interest on the Outstanding Bonds, until the principal of and interest on the 2006B Bonds and 2006C Bonds shall have been fully paid or provision for the payment thereof shall have been made in accordance with the Indenture, a sum equal to the amount then payable as principal (whether at maturity or upon redemption or acceleration) and interest on the 2006B Bonds and 2006C Bonds as provided in the Indenture. Notwithstanding the foregoing, with respect to any Sinking Fund Installment, the City shall make monthly Bond Payments during the year prior to the date such Sinking Fund Installment is due in an amount equal to 1/12 (one-twelfth) of the amount of such Sinking Fund Installment, such payments to be deposited by the trustee into the Debt Service Fund. In addition, the City has covenanted to pay to the Trustee, as assignee of the Authority, as a Qualified Swap Payment on or before each date provided in or pursuant to the Swap Agreement for the payment of any amount by the Authority, including without limitation Net Payments and Termination Payments, all amounts payable by the Authority on such date. The City has also covenanted pursuant to the Gas Supply Agreement to pay certain other amounts and fees referred to as “Additional Gas Payments.”

The obligations of the City to make the payments required under the Gas Supply Agreement, including the Bond Payments, the Qualified Swap Payments, the Bank Payments and the Additional Gas Payments, and to perform and observe the other agreements on its part contained therein are absolute and unconditional, irrespective of any defense or any rights of setoff, recoupment or counterclaim the City might otherwise have against the Authority or any other person, and the City shall pay from the revenues of the Electric System absolutely net the payments required by the Gas Supply Agreement as prescribed therein, free of any deductions and without abatement, diminution or setoff.

*Nature of City’s Payment Obligations.* The payment obligations of the City under the Gas Supply Agreement, including the obligation to make the Bond Payments, the Swap Payments, the Bank Payments and Additional Gas Payments, do not constitute a charge against the general credit of the City but are special obligations payable only from amounts in the City’s Light and Power Fund as an Operation and Maintenance Expense of the Electric System. Upon receipt of Electric System Revenues, the City deposits all such amounts into the City’s Light and Power Fund, from which it pays Operation and Maintenance Expenses. The City has covenanted in the Gas Supply Agreement to apply the moneys in the Light and Power Fund to the payment of Operation and Maintenance Expenses then due and payable, which the City has represented and warranted include the Bond Payments, the Qualified Swap Payments, the Bank Payments, Additional Gas Payments and all other amounts due under the Gas Supply Agreement, before applying such moneys to any other purpose. For information relating to the City’s Electric System, see “APPENDIX A—CITY OF VERNON ELECTRIC SYSTEM.”

**The amounts due from the City to the Authority, including the Bond Payments, the Qualified Swap Payments, the Bank Payments and Additional Gas Payments, are not secured by a legal or equitable pledge of, or lien or charge upon, any property of the City or any of its income or receipts but are payable only from amounts in the Light and Power Fund. Neither the faith and credit nor the taxing power of the State, the City or any other public agency is pledged to the payment of amounts due under the Gas Supply Agreement, and the execution and delivery of the Gas Supply Agreement do not directly, indirectly or contingently obligate the City, the State or any political subdivision thereof to levy or pledge any form of taxation or to make any appropriation for the payments due thereunder.**

#### **Application of Amounts in Revenue Fund**

Pursuant to the Indenture, the Authority will deposit, or cause to be deposited, in the Revenue Fund all Revenues and all other amounts received by the Authority in connection with the Gas Supply Agreement, the Gas

Purchase Agreement and the Guarantee promptly upon receipt thereof. Moneys in the Revenue Fund will be applied as set forth below. The Trustee will transfer moneys from the Revenue Fund to the following funds and accounts in the following order of priority, amounts and times (except that if on any date a transfer is to be made to the Debt Service Fund, the Credit Enhancement Fund (but only with respect to a transfer relating to reimbursement for payment of principal of or interest on Bonds or payment of a Facility Fee) and/or, with respect to a Net Payment, the Qualified Swap Fund, there are insufficient moneys in the Revenue Fund to make all such transfers, then such transfers will be made ratably based on the amount due each such fund):

(a) On each when a Rebate Requirement is due pursuant to the Tax Agreement with respect to any Bonds, to the Rebate Fund, the amount necessary to make the amount available in the Rebate Fund equal the Rebate Payment payable on such date;

(b) on each Interest Payment Date and each other date when interest on the Bonds is due and payable, to the Interest Account in the Debt Service Fund, an amount equal to the interest payable on the Outstanding Bonds on such date;

(c) on the first day of each month (or if such date is not a Business Day, on the preceding Business Day), to the Principal Account an amount equal to one-twelfth of the principal amount of the Outstanding Bonds scheduled to mature on the next succeeding August 1 which are not payable from Sinking Fund Installments, plus an amount equal to one-twelfth of the Sinking Fund Installments due with respect to the Outstanding Bonds on the next succeeding August 1;

(d) on each date on which the principal of Outstanding Bonds is due and payable upon acceleration, to the Principal Account, an amount equal to the principal of the Outstanding Bonds coming due on such date;

(e) on each date on which (i) any amounts are due under a Bank Agreement relating to the reimbursement or payment of principal of or interest on Bonds, to the Credit Enhancement Fund in an amount equal to the amounts coming due under such Bank Agreement on such date, and (ii) any Facility Fee is due, to the Credit Enhancement Fund in an amount equal to the amount of such Facility Fee coming due on such date;

(f) on each date the Authority is required to make a Net Payment under a Qualified Swap Agreement, to the Qualified Swap Fund an amount equal to the amount coming due under the Qualified Swap Agreement on such date;

(g) after each withdrawal of moneys from the Debt Service Reserve Fund and on each Debt Service Reserve Valuation Date, to the Debt Service Reserve Fund an amount such that, after the deposit of such amount in the Debt Service Reserve Fund, the amount on deposit in such Fund shall be at least equal to the Debt Service Reserve Requirement, including amounts necessary to reinstate any Reserve Financial Guaranties on deposit in the Debt Service Reserve Fund;

(h) on each date the Authority is required to make a Termination Payment under a Qualified Swap Agreement, to the Qualified Swap Fund an amount equal to the amount coming due under the Qualified Swap Agreement on such date; and

(i) on each date any amounts are due and payable under a Bank Agreement, to the extent not paid above, to the Credit Enhancement Fund, in an amount equal to such previously unpaid amounts, without duplication, coming due under such Bank Agreement on such date.

### **Rate Covenant**

Pursuant to the Gas Supply Agreement, the City has covenanted that it will at all times fix, prescribe and collect rates and charges for the Electric System during each Fiscal Year which shall provide Electric System Revenues sufficient, together with other available funds, to pay when due the Operation and Maintenance Expenses, including all payments required of the City under the Gas Supply Agreement (which includes the Bond Payments, the Qualified Swap Payments, the Bank Payments and the Additional Gas Payments), and all other payments which are a charge or lien on the Electric System Revenues as the same become due and payable.

## **Other Parties Secured by the Trust Estate**

Under the terms of the Indenture, the Trust Estate is pledged equally and ratably to the payment of (i) the principal of and interest on the 2006 Bonds and any additional Bonds issued pursuant to the terms of the Indenture, (ii) all amounts due and payable by the Authority pursuant to any Bank Agreement, and (iii) all amounts due from the Authority pursuant to the Swap Agreement and any other Qualified Swap Agreement entered into by the Authority. See APPENDIX D—SUMMARY OF CERTAIN PROVISIONS OF THE INDENTURE—The Indenture.”

As described under “PLAN OF FINANCE – Swap Agreement” herein, the City expects to enter into the Swap Agreement in connection with the issuance of the 2006 Bonds. Under the terms of the Indenture, the Authority has pledged the Trust Estate to secure the payment by the Authority of any amounts owed by it under the Swap Agreement, which pledge is on a parity with the pledge of the Trust Estate made by the Authority under the Indenture to secure the Bonds. Amounts received by the Authority under the Swap Agreement constitute “Revenues” under the Indenture. The obligation of the Swap Counterparty to make payments under the Swap Agreement does not affect the Authority’s obligation under the Indenture for the payment of the Bonds. Neither the Owners of the Bonds, nor any other person other than the City and the Authority will have any rights under the Swap Agreement. Under certain circumstances, the Swap Agreement is subject to early termination prior to the maturity of the 2006 Bonds, in which event the City could be obligated to make a substantial payment to the Swap Counterparty. Amounts due from the Authority upon any early termination of a transaction under the Swap Agreement are subordinate as to payment from the amounts in the Revenue Fund to the payment of amounts due with respect to the Bonds.

## **Debt Service Reserve Fund**

The Debt Service Reserve Fund is required to be maintained in an amount equal to the “Debt Service Reserve Requirement,” which is defined in the Indenture to mean, as of any date of calculation, an amount equal to the least of (a) ten percent (10%) of the initial offering price to the public of the Bonds as determined under the Code, or (b) the greatest amount of debt service on the Outstanding Bonds in any Fiscal Year during the period commencing with the Fiscal Year in which the determination is being made and terminating with the last Fiscal Year in which any Outstanding Bond is due, or (c) one hundred twenty-five percent (125%) of the sum of the debt service for all Fiscal Years during the period commencing with the Fiscal Year in which such calculation is made (or if appropriate, the first full Fiscal Year following the issuance of any Bonds) and terminating with the last Fiscal Year in which any debt service on an Outstanding Bond is due, divided by the number of such Fiscal Years, all as computed and determined by the Authority and specified in writing to the Trustee; provided, however that in determining debt service with respect to any Bonds that constitute Variable Rate Bonds, the interest rate on such Bonds for any period as to which such interest rate has not been established shall be assumed to be (i) with respect to Bonds which are tax-exempt, the ten year historical average of the BMA Index ending with the week preceding the date of calculation, and (ii) with respect to Bonds which are not tax-exempt, the ten year historical average of one-month LIBOR ending with the month preceding the date the calculation is made, or if one-month LIBOR is not available for such period, another similar rate or index selected by the Authority.

Pursuant to the Indenture, in lieu of the required deposits and transfers of money to the Debt Service Reserve Fund, the City may cause to be deposited in the Debt Service Reserve Fund a Reserve Financial Guaranty or Guaranties such as the Debt Service Reserve Fund Surety Bond (as hereinafter defined) in an amount equal to the difference between the Debt Service Reserve Requirement and the sums, if any, then on deposit in the Debt Service Reserve Fund or being deposited in such Fund concurrently with such Reserve Financial Guaranty or Guaranties. “Reserve Financial Guaranty” is defined in the Indenture to mean a policy of municipal bond insurance or surety bond issued by a municipal insurer or a letter of credit issued by a bank or other institution if the obligations insured by such insurer or issued by such bank or other institution, as the case may be, have ratings at the time of issuance of such policy or surety bond or letter of credit in the highest rating category (without regard to qualifiers) by S&P and Moody’s and, if rated by A.M. Best & Company, also in the highest rating category (without regard to qualifiers) by A.M. Best & Company. Any Reserve Financial Guaranty must be acceptable to the Insurer.

Upon the issuance of the 2006 Bonds, the Debt Service Reserve Fund will be funded solely by the Debt Service Reserve Fund Surety Bond issued by MBIA Insurance Corporation. See "--Debt Service Reserve Fund Surety Bond" below.

The Trustee shall draw upon or otherwise take such action as is necessary in accordance with the terms of the Reserve Financial Guaranties (including the Debt Service Reserve Fund Surety Bond) to receive payments with respect thereto (including the giving of notice as required thereunder): (i) on any date on which moneys will be required to be withdrawn from the Debt Service Reserve Fund and applied to the payment of principal of or interest on any Bonds and such withdrawal cannot be met by amounts on deposit in the Debt Service Reserve Fund; (ii) on the first Business Day which is at least ten (10) days prior to the expiration date of each Reserve Financial Guaranty, in an amount equal to the deficiency which would exist in the Debt Service Reserve Fund if such Reserve Financial Guaranty expired, unless a substitute Reserve Financial Guaranty with an expiration date not earlier than 180 days after the expiration date of the expiring Reserve Financial Guaranty is acquired prior to such date or the City deposits funds in the Debt Service Reserve Fund before such date so that the amount in the Debt Service Reserve Fund on such date (without regard to such expiring Reserve Financial Guaranty) is at least equal to the Debt Service Reserve Requirement.

### **Debt Service Reserve Fund Surety Bond**

The Insurer has issued its commitment to issue a surety bond with respect to the Debt Service Reserve Fund (the "Debt Service Reserve Fund Surety Bond"). The Debt Service Reserve Fund Surety Bond will provide that upon notice from the Trustee to the Insurer to the effect that insufficient amounts are on deposit in the Debt Service Fund to pay the principal of (at maturity or pursuant to mandatory redemption requirements) and interest on the 2006 Bonds, the Insurer will promptly deposit with the Trustee an amount sufficient to pay the principal of and interest on the 2006 Bonds or the available amount of the Debt Service Reserve Fund Surety Bond, whichever is less. Upon the later of: (i) three (3) days after receipt by the Insurer of a Demand for Payment in the form attached to the Debt Service Reserve Fund Surety Bond, duly executed by the Trustee; or (ii) the payment date of the 2006 Bonds as specified in the Demand for Payment presented by the Trustee to the Insurer, the Insurer will make a deposit of funds in an account with U.S. Bank Trust National Association, in New York, New York, or its successor, sufficient for the payment to the Trustee, of amounts which are then due to the Trustee (as specified in the Demand for Payment) subject to the Surety Bond Coverage.

The available amount of the Debt Service Reserve Fund Surety Bond is the initial face amount of the Debt Service Reserve Fund Surety Bond less the amount of any previous deposits by the Insurer with the Trustee which have not been reimbursed by the Authority. The City, the Authority and the Insurer have entered into a Financial Guaranty Agreement (the "Financial Guaranty Agreement"). Pursuant to the Financial Guaranty Agreement, the Authority is required to reimburse the Insurer, within one year of any deposit, the amount of such deposit made by the Insurer with the Trustee under the Debt Service Reserve Fund Surety Bond. Such reimbursement shall be made only after the deposits described above in paragraphs (a) through (f) under the heading "-- Application of Amounts in Revenue Fund" have been made.

Under the terms of the Financial Guaranty Agreement, the Trustee is required to reimburse the Insurer, with interest, until the face amount of the Debt Service Reserve Fund Surety Bond is reinstated before any deposit is made to those funds described in paragraphs (h) and (i) under the heading "-- Application of Amounts in Revenue Fund." No optional redemption of 2006 Bonds may be made until the Insurer's Debt Service Reserve Fund Surety Bond is reinstated. The Debt Service Reserve Fund Surety Bond will be held by the Trustee in the Debt Service Reserve Fund and is provided as an alternative to the Authority depositing funds equal to the Debt Service Requirement for outstanding 2006 Bonds. The Debt Service Reserve Fund Surety Bond will be issued in the face amount equal to the Debt Service Reserve Amount for the 2006 Bonds and the premium therefor will be fully paid by the Authority at the time of delivery of the 2006 Bonds.

### **Parity Obligations**

*2006A Bonds.* As described above, concurrently with the issuance of the 2006B Bonds and 2006C Bonds, the Authority expects to issue the 2006A Bonds, which are secured by the Trust Estate "on a parity basis with the

2006B Bonds and the 2006C Bonds under the Indenture. The 2006 Bonds will be the first Series of Bonds issued under the Indenture.

*Additional Bonds.* The Authority may issue additional Bonds secured under the Indenture pursuant to the terms set forth therein. Any such Bonds shall only be issued for one of the following purposes: (i) prepaying all of the costs of acquiring additional natural gas under the Gas Purchase Agreement which gas is sold to the City pursuant to the Gas Supply Agreement; or (ii) refunding an Outstanding Bond or Bonds.

*Other Parity Obligations.* The pledge of the Trust Estate under the Indenture also secures the payment of all amounts due from the Authority under any Bank Agreement and any Qualified Swap Agreement. Such pledge is on parity with the pledge of the Trust Estate made under the Indenture to secure the payments due in respect of the Bonds.

See “APPENDIX D—SUMMARY OF CERTAIN PROVISIONS OF THE INDENTURE.”

### **Limitations on Remedies**

The rights of the Owners of the 2006B Bonds and 2006C Bonds are subject to the limitations on legal remedies against public entities in the State. Additionally, enforceability of the rights and remedies of the Owners of the 2006B Bonds and 2006C Bonds, and the obligations incurred by the Authority and the City, may become subject to the following: the Federal Bankruptcy Code and applicable bankruptcy, insolvency, reorganization, moratorium, or similar laws relating to or affecting the enforcement of creditor’s rights generally, now or hereafter in effect; equity principles which may limit the specific enforcement under State law of certain remedies; the exercise by the United States of America of the powers delegated to it by the Constitution; and the reasonable and necessary exercise, in appropriate situations, of the police powers inherent in the sovereignty of the State and its governmental bodies in the interest of serving a significant and legitimate public purpose. Bankruptcy proceedings, or the exercise of powers by the federal or State government, if initiated, could subject the Owners of the 2006B Bonds and 2006C Bonds to judicial discretion and interpretation of their rights in bankruptcy or otherwise, and consequently may entail risks of delay, limitation, or modification of their rights.

### **BOND INSURANCE**

*The following information has been furnished by the Insurer for use in this Official Statement. Reference is made to Appendix F for a specimen of the Policies with respect to the 2006B Bonds or 2006C Bonds.*

The Insurer accepts no responsibility for the accuracy or completeness of this Official Statement or any other information or disclosure contained herein, or omitted herefrom, other than with respect to the accuracy of the information regarding the Policies and the Insurer and its affiliates set forth under the heading “BOND INSURANCE”. In addition, the Insurer makes no representation regarding the 2006B Bonds or 2006C Bonds or the advisability of investing in the 2006B Bonds or 2006C Bonds.

### **The Policies**

The Policies unconditionally and irrevocably guarantees the full and complete payment required to be made by or on behalf of the Authority of an amount equal to (i) the principal of (either at the stated maturity or by an advancement of maturity pursuant to a mandatory sinking fund payment) and interest on, the 2006B Bonds or 2006C Bonds as such payments shall become due but shall not be so paid (except that in the event of any acceleration of the due date of such principal by reason of mandatory or optional redemption or acceleration resulting from default or otherwise, other than any advancement of maturity pursuant to a mandatory sinking fund payment, the payments guaranteed by the Policies shall be made in such amounts and at such times as such payments of principal would have been due had there not been any such acceleration, unless Insurer elects in its sole discretion, to pay in whole or in part any principal due by reason of such acceleration); and (ii) the reimbursement of any such payment which is subsequently recovered from any owner of the 2006B Bonds or 2006C Bonds pursuant to a final judgment by a court of competent jurisdiction that such payment constitutes an avoidable preference to such owner within the meaning of any applicable bankruptcy law (a “Preference”).

The Policies do not insure against loss of any prepayment premium which may at any time be payable with respect to any 2006B Bonds or 2006C Bonds. The Policies do not, under any circumstance, insure against loss relating to: (i) optional or mandatory redemptions (other than mandatory sinking fund redemptions); (ii) any payments to be made on an accelerated basis; (iii) payments of the purchase price of 2006B Bonds or 2006C Bonds upon tender by an owner thereof; or (iv) any Preference relating to (i) through (iii) above. The Policies also do not insure against nonpayment of principal of or interest on the 2006B Bonds or 2006C Bonds resulting from the insolvency, negligence or any other act or omission of the Trustee or any other paying agent for the 2006B Bonds or 2006C Bonds.

Upon receipt of telephonic or telegraphic notice, such notice subsequently confirmed in writing by registered or certified mail, or upon receipt of written notice by registered or certified mail, by Insurer from the Trustee or any owner of a 2006B Bonds or 2006C Bonds the payment of an insured amount for which is then due, that such required payment has not been made, Insurer on the due date of such payment or within one Business Day after receipt of notice of such nonpayment, whichever is later, will make a deposit of funds, in an account with U.S. Bank Trust National Association, in New York, New York, or its successor, sufficient for the payment of any such insured amounts which are then due. Upon presentment and surrender of such 2006B Bonds or 2006C Bonds or presentment of such other proof of ownership of the 2006B Bonds or 2006C Bonds, together with any appropriate instruments of assignment to evidence the assignment of the insured amounts due on the 2006B Bonds or 2006C Bonds as are paid by Insurer, and appropriate instruments to effect the appointment of the Insurer as agent for such owners of the 2006B Bonds or 2006C Bonds in any legal proceeding related to payment of insured amounts on the 2006B Bonds or 2006C Bonds, such instruments being in a form satisfactory to U.S. Bank Trust National Association, U.S. Bank Trust National Association shall disburse to such owners or the Trustee payment of the insured amounts due on such 2006B Bonds or 2006C Bonds, less any amount held by the Trustee for the payment of such insured amounts and legally available therefor.

### **MBIA Insurance Corporation**

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

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

### **Regulation**

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

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

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

## **Financial Strength Ratings of the Insurer**

Moody's rates the financial strength of the Insurer "Aaa." S&P rates the financial strength of the Insurer "AAA." Fitch Ratings rates the financial strength of the Insurer "AAA."

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

The above ratings are not recommendations to buy, sell or hold the 2006B Bonds or 2006C Bonds, and such ratings may be subject to revision or withdrawal at any time by the rating agencies. Any downward revision or withdrawal of any of the above ratings may have an adverse effect on the market price of the 2006B Bonds or 2006C Bonds. The Insurer does not guaranty the market price of the 2006B Bonds or 2006C Bonds nor does it guaranty that the ratings on the 2006B Bonds or 2006C Bonds will not be revised or withdrawn.

## **Financial Information of the Insurer**

As of December 31, 2005, the Insurer had admitted assets of \$11.0 billion (unaudited), total liabilities of \$7.2 billion (unaudited), and total capital and surplus of \$3.8 billion (unaudited) determined in accordance with statutory accounting practices prescribed or permitted by insurance regulatory authorities. As of March 31, 2006, the Insurer had admitted assets of \$11.2 billion (unaudited), total liabilities of \$7.5 billion (unaudited), and total capital and surplus of \$3.8 billion (unaudited) determined in accordance with statutory accounting practices prescribed or permitted by insurance regulatory authorities.

For further information concerning the Insurer, see the consolidated financial statements of the Insurer and its subsidiaries as of December 31, 2005 and December 31, 2004 and for each of the three years in the period ended December 31, 2005, prepared in accordance with generally accepted accounting principles, included in the Annual Report on Form 10-K of the Company for the year ended December 31, 2005 and the consolidated financial statements of the Insurer and its subsidiaries as of March 31, 2006 and for the three month period ended March 31, 2006 and March 31, 2005 included in the Quarterly Report on Form 10-Q of the Company for the period ended March 31, 2006, which are hereby incorporated by reference into this Official Statement and shall be deemed to be a part hereof.

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

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

The following documents filed by the Company with the SEC are incorporated by reference into this Official Statement:

- (1) The Company's Annual Report on Form 10-K for the year ended December 31, 2005; and
- (2) The Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2006.

Any documents, including any financial statements of the Insurer and its subsidiaries that are included therein or attached as exhibits thereto, filed by the Company pursuant to Sections 13(a), 13(c), 14 or 15(d) of the Exchange Act after the date of the Company's most recent Quarterly Report on Form 10-Q or Annual Report on Form 10-K, and prior to the termination of the offering of the 2006B Bonds or 2006C Bonds offered hereby shall be deemed to be incorporated by reference in this Official Statement and to be a part hereof from the respective dates of filing such documents. Any statement contained in a document incorporated or deemed to be incorporated by reference herein, or contained in this Official Statement, shall be deemed to be modified or superseded for purposes of this Official Statement to the extent that a statement contained herein or in any other subsequently filed document which also is or is deemed to be incorporated by reference herein modifies or supersedes such statement. Any such statement so modified or superseded shall not be deemed, except as so modified or superseded, to constitute a part of this Official Statement.

The Company files annual, quarterly and special reports, information statements and other information with the SEC under File No. 1-9583. Copies of the Company's SEC filings (including (1) the Company's Annual Report on Form 10-K for the year ended December 31, 2005, and (2) the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2006 are available (i) over the Internet at the SEC's web site at <http://www.sec.gov>; (ii) at the SEC's public reference room in Washington D.C.; (iii) over the Internet at the Company's web site at <http://www.mbia.com>; and (iv) at no cost, upon request to the Insurer at its principal executive offices.

## THE LIQUIDITY FACILITIES

The following summary of the Liquidity Facilities for the 2006B Bonds and the 2006C Bonds does not purport to be comprehensive or definitive and is subject to all of the terms and provisions of the Liquidity Facilities, to which reference is made hereby. Investors are urged to obtain and review copies of the Liquidity Facilities in order to understand all of the terms thereof.

**Each Liquidity Facility secures only payment of the purchase price of the 2006B Bonds or 2006C Bonds, respectively, tendered for purchase as described above, and do not otherwise secure payment of the principal of or interest on the 2006B Bonds or 2006C Bonds. Each Liquidity Facility is subject to termination at the option of the Liquidity Provider as described below.**

### General

Each Liquidity Facility contains various provisions, covenants and conditions, certain of which are summarized below. The terms of each Liquidity Facility are substantively identical. Capitalized terms used in the following summary are defined in Appendix C to this Official Statement or in the Liquidity Facilities and reference thereto is made for full understanding of their import. References in this section to the "Liquidity Facility" without further qualification shall mean either the Liquidity Facility with respect to the 2006B Bonds or the Liquidity Facility with respect to the 2006C Bonds, as applicable.

On the date of issuance of the 2006B Bonds and 2006C Bonds, the Authority will enter into the Liquidity Facilities with the Liquidity Provider and the Trustee and Tender Agent. The Liquidity Facilities will be effective on the date of issuance of the 2006B Bonds and 2006C Bonds upon satisfaction of certain conditions set forth in the Liquidity Facilities, or such other date that the conditions set forth in the Liquidity Facilities are satisfied (the "Liquidity Facility Effective Date"). Each Liquidity Facility requires the Liquidity Provider from time to time to extend credit through the purchase of Eligible Bonds, subject to certain conditions described below. Eligible Bonds to be purchased and held by the Liquidity Provider will bear interest at the Bank Bond Rate in accordance with each Liquidity Facility.

The Purchase Period for each Liquidity Facility shall be the period from the Liquidity Facility Effective Date to and including the close of business (New York time) on the earliest of (i) June 27, 2009, as the same may be extended from time to time in accordance with the terms of the Liquidity Facility, (ii) the date on which no Eligible Bonds of the related Series are Outstanding, or (iii) the date on which the Available Commitment and the Liquidity Provider's obligation to purchase Eligible Bonds of the related Series have terminated.

### Commitment to Purchase 2006B Bonds and 2006C Bonds

If, on any Purchase Date during the Purchase Period, the Liquidity Provider receives a Notice of Bank Purchase from the Tender Agent not later than 11:15 a.m. (New York time), the Liquidity Provider shall, subject to the satisfaction of certain requirements set forth in the related Liquidity Facility, transfer to the Tender Agent not later than 2:15 p.m. (New York time) on such Purchase Date, in immediately available funds, an amount equal to the aggregate Purchase Price of all Eligible Bonds of the related Series tendered or deemed tendered for purchase on such date but not remarketed as specified in such Notice of Bank Purchase.

### Events of Default

The occurrence of any of the events set forth under the subheading "Events of Default Not Permitting Immediate Termination" or "Events of Default Permitting Immediate Suspension or Termination" below shall



constitute an Event of Default under the Liquidity Facility. Upon an Event of Default, the Liquidity Provider may exercise those rights and remedies provided under the subheading “Remedies” below.

### **Events of Default Not Permitting Immediate Termination**

(a) The Authority fails to pay when due (i) any installment of the Facility Fee and such failure is not cured within 10 days after the Insurer and the City have been given written notice of such failure; or (ii) any other amounts (other than payments covered by paragraph (a) under the subheading “Events of Default Permitting Immediate Suspension or Termination”) owed by the Authority to the Liquidity Provider pursuant to the Liquidity Facility and such failure is not cured within 20 days after the Authority and the Insurer have been given written notice of such failure.

(b) Any representation or warranty made by or on behalf of (i) the Authority in the Liquidity Facility or in any other Related Document or in any certificate or statement delivered by it under the Liquidity Facility or in such Related Document or (ii) the City in the Gas Supply Agreement, the Letter of Representation or any certificate or statement delivered by it thereunder, shall prove to have been incorrect or untrue in any material respect when made or deemed to have been made.

(c) The Authority fails to (i) use the proceeds of the 2006B Bonds or 2006C Bonds solely for the purposes described in the Indenture, (ii) cause the amounts advanced under the Liquidity Facility to be used only to pay the Purchase Price due and payable on any Purchase Date in connection with any Eligible Bonds, or (iii) observe any of the negative covenants set forth in the Liquidity Facility.

(d) The (i) Authority fails to perform or observe any term, covenant or agreement (other than ones described in any other paragraph of this section) contained in the Liquidity Facility on its part to be performed or observed or (ii) City shall fail to perform or observe any term, covenant or agreement contained in the Gas Supply Agreement or the Letter of Representation on its part to be performed or observed, and such failure is not cured within 30 days of notice thereof from the Liquidity Provider.

(e) Default by the Authority in the payment of any amount due in respect of any Debt as and when the same shall become due, or default under any mortgage, agreement or other instrument under or pursuant to which such Debt is incurred or issued, and continuance of such default beyond the period of grace, if any, allowed with respect thereto, or the occurrence of any act or omission by the Authority under any such mortgage agreement or other instrument which results in such Debt becoming, or being capable of becoming, immediately due and payable (or, with respect to any Interest Rate Protection Agreement, which results in such Interest Rate Protection Agreement being terminated early or being capable of being terminated early).

(f) Any provision of the Liquidity Facility, the 2006B Bonds or 2006C Bonds, the Gas Supply Agreement or any of the other Related Documents shall cease to be valid and binding, or the Authority or the City shall contest any such provision, or the Authority, the City or any agent or trustee on behalf of any of them shall deny that it has any further liability under any provision of the Liquidity Facility, the 2006B Bonds or 2006C Bonds, the Gas Supply Agreement or any of the other Related Documents to which it is a party.

(g) Any event of default under any of the Related Documents shall occur.

(h) An Event of Insolvency shall have occurred with respect to the Authority or the City.

(i) The Insurer shall fail to maintain the Permitted Minimum Bond Insurer Rating for a period of thirty (30) consecutive Business Days.

(j) Either the Authority or the City shall fail to pay, when due, a final, non-appealable judgment against itself.

(k) The 2006B Bonds or 2006C Bonds (including Bank Bonds) are declared to be taxable and the interest thereon cannot be excluded from the gross income of the Owners thereof for purposes of Federal income taxation under the Code.

## **Events of Default Permitting Immediate Suspension or Termination**

The following Events of Default shall permit the Liquidity Provider to immediately terminate or suspend its obligation to purchase 2006B Bonds or 2006C Bonds under the related Liquidity Facility:

(a) Any principal or interest due on the 2006B Bonds or 2006C Bonds is not paid when due and such principal or interest is not paid by the Insurer when, as, and in the amounts required to be paid pursuant to the terms of the Policy; or

(b) The President or any Executive Vice President of the Insurer shall in writing claim that the Policy with respect to the payment of principal of or interest on the 2006B Bonds or 2006C Bonds, as the case may be, is not valid and binding on the Insurer, or repudiate the obligations of the Insurer under such Policy with respect to payment of such principal or interest, or the Insurer shall initiate any legal proceedings to seek an adjudication that the Policy, with respect to the payment of such principal or interest, or the special redemption of the 2006B Bonds or 2006C Bonds pursuant to the terms of the Liquidity Facility, is not valid and binding on the Insurer, or a final non-appealable decision of a court of competent jurisdiction or governmental authority with jurisdiction to rule on the validity of the Policy that the Policy is not valid and binding on the Insurer; or

(c) Either (i) the occurrence of a Bond Insurer Event of Insolvency, or (ii) each of Moody's, Fitch and S&P withdraws or suspends the claims paying or financial strength rating of the Bond Insurer (but excluding any withdrawal or suspension of any such ratings where the Rating Agency stipulates in writing that the rating action is being taken for non credit related reasons) or reduces such rating, in the case of S&P and Fitch, below BBB-, and in the case of Moody's, below Baa3; or

(d) Any default by the Insurer in making payment when, as and in the amounts required to be made pursuant to the express terms and provisions of any other financial guaranty insurance policy issued by the Insurer insuring publicly-rated bonds and such failure continues for thirty (30) consecutive days, unless the obligation of the Insurer to make such payment is being contested in good faith by appropriate proceedings which the Bond Insurer is diligently pursuing; or

(e) Without the prior written consent of the Liquidity Provider, the Policy is cancelled or terminated or is adversely amended, modified or supplemented.

## **Remedies**

Upon the occurrence of an Event of Default, the Liquidity Provider may take one or more of the following actions:

(a) In the case of an Event of Default specified in paragraph (a), (c) (other than a default pursuant to paragraph (c)(i) with respect to an order described in clause (a) of the definition of Bond Insurer Event of Insolvency), (d) or (e) under the subheading "Events of Default Permitting Immediate Suspension or Termination" above, the Available Commitment, the Purchase Period and the obligation of the Liquidity Provider to purchase 2006B Bonds or 2006C Bonds, as the case may be, shall immediately terminate without notice or demand, and thereafter the Liquidity Provider shall be under no obligation to purchase 2006B Bonds or 2006C Bonds, as the case may be. Promptly upon the Liquidity Provider obtaining knowledge of an Immediate Termination Event, the Liquidity Provider shall give written notice of the same to the Trustee, the Tender Agent, the Authority, the Remarketing Agent and the Insurer; provided, that the Liquidity Provider shall incur no liability or responsibility whatsoever by reason of its failure to give such notice and such failure shall in no manner affect the immediate termination of the Available Commitment and of the Liquidity Provider's obligation to purchase 2006B Bonds or 2006C Bonds, as the case may be, pursuant to the related Liquidity Facility. In addition, upon the occurrence of an Immediate Termination Event, the obligations of the Authority under the related Liquidity Facility and under the Liquidity Provider Bonds shall become immediately due and payable without demand, presentment, protest or notice of any kind, all of which are expressly waived by the Authority.

(b) In the case of any Event of Default set forth in (a)(i) or (i) under the subheading "Events of Default Not Permitting Immediate Termination" above, the Liquidity Provider may terminate the Available Commitment and Purchase Period by giving a Termination Notice to the Trustee, the Tender Agent, the Authority,

the Remarketing Agent and the Bond Insurer, specifying the date on which the Available Commitment and Purchase Period shall terminate, which date shall be not less than thirty (30) days from the date of receipt of such notice by the Trustee. Provision of such notice shall constitute a Mandatory Standby Tender with respect to the related Series of 2006 Bonds. On and after such date of termination, the Liquidity Provider shall be under no further obligation to purchase the related Series of 2006 Bonds.

(c) In the case of an Event of Default specified in paragraph (b) under the subheading “Events of Default Permitting Immediate Suspension or Termination” above, the Liquidity Provider’s obligation to purchase 2006B Bonds or 2006C Bonds, as the case may be, shall be immediately suspended without notice or demand and thereafter the Liquidity Provider shall be under no obligation to purchase such 2006B Bonds or 2006C Bonds unless and until the Available Commitment is reinstated as described in this paragraph (c). Promptly upon the Liquidity Provider obtaining knowledge of any such Event of Default, the Liquidity Provider shall give written notice of the suspension to the Authority, the Trustee, the Tender Agent, the Remarketing Agent, the Tender Agent and the Insurer; provided, that the Liquidity Provider shall incur no liability or responsibility whatsoever by reason of its failure to give such notice and such failure shall in no way affect the suspension of the Liquidity Provider’s obligations to purchase the related Series of 2006 Bonds. If a court with jurisdiction to rule on the validity of the Policy shall thereafter enter a final, non-appealable judgment that the Policy is not valid and binding on the Insurer, then the Available Commitment, the Purchase Period and the Liquidity Provider’s obligation to purchase the related Series of 2006 Bonds shall immediately terminate and, upon such occurrence, the obligations of the Authority under the related Liquidity Facility and under the Bank Bonds shall become immediately due and payable without demand, presentment, protest or notice of any kind, all of which have been expressly waived by the Authority. If a court with jurisdiction to rule on the validity of the Policy shall find or rule that the Policy is valid and binding on the Insurer, the Liquidity Provider’s obligation to purchase the related Series of 2006 Bonds under the related Liquidity Facility shall be automatically reinstated and the terms of the related Liquidity Facility will continue in full force and effect (unless the Liquidity Provider’s obligation to purchase the related Series of 2006 Bonds shall otherwise have terminated or been suspended in accordance with the terms of the related Liquidity Facility). In the event that the Available Commitment is reinstated as described herein, the applicable Liquidity Provider shall notify the Authority, the Trustee, the Tender Agent, the Remarketing Agent and the Insurer of such reinstatement in writing; provided, that the applicable Liquidity Provider shall incur no liability or responsibility whatsoever by reason of its failure to give such notice and such failure shall in no way affect the reinstatement of the Available Commitment and the applicable Liquidity Provider’s obligation to purchase the related Series of 2006 Bonds pursuant to the related Liquidity Facility. Notwithstanding the foregoing, if, upon the earlier of the Expiration Date or the date which is two (2) years after the effective date of the suspension of the Liquidity Provider’s obligations as described in this paragraph (c), litigation is still pending and a judgment regarding the validity of the Policy as is the subject of such Event of Default has not been obtained, then the Available Commitment, the Purchase Period and the obligation of the Liquidity Provider to purchase the related Series of 2006 Bonds shall at such time immediately terminate without notice or demand, and thereafter the Liquidity Provider shall be under no obligation to purchase the related Series of 2006 Bonds.

(d) During the pendency of an Event of Default pursuant to Section (c)(i) under the subheading “Events of Default Permitting Immediate Suspension or Termination” above (with respect to an order described in clause (a) of the definition of “Bond Insurer Event of Insolvency” as set forth in the Liquidity Facility), the Liquidity Provider’s obligation to purchase the related Series of 2006 Bonds shall be immediately suspended without notice or demand and thereafter the Liquidity Provider shall be under no obligation to purchase the related Series of 2006 Bonds until the Available Commitment is reinstated as described in this paragraph (d). Promptly upon the Liquidity Provider obtaining knowledge of the pendency of any such Event of Default, the Liquidity Provider shall give written notice of such suspension to the Authority, the Trustee, the Tender Agent, the Remarketing Agent and the Insurer; provided, however, that the Liquidity Provider shall incur no liability or responsibility whatsoever by reason of its failure to give such notice and such failure shall in no way affect the suspension of the Liquidity Provider’s obligations under the Liquidity Facility. In the event the pendency of any such Event of Default is cured prior to becoming an Event of Default, the Liquidity Provider’s obligations shall be automatically reinstated and the terms of the Liquidity Facility will continue in full force and effect (unless the Liquidity Provider’s obligation to purchase the related Series of 2006 Bonds thereunder shall otherwise have terminated or been suspended in accordance with the terms of the Liquidity Facility). In the event that the Available Commitment is reinstated as described herein, the applicable Liquidity Provider shall notify the Authority, the Trustee, the Remarketing Agent, the Tender Agent and the Insurer of such reinstatement in writing; provided, that the applicable Liquidity Provider shall incur no liability or responsibility whatsoever by reason of its

failure to give such notice and such failure shall in no way affect the reinstatement of the Available Commitment and the applicable Liquidity Provider's obligation to purchase the applicable Series of 2006 Bonds pursuant to the applicable Liquidity Facility.

(e) In the case of the pendency of any such Event of Default specified in paragraph (d) under the subheading "Events of Default Permitting Immediate Suspension or Termination" above, the Liquidity Provider's obligations to purchase the related Series of 2006 Bonds shall be immediately suspended without notice or demand and thereafter the Liquidity Provider shall be under no obligation to purchase Eligible Bonds until the Available Commitment is reinstated as described in this paragraph (e). Promptly upon the Liquidity Provider obtaining knowledge of the pendency of any such Event of Default, the Liquidity Provider shall give written notice of the same to the Authority, the Trustee, the Remarketing Agent, the Tender Agent and the Insurer; provided, that the Liquidity Provider shall incur no liability or responsibility whatsoever by reason of its failure to give such notice and such failure shall in no way affect the suspension of the Liquidity Provider's obligations to purchase the related Series of 2006 Bonds. If the Insurer fails to pay under a bond insurance policy as described in paragraph (d) under the subheading "Events of Default Permitting Immediate Suspension or Termination" above, and such failure continues for 30 days without the Insurer diligently contesting such obligation in good faith, the Purchase Period, the Available Commitment and the Liquidity Provider's obligation to purchase the related Series of 2006 Bonds shall immediately terminate. If the Bond Insurer fails to pay under a bond insurance policy as described in paragraph (d) under the subheading "Events of Default Permitting Immediate Suspension or Termination" above and prior to the date which is 30 days after such failure, the Insurer diligently contests such obligation in good faith and thereafter a court with jurisdiction to rule on the obligation of the Insurer under such policy shall thereafter enter a final, non-appealable judgment that the Insurer is obligated to make such contested payment and the Insurer thereafter fails to make such payment then the Purchase Period, the Available Commitment and the Liquidity Provider's obligation to purchase the related Series of 2006 Bonds shall immediately terminate. If the Insurer fails to make a payment with respect to a bond insurance policy and such obligation is contested as described in the preceding sentence and a court with jurisdiction to rule on the Insurer's obligation shall find or rule that the Insurer is not obligated to make such contested payment, the Liquidity Provider's obligations to purchase the related Series of 2006 Bonds under the Liquidity Facility shall be automatically reinstated and the terms of such Liquidity Facility will continue in full force and effect (unless the Liquidity Provider's obligation to purchase the related Series of 2006 Bonds shall otherwise have terminated or been suspended in accordance with the terms of the Liquidity Facility). Notwithstanding the foregoing, if, upon the earlier of the Expiration Date or the date which is two (2) years after the effective date of the suspension of the Liquidity Provider's obligations as described in this paragraph (e), litigation regarding the obligation of the Insurer to make such contested payment is still pending and a judgment has not been obtained, then the Purchase Period, the Available Commitment and the obligation of the Liquidity Provider to purchase the related Series of 2006 Bonds shall at such time immediately terminate, and thereafter the Liquidity Provider shall be under no obligation to purchase the related Series of 2006 Bonds.

(f) In addition to the rights and remedies set forth in paragraphs (a) through (e) under the subheading "Remedies" above, in the case of any Event of Default, upon the election of the Liquidity Provider: (i) all amounts payable under the Liquidity Facility (other than payments of principal and redemption price of and interest on the related Bank Bonds or payments of Excess Interest Amount) shall upon notice to the Authority become immediately due and payable without presentment, demand, protest or further notice of any kind, all of which are expressly waived by the Authority; and (ii) the Liquidity Provider shall have all the rights and remedies available to it under the Liquidity Facility, the other Related Documents, the Policy or otherwise pursuant to law or equity; provided, however, that the Liquidity Provider shall not have the right to terminate its obligation to purchase the related Series of 2006 Bonds or to declare any amount under the Liquidity Facility due and payable except as expressly provided in the Liquidity Facility. Without limiting the generality of the foregoing, the Liquidity Provider agrees to purchase 2006B Bonds or 2006C Bonds on the terms and conditions of the related Liquidity Facility notwithstanding the institution or pendency of any bankruptcy, insolvency or similar proceeding with respect to the Authority. The Liquidity Provider will not assert as a defense to its obligation to purchase 2006B Bonds or 2006C Bonds under the related Liquidity Facility (y) the institution or pendency of a bankruptcy, insolvency or similar proceeding with respect to the Authority, or (z) a determination by a court of competent jurisdiction in a bankruptcy, insolvency or similar proceeding with respect to the Authority that the Liquidity Facility is not enforceable against the Authority under applicable bankruptcy, insolvency or similar laws. This paragraph shall not limit the exercise of the Liquidity Provider's remedies expressly provided for under any other paragraph under the subheading "Remedies."

## **Alternate Liquidity Facilities**

The 2006B and the 2006C Bonds shall be subject to mandatory tender upon the termination of the applicable Liquidity Facility and provision of an Alternate Liquidity Facility.

## **LITIGATION**

### **General**

There is no controversy or litigation of any nature now pending or threatened restraining or enjoining, or seeking to restrain or enjoin, the issuance of any of the 2006 Bonds or the execution, delivery and performance of the Gas Purchase Agreement, the Gas Supply Agreement or any other Related Document, or in any way contesting or affecting the validity thereof or any proceedings of the City or the Authority taken with respect to the issuance or sale thereof or the execution, delivery and performance of any of the foregoing documents.

### **On-going Litigation with the former City Attorney**

The City is currently a party to litigation involving its former City Attorney. In 2004, the City filed suit against its former City Attorney for malpractice relating to several matters handled by such individual and provided such individual six months' notice of termination of employment with the City. The former City Attorney filed a counterclaim against the City for wrongful termination and breach of contract. In addition to such counterclaim, the former City Attorney prepared and submitted to the City Council a report alleging certain improper reimbursement of expenses of the City Administrator of the City. Such report was also filed with the District Attorney of Los Angeles County and is the subject of an ongoing investigation by the District Attorney. The City believes the all expenses reimbursed to the City Administrator were properly included as part of the City Administrator's contractual compensation arrangements and has objected to the misleading nature of the report prepared by the former City Attorney. The City has engaged both internal and external independent auditors and an independent law firm to investigate the matter, none of whom have discovered any improper reimbursement or compensation. The City has offered to provide all information contained in the report to the District Attorney in its original form, and has obtained a protective order from the Superior Court of Los Angeles County preventing disclosure of various portions of the report. The District Attorney's investigation is ongoing, but the City believes all allegations of the former City Attorney's counterclaim and the allegations of improper reimbursement of expenses to the City Administrator are without merit.

### **Election Controversy**

On January 13, 2006, eight individuals attempted to establish domicile in a commercial structure in the City for the purpose of becoming registered voters in the City. Based on this claim of domicile, these individuals presented three candidates for election to City Council, whose names were included on the ballot in the City Council election held on April 11, 2006. The structure these individuals claimed as their domicile was not habitable, however, and the individuals did not own the structure and were found to be trespassing. As a result, these individuals were evicted from the premises. The City filed a claim with the Superior Court of Los Angeles County seeking to invalidate the voter registration of the eight individuals and the removal of the three additional names from the ballot, which claim was pending at the time of the election. Ballots were cast on April 11, 2006 as scheduled, but the results were sealed, uncounted, by order of Superior Court, and will not be opened and counted until the litigation is resolved. All action taken by the City Council relating to the creation of the Authority and the issuance of the 2006 Bonds, including authorization of the execution, delivery and performance of the Supply Contract, were taken prior to the election and will not be affected by the election results or the results of the on-going litigation.

### **Other Litigation**

Mirant Americas Energy Marketing, Inc., which is currently in bankruptcy, has obtained an approximately \$14 million judgment from the bankruptcy court against the City with respect to the termination of an energy supply contract. The City has appealed the judgment to the United States Circuit Court for the Fifth Circuit. This Court has stayed the action pending FERC's decision to assert jurisdiction over the matter as part of FERC's proceedings in connection with termination payments relating to the California energy crisis of 2000 and

2001. The City is unable to determine the ultimate loss related to this matter at this time. See "DEVELOPMENTS IN THE CALIFORNIA ENERGY MARKETS - Matters Relating to the California Energy Crisis" in Appendix A. At any given time, including the present, there are certain other claims and disputes, including those currently in litigation, that arise in the normal course of the City's activities. Such matters could, if determined adversely to the City, affect expenditures by the City, and in some cases, the Electric System Revenues. The City's management and the City Attorney are of the opinion that none of such other pending actions are likely to have a material adverse effect on the City's ability to make all required payments under the Gas Supply Agreement when due.

## **TAX MATTERS**

In the opinion of Orrick, Herrington & Sutcliffe LLP ("Bond Counsel"), based on an analysis of existing laws, regulations, rulings and court decisions, and assuming, among other matters, the accuracy of certain representations and compliance with certain covenants, interest on the 2006B Bonds and 2006C Bonds is excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986 (the "Code"). Bond Counsel is of the further opinion that interest on the 2006B Bonds and 2006C Bonds is not a specific preference item for purposes of the federal individual or corporate alternative minimum taxes, although Bond Counsel observes that such interest is included in adjusted current earnings when calculating corporate alternative minimum taxable income. Bond Counsel is also of the opinion that interest on the 2006B Bonds and 2006C Bonds is exempt from State of California personal income taxes. A complete copy of the proposed form of opinion of Bond Counsel is set forth in Appendix E hereto.

The Code imposes various restrictions, conditions and requirements relating to the exclusion from gross income for federal income tax purposes of interest on obligations such as the 2006B Bonds and 2006C Bonds. The Authority and the City have made certain representations and covenanted to comply with certain restrictions, conditions and requirements designed to ensure that interest on the 2006B Bonds and 2006C Bonds will not be included in federal gross income. Inaccuracy of these representations or failure to comply with these covenants may result in interest on the 2006B Bonds and 2006C Bonds being included in gross income for federal income tax purposes, possibly from the date of original issuance of the 2006B Bonds and 2006C Bonds. The opinion of Bond Counsel assumes the accuracy of these representations and compliance with these covenants. Bond Counsel has not undertaken to determine (or to inform any person) whether any actions taken (or not taken), or events occurring (or not occurring), or any other matters coming to Bond Counsel's attention after the date of issuance of the 2006B Bonds and 2006C Bonds may adversely affect the value of, or the tax status of interest on, the 2006B Bonds and 2006C Bonds.

The interest rate mode and certain requirements and procedures contained or referred to in the Indenture, the Tax Agreement, and other relevant documents may be changed and certain actions (including, without limitation, defeasance of 2006B Bonds and 2006C Bonds ) may be taken or omitted under the circumstances and subject to the terms and conditions set forth in such documents. Bond Counsel expresses no opinion as to any 2006B Bond or 2006C Bond or the interest thereon if any such change occurs or action is taken or omitted upon the advice or approval of Bond Counsel other than Orrick, Herrington & Sutcliffe LLP.

Although Bond Counsel is of the opinion that interest on the 2006B Bonds and 2006C Bonds is excluded from gross income for federal income tax purposes and is exempt from State of California personal income taxes, the ownership or disposition of, or the accrual or receipt of interest on, the 2006B Bonds and 2006C Bonds may otherwise affect a Beneficial Owner's federal, state or local tax liability. The nature and extent of these other tax consequences depend upon the particular tax status of the Beneficial Owner or the Beneficial Owner's other items of income or deduction. Bond Counsel expresses no opinion regarding any such other tax consequences.

Future legislation, if enacted into law, or clarification of the Code may cause interest on the 2006B Bonds and 2006C Bonds to be subject, directly or indirectly, to federal income taxation, or otherwise prevent Beneficial Owners from realizing the full current benefit of the tax status of such interest. The introduction or enactment of any such future legislation or clarification of the Code may also affect the market price for, or marketability of, the 2006B Bonds and 2006C Bonds. Prospective purchasers of the 2006B Bonds and 2006C Bonds should consult their own tax advisers regarding any pending or proposed federal tax legislation, as to which Bond Counsel expresses no opinion.

The opinion of Bond Counsel is based on current legal authority, covers certain matters not directly addressed by such authorities, and represents Bond Counsel's judgment as to the proper treatment of the 2006B Bonds and 2006C Bonds for federal income tax purposes. It is not binding on the Internal Revenue Service ("IRS") or the courts. Furthermore, Bond Counsel cannot give and has not given any opinion or assurance about the future activities of the Authority or the City, or about the effect of future changes in the Code, the applicable regulations, the interpretation thereof or the enforcement thereof by the IRS. The Authority and the City have covenanted, however, to comply with the requirements of the Code.

Bond Counsel's engagement with respect to the 2006B Bonds and 2006C Bonds ends with the issuance of the 2006B Bonds and 2006C Bonds, and, unless separately engaged, Bond Counsel is not obligated to defend the Authority, the City or the Beneficial Owners regarding the tax-exempt status of the 2006B Bonds and 2006C Bonds in the event of an audit examination by the IRS. Under current procedures, parties other than the Authority and its appointed counsel, including the Beneficial Owners, would have little, if any, right to participate in the audit examination process. Moreover, because achieving judicial review in connection with an audit examination of tax-exempt bonds is difficult, obtaining an independent review of IRS positions with which the Authority legitimately disagrees may not be practicable. Any action of the IRS, including but not limited to selection of the 2006B Bonds and 2006C Bonds for audit, or the course or result of such audit, or an audit of bonds presenting similar tax issues, may affect the market price for, or the marketability of, the 2006B Bonds and 2006C Bonds and may cause the Authority, the City or the Beneficial Owners to incur significant expense.

#### **APPROVAL OF LEGALITY**

The issuance of the 2006B Bonds and 2006C Bonds is subject to the approving opinion of Orrick, Herrington & Sutcliffe LLP, Los Angeles, California, Bond Counsel, substantially in the form set forth as Appendix E. Certain legal matters will be passed upon for the Underwriter by King & Spalding LLP, New York, New York, for the Authority by Orrick, Herrington & Sutcliffe LLP, Los Angeles, California, Latham & Watkins LLP, Los Angeles, California, Karns and Karabian, Los Angeles, California, and for the City by Karns & Karabian, Los Angeles, California, and Eric T. Fresch, City Attorney, Vernon California.

#### **RATINGS**

Moody's and S&P have assigned the 2006B Bonds and 2006C Bonds the ratings of "Aaa/VMIG 1" and "AAA/A-1+," respectively, which long-term ratings are based on the understanding that upon delivery of the 2006B Bonds and 2006C Bonds, the Insurer will issue the Policies guaranteeing the scheduled payment of principal and interest on the 2006B Bonds and 2006C Bonds when due, and which short-term ratings are based on the availability of the Liquidity Facilities to pay the purchase price of 2006B Bonds and 2006C Bonds tendered for purchase. The ratings reflect only the respective views of the Rating Agencies and any explanation of the significance of such ratings may be obtained only from such Rating Agencies as follows: Moody's Investors Service, 99 Church Street, New York, New York 10007; and Standard & Poor's, 55 Water Street, New York, New York 10041. There is no assurance that the ratings will remain in effect for any given period of time or that they will not be revised downward or withdrawn entirely by such Rating Agencies, or either of them, if, in their respective judgments, circumstances so warrant. Any downward revision or withdrawal of any rating may have an adverse effect on the market price of the 2006B Bonds and 2006C Bonds.

#### **UNDERWRITING**

Citigroup Global Markets Inc. (the "Underwriter") has agreed, subject to certain conditions, to purchase (i) the 2006B Bonds at a price equal of \$115,244,196.47 (which represents the par amount of the 2006B Bonds less underwriter's discount of \$195,803.53), and (ii) the 2006C Bonds at a price equal of \$115,209,255.83 (which represents the par amount of the 2006C Bonds less underwriter's discount of \$195,744.17). The Underwriter is obligated to purchase all of the 2006B Bonds and 2006C Bonds if any Bonds of such Series are purchased. The Underwriter will enter into a separate bond purchase contract with the Authority relating to the 2006A Bonds.

#### **BASIC FINANCIAL STATEMENTS**

The audited Basic Financial Statements of the City, as of June 30, 2005 and June 30, 2004, are included in Appendix B to this Official Statement. The Basic Financial Statements have been audited by Macias Gini &

Company LLP, Los Angeles, California, independent accountants (the “Independent Accountants”) as stated in their reports appearing in Appendix B. The Independent Accountants have consented to the inclusion of the audited financial statements of the City for the Fiscal Years ended June 30, 2005 and June 30, 2004 as Appendix B to this Official Statement.

The financial statements set forth in Appendix B include the City’s General Fund and all other funds of the City, in addition to the Light and Power Fund through which the operations of the Electric System are accounted. The financial statements relating to the Light and Power Fund are included in the Basic Financial Statements and presented as a major proprietary fund. The payments to be made by the City pursuant to the Gas Supply Agreement are special obligations of the City payable solely from amounts in the Light and Power Fund and are payable from any other property of the City or any of its other income or receipts.



The execution and delivery of this Official Statement has been duly authorized by the Authority and approved by the City.

**VERNON NATURAL GAS FINANCING AUTHORITY**

By: /s/ Bruce Malkenhorst, Jr.  
Title: Executive Director

Approved by:

**CITY OF VERNON, CALIFORNIA**

By: /s/ Leonis C. Malburg  
Title: Mayor

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## APPENDIX A

### CITY OF VERNON ELECTRIC SYSTEM

#### GENERAL

##### City of Vernon

The City of Vernon (the "City") is located in Los Angeles County, California, approximately four miles southeast of downtown Los Angeles. The City was incorporated on September 16, 1905 as a general law city, with the goal of promoting industry within its borders. Effective July 1, 1988, the City became a chartered city. The City is almost exclusively industrial, with an estimated resident population of 110 as of January 1, 2006. The City has approximately 1,260 businesses (primarily industrial and commercial) located within its 5.2 square miles and a work day population of more than 45,000.

The City is a developed industrial rail city, with major railroads, including Union Pacific ("UP") and the Burlington Northern Santa Fe ("BNSF"), running through it. The City's northern borders include some of the country's largest intermodal freight yards operated by UP and the BNSF. These 200-acre rail facilities handle 1.5 million container and trucks on flatcars per year (much of it goods manufactured in the City) heading for domestic and world markets.

In addition to rail, the City has excellent freeway access with State Highway 710 adjacent to the City line and State Highway 10 being less than 2 miles from the center of the City affording easy access to major highways in all directions. The City's location expedites the delivery of raw materials to City businesses and the distribution of final products, particularly for non-foreign processed foods.

In addition to the Electric System, the City owns and operates a water system (the "Water System") which provides water service within the City and a natural gas system (the "Gas System") which currently provides natural gas to the Electric System. The City operates each of the Electric System, the Water System and the Gas System as distinct enterprises with the revenues and expenses of each enterprise separately accounted for by the City.

##### The Electric System

The City established its Electric System in 1933 through the acquisition of the existing electric distribution system within the City and the construction of a diesel generating station at Station A (located at 2715 East 50<sup>th</sup> Street, Vernon, California) ("Station A"). The City operates the Electric System through its Light and Power Department with all revenues of the Electric System being credited to, and all expenses of the Electric System being payable from, the Light and Power Department Fund. The Electric System serves all electric users within the City. In keeping with the character of the City, the Electric System serves primarily industrial and commercial customers. During the Fiscal Year ended June 30, 2005, the Electric System served 2,044 meters (with a number of customers having several meters), supplied approximately 1,123.6 million kWhs of electric energy and had a peak demand of approximately 196 megawatts ("MW"). See "RETAIL ENERGY SALES - Customers, Retail Sales, Revenues and Demands" below.

Historically the City supplied only a modest portion of its customers' load requirements from its own generation resources. The Electric System relied first on a partial requirements wholesale power contract with the Southern California Edison Company ("Edison") and then on a combination of wholesale power contracts. See "POWER SUPPLY RESOURCES – General." To stabilize the cost of power and to increase reliability for its customers, the City commenced development of the Malburg Generating Station, a 120 MW net load combined cycle electric generation plant located at Section A. The Malburg Generating Station commenced commercial operation in October 2005 and has been successfully operating as a base load generation resource for the City since such date. See "POWER SUPPLY RESOURCES – City-Owned Generating Facilities-Malburg Generating Station."

The City operates and expects to continue operating the Malburg Generating Station as a base load plant providing up to 60% of the Electric System's requirements. For that reason the City has undertaken a program of natural gas procurement and price management to stabilize the cost of the gas required as fuel for the Malburg Generating Station and its other generating units. The acquisition of the Gas Supply with the proceeds of the 2006 Bonds is a major element of such plan. See "POWER SUPPLY RESOURCES – City-Owned Generating Facilities-Natural Gas Procurement."

As more fully described below, the Electric System also includes ownership interests or capacity rights in other electric generation and transmission facilities and the local electric distribution system.

The City currently operates and maintains the Electric System facilities located within the City. The City is negotiating with experienced power plant operation and maintenance companies to obtain a long-term service, operation and maintenance agreement for Malburg Generating Station. However, if the City is unable to obtain a cost effective long term contract with one of these companies, the City will continue to operate and maintain the plant. Petrelli Electric Inc. currently maintains the City's electric distribution system under contract with the City.

## **MANAGEMENT**

The Electric System is operated and maintained through the City's Light and Power Department which is governed by the City Council. The Light and Power Department is managed by the Director of Light and Power whose duties include overseeing the operation and maintenance of the Electric System's generation, transmission and distribution facilities, metering, power purchasing, scheduling, billing and settlements. The Director of Light and Power is also responsible for the management of the City's Gas System.

### **City Council**

The current members of the City Council are as follows:

**Leonis C. Malburg**, Mayor, was first elected to the City Council in 1956 and was appointed as Mayor in 1974. Mr. Malburg was born in the City and is the grandson of founding father, John B. Leonis.

**Thomas A. Ybarra**, Mayor Pro Tempore, was first elected to the City Council in 1966. After serving with the U.S. Army's 20<sup>th</sup> Infantry Regiment of the 6<sup>th</sup> Infantry Division in Korea, Mr. Ybarra worked for the American Can Company for 30 years.

**William J. Davis**, Council Member, was first elected to the City Council in 1981. Mr. Davis was born in Manila, Philippines and came to the United States in 1969. Prior to returning, Mr. Davis worked at Southern California Edison.

**Hilario Gonzalez**, Council Member, was appointed to the City Council in 1974 and has been a resident of the City since 1952.

**W. Michael McCormick**, Council Member, was first elected to the City Council in 1974 and has been a resident of the City since 1969. Mr. McCormick works at the Safeway meat processing plant in the City.

## **ELECTRIC SYSTEM MANAGEMENT**

The following are brief resumes of the Director of Light and Power and the senior management personnel whom are responsible for Electric System operations.

**Donal O'Callaghan**, the Director of Light and Power, provides overall direction, structure, conduct, control and reporting of the Electric System and the Gas System. Prior to joining the City in March, 2005, Mr. O'Callaghan was employed by the City of Santa Clara as a Project Manager assigned to the Pico Power Project, 154 MW combined cycle power plant. In addition, Mr. O'Callaghan has held positions in various locations throughout North America for the past seven years as a Project Manager for several companies including NEPCO/ENRON and

S & B Engineers in which he was responsible for management of the construction and operation of over 4 power plants. Mr. O'Callaghan has a Bachelor of Science Degree from the University of Ulster, Jordanstown in 1981 and is a member of the Mechanical Engineers Institute and the Chartered Engineers Institute. Mr. O'Callaghan has 26 years of global experience in the power industry including engineering, power generation, transmission, distribution, operations, commissioning/startup, facility and projects management.

**Peter Hervish** is the Technical Services Manager of the Light and Power Department responsible for engineering and operations support. Mr. Hervish has over 25 years of experience in the power industry spanning all facets of power plant engineering and maintenance. Prior to joining the City in April 2005, Mr. Hervish held several positions at Progress Energy, Inc., including Manager of Plant Maintenance and Construction Projects and Lead Engineer. Prior to his tenure at Progress Energy, Mr. Hervish held several positions at what is now Siemens/Westinghouse Power Corporation and at Foster-Wheeler Corporation, including Site Installation and Commissioning Manager, Consortium Site Manager, Project Manager Latin America and Senior Plant Thermal Systems Engineer. Mr. Hervish holds a Bachelor of Science degree and a Masters degree from the State University of New York. During his tenure at Siemens/Westinghouse and Foster-Wheeler, Mr. Hervish was granted several patents and published a number of articles on engineering and plant maintenance/operations.

**Carlos Fandino** is the Transmission and Distribution Operations and Maintenance Manager of the Light and Power Department. Mr. Fandino has over 17 years of experience in the Light and Power Department and is responsible for the day-to-day operations of the electric transmission and distribution facilities. Mr. Fandino holds a Bachelor of Science Degree in Engineering from the University of Woodbury, magna cum laude.

**Krishna Nand** has been the Environmental Compliance Manager for the Light and Power Department since March 2005. Dr. Nand has over 40 years of experience in the area of environmental impacts and permit compliance. Prior to joining the City, Dr. Nand worked for 20 years at Parsons Engineering, Inc. holding the position of Senior Project Manager. While at Parsons Engineering, Inc., Dr. Nand was the AFC Project Manager for the Malburg Generating Station as well as the repowering projects at the Haynes Electrical Generating Station and the Valley Electrical Generation Station of California Energy Commission Application for Certification and Conditions of Certification process, the Los Angeles Department of Water and Power and at the Electrical Generation Station of the City of Pasadena Water and Power Department. Dr. Nand holds a Masters of Science and a PhD in Physics, as well as a Bachelors of Science in Physics, Chemistry, and Mathematics, University of Lucknow, India.

## POWER SUPPLY RESOURCES

### General

The Electric System was established in 1933 with the City's purchase of the existing electric distribution system of Edison and the construction of five small diesel-powered generating units, four of which still serve as an emergency source of power. Even with the ownership of the diesel units, historically the City purchased virtually all of its power requirements under a contract with Edison. In the 1980's the City expanded its resource base by (i) entering into a long-term power purchase contract with the Southern California Public Power Authority ("SCPPA") with respect to a portion of SCPPA's interest in the Palo Verde Nuclear Generating Station ("PVNGS"), (ii) participating in a project to upgrade the generating resources of the Hoover Dam (the "Hoover Uprating Project") and (iii) constructing two small gas generating units (the "H. Gonzales Generating Station") at Station A. At this time the City was a partial requirements customer of Edison. Because its own resources supplied less than ten percent of the Electric System's requirements and the cost of power in the short-term market was substantially less than comparable power purchased under its Edison contract, in the 1990's the City commenced a program of purchasing power in the short-term market to meet the bulk of its load. In 1998, in connection with Edison's changing role under the California electric industry deregulation, the City terminated Edison's obligation to provide power, high voltage transmission services and ancillary services to the City. During the period from 1998 to 2000, the City purchased in the short-term market almost all of its power requirements not met from its own resources. In early 2000, the market price of power increased. See "DEVELOPMENTS IN THE ENERGY MARKETS – Industry Restructuring and the Energy Crisis" herein. To stabilize its cost of power the City entered into a number of long-term power purchase contracts to supply the bulk of the Electric System's power. With the exception of one

long-term term contract with American Electric Power, the Malburg Generating Station has replaced much of the power previously supplied under these long-term contracts.

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The power supply resources of the Electric System for the past five Fiscal Years are described in the following table.

**CITY OF VERNON  
ELECTRIC SYSTEM  
POWER SUPPLY RESOURCES**

	Fiscal Year Ended June 30,				
	2001	2002	2003	2004	2005
<b>Short-Term Contracts <sup>(1)</sup></b>					
Actual Energy	736,606	307,666	276,407	376,996	401,460
Percentage of Total Energy	52.25%	22.69%	21.00%	28.15%	29.33%
<b>Long-Term Contracts <sup>(2)</sup></b>					
Actual Energy	553,200	933,375	924,800	857,600	868,000
Percentage of Total Energy	39.24%	68.84%	70.27%	64.04%	63.42%
<b>SCPPA Palo Verde</b>					
Actual Energy	86,953	85,305	88,024	78,785	79,168
Percentage of Total Energy	6.17%	6.29%	6.68%	5.88%	5.78%
<b>Hoover Upgrade</b>					
Actual Energy	27,887	28,834	26,455	25,752	20,004
Percentage of Total Energy	1.98%	2.13%	2.01%	1.92%	1.46%
<b>Malburg Generating Station and other City-Owned Generation</b>					
Actual Energy <sup>(3)</sup>	5,027	621	349	0	0
Percentage of Total Energy	0.36%	0.05%	0.02%	0.00%	0.00%
<b>Total Energy</b>	1,409,673	1,355,801	1,316,035	1,339,133	1,368,632

Source: City of Vernon

- (1) Term of less than one year.
- (2) Term of one year or longer.
- (3) Megawatt hours ("mwh").

**City-Owned Generating Facilities**

**Malburg Generating Station.** The Malburg Generating Station is a 120 MW base load/134 MW full load combined cycle, natural gas-fired, electric power plant located at Station A, an approximately 3.4 acres site at 2715 East 50th Street in the City. The Malburg Generating Station achieved commercial operation in October 2005. The Malburg Generating Station includes two Siemens (formerly Alstom) GTX100 natural gas-fired combustion turbine generators ("CTGs") known as Malburg Units 1 and 2. Hot exhaust gases from the CTGs are directed to two parallel heat recovery steam generators ("HRSGs"). Steam from the HRSGs are directed to a steam turbine generator ("STG") known as Malburg Unit 3. The HRSGs include duct burners to increase steam output and achieve higher levels of power output from the steam turbine in selected modes of operation. The CTGs are each equipped with an evaporative inlet air cooler/filter to cool combustion turbine inlet air and achieve higher levels of power from the CTGs in selected modes of operation. The exhaust gases from each HRSG are released to the atmosphere through a 110-foot high stack. Each CTG and the STG are separate electric generators. Each generator, rated at 13.2 kV, is connected to the existing 66 kV bus at the Vernon Substation, located at Station A, through three separate 13.2/66 kV generator step up transformers.

The Malburg Generating Station also includes a new staff parking area, electrical equipment building, cooling tower, condenser, a gas metering and pressure regulating station, fuel gas compressor skid, water storage tank, and water treatment and wastewater treatment facilities. There are also pipelines for gas supply, water supply, and wastewater discharge.

Air emission control technology employed at the Malburg Generating Station consists of dry low nitrogen oxide combustors in the CTGs, with a selective catalytic and CO reduction system in the HRSGs to achieve the Best Available Control Technology/Lowest Available Emission Rate requirements of the local air quality management district. The Malburg Generating Station consumes water for cooling tower makeup, steam cycle makeup, the CTG inlet air evaporative cooler, fire protection, and domestic uses. Reclaimed water supplied by the Central Basin Municipal Water District is the primary source used for cooling tower makeup and steam cycle makeup. Wastewater discharge from the Malburg Generating Station is discharged to the existing sanitation districts of the Los Angeles County sewer system via a clarifier and oily water separator.

The Malburg Generating Station is fueled entirely by pipeline quality natural gas. A new looped 10-inch diameter, 1,300-foot long, lateral natural gas pipeline delivers natural gas to Station A from the local natural gas distribution system of the City. The City system, in turn, is interconnected to a line at the Spence Street station of the Southern California Gas Company ("SoCal Gas Company"). While the SoCal Gas Company line is rated at a maximum allowable operating pressure of 720 pounds per square inch gauge ("psig"), SoCal Gas Company does not guarantee the delivery pressure. During times of the year when the delivery pressures are less than the required minimum CTG inlet pressure requirement of 378 psig, three new 50 percent natural gas compressors boost the natural gas pressure to the minimum required. See "Natural Gas Procurement" below.

Since October 2005, the City has operated the Malburg Generating Station as a base-load resource to provide energy to serve the City's electric utility customers. There have been no significant forced outages at the facility since commercial operations began in October 2005. The Malburg Generating Station is operating with a capacity factor between 60% and 85%, and has had an availability factor of between 90% and 98%. The Malburg Generating Station operates 7 days per week and generally 24 hours per day.

**H. Gonzales Generating Station.** The City owns the H. Gonzales Generating Station consisting of two small gas turbine units located at Station A with each unit having a net capacity of 5.5 MW. The two units are used for peaking purposes and are not expected to be used more than 500 hours per year. Each of the units are restricted to run on natural gas for no more than six hours per day or on diesel fuel for no more than five hours per day.

**Johnson & Heinz Diesel Plant.** The City owns the Johnson & Heinz Diesel Plant consisting of five diesel generator units installed in 1933. Each unit has a net capacity of 3.5 MW for a total net capacity for the plant of 17.5 MW. One of the units is currently inoperable. The other four units are currently used only for emergency purposes. These units operate very few hours per year with an operational restriction of 199 hours each per year. The Johnson & Heinz Diesel Plant is located at the City's existing Station A.

## **Natural Gas Procurement**

Since 1988, the City has provided for the acquisition and delivery of natural gas to Station A to serve the H. Gonzales gas units. The City obtains the natural gas for the Malburg Generating Station and the H. Gonzales Station through its Gas Department. The City is implementing a long term natural gas procurement program for the Malburg Generating Station and the H. Gonzales Station consisting of approximately 70% fixed priced gas and approximately 30% indexed price gas.

The Acquisition Agreement is the cornerstone of the City's natural gas procurement program for fixed price gas. See "PLAN OF FINANCE" in the Official Statement to which this Appendix is attached. The gas supplied under the Acquisition Agreement will provide approximately 87% of the fuel requirements for the Malburg Generation Station when running as a base load unit in average climatic conditions.

The remaining 13% of fuel requirements for the Malburg Generating Station, and the fuel requirements for the H. Gonzales Station gas turbines, will be met initially through a partial requirements contract (the "Partial Requirements Contract") with Citigroup Energy Inc. (the "Partial Requirements Provider"). The gas delivered under the Partial Requirements Contract will be priced based on a recognized index price which will fluctuate from time to time. The City may fix the price of a portion of the such gas from time to time at then market prices. As described below, the City monitors the price of natural gas on a regular basis. The City anticipates entering into both long-term and short-term fixed-price contracts for gas at targeted prices to displace gas delivered under the Partial



Requirements Contract. The City may also enter into indexed-price gas contracts for certain periods other than the Partial Requirements Contract.

To provide for the transportation of purchased gas from the California border to the City, the City executed a Master Services Agreement (the "Master Services Agreement") with the SoCal Gas Company. The City will take firm service under the Master Services Agreement pursuant to SoCal Gas Company's wholesale transportation tariff Schedule GW-VRN. SoCal Gas Company's service under the Master Services Agreement and such tariff is subject to regulation by the California Public Utilities Commission.

### **Power Purchase Agreements**

**Long-Term Power Contracts.** The City has one fixed-price contract for the purchase of power for the on-peak period. The amount of power to be delivered under such contract decreases over time from 50 MWs on-peak at the beginning of calendar year 2005 to 25 MWs on-peak by the end of calendar year 2010. This contract is in the form of the Western Systems Power Pool power purchase agreement. The cost of power under this contract is \$57.38/MWh for the Fiscal Year ending June 30, 2006.

**Short-Term Power Contracts.** The City expects to provide power for the Electric System's load requirements that are not met from its own resources (including the Malburg Generating Station) or from the long-term power purchase contract described above through short-term power purchases. The City expects to make these short-term power purchases under contracts in the form of the Western Systems Power Pool power purchase agreement. The cost of power under such contracts will vary depending on then existing market conditions, which can be affected by a number of factors.

### **SCPPA Palo Verde Nuclear Generating Station Interest**

Through its participation in SCPPA, the City has an entitlement to the Palo Verde Nuclear Generating Station near Phoenix, Arizona. SCPPA, pursuant to the Arizona Nuclear Power Project Participation Agreement, has a 5.91% interest in PVNGS, consisting of three nuclear electric generating units, each with a nominal rating of 1,270 MW, and certain associated facilities and contractual rights. The maximum dependable capacity of the three units under adverse atmospheric conditions is 1,243 MW, 1,243 MW and 1,247 MW, respectively. SCPPA has also purchased (i) a 5.56% undivided ownership interest in the Arizona Nuclear Power Project ("ANPP") High Voltage Switchyard and contractual rights thereto; and (ii) a 6.55% share of the right to use certain portions of the Arizona Nuclear Power Project Valley Transmission System in order to transmit PVNGS power to its members which are participating in the project.

The City has a 4.90% entitlement interest (11.03 MW) in SCPPA's ownership interest in the PVNGS, the ANPP High Voltage Switchyard and the ANPP Valley Transmission System. The City has entered into a power sales contract with SCPPA which provides the City with its share of capacity and energy from PVNGS, including its share of debt service on SCPPA bonds issued for the project on a "take-or-pay" basis. In 1997 SCPPA began taking steps designed to accelerate the payment of all fixed rate subordinate bonds relating to PVNGS by July 1, 2004 (the "PVNGS Restructuring Plan"). The PVNGS Restructuring Plan has been completed and the delivered cost of energy produced by PVNGS decreased significantly on July 1, 2004. See "INDEBTEDNESS – Palo Verde Nuclear Generating Station." In the Fiscal Year ended June 30, 2005, PVNGS provided 79,168 MWh of energy to the City at an average cost of delivered energy of approximately \$48.00 per MWh. Due to forced outages at PVNGS, the City anticipates receiving approximately 17% less than that amount of energy from PVNGS during the Fiscal Year ending June 30, 2006.

Generally, federal and state efforts to provide adequate interim and long-term storage facilities for low-level and high-level nuclear waste have proven unsuccessful to date. Currently, nuclear waste from PVNGS is either stored on-site or sent to outside disposal facilities. Although federal and state efforts continue with respect to such storage facilities, SCPPA has advised the City that it is not able to predict when sufficient facilities will exist to accommodate the long-term storage needs of PVNGS.

## **Hoover Upgrading Program**

The City participated in the Hoover Upgrading Project. The Hoover Upgrading Project consists principally of the upgrading of the capacity of 17 generating units at the hydroelectric power plant of the Hoover Dam, located approximately 25 miles from Las Vegas, Nevada. Modern insulation technology made it possible to “uprate” the nameplate capacity of the existing generators. The U.S. Bureau of Reclamation (the “Bureau”) owns and operates the Hoover Dam facility and the Western Area Power Association (“Western”) markets the power from the facility. The City has a power purchase agreement with Western pursuant to which the City made an upfront payment for its share of the construction cost of the Hoover Upgrading Project, is entitled to approximately 22 MW of capacity and 28,000 MWh of associated energy annually from the Hoover Upgrading Project and is responsible for its share of the operating costs of the facility.

The lower Colorado River has been included in a Critical Habitat Designated Area, which required the Bureau to prepare and file with the United States Fish and Wildlife Service (the “Service”) a Biological Assessment of the effect of its operations of the lower Colorado River on endangered species within the Critical Habitat Designated Area. The Service has issued a Biological Opinion regarding the Bureau’s operations and will outline remedial actions to be taken to correct any adverse effects to endangered species. Such remedial actions could adversely affect the operation of the Hoover power plant, which would in turn materially adversely affect the amount of power available to Hoover customers. The Hoover customers, together with certain other parties, are working on a plan in cooperation with the Bureau and the Service to mitigate operational scenarios which would adversely affect the Hoover participants and the other parties.

## **TRANSMISSION RESOURCES**

### **Agreement With Edison**

The City entered into an interconnection service agreement with Edison in 1997 (the “Laguna Bell – Vernon Interconnection Service Agreement”) which provides the City with firm bi-directional transmission service between Edison’s Laguna Bell 220 kV Interconnection Point and the City’s facilities. The Electric System is dependent on the Edison transmission lines and the Laguna Bell Substation to reach the ISO controlled grid. Currently there are five 66 kV transmission lines between the City limits and the Laguna Bell Substation. The agreement provides for all power to be scheduled through the ISO.

### **California Independent System Operator**

The City is part owner of several transmission facilities which are described below. Pursuant to Assembly Bill 1890 of 1996 (“AB 1890”) (see “DEVELOPMENTS IN THE CALIFORNIA ENERGY MARKETS”), on March 31, 1998 the California Independent System Operator (“ISO”) assumed the operational control of the high voltage transmission systems of Edison, Pacific Gas and Electric Company (“PG&E”) and San Diego Gas and Electric Company (“SDG&E”) and, together with Edison and PG&E, the “IOUs”) and became the Control Area Operator in the PG&E/Edison/SDG&E service territories. The three IOUs and the City, as well as several other municipal utilities, have signed “Utility Distribution Company” agreements with the ISO. This agreement provides the relationship between the Control Area Operator, and the utility responsible for transmitting energy to the load.

Effective January 1, 2001, the City became the first municipal utility to turn over operational control of its high voltage transmission entitlements to the ISO thereby becoming a Participating Transmission Owner in the ISO. As a Participating Transmission Owner in the ISO, the City continues to own its transmission facilities and to be bound by its contractual arrangements. The ISO provides to the City (as well as other Participating Transmission Owners, including the IOUs) access to the ISO Controlled Grid; however, the ISO maintains operational control for the benefit of all market participants by providing non-discriminatory transmission access, congestion management, grid security, and control area services. The City acts as Scheduling Coordinator for all of its load transmitted over the ISO, and for all costs associated with serving its load.

The City is recompensed for use of its transmission facilities through FERC-approved ISO tariff rates. Currently, the ISO tariff transmission rate (referred to as the “transmission access charge” or “TAC” rate) is

established based in part upon the TRRs of the Participating Transmission Owners in the City's TAC Area (a regional area designated in the ISO's transmission tariff and corresponding to the former control area of Edison), which is the East/Central TAC area, and in part upon the TRRs of all Participating Transmission Owners. Each Participating Transmission Owner's entitlement to portions of ISO rates collected by the ISO for transmission services is thus largely determined by that Participating Transmission Owner's TRR relative to the TRRs of other Participating Transmission Owners, particularly those Participating Transmission Owners in the same TAC area as the Participating Transmission Owner.

The formula for compensation to the City for the ISO's use of the City transmission facilities contains certain caps applicable for the period ending December 31, 2010 that could limit the City's collection of its full TRR from the ISO if additional entities become Participating Transmission Owners. The FERC orders that established this rate and compensation methodology are not filed, and certain issues in the docket in which they were issued have been set for hearing by FERC and are presently before an Administrative Law Judge. Among other things, the caps on TRR recovery described above will likely be one of the subjects of this litigation. The City cannot predict what the ultimate outcome or impact of this litigation will be. See "RATE REGULATION" herein.

### **Mead-Phoenix Transmission Project**

The Mead-Phoenix Transmission Project consists of a 256-mile, 500-kV AC transmission line that extends between a southern terminus at the existing Westwing Substation (in the vicinity of Phoenix, Arizona) and a northern terminus at Marketplace Substation, a substation located approximately 17 miles southwest of Boulder City, Nevada. The line is looped through the new 500-kV switchyard constructed in the existing Mead Substation in southern Nevada with a transfer capability of 1,300 MW. By connecting to Marketplace Substation, the Mead-Phoenix Transmission Project interconnects with the Mead-Adelanto Transmission Project and with the existing McCullough Substation. The Mead-Phoenix Transmission Project is comprised of three project components as described below. The City has executed an ownership agreement providing it with a 2.1538% member-related ownership share in the Westwing-Mead project component, a 3.7934% member-related ownership share in the Mead Substation project component, and a 4.0497% member-related ownership share in the Mead-Marketplace project component. Other owners of the line are SCPPA, Arizona Public Service Company, M-S-R Public Power Agency ("M-S-R") and the Salt River Project Agricultural Improvement and Power District ("Salt River Project"). The construction costs for the project were approximately \$230 million. The commercial operation date for the project was April 15, 1996. The City paid for its share of the construction costs of the Mead-Phoenix Project from revenues of the Electric System.

### **Mead-Adelanto Transmission Project**

The Mead-Adelanto Transmission Project, which was undertaken in connection with the Mead-Phoenix Transmission Project, consists of a 202-mile, 500-kV AC transmission line that extends between a southwest terminus at the existing Adelanto Substation in southern California and a northeast terminus at Marketplace Substation, a substation located approximately 17 miles southwest of Boulder City, Nevada. By connecting to Marketplace Substation, the line also interconnects with the Mead-Phoenix Transmission Project and the Mead-Adelanto Transmission Project interconnects with the existing McCullough Substation in southern Nevada. The line has a transfer capability of 1,200 MW. The City has a 6.25% ownership share in the project. The other owners of the project are SCPPA and M-S-R. The construction costs for the project were approximately \$204 million. The commercial operation date for the project was April 15, 1996, which coincided with the completion of the Mead-Phoenix Transmission Project. The City paid for its share of the construction costs of the Mead-Adelanto Project from revenues of the Electric System.

### **California-Oregon Transmission Project**

The California-Oregon Transmission Project ("COTP") is a 339-mile long, 1,600 MW, 500 kV alternating current ("AC") transmission project between southern Oregon and central California. The COTP was placed in service on March 24, 1993, at a cost of approximately \$430 million.

The COTP is owned by the Transmission Agency of Northern California (79.3022%), the City (7.5497%), Western (9.3750%), the City of Shasta Lake (1.5856%), two California districts (0.1250%) and PG&E (2.0625%) (referred to herein as the “COTP Participants”) pursuant to the terms of an Interim Participation Agreement, executed as of September 30, 1991 (the “Interim Participation Agreement”), among the COTP Participants. Under the Interim Participation Agreement, each COTP Participant is granted a percentage entitlement in project transfer capability (“Entitlements”) and was required to provide a percentage of the costs of the project and betterments thereto. The City paid for its share of the construction costs of the COTP from revenues of the Electric System.

The Interim Participation Agreement provides for a management committee (the “Management Committee”) to provide for governance of the project. Each COTP Participant has representation on the Management Committee. All actions or decisions by the Management Committee are required to be made by agreement of COTP Participants having Entitlements aggregating at least 75%. The purpose of the Management Committee is to secure managerial and policy direction, cooperation and interchange of information, provide consultation among the COTP Participants in connection with the project and to oversee and approve all project work on behalf of the COTP Participants. In March 1993, the COTP Participants entered into the Project Operation and Maintenance Agreement (the “POMA”). The POMA provides for the conduct and payment for the operation, maintenance, and capital improvements for the COTP. Pursuant to the POMA, TANC and Western share various duties regarding operation and maintenance of the COTP and related facilities.

To utilize the full transfer capability of the COTP on a firm basis and maximize the benefits of the line, the COTP must be operated on a coordinated basis with the Pacific AC intertie (“PACI”), a two line system which, like the COTP, connects California utilities with those in the Pacific Northwest. The three-line system, collectively referred to as the California-Oregon Interconnection (“COI”), was operated by PG&E, acting as the control area operator, under a Coordinated Operations Agreement (“COA”), among the COTP Participants and the owners of the PACI, and a FERC rate schedule, which conforms to FERC Opinion No. 389, issued May 26, 1994 and Opinion No. 389A, issued November 16, 1998. Under operating instructions designed to implement the COA, the ISO began operating the PACI on March 31, 1998 and a portion of the COTP is operated by the Transmission Agency of Northern California and the balance of the COTP is operated by Western.

On September 3, 1992, the City entered into a transmission service exchange agreement with PG&E (the “Vernon/PG&E Exchange Agreement”) pursuant to which PG&E provides the City with transmission service from its entitlement in a 500 kV direct current transmission line entitlement (the “DC Line”) between northern Oregon and southern California in exchange for the use by PG&E of the City’s share of the COTP. The Vernon/PG&E Exchange Agreement remains in effect for 50 years from its date, subject to certain prior termination rights, including: (i) termination in 2007 (upon one year’s prior notice) by PG&E if PG&E has not retained at least a 659 MW transmission entitlement in the DC Line after such time, (ii) termination in 2007 by the City if arrangements entered into by PG&E for operation of the DC Line are such as to reduce the transmission capability thereof, (iii) termination if either the COTP or DC Line facilities are retired, (iv) termination upon five years’ advance notice in the event the City elects to participate in an alternate project that provides the City with transmission capability between the southern terminus of the COTP and the Electric System, and (v) termination (after compliance with certain procedures) in the event that an action by one of the parties or third parties has so affected the operation of the COTP or the DC Line as to reduce the transmission capability to the City or PG&E. Transfer of operational control of the City’s COTP interest to the ISO is subject to the terms of the Vernon/PG&E Exchange Agreement.

Sierra Pacific Power (“Sierra Pacific”) has constructed a 345 kV transmission line from the Reno, Nevada area to Alturas, California (the “Alturas Intertie Project”). The Alturas Intertie Project interconnects with the Bonneville Power Administration system in California. Western Systems Coordinating Council has given the Alturas Intertie Project a 300-MW non-simultaneous transfer capability rating. However, the simultaneous operation of the Alturas Intertie Project with the COI could potentially reduce the COI delivery capability on a MW for MW basis, thereby directly impacting the interests of the COTP Participants. Sierra Pacific has filed an Alturas Intertie Project Interconnection Agreement and an Operating and Scheduling Agreement for the Alturas Intertie Project, which have been accepted by FERC. Pursuant to the terms of the Vernon/PG&E Exchange Agreement, in the event of any changes in the transmission capability of the COTP (e.g., as a result of a reduction in delivery capability), the City’s transmission service exchange rights from PG&E under the Vernon/PG&E Exchange Agreement may be subject to adjustment if determined appropriate by the City and PG&E.

## CAPITAL REQUIREMENTS

The City expects capital requirements for the Electric System for the five Fiscal Years ended June 30, 2006 through 2010 to aggregate approximately \$18.4 million. The capital requirements are for the expansion of distribution facilities, substation upgrades, switch gear improvements, transformer improvements, generation facility equipment purchases and other electric system improvements. It is expected that these requirements will be funded from Electric System revenues and reserves, although the City may seek reimbursement from the proceeds of future tax-exempt financings. The following table lists the expected annual capital requirements:

<b>Fiscal Year</b>	<b>Capital Requirements (in thousands)</b>
2005-06	\$3,000
2006-07	1,700
2007-08	2,900
2008-09	4,800
2009-10	<u>6,000</u>
<b>Total</b>	<b>\$18,400</b>

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## RETAIL ENERGY SALES

### Customers, Retail Energy Sales Revenues and Demand

The average number of customers, retail kWh sales and revenues derived from retail sales, by classification of service, and peak demand during the past five Fiscal Years, are listed below.

#### CITY OF VERNON ELECTRIC SYSTEM CUSTOMERS, RETAIL SALES, REVENUES AND DEMAND

	Fiscal Years Ended June 30				
	2001	2002	2003	2004	2005
Number of Customers:					
Residential	27	27	26	26	30
Commercial	1,015	1,026	1,025	1,020	995
Industrial	869	870	860	858	837
Other	148	145	148	157	182
Total Customers <sup>(1)</sup>	<u>2,059</u>	<u>2,068</u>	<u>2,059</u>	<u>2,061</u>	<u>2,044</u>
Kilowatt-Hour Sales (in Millions):					
Residential	0.1	0.1	0.1	0.1	0.1
Commercial	235.3	231.0	256.6	280.4	258.2
Industrial	926.3	869.2	870.0	898.5	852.5
Other	10.2	10.5	12.3	12.7	12.8
Total kWh Retail Sales	<u>1,171.9</u>	<u>1,110.8</u>	<u>1,138.9</u>	<u>1,191.7</u>	<u>1,123.6</u>
Revenues from Sale of Retail Energy (\$000's):					
Residential	\$ 5	\$ 6	\$ 6	\$ 7	\$ 7
Commercial	16,162	18,445	23,659	24,329	22,955
Industrial	54,399	61,171	60,017	63,838	63,190
Other	915	1,076	1,003	891	1,208
Total Revenues from Sale of Energy <sup>(2)</sup>	<u>\$71,481</u>	<u>\$80,698</u>	<u>\$84,686</u>	<u>\$89,067</u>	<u>\$87,360</u>
Peak Retail Demand (MW)	<u>195.8</u>	<u>184.1</u>	<u>190.5</u>	<u>194.4</u>	<u>195.9</u>

<sup>(1)</sup> Some businesses have more than one meter. The City considers each meter to be a customer.

<sup>(2)</sup> Excludes 2.85% AB 1890 public benefit surcharge pursuant to Section 385 of the California Public Utilities Code.

### Largest Customers

The Electric System's ten largest customers accounted for approximately 37% of the Electric System's energy sales for such period, and the Electric System's 20 largest customers accounted for approximately 47% of the Electric System's energy sales for such period. The table below sets forth the Electric System's ten largest customers (in alphabetical order) from July 1, 2005 through May 31, 2006.

**CITY OF VERNON  
ELECTRIC SYSTEM  
TEN LARGEST CUSTOMERS  
(In Alphabetical Order)  
From July 1, 2005 through May 31, 2006**

<b>Business Name</b>	<b>In Vernon Since</b>	<b>Type of Business</b>
Clougherty Packing/Farmer John	1944	Meat Packing Plants
Container Corp. of America/Jefferson Smurfit	1967	Paperboard Mills
Exide/GNB Batteries	1964	Primary Batteries, Dry And Wet
Kal Kan Foods	1967	Wet Corn Milling
Overhill Farms, Inc.	1989	Meat Processing Plant
Owens Brockway/Owens Illinois	1944	Glass Containers
PABCO Paper Products	1957	Paperboard Boxes
Rehrig Pacific	1973	Plastic Products
Service Packing (United Food Group)	1974	Meat Packing Plants
U.S. Growers Cold Storage, Inc.	1987	Refrigerated Warehousing and Storage

**ELECTRIC RATES**

**General**

The Electric System's retail rates are established by the City Council and are not subject to regulation by the California Public Utility Commission or any other state agency. See "RATE REGULATION" herein. The Electric System provides no free service. The retail rates include a 3% surcharge for payments in lieu of franchise tax to the City's General Fund and the 2.85% public benefits surcharge under AB 1890.

Prior to the addition of the AB 1890 public benefits surcharge to the rates in 1998, the rates had not been adjusted by the City Council since 1984. Since 2000, the rates have been increased six times as indicated in the table below.

**PERCENTAGE CHANGE IN  
ELECTRIC RATES**

<b>Effective Date</b>	<b>Average Percent Increase in Rate</b>
November 1, 2006 <sup>(1)</sup>	5.00%
June 1, 2005	4.70
November 1, 2003	3.00
May 1, 2001	19.00
October 1, 2000	9.75
July 1, 2000	16.00

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<sup>(1)</sup> Pursuant to Resolution No. 9054 adopted by the City Council on May 24, 2006.

The table below sets forth the average billing price per kilowatt-hour of the Electric System's various customer classes for the periods indicated.

**CITY OF VERNON  
ELECTRIC SYSTEM**

**AVERAGE BILLING PRICE  
(CENTS PER KILOWATT-HOUR)**

	Fiscal Year Ended June 30,				
	2001	2002	2003	2004	2005
Residential	3.77	4.82	4.94	4.96	5.06
Commercial	6.87	7.99	9.73	9.86	8.89
Industrial	5.87	7.04	6.75	6.81	7.41
Other	8.97	10.26	11.04	11.03	9.44
Weighted Average	6.10	7.26	7.42	7.47	7.78

All electric bills are due and payable on the date of billing and become delinquent 20 days thereafter. If such bills remain unpaid on the 35th day after billing, all electric services are subject to termination until all fees, charges, penalties and the entire delinquent balance have been paid.

The City considers its write-offs for uncollectible accounts to be low by electric utility industry standards for urban areas. The write-offs for uncollectible accounts have been less than 0.13% over the last five Fiscal Years.

**CITY OF VERNON  
ELECTRIC SYSTEM  
UNCOLLECTIBLE REVENUES**

Fiscal Year Ended June 30	Uncollectible Revenues	Percent of Gross Billings
2001	\$90,567	0.126%
2002	69,397	0.086
2003	36,406	0.042
2004	48,435	0.054
2005	46,499	0.053

**Comparison of Selected Monthly Electric Bills**

The following table shows a comparison of selected monthly electric bills for utilities operating in the Southern California region as of January 2006 for large commercial/industrial customers. The monthly electric bills shown in the following tables are based on available information as of the date indicated and are not reflective of what the electric rates for any category of customers or the average monthly electric bills of the respective utility are or will be at any date subsequent to the date indicated. See "Electric Rates" above for additional information regarding the City's historical and projected future electric system rates.



## COMPARISON OF SELECTED MONTHLY ELECTRIC BILLS

	<b>Large Commercial/Industrial (January 2006)</b>		
	<b>7,000,000</b>	<b>2,000,000</b>	<b>300,000</b>
	<b>kWh/10,000 kW</b>	<b>kWh/5,000 kW</b>	<b>kWh/1,000 kW</b>
Pasadena	N/A	\$ 180,933	\$ 29,215
Riverside	N/A	195,035	32,250
Burbank	N/A	241,719	38,109
Anaheim	N/A	189,376	30,590
Glendale	N/A	194,662	32,364
LADWP <sup>(1)</sup>	\$545,954	192,278	32,747
SCE	504,836	189,301	30,814
Vernon	442,121	146,126	24,365

<sup>(1)</sup> Does not include 12% City Tax.

Source: Los Angeles Department of Water and Power.

## INDEBTEDNESS

### Direct Electric System Revenue Indebtedness

The City has previously issued (i) \$90,150,000, 2004 Series A, (ii) \$83,575,000, 2004 Series B, (iii) \$39,875,000, 2004 Series C, and (iv) \$69,100,000, 2004 Series D, Electric System Revenue Bonds (collectively, the “2004 Bonds”). The 2004 Bonds were issued to provide funds to (i) refund \$162,610,000 of outstanding Electric System Revenue Bonds of the City; (ii) finance the costs of improvements to the City’s substation and distribution facilities and certain costs of completion of the Malburg Generating Station; (iii) finance the reimbursement to the City of certain costs incurred in connection with the City’s electric system facilities, (iv) to fund a deposit to a debt service reserve fund; and (v) pay the costs of issuance of the 2004 Bonds. Each series of 2004 Bonds bears interest a variable rate set periodically through an auction process. Debt service on the 2004 Bonds is payable from, and secured by a lien on, the Electric System’s Net Revenues which are determined after providing for Operation and Maintenance Expenses, including amounts payable by the City under the Gas Supply Agreement. See “SUMMARY OF OPERATING RESULTS – “Net Revenues Under City Bond Indenture” and Note 6 of the notes to the Financial statement for the Fiscal Year ended June 30, 2005 in Appendix B to the Official Statement to which this Appendix is attached.

In addition, the City is obligated to make certain payments under various interest rate swap agreements (the “Outstanding Swap Agreements”) relating to the 2004 Bonds and certain bonds that were defeased with the proceeds of the 2004 Bonds. The payments due with respect to the 2004 Bonds and the Outstanding Swap Agreements are on a parity and secured by a pledge of “Net Revenues” of the City’s Electric System as defined in the City Bond Indenture. See “SUMMARY OF OPERATING RESULTS – Net Revenues Under City Bond Indenture” and Note 7 to the notes to the financial statements for the Fiscal Year ended June 30, 2005 in Appendix B to the Official Statement to which this Appendix is attached.

### Palo Verde Nuclear Generating Station

The City has entered into a power purchase contract with SCPPA with respect to the Palo Verde Nuclear Generating Station. See “Power Supply Resources – SCPPA Palo Verde Nuclear Generating Station Interest” above. The PVNGS contract requires the City to pay its share of SCPPA’s costs for the project including operation and maintenance expenses and debt service on bonds issued by SCPPA for the project. Following the completion of the PVNGS Restructuring Plan on July 1, 2004 and the defeasance of a significant portion of SCPPA’s outstanding PVNGS project bonds, approximately \$108,000,000 principal amount of bonds relating to PVNGS remained outstanding as of July 1, 2005, of which the City’s share is approximately \$2,550,000. Obligations of the City under its contract with SCPPA constitute Operation and Maintenance Expenses of the Electric System payable on a parity with the payments to be made under the Gas Supply Agreement. The PVNGS power purchase contract is on a “take-

or-pay” basis, which requires payments to be made whether or not the project is operating or operable, or whether the output from the project is suspended, interfered with, reduced, curtailed or terminated in whole or in part. Amounts otherwise payable by the City under the PVNGS power purchase contract can be increased due to the default of other SPPA participants in the project. For further information, see “Project Commitments - Southern California Public Power Authority” under Note 3 of the notes to the financial statements for the Fiscal Year ended June 30, 2005 in APPENDIX B to the Official Statement to which this Appendix is attached.

### **SUMMARY OF OPERATING RESULTS**

A summary of operating results for the City’s Electric System for the five Fiscal Years ended June 30, 2001 through 2005 is shown in the following table. This summary was prepared by the City from information derived from its audited annual financial statements for such five Fiscal Years.

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**CITY OF VERNON  
ELECTRIC SYSTEM  
SUMMARY OF OPERATING RESULTS**

	<b>Fiscal Year Ended June 30, (Audited)</b>				
	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>
<b>Total Operating Revenues</b>	\$96,878,328	\$99,393,077	\$101,393,301	\$107,052,500	\$110,484,895
<b>Operating Expenses:</b>					
Cost of Sales	\$97,387,167	\$95,140,712	\$80,683,554	\$ 88,755,276	\$ 88,592,068
In Lieu of Franchise Tax <sup>(1)</sup>	2,202,633	2,455,094	2,728,886		
Depreciation	2,798,753	3,203,832	2,972,243	3,316,122	4,231,020
<b>Total Operating Expenses</b>	<b>\$102,388,553</b>	<b>\$100,799,638</b>	<b>\$86,384,684</b>	<b>\$92,071,398</b>	<b>\$92,823,088</b>
<b>Operating Income (Loss)</b>	<b>\$(5,510,225)</b>	<b>\$(1,406,561)</b>	<b>\$15,008,617</b>	<b>\$14,981,102</b>	<b>\$17,661,807</b>
<b>Nonoperating Revenues (Expenses):</b>					
Investment Income	\$3,764,824	\$3,959,632	\$3,843,381	\$2,837,609	\$5,221,357
Realized Gain (Loss) on Investments	—	4,978,993	914,764	—	—
Net increase (decrease) in fair value of Investments	5,036,815	521,451		(981,890)	(450,344)
Bond Interest Expense <sup>(2)</sup>	(95,796)	—	—	—	(1,310,835)
Other Non-Recurring Income	—	—	4,170,000 <sup>(4)</sup>	7,148,889 <sup>(5)</sup>	(3,550,000) <sup>(6)</sup>
<b>Total Nonoperating Revenue, Net</b>	<b>\$8,705,843</b>	<b>\$9,460,076</b>	<b>\$8,928,145</b>	<b>\$9,004,608</b>	<b>\$(89,822)</b>
<b>Net Income (Loss) Before Operating Transfers to General Fund</b>	<b>\$3,195,618</b>	<b>\$8,053,515</b>	<b>\$23,936,762</b>	<b>\$23,985,710</b>	<b>\$17,571,895</b>
Operating Transfers to General Fund <sup>(3)</sup>	(7,612,243)	(8,503,702)	(7,314,305)	(5,523,644)	(5,480,789)
<b>Net Income (Loss)</b>	<b>\$(4,416,625)</b>	<b>\$(450,187)</b>	<b>\$16,622,457</b>	<b>\$18,462,066</b>	<b>\$12,091,106</b>

- (1) Commencing with the Fiscal Year ended June 30, 2004, the In Lieu of Franchise Tax was included in Cost of Sales.
- (2) In Fiscal Year 2000-01, represents interest expense in connection with certain certificates of participation which were retired in September 2000. For Fiscal Years 2002-03, 2003-04, and 2004-05 interest on all but \$69,100,000 principal amount of the City's outstanding Electric System Revenue Bonds was capitalized.
- (3) For the Fiscal Year ended June 30, 2001, includes investment income on certain Electric System funds and the Electric System's share of the City's allocated administrative costs. Beginning in the Fiscal Year ended June 30, 2002, the Electric System's share of the City's allocated administrative costs is included in Cost of Sales. For the Fiscal Years ended June 30, 2002 through 2004, includes investment income on certain Electric System funds and capital gains on certain securities sold during the Fiscal Year. For the Fiscal Year ended June 30, 2003, includes amounts paid to the City from the suspension of an interest rate swap. See Note 7 to the City's audited financial statements for the Fiscal Year ended June 30, 2004 included in Appendix B to the Official Statement to which this Appendix is attached. For the Fiscal Year ended June 30, 2005, excludes transfer of \$66,846,257 of Series 2004D proceeds to the General Fund.
- (4) Represents payment received by the City in connection with suspension of interest rate swap. See Note 7 to the City's audited financial statements for the Fiscal Year ended June 30, 2004 included in Appendix B to the Official Statement to which this Appendix is attached.
- (5) Represents funds received from legal settlement. See Note 10 to the City's audited financial statements for the Fiscal Year ended June 30, 2004 included in Appendix B to the Official Statement to which this Appendix is attached.
- (6) Represents funds paid out in legal settlement. See Note 11 to the City's audited financial statements for the Fiscal Year ended June 30, 2005 included in Appendix B to the Official Statement to which this Appendix is attached.

## Management's Discussion of Operating Results

**General.** While the Electric System had positive Net Income before Operating Transfers to General Fund for each of the five Fiscal Years ending on June 30, 2005, the Electric System experienced an operating loss after such transfers in the Fiscal Year ended June 30, 2001 and the Fiscal Year ended June 30, 2002. The Electric System had operating income of over \$15 million in the Fiscal Year ended June 30, 2003, over \$14 million in the Fiscal Year ended June 30, 2004 and over \$17 million in the Fiscal Year ended June 30, 2005. Operating losses in prior years were primarily the result of increased purchased power costs, including ancillary services, due to the effect of industry restructuring and the energy crisis. The Electric System's purchased power costs were \$58.2 million in the Fiscal Year ended June 30, 2001 and \$62.8 million in the Fiscal Year ended June 30, 2002. To mitigate the impact of rate increases during this period, the City elected to fund a portion of such increased purchased power costs from its cash reserves rather than covering all such cost from the Electric System rates. In response to the California energy crisis, in early 2000 the City began the process to increase the Electric System rates in conjunction with contracting for long-term power. See "DEVELOPMENTS IN THE CALIFORNIA ENERGY MARKETS— Industry Restructuring and the Energy Crisis" and "POWER SUPPLY RESOURCES" herein. As a result of this process, the City instituted five Electric System rate increases in the period from July 1, 2000 to June 1, 2005 for an approximately 52.45% increase in the average rate. In addition, on May 24, 2006, the City Council approved a 5% rate increase to be effective November 1, 2006. See "ELECTRIC RATES" herein.

**Fiscal Years 2003-04 and 2004-05.** The financial statements included in Appendix B to the Official Statements to which this Appendix is attached contain the City's Management Discussion of Operating Results for the Fiscal Years ended June 30, 2004 and June 30, 2005.

**Fiscal Year 2002-03.** Operating expenses decreased by \$14 million (a decrease of approximately 14%) over the prior year due to a decrease in the cost of purchased power. The City entered into some long term contracts during the energy crisis of 2001 that ended in 2003. The City was then able to enter into lower cost contracts, which significantly reduced the cost of purchased power.

Nonoperating revenues included a \$4,170,000 gain received for altering bond interest rate swap arrangements.

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## Net Revenues Under City Bond Indenture

Debt service on the 2006 Bonds is payable as an Operation and Maintenance Expense of the Electric System. The table below presents the calculation of the Electric System's Net Revenues determined in accordance with the City Bond Indenture (and not in accordance with generally accepted accounting principles) for the five Fiscal Years ended June 30, 2001 through 2005. This table was prepared by the City from information derived from its audited annual financial statements for such five Fiscal Years. In accordance with the provisions of the City Bond Indenture, depreciation expense and other non-cash items are not included in Operation and Maintenance Expenses.

### CITY OF VERNON ELECTRIC SYSTEM

#### DETERMINATION OF NET REVENUES UNDER CITY BOND INDENTURE

	Fiscal Year Ended June 30,				
	2001	2002	2003	2004	2005
Revenues <sup>(1)</sup>	\$100,643,152	\$108,331,702	\$110,321,446	\$117,038,998	\$112,156,252
Operation and Maintenance Expenses: <sup>(2)</sup>	<u>99,589,800</u>	<u>97,595,806</u>	<u>83,412,440</u>	<u>88,755,276</u>	<u>88,592,068</u>
<b>Net Revenues under City Bond Indenture</b>	\$ 1,053,352	\$ 10,735,896	\$ 26,909,006	\$ 28,283,722	\$ 23,564,184

(1) As defined in the City Bond Indenture which is substantially the same as the definition of Electric System Revenues in Appendix C. Includes all operating income, investment income, realized gains (losses) on investments and other non-recurring income. Excludes net increase in fair value of investments.

(2) As defined in the City Bond Indenture which is substantially the same as the definition of Operation and Maintenance Expenses in Appendix C. Excludes depreciation, amortization, and other non-cash items.

## EMPLOYEE RELATIONS

As of June 30, 2005, 41 full-time equivalent City employees were assigned to the Electric System. Additionally, other City personnel provide support services to the Electric System as required, including the City's Finance Department and the City Attorney. All of the City's employees, including those assigned to the Electric System, are non-union. There have been no strikes or other work stoppages against the City within the last twenty years.

Retirement benefits to City employees, including those assigned to the Electric System, are provided through the City's participation in the California Public Employees Retirement System (CalPERS), an agent multiple-employer retirement system that acts as a common investment and administrative agent for participating public entities within the State of California.

The State-required City employee salary contributions of 7% for miscellaneous employees and 9% for safety members are subsidized by the City. The City is required to contribute the remaining amounts necessary to fund the benefits for its members, using the actuarial basis adopted by the CalPERS Board of Administration.

The City's total contribution to CalPERS for the year ended June 30, 2005 was \$4,610,702. City contribution rates as a percentage of covered payroll were 1.926% for miscellaneous plan members and 25.200% for safety plan members. The City's contribution was made in accordance with actuarially determined requirements. The most recent actuarial valuation performed as of June 30, 2002 which indicated the City had no unfunded pension benefit obligation. The City has contributed its annual pension cost payments with respect to all employees as required by CALPERS and estimates that it will not have any unfunded pension liability as of the next actuarial valuation. See Note 10 to the City's audited financial statements for the Fiscal Year ended June 30, 2005 included in Appendix B to the Official Statement to which this Appendix is attached.

The City Council approved a post-retirement medical benefit plan for all employees with 20 years of service who retire at 60 or after 30 years or more of service to the City. The plan pays for qualified employees' medical and dental insurance premiums and claims from age 60 to 65. Funding of the plan is on a pay-as-you-go basis. During the Fiscal Year ended June 30, 2005, approximately 43 employees were eligible to receive benefits. Amounts paid for the Fiscal Year ended June 30, 2005 totaled \$386,720. See Note 14 to the City's audited financial statements for the Fiscal Year ended June 30, 2005 included in Appendix B to the Official Statement to which this Appendix is attached.

## **INSURANCE**

The City has obtained various insurance policies that provide coverage for "Special Form Perils" against direct physical loss or damage, including earthquake and flood, to all real and personal property of the City. The policy limits for perils other than earthquake and flood are \$150 million per occurrence with deductibles of up to \$100 thousand per occurrence. The earthquake and flood portion of the policies have limits of \$50 million per occurrence with a 5% deductible. Due to increasing premiums and limitations on available coverage, the City expects to reduce and possibly eliminate, earthquake and flood insurance coverage. The City has also obtained various insurance policies that provide general liability, automobile liability and employment benefits liability coverage with policy limits of \$20 million per occurrence and in the annual aggregate, with a deductible of \$2 million. The City has a workmen's compensation insurance policy with a \$50 million limit and a \$1 million deductible amount.

Deductibles and amounts in excess of policy limits are self-insured. There have been no significant reductions of coverage from the prior year. There have been no settlements exceeding insurance coverage for each of the past three Fiscal Years.

## **RATE REGULATION**

The City sets rates, fees and charges for electric service provided at retail within its boundaries. The authority of the City to impose and collect rates and charges for retail electric service is not subject to the general regulatory jurisdiction of the California Public Utilities Commission ("CPUC"). Currently neither the CPUC nor any other regulatory authority of the State of California nor the Federal Energy Regulatory Commission ("FERC") reviews such rates and charges. The California Energy Commission is authorized to evaluate rate policies for electric energy as related to the goals of the Energy Resources Conservation and Development Act and to make recommendations to the Governor, the Legislature and publicly owned electric utilities.

As described under "TRANSMISSION RESOURCES – California Independent System Operator," the City turned over operational control of its high voltage transmission facilities to the ISO effective January 1, 2001 and thereby became a "Participating Transmission Owner" with the ISO. As a result of its status as a Participating Transmission Owner, the City is compensated for the use of the Electric System's high voltage transmission assets (including both ownership interests in, and contractual rights to, high voltage transmission facilities) through the recovery of its transmission revenue requirements ("TRR"). The Electric System's TRR is recovered from amounts paid by the ISO from the rates it charges users of the transmission system under its operational control. The City Council establishes the TRR for the Electric System but such TRR is subject to approval by FERC in connection with FERC's approval of the rates charged to users of the transmission facilities controlled by the ISO.

The Electric System is currently receiving an annual TRR of approximately \$8.7 million. In January 2001, FERC approved an approximately \$10.2 million annual TRR for the Electric System which became effective on January 1, 2001. The ISO began collecting rates for use of transmission services on its system (including the Electric System's transmission facilities) based in part upon the Electric System's TRR. Petitions for review of FERC's approval of the Electric System's TRR were filed by PG&E and Edison in the United States Court of Appeals for the District of Columbia Circuit. On October 15, 2002, the Court of Appeals ruled that the way FERC arrived at its decision was improper and remanded the case back to FERC for further proceedings. FERC issued an order consolidating the remand with the petitions for declaratory order of the Cities of Azusa, Anaheim, Banning, and Riverside, California wherein those cities seek FERC approval, among other things, of their TRRs for purposes of their becoming Participating Transmission Owners. In August 2005 FERC issued an order rejecting a portion of

the City's TRR holding that certain of the City's transmission assets were not eligible for inclusion in the TRR until January 1, 2003 due to the ISO's inability to control such assets until that date and that certain depreciation adjustments had to be made to the value of certain transmission assets. FERC ordered the City to refund all over-collections. On June 7, 2006, FERC denied the City's request for a rehearing on this issue. FERC has not issued any decision on the amount of the refund the City is to pay or on the formula under which the TRR of the Electric System and other governmental Participating Transmission Owners is to be determined. The City cannot predict the outcome of this proceeding, but it is possible that the outcome could affect the Electric System's TRR in certain ways including, among others, the current level of the TRR, how the TRR is established, under what standards it is considered by FERC, and the amount of any refunds to be made by the City in connection with its previously collected TRR. The City estimates that its exposure to any refunds relating to collected TRR will not exceed \$7 million.

Although its retail rates are not subject to approval by any federal agency, the City is subject to certain ratemaking provisions of the federal Public Utility Regulatory Policies Act of 1978 ("PURPA"). The City believes that it is operating in compliance with PURPA.

## **DEVELOPMENTS IN THE CALIFORNIA ENERGY MARKETS**

### **Industry Restructuring and the Energy Crisis**

**Background.** In 1996, California partially deregulated its electric energy market. An independent system operator of the transmission system, the California Independent System Operator, was established, as well as an independent power exchange, the California Power Exchange (the "PX"). The PX was originally established to permit power generators to sell power on a competitive spot-market basis; however, the PX has ceased all operations and filed for bankruptcy protection.

**Financial Difficulties of Market Participants.** As a consequence of deregulation, the California investor-owned utilities sold a large portion of their generation resources. As a result, three major IOUs in California, the Pacific Gas and Electric Company, San Diego Gas & Electric Co. and the Southern California Edison Company are net buyers of electricity. Following the deregulation of the California energy markets, the IOUs were purchasing electricity at fluctuating short-term and spot wholesale prices while the retail prices that they would charge their residential and small business customers were capped at specified levels. During portions of 2000 and 2001, the market price of electricity in California significantly exceeded such capped prices, resulting in the deterioration of the creditworthiness of PG&E and Edison. In April 2001, PG&E filed for voluntary protection under Chapter 11 of the federal Bankruptcy Code. PG&E ultimately emerged from bankruptcy in April 2004. Also in 2001, Enron Corporation experienced severe financial difficulties and voluntarily filed for bankruptcy protection under Chapter 11 of the federal Bankruptcy Code. Since then, certain other marketers, power suppliers and power plant developers have experienced downgrades of their credit ratings.

**Matters Relating to the California Energy Crisis.** In connection with the California energy crisis in 2000 and 2001, the City engaged in increased wholesale spot energy sale transactions and sales of ancillary services. A portion of these sales was made in the markets operated by the ISO and the PX. As a result of these sales during the energy crisis, the City has become involved in a number of administrative and court proceedings involving claims by and against the City in connection with such sales. Certain of these proceedings are described below.

There are proceedings before FERC (the "Refund Proceedings") to determine the amount of refunds, if any, to be paid to the purchasers by sellers of power, including the City, in the California markets during the period October 1, 2000 through June 20, 2001. The City asserts that some of the sales being considered in the Refund Proceedings were bilateral contracts (as to which FERC has ruled it does not have jurisdiction with respect to governmental entities such as the City) and is proceeding to exclude such sales. FERC has established a pricing formula to be applied to the sales under consideration. Based on the formula, the City estimates its exposure to refund liability in connection with the Refund Proceedings is between \$10 million and \$14 million. Although the Department contends that it is not subject to FERC jurisdiction, it is cooperating in the FERC proceedings and monitoring them closely. On September 6, 2005, in *Bonneville Power Administration v. Federal Energy Regulatory Commission* (the "Bonneville Decision"), the United States Court of Appeals for the Ninth Circuit held that FERC

could not order refunds from government utilities, such as the City, and remanded the proceeding back to FERC. It is not known whether defendants will seek further review of this order.

Based upon a reference by the Ninth Circuit Court of Appeals to the possibility of a viable action for breach of contract, the real parties in interest (California Energy Oversight Board, SDG&E, PG&E and Edison) and the California Attorney General (on behalf of the California Department of Water Resources) have presented claims to the City seeking damages for breach of contract. The City Council returned all such claims as untimely filed. The California Energy Oversight Board, Edison and PG&E have sued the City in the United States District Court for the Eastern District of California, and SDG&E has separately filed suit against the City in such court. Each of these suits are for breach of contract and seek substantially the same relief as sought in the Refund Proceedings.

If the Bonneville Decision becomes final, it is likely that the City will have no refund liability in the action at FERC, but the City will still need to prevail in the actions brought for breach of contract. If the Bonneville Decision is reversed and refunds are ordered or if the City does not prevail in the breach of contract action, the City will assert that such refunds or damages should be offset against the amounts owed it by the PX and ISO which are in excess of the City's estimate of refund liability.

***Shortages and Volatility Could Occur in the Future.*** During portions of 2000 and 2001, California experienced extreme fluctuations in the prices and supplies of natural gas and electricity. Licenses for new power plants have been issued by the California Energy Commission, construction on several power plants has been completed and construction of additional power plants is underway. Progress on new transmission line projects within California has been slow. There also has been a substantial rise in the cost of natural gas, which is the fuel source for many of California's electric generating units. State agencies have issued warnings that further power shortages are possible for Southern California. As a result of the foregoing and other factors, no assurance can be given that measures undertaken during the last several years, together with measures to be taken in the future, will be sufficient to prevent shortages, price volatility or other energy problems that have adversely affected the City and other California electric utilities from occurring again in California.

## **State Legislation**

Senate Bill 1037 ("S.B. 1037"), signed by the Governor on September 29, 2005, requires that each local publicly-owned electric utility, including the Electric System, in procuring energy, first acquire all available energy efficiency and demand reduction resources that are cost effective, reliable and feasible. S.B. 1037 also requires each local publicly-owned electric utility to report annually to its customers and to the State Energy Resources Conservation and Development Commission its investment in energy efficiency and demand reduction programs.

## **OTHER FACTORS AFFECTING THE ELECTRIC UTILITY INDUSTRY**

### **Energy Policy Act of 1992**

The Energy Policy Act of 1992 (the "1992 Energy Policy Act") made fundamental changes in the federal regulation of the electric utility industry, particularly in the area of transmission access under Sections 211, 212 and 213 of the Federal Power Act. The purpose of these changes, in part, was to bring about increased competition in the electric utility industry.

As amended by the 1992 Energy Policy Act, Sections 211, 212 and 213 of the Federal Power Act provide FERC authority, upon application by any electric utility, federal power marketing agency or other person or entity generating electric energy for sale or resale, to require a transmitting utility to provide transmission services (including any enlargement of transmission capacity necessary to provide such services) to the applicant at rates, charges, terms and conditions set by FERC based on standards and provisions in the Federal Power Act. Under the 1992 Energy Policy Act, electric utilities owned by municipalities and other public agencies which own or operate electric power transmission facilities which are used for the sale of electric energy at wholesale are "transmitting utilities" subject to the requirements of Sections 211, 212 and 213.



## **Changes in Federal Regulation of Electric Utilities**

In 1996, FERC issued a final rule that effected significant changes in the regulation of transmission services provided by public utilities (as defined in the Federal Power Act) that own, operate or control interstate transmission facilities and which are subject to FERC jurisdiction over wholesale contracts, rates and services (“jurisdictional utilities”). The Electric System is not a public utility (as defined in the Federal Power Act) and is not a jurisdictional utility under the Federal Power Act.

FERC is encouraging the voluntary formation of regional transmission organizations (“RTOs”) that are independent from owners of generation and other market participants and that will provide transmission access on a non-discriminatory basis to buyers and sellers of power. IOUs and publicly-owned utilities are being encouraged to participate in the formation and operation of RTOs, but are not, at this time, being ordered by FERC to participate. The City has turned operational control of its high voltage transmission assets to the ISO. See “TRANSMISSION RESOURCES – California Independent System Operator.” FERC also supports a national standard for the exchange of electricity and transmission services. It is not certain at this time what impact, if any, the formation of RTOs or the adoption of a national standard for exchange of electric services will have on the Electric System.

## **Recent Federal Energy Legislation**

On August 8, 2005, President Bush signed the Energy Policy Act of 2005 (“EPACT 2005”). EPACT 2005 addresses a wide array of energy matters that could affect the entire electric utility industry, including the City’s Electric System. It expands FERC’s jurisdiction to require open access transmission by municipal utilities that sell more than four million megawatt hours of energy and to order refunds under certain circumstances for municipal utilities that sell more than eight million megawatt hours of energy. The City is unable to predict when, if ever, its sales of electricity would reach eight million megawatt hours. EPACT 2005 requires that FERC conclude its investigation into the allegations of overcharges during the California energy crisis in 2000 and 2001 and submit a report to Congress. It also provides for mandatory reliability standards to increase system reliability and minimize blackouts, criminal penalties for manipulative energy trading practices and the repeal of the Public Utility Holding Company Act of 1935, which prohibited certain mergers and consolidations involving electric utilities. The market manipulation provisions, enacted in response to the Enron-type trading strategies uncovered during FERC’s investigation of the western energy markets during 2000-2001, prohibit the use by any entity, including those not normally subject to FERC regulation, such as the City, of “any manipulative or deceptive device or contrivance (as those terms are used in Section 10(b) of the Securities Exchange Act of 1934....)” in contravention of FERC rules. EPACT 2005 granted FERC authority to impose penalties of up to \$1 million per day for each day that a violation of the Federal Power Act or any rule or order issued under the FPA, continues. Under EPACT 2005, by February 2007 investor-owned utilities must offer each of their customer classes a time-based rate schedule to enable customers to manage energy use through advanced metering and communications technology. It authorizes FERC to exercise eminent domain powers to construct and operate transmission lines if FERC determines a state has unreasonably withheld approval. EPACT 2005 contains provisions designed to increase imports of liquefied natural gas and incentives to support renewable energy technologies, including a new two-year program for tax credit bonds for local governments to finance certain renewable energy facilities. EPACT 2005 also extends for 20 years the Price-Anderson Act, which concerns nuclear power liability protection, and provides incentives for the construction of new nuclear plants.

The City is unable to predict at this time the impact that EPACT 2005 will have on the operations and finances of the Electric System or the electric utility industry generally.

## **Other Factors**

The electric utility industry in general has been, or in the future may be, affected by a number of other factors which could impact the financial condition and competitiveness of many electric utilities and the level of utilization of generating and transmission facilities. In addition to the factors discussed above, such factors include, among others, (a) effects of compliance with rapidly changing environmental, safety, licensing, regulatory and legislative requirements other than those described above, (b) changes resulting from conservation and demand-side management programs on the timing and use of electric energy, (c) changes resulting from a national energy policy,

(d) effects of competition from other electric utilities (including increased competition resulting from mergers, acquisitions, and “strategic alliances” of competing electric and natural gas utilities and from competitors transmitting less expensive electricity from much greater distances over an interconnected system) and new methods of, and new facilities for, producing low-cost electricity, (e) increased competition from independent power producers and marketers, brokers and federal power marketing agencies, (f) “self-generation” or “distributed generation” (such as microturbines and fuel cells) by industrial and commercial customers and others, (g) issues relating to the ability to issue tax-exempt obligations, including severe restrictions on the ability to sell to nongovernmental entities electricity from generation projects and transmission service from transmission line projects financed with outstanding tax-exempt obligations, (h) effects of inflation on the operating and maintenance costs of an electric utility and its facilities, (i) changes from projected future load requirements, (j) increases in costs and uncertain availability of capital, (k) shifts in the availability and relative costs of different fuels (including the cost of natural gas), (l) sudden and dramatic increases in the price of energy purchased on the open market that may occur in times of high peak demand in an area of the country experiencing such high peak demand, such as has occurred in California, (m) inadequate risk management procedures and practices with respect to, among other things, the purchase and sale of energy and transmission capacity, (n) other legislative changes, voter initiatives, referenda and statewide propositions, (o) effects of changes in the economy and (p) effects of possible manipulation of electric markets. Any of these factors (as well as other factors) could have an adverse effect on the financial condition of any given electric utility and likely will affect individual utilities in different ways.

**The City cannot predict what effects such factors will have on the business operations and financial condition of the Electric System, but the effects could be significant. The foregoing is a brief discussion of certain of these factors. This discussion does not purport to be comprehensive or definitive, and these matters are subject to change subsequent to the date hereof. Extensive information on the electric utility industry is, and will be, available from the legislative and regulatory bodies and other sources in the public domain, and potential purchasers of the 2006 Bonds should obtain and review such information.**

## **CONSTITUTIONAL LIMITATIONS ON TAXES AND APPROPRIATIONS**

### **California Constitution Articles XIII A and XIII B**

Article XIII A of the California Constitution limits the taxing powers of California public agencies. Article XIII A provides that the maximum ad valorem tax on real property cannot exceed one percent of the “full cash value” of the property, and effectively prohibits the levying of any other ad property tax except for taxes above that level required to pay debt service on voter-approved general obligation bonds. “Full cash value” is defined as “the County Assessor’s valuation of real property as shown on the 1975-76 tax bill under ‘full cash value’ or, thereafter, the appraised value of real property when purchased, newly constructed, or a change in ownership has occurred after the 1975 assessment.” The “full cash value” is subject to annual adjustment to reflect inflation at a rate not to exceed two percent or a reduction in the consumer price index or comparable local data, or declining property value caused by damage, destruction or other factors.

The foregoing limitation does not apply to ad valorem taxes or special assessments to pay the interest and redemption charges on any indebtedness approved by the voters before July 1, 1978 or any bonded indebtedness for the acquisition or improvement of real property approved by the applicable percentage of the votes cast by the voters voting on the proposition.

Under Article XIII B of the California Constitution, state and local government entities have an annual “appropriations limit” which limits their ability to spend certain moneys called “appropriations subject to limitation,” which consist of tax revenues, certain state subventions and certain other moneys, including user charges to the extent they exceed the costs reasonably borne by the entity in providing the service for which it is levying the charge. The City is of the opinion that the electric service and use charges imposed by the City do not exceed the costs the City reasonably bears in providing the electric service. In general terms, the “appropriations limit” is to be based on certain 1978/79 expenditures, and is to be adjusted annually to reflect changes in the consumer price index, population, and services provided by these entities. Among other provisions of Article XIII B,

if an entity's revenues in any year exceed the amount permitted to be spent, the excess would have to be returned by revising tax rates or fee schedules over the subsequent two years.

### **Constitutional Changes in California**

Proposition 218, a State ballot initiative known as the "Right to Vote on Taxes Act," was approved by the voters of the State of California on November 5, 1996. Proposition 218 added Articles XIIC and XIID to the State Constitution. Article XIID creates additional requirements for the imposition by most local governments (including the City) of general taxes, special taxes, assessments and "property-related" fees and charges. Article XIID explicitly exempts fees for the provision of electric service from the provisions of such article. Article XIIC expressly extends the people's initiative power to reduce or repeal previously-authorized local taxes, assessments, and fees and charges. Since the terms "fees and charges" are not defined in Article XIIC, the initiative powers may affect more than "property-related" fees and charges as defined in Article XIID. Additionally, in the case of Bock v. City Council of Lompoc, 109 Cal.App.3d 43 (1980), the Court of Appeal determined that electric rate ordinances are not subject to the same constitutional restrictions that are applied to the use of the initiative process for tax measures. However, the City believes that even if the electric rates of the City are subject to the initiative power, under Article XIIC or otherwise, the electorate of the City would be precluded from reducing electric rates and charges in a manner adversely affecting the payment of the amounts due under the Gas Supply Agreement by virtue of the "impairment clauses" of the United States and California Constitutions.

### **Future Initiatives**

Article XIIA, Article XIIB, and Articles XIIC and XIID, were each adopted pursuant to measures qualified for the ballot pursuant to California's constitutional initiative process. From time to time other initiative measures could be adopted by California voters. The adoption of any such initiatives might place limitations on the ability of the City to increase revenues or to increase appropriations.

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**APPENDIX B**

**AUDITED FINANCIAL STATEMENTS OF THE CITY OF VERNON  
FOR THE FISCAL YEARS ENDED JUNE 30, 2005 AND JUNE 30, 2004**

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**CITY OF VERNON**

**Management's Discussion and Analysis and  
Basic Financial Statements  
with Independent Auditor's Report**

**Fiscal Year Ended June 30, 2005**

**CITY OF VERNON**  
**FISCAL YEAR ENDED JUNE 30, 2005**

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## MACIAS GINI & COMPANY LLP

515 S. Figueroa Street, Ste. 325  
Los Angeles, California 90071

213.286.6400 PHONE  
213.286.6426 FAX

### INDEPENDENT AUDITOR'S REPORT

To the City Council  
City of Vernon, California

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Vernon, California, (City), as of and for the fiscal year ended June 30, 2005, which collectively comprise the City's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the City's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City as of June 30, 2005, and the respective changes in financial position and cash flows, where applicable, thereof for the fiscal year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 2 of the basic financial statements, effective July 1, 2004, the City adopted the provisions of GASB Statement No. 40 – *Deposit and Investment Risk Disclosures* – an amendment of GASB Statement No. 3.

The management's discussion and analysis and budgetary comparison information on pages 3 through 15 and 56 through 57, are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

*Truax Jiri & Company LLP*

Certified Public Accountants

Los Angeles, California  
December 16, 2005

**CITY OF VERNON, CALIFORNIA**  
**Management's Discussion and Analysis**  
**For the Fiscal Year Ended June 30, 2005**  
**(Unaudited)**

As management of the City of Vernon ("the City"), we offer readers of the financial statements this narrative overview and analysis of the financial activities of the City for the fiscal year ended June 30, 2005.

**Financial Highlights**

- The assets of the City exceeded its liabilities at the close of the most recent fiscal year by \$335,632,812 (*net assets*). Of this amount, \$103,390,733 (*unrestricted net assets*) may be used to meet the City's ongoing obligations to citizens and creditors.
- The City's total net assets increased by \$13,586,476. This increase is attributable to the Light and Power Fund which generated an increase in net assets before transfers of \$17,571,985.
- As of the close of the current fiscal year, the City's governmental funds reported combined ending fund balances of \$64,295,994, an increase of \$37,922,696 in comparison with the prior year. Approximately 69% of the governmental funds balances, \$44,634,875, are *available for spending* at the City's discretion (*unreserved fund balances*).

**Overview of the Financial Statements**

This discussion and analysis are intended to serve as an introduction to the City's basic financial statements. The City's basic financial statements comprise three components: 1) government-wide financial statements, 2) fund financial statements, and 3) notes to the basic financial statements.

**Government-wide financial statements.** The *government-wide financial statements* are designed to provide readers with a broad overview of the City's finances, in a manner similar to a private-sector business.

The *statement of net assets* presents information on all of the City's assets and liabilities, with the difference between the two reported as *net assets*. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the City is improving or deteriorating.

The *statement of activities* presents information showing how the City's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, *regardless of the timing of related cash flows*. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods (e.g., uncollected taxes and earned but unused vacation leave).

Both of the government-wide financial statements distinguish functions of the City that are principally supported by taxes and intergovernmental revenues (*governmental activities*) from other functions that are intended to recover all or a significant portion of their costs through user

fees and charges (*business-type activities*). The governmental activities of the City include general government, public safety, public works, and health services. The business-type activities of the City include the Light and Power Department, Gas Department, Water Department and Fiber Optic Department.

The government-wide financial statements can be found on pages 16-17 of this report.

**Fund financial statements.** A *fund* is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The City, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of the City can be divided into two categories: governmental funds and proprietary funds.

**Governmental funds.** *Governmental funds* are used to account for essentially the same functions reported as *governmental activities* in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on *near-term inflows and outflows of spendable resources*, as well as on *balances of spendable resources* available at the end of the fiscal year. Such information may be useful in evaluating a government's near-term financing requirements.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for *governmental funds* with similar information presented for *governmental activities* in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the governmental funds balance sheet and the governmental funds statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between *governmental funds* and *governmental activities*.

The City adopts an annual appropriated budget for its General Fund. A budgetary comparison schedule has been provided for the general fund to demonstrate compliance with this budget.

The basic governmental funds financial statements can be found on pages 18-21 of this report.

**Proprietary funds.** The City maintains two different types of proprietary funds. *Enterprise funds* are used to report the same functions presented as *business-type activities* in the government-wide financial statements. The City uses enterprise funds to account for its Light and Power Department, Water Department, Gas Department and Fiber Optic Department. *Internal service funds* are an accounting device used to accumulate and allocate costs internally among the City's various functions. The City uses internal service funds to account for its fleet of vehicles, insurance, and retirement. Because these services predominantly benefit governmental rather than business-type functions, they have been included within *governmental activities* in the government-wide financial statements.

Proprietary funds provide the same type of information as the government-wide financial statements, only in more detail. The proprietary fund financial statements provide separate information for the Light and Power Fund, which is considered to be a major fund of the City.

Conversely, the internal service funds are combined into a single, aggregated presentation in the proprietary fund financial statements.

The basic proprietary fund financial statements can be found on pages 22-24 of this report.

### **Government-wide Financial Analysis**

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. In the case of the City, assets exceeded liabilities by \$335,632,812 at the close of the most recent fiscal year.

### **City's Net Assets**

At the end of the current fiscal year, the City is able to report positive balances in all categories of net assets, both for the government as a whole, as well as for its separate governmental and business-type activities.

The category of the City's net assets with the largest balance totaling \$188,967,530 (56%) represents resources that are invested in capital assets, net of related debt.

The second largest category of net assets, \$103,390,733 (31%) represents unrestricted net assets that can be used to meet the City's ongoing obligations to its citizens and creditors.

The last remaining category of net assets, totaling \$43,274,549 (13%) represents the City's restricted assets, which is restricted for special purposes and payment of long-term debt.

## Changes in Net Assets

Governmental activities' net assets increased by \$68,178,921 and business-type activities' net assets decreased by \$54,592,445 for a net increase of \$13,586,476 for the City. The significant increase and decrease between the two activities were mainly caused by the Light and Power Fund transferring \$66,846,257 of its 2004 Taxable Series D Bond proceeds to the General Fund to reimburse the General Fund for costs incurred in connection with the City's Electric System since inception (1934) and the City's Proprietary Funds transferring \$2,801,081 of In-Lieu Taxes to the General Fund.

City of Vernon						
Net Assets						
June 30, 2005 and 2004						
	Governmental Activities		Business-type Activities		Totals	
	2005	2004	2005	2004	2005	2004
<b>Assets:</b>						
Current and other assets	\$ 81,468,279	\$ 42,948,135	\$123,914,496	\$136,362,800	\$205,382,775	\$ 179,310,935
Restricted assets	388,508	323,448	73,744,545	71,121,961	74,133,053	71,445,409
Capital assets	74,614,172	44,803,075	282,137,513	219,524,343	356,751,685	264,327,418
Total assets	<u>156,470,959</u>	<u>88,074,658</u>	<u>479,796,554</u>	<u>427,009,104</u>	<u>636,267,513</u>	<u>515,083,762</u>
<b>Liabilities</b>						
Current liabilities	7,244,297	6,850,860	23,916,473	22,892,110	31,160,770	29,742,970
Long-term liabilities	3,328,638	3,504,695	266,145,293	159,789,761	269,473,931	163,294,456
Total liabilities	<u>10,572,935</u>	<u>10,355,555</u>	<u>290,061,766</u>	<u>182,681,871</u>	<u>300,634,701</u>	<u>193,037,426</u>
<b>Net Assets:</b>						
Invested in capital assets, net of related debt	74,614,172	44,803,075	114,353,358	109,016,771	188,967,530	153,819,846
Restricted	338,664	386,591	42,935,885	10,019,524	43,274,549	10,406,115
Unrestricted	70,945,188	32,529,437	32,445,545	125,290,938	103,390,733	157,820,375
Total net assets	<u>\$145,898,024</u>	<u>\$ 77,719,103</u>	<u>\$189,734,788</u>	<u>\$ 244,327,233</u>	<u>\$335,632,812</u>	<u>\$ 322,046,336</u>

City of Vernon  
 Changes in Net Assets  
 Fiscal Year Ended June 30, 2005 and 2004

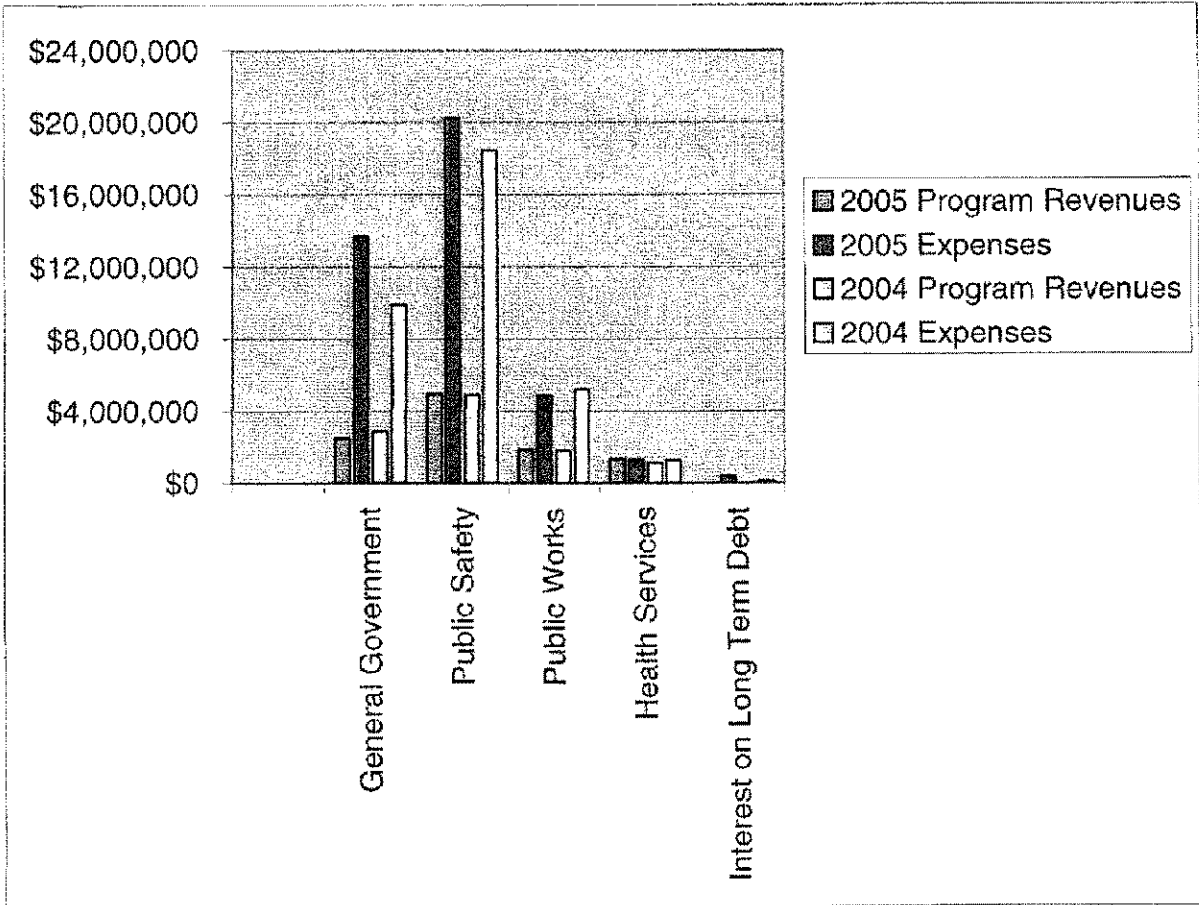
	Governmental Activities		Business-type Activities		Total	
	2005	2004	2005	2004	2005	2004
<b>Revenues:</b>						
<b>Program Revenues:</b>						
Charges for services	\$ 10,691,792	\$ 10,740,212	\$ 116,681,653	\$ 113,830,860	\$ 127,373,445	\$ 124,571,072
Operating grants and contributions	192,335	268,804	-	-	192,335	268,804
<b>General Revenues:</b>						
Taxes	17,093,349	14,561,904	-	-	17,093,349	14,561,904
State allocations	4,835,991	4,965,801	-	-	4,835,991	4,965,801
Investment income	902,085	(163,338)	4,771,013	1,855,719	5,673,098	1,692,381
Gain on sale of property	1,659,870	-	-	-	1,659,870	-
Other revenues	738,463	27,080	-	7,148,889	738,463	7,175,969
<b>Total revenues</b>	<b>36,113,885</b>	<b>30,400,463</b>	<b>121,452,666</b>	<b>122,835,468</b>	<b>157,566,551</b>	<b>153,235,931</b>
<b>Program Expenses</b>						
<b>Governmental activities</b>						
General government	13,667,855	9,910,746	-	-	13,667,855	9,910,746
Public safety	20,240,186	18,443,338	-	-	20,240,186	18,443,338
Public works	4,857,135	5,207,892	-	-	4,857,135	5,207,892
Health services	1,311,479	1,266,686	-	-	1,311,479	1,266,686
Interest on long-term debt	373,879	96,612	-	-	373,879	96,612
<b>Business-type activities</b>						
Light and Power	-	-	97,683,923	92,071,398	97,683,923	92,071,398
Other	-	-	5,845,618	5,845,103	5,845,618	5,845,103
<b>Total expenses</b>	<b>40,450,534</b>	<b>34,925,274</b>	<b>103,529,541</b>	<b>97,916,501</b>	<b>143,980,075</b>	<b>132,841,775</b>
Increase (decrease) in net assets before transfers	(4,336,649)	(4,524,811)	17,923,125	24,918,967	13,586,476	20,394,156
Transfers	72,515,570	5,718,766	(72,515,570)	(5,718,766)	-	-
<b>Increase in net assets</b>	<b>68,178,921</b>	<b>1,193,955</b>	<b>(54,592,445)</b>	<b>19,200,201</b>	<b>13,586,476</b>	<b>20,394,156</b>
<b>Net assets- beginning of year</b>	<b>77,719,103</b>	<b>76,525,148</b>	<b>244,327,233</b>	<b>225,127,032</b>	<b>322,046,336</b>	<b>301,652,180</b>
<b>Net assets- end of year</b>	<b>\$ 145,898,024</b>	<b>\$ 77,719,103</b>	<b>\$ 189,734,788</b>	<b>\$ 244,327,233</b>	<b>\$ 335,632,812</b>	<b>\$ 322,046,336</b>

**Governmental activities.** Governmental activities increased the City's net assets by \$68,178,921. This is an increase of \$66,984,966 from the prior year. The key reasons for this increase in change in net assets are as follows:

- The Light and Power Fund transferred \$66,846,257 of its 2004 Taxable Series D Bond proceeds to the General Fund to reimburse the General Fund for costs incurred in connection with the City's Electric System since inception (1934).
- The City received \$1,850,000 from BNSF (railroad) for a settlement over parcel tax Ordinance No. 1076.
- The City sold a piece of property generating \$1,659,870 of additional revenue in the current year.
- The City earned a higher return on its investments as compared to the prior year. This higher return coupled with a decrease in the fair market value of the City's investments caused a net increase in investment earnings of \$1,065,423 as compared to the prior year.
- The City spent \$870,574 more for the Police Department and \$1,309,967 more for the Fire Department as compared to the prior year. A significant portion of this increase was due to the PERS rate increase from 9.562% to 25.20% for public safety employees that became effective July 1, 2004.
- The City spent \$4,035,893 more on legal costs as compared to the prior year. These higher legal costs resulted from the City's outsourcing of legal work to outside law firms. These legal costs included research and consulting on land use, environmental issues and permitting incurred by the City in its current industrial development programs.

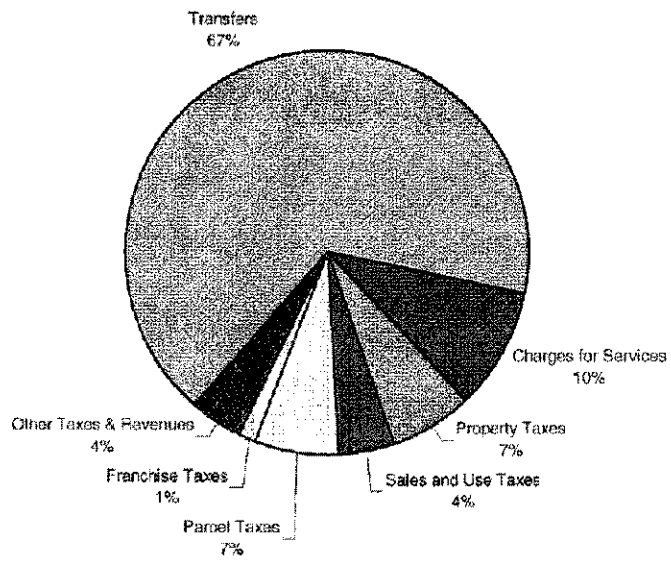


**Expenses and Program Revenues — Governmental Activities**  
**For the Fiscal Years Ended June 30, 2005 and 2004**

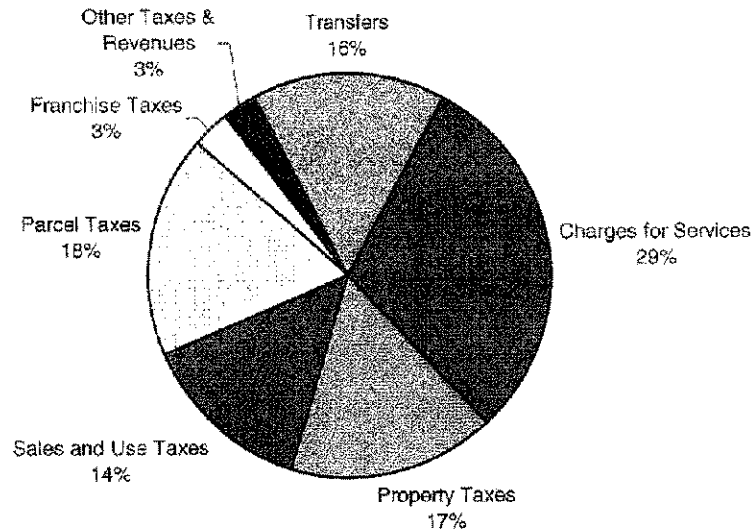


Revenues by Source — Governmental Activities  
For the Fiscal Years Ended June 30, 2005 and 2004

**2005 Governmental Activities Revenues**



### 2004 Governmental Activities Revenues

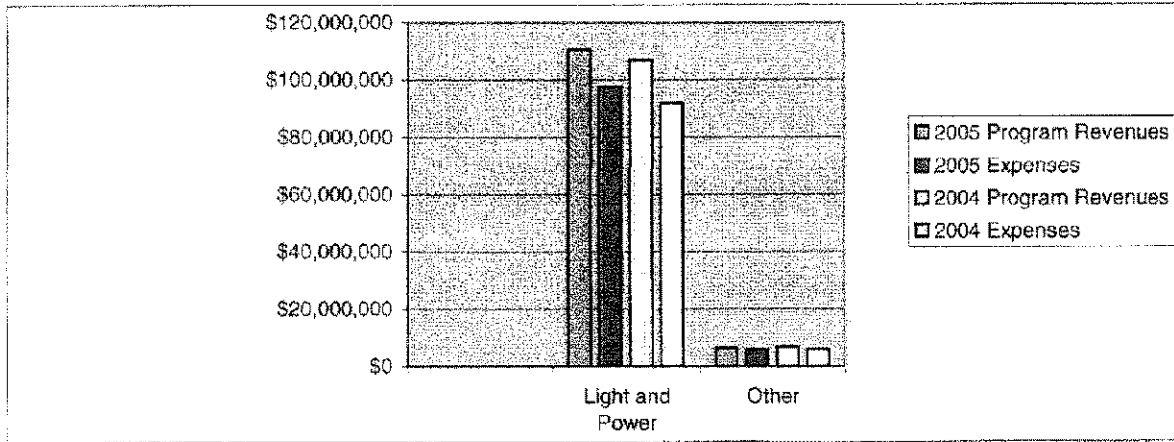


#### Business-type activities.

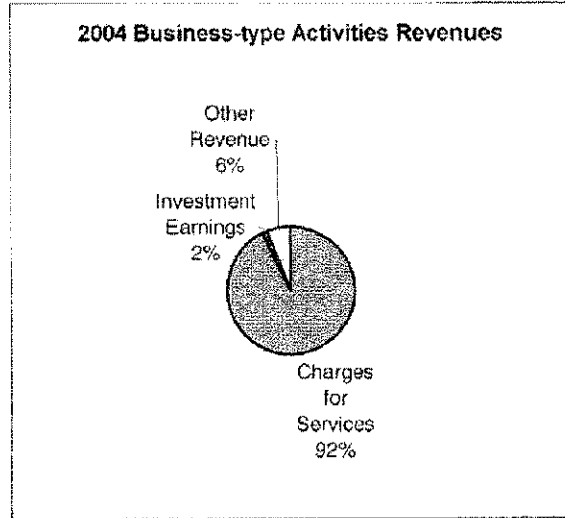
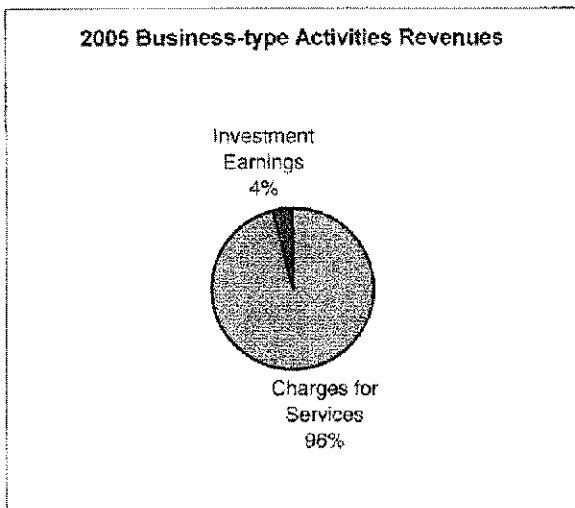
Business-type activities decreased the City's net assets by \$54,592,445. The key reason for this decrease is that the Light and Power Fund transferred \$66,846,257 of its 2004 Taxable Series D Bond proceeds to the General Fund to reimburse the General Fund for costs incurred in connection with the City's Electric System since inception (1934). However, the business-type activities had an increase in net assets before transfers of \$17,923,125 with the Light and Power Fund accounting for \$17,571,985 (98%) of the total business-type activities income.

In 2004, the Light and Power Fund had an increase in net assets before transfers of \$23,985,710. The main reason for the \$6,413,725 decrease in Light and Power Department's net assets before transfers between 2004 and 2005 is due to a \$7,148,889 revenue that the Light and Power Department received in 2004 as a result of a legal settlement. In 2005, the Light and Power Fund incurred a legal settlement cost of \$3,550,000 to settle a dispute with Enron Power Marketing, Inc. (ENRON). However, the Light and Power Department had an increase in net assets before transfers of \$17,571,985 due to favorable wholesale electricity prices and earning a higher return on its investments as compared to the prior year.

**Expenses and Program Revenues — Business-type Activities**  
**For the Fiscal Years Ended June 30, 2005 and 2004**



**Revenues by Source — Business-type Activities**  
**For the Fiscal Years Ended June 30, 2005 and 2004**



## **Financial Analysis of the Governmental Funds**

As noted earlier, the City uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

**Governmental funds.** The focus of the City's *governmental funds* is to provide information on near-term inflows, outflows, and balances of *spendable* resources. Such information is useful in assessing the City's financing requirements. In particular, *unreserved fund balance* may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year.

At the end of the current fiscal year, the City's governmental funds reported combined ending fund balances of \$64,295,994, an increase of \$37,922,696 in comparison with the prior year. Approximately 69% of total fund balance amount, \$44,634,875, constitutes *unreserved fund balance*, which is available for spending at the City's discretion. The remainder of fund balance, \$19,661,119, is *reserved* to indicate that it is not available for new spending because it has already been committed 1) to liquidate contracts and purchase orders of the current period (\$694,134), 2) advances and loans receivable in the event of a default by other funds (\$17,783,076), and 3) for a variety of other restricted purposes (\$1,183,909).

The General Fund is the operating fund of the City. At the end of the current fiscal year, the total fund balance was \$72,233,702 of which \$52,678,746 (73%) is unreserved. This unreserved amount is approximately 118% of total expenditures.

**Proprietary funds.** The City's proprietary funds provide the same type of information found in the government-wide financial statements, but in more detail.

Unrestricted net assets for the Light and Power Fund at the end of the year amounted to \$57,411,449. Unrestricted net assets of the non-major enterprise funds (Water, Gas and Fiber Optic Funds) amounted to a deficit of \$24,965,904. This deficit balance in unrestricted net assets for the nonmajor enterprise funds is primarily due to the Gas Fund. The Gas Department is currently building natural gas lines within the City to sell intragovernmentally as well as to customers. The natural gas lines are expected to be operational as of June 30, 2006. Once the natural gas lines are operational, the Gas Fund expects to eliminate this deficit balance through revenue from customer purchases.

Total (decline) growth in net assets for the Light and Power Fund and the non-major enterprise funds was (\$54,755,061) and \$162,616, respectively. Other factors concerning the finances of these funds have already been addressed in the discussion of the City's business-type activities.

## **Capital Asset and Debt Administration**

**Capital assets.** The City's investment in capital assets for its governmental and business-type activities as of June 30, 2005, amounts to \$356,751,685 (net of accumulated depreciation). This investment in capital assets includes land, buildings, utilities system improvements, machinery

and equipment, and infrastructure such as roads. The total increase in the City's investment in capital assets for the current fiscal year was \$92,424,267 (net of depreciation).

Major capital asset events during the current fiscal year included the following:

- Construction on the Malburg Generating Station; construction in progress costs for the fiscal year were \$55,995,055.
- Construction in progress costs related to a variety of construction projects and widening and expansion projects for existing streets and bridges for the fiscal year were \$2,138,755.
- Several land parcels were purchased for eventual City use totaling \$ 29,883,814.

**Current Construction Commitments.** As of June 30, 2005, the City's Light and Power Fund had commitments for construction contracts and open purchase orders totaling approximately \$1 million. These commitments and purchase orders were made for the Malburg Generating Station.

Additional information on the City's capital assets can be found in Note 5 on pages 37-39 of this report.

### **Outstanding Debt**

During the fiscal year 2005, the City issued \$90,150,000, 2004 Series A, \$83,575,000, 2004 Series B, \$39,875,000, 2004 Series C, and \$69,100,000, 2004 Series D, Electric System Revenue Bonds. The 2004 Bonds were issued to provide funds (i) to refund \$162,610,000 of outstanding Electric System Revenue Bonds of the City; (ii) to finance the costs of improvements to the City's substation and distribution facilities and certain costs of completion of the City's Malburg Generating Station; (iii) to finance the reimbursement to the City of certain costs incurred in connection with the City's electric system facilities; (iv) to fund a deposit to the Debt Service Reserve Fund; and (v) to pay the costs of issuance of the 2004 Bonds.

Additional information on the City's long-term debt can be found in Notes 6 and 7 on pages 39-47 of this report.

### **Economic Factors and Next Year's Budgets and Rates**

The City originally budgeted \$44,257,226 for general fund expenditures in 2005. The final budget for general fund expenditures was decreased by \$67,309 to \$44,189,917 in order to reduce costs in the general government.

The General Fund's total variance between the final budgeted amounts and actual amount was \$1,443,688 in deficiency of revenues under expenditures. The key reason for this variance is excess expenditures over appropriations in legal costs (general government expenditures) and land acquisitions (capital outlay expenditures) incurred by the City's in its current industrial development programs.

- The unemployment rate for the City and adjacent communities is currently 2.7%. This compares favorably to the state's average unemployment rate of 5.4% and the national average rate of 5.0%.
- The occupancy rate of the City's central business district has remained at 95% for the past four years.
- Inflationary trends in the region compare favorably to national indices.

All of these factors were considered in preparing the City's budget for the 2006 fiscal year.

### **Requests for Information**

This financial report is designed to provide a general overview of the City's finances for all those with an interest in the City's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Office of the Finance Director, 4305 Santa Fe Avenue, Vernon, California 90058.

**CITY OF VERNON, CALIFORNIA**

Statement of Net Assets

June 30, 2005

	Governmental Activities	Business-type Activities	Total
	<u>                    </u>	<u>                    </u>	<u>                    </u>
<b>ASSETS:</b>			
Cash and investments	\$ 91,001,129	\$ 72,919,992	\$ 163,921,121
Receivables	4,722,964	11,486,014	16,208,978
Accrued unbilled revenue	-	7,525,500	7,525,500
Accrued interest receivable	62,883	2,169,217	2,232,100
Inventories	758,905	2,667	761,572
Internal balances	(15,080,879)	15,080,879	-
Deposits and prepaid expenses	-	199,444	199,444
Restricted cash and investments	388,508	73,744,545	74,133,053
Note receivable	-	4,350,997	4,350,997
Bond issuance costs	-	5,634,916	5,634,916
Other assets	3,277	4,544,870	4,548,147
Capital assets:			
Nondepreciable	52,940,698	212,491,691	265,432,389
Depreciable, net	21,673,474	69,645,822	91,319,296
Total assets	<u>156,470,959</u>	<u>479,796,554</u>	<u>636,267,513</u>
<b>LIABILITIES:</b>			
Accounts payable	2,417,356	16,728,321	19,145,677
Accrued wages and benefits	1,131,000	659,636	1,790,636
Customer deposits and funds held for others	412,747	1,252,904	1,665,651
Accrued interest payable	-	1,757,919	1,757,919
Unearned revenue	674,107	-	674,107
Long-term liabilities:			
Due within one year	2,609,087	3,517,693	6,126,780
Due in more than one year	3,328,638	266,145,293	269,473,931
Total liabilities	<u>10,572,935</u>	<u>290,061,766</u>	<u>300,634,701</u>
<b>NET ASSETS:</b>			
Invested in capital assets, net of related debt	74,614,172	114,353,358	188,967,530
Restricted for:			
Special purpose	338,664	27,928,700	28,267,364
Debt service	-	15,007,185	15,007,185
Unrestricted	70,945,188	32,445,545	103,390,733
Total net assets	<u>\$ 145,898,024</u>	<u>\$ 189,734,788</u>	<u>\$ 335,632,812</u>

See accompanying notes to the basic financial statements.



**CITY OF VERNON, CALIFORNIA**  
**Statement of Activities**  
**For the Fiscal Year Ended June 30, 2005**

FUNCTION/PROGRAM ACTIVITIES:	Program Revenues				Net (Expenses) Revenues and Change in Net Assets		
	Expenses	Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Governmental Activities	Business-	
						type Activities	Total
<b>Governmental activities:</b>							
General government	\$ 13,667,855	\$ 2,497,008	\$ 192,335	\$ -	\$ (10,978,512)	\$ -	\$ (10,978,512)
Public safety	20,240,186	4,958,560	-	-	(15,281,626)	-	(15,281,626)
Public works	4,857,135	1,872,831	-	-	(2,984,304)	-	(2,984,304)
Health services	1,311,479	1,363,393	-	-	51,914	-	51,914
Interest on long-term debt	373,879	-	-	-	(373,879)	-	(373,879)
Total governmental activities	<u>40,450,534</u>	<u>10,691,792</u>	<u>192,335</u>	<u>-</u>	<u>(29,566,407)</u>	<u>-</u>	<u>(29,566,407)</u>
<b>Business-type activities:</b>							
Light and power	97,683,923	110,484,895	-	-	-	12,800,972	12,800,972
Other	5,845,618	6,196,758	-	-	-	351,140	351,140
Total business-type activities	<u>103,529,541</u>	<u>116,681,653</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>13,152,112</u>	<u>13,152,112</u>
<b>Total</b>	<u>\$ 143,980,075</u>	<u>\$ 127,373,445</u>	<u>\$ 192,335</u>	<u>\$ -</u>	<u>(29,566,407)</u>	<u>13,152,112</u>	<u>(16,414,295)</u>
<b>General Revenues:</b>							
Property taxes					7,097,687	-	7,097,687
Parcel taxes					7,447,221	-	7,447,221
Franchise taxes					1,343,201	-	1,343,201
Business license taxes					1,082,523	-	1,082,523
Other license taxes					122,717	-	122,717
Investment income					1,184,235	5,221,357	6,405,592
Net decrease in fair value of investments					(282,150)	(450,344)	(732,494)
State contribution - sales and use taxes					4,835,991	-	4,835,991
Gain on sale of property					1,659,870	-	1,659,870
Other revenues					738,463	-	738,463
Transfers					72,515,570	(72,515,570)	-
Total general revenues and transfers					<u>97,745,328</u>	<u>(67,744,557)</u>	<u>30,000,771</u>
Change in net assets					68,178,921	(54,592,445)	13,586,476
<b>NET ASSETS, BEGINNING OF YEAR</b>					<u>77,719,103</u>	<u>244,327,233</u>	<u>322,046,336</u>
<b>NET ASSETS, END OF YEAR</b>					<u>\$ 145,898,024</u>	<u>\$ 189,734,788</u>	<u>\$ 335,632,812</u>

See accompanying notes to the basic financial statements.

**CITY OF VERNON, CALIFORNIA**  
 Balance Sheet  
 Governmental Funds  
 June 30, 2005

	General Fund	Redevelopment Agency Fund	Other Governmental Funds	Total Governmental Funds
<b>ASSETS:</b>				
Cash and investments	\$ 56,375,574	\$ 444,391	\$ 23,722,989	\$ 80,542,954
Receivables	1,124,887	595,217	3,002,860	4,722,964
Accrued interest receivable	62,883	-	-	62,883
Advances to other funds	17,783,076	-	-	17,783,076
Inventories	758,905	-	-	758,905
Restricted cash and investments	388,508	-	-	388,508
Other assets	3,277	-	-	3,277
Total assets	<u>\$ 76,497,110</u>	<u>\$ 1,039,608</u>	<u>\$ 26,725,849</u>	<u>\$ 104,262,567</u>
<b>LIABILITIES AND FUND BALANCES:</b>				
<i>Liabilities:</i>				
Accounts payable	\$ 1,918,389	\$ 10,000	\$ 400,333	\$ 2,328,722
Accrued wages and benefits	1,082,913	33,769	14,318	1,131,000
Advances from other funds	-	12,827,875	19,739,432	32,567,307
Due to other funds	188,433	-	34,100	222,533
Customer deposits and funds held for others	262,747	150,000	-	412,747
Deferred revenue	810,926	-	2,493,338	3,304,264
Total liabilities	<u>4,263,408</u>	<u>13,021,644</u>	<u>22,681,521</u>	<u>39,966,573</u>
<i>Fund balances:</i>				
<i>Reserved for:</i>				
Federal forfeiture funds	338,664	-	-	338,664
Advances to other funds	17,783,076	-	-	17,783,076
Inventories	758,905	-	-	758,905
Encumbrances	587,971	-	106,163	694,134
Employee loans receivable	86,340	-	-	86,340
Unreserved	52,678,746	(11,982,036)	-	40,696,710
<i>Unreserved, reported in nonmajor:</i>				
Special revenue funds	-	-	21,523,436	21,523,436
Capital projects funds	-	-	(17,585,271)	(17,585,271)
Total fund balances	<u>72,233,702</u>	<u>(11,982,036)</u>	<u>4,044,328</u>	<u>64,295,994</u>
<b>Total liabilities and fund balances</b>	<u>\$ 76,497,110</u>	<u>\$ 1,039,608</u>	<u>\$ 26,725,849</u>	<u>\$ 104,262,567</u>

See accompanying notes to the basic financial statements.

**CITY OF VERNON, CALIFORNIA**  
**Reconciliation of the Governmental Funds Balance Sheet to**  
**Statement of Net Assets - Governmental Activities**  
**June 30, 2005**

Fund balances - total governmental funds (page 18)	\$	64,295,994
Amounts reported for governmental activities in the statement of net assets are different because:		
Capital assets used in governmental activities are not financial resources and therefore are not reported in the governmental funds.		74,614,172
In accordance with GASB Interpretation No. 6, governmental funds recognize compensated absences liabilities and expenditures to the extent the liabilities are normally expected to be liquidated with expendable available financial resources, which is defined as when such benefits are due and payable at fiscal year end.		(944,768)
Internal service funds are used by management to charge the costs of employee benefits for health insurance, workers compensation, etc., to individual funds. The assets and liabilities of these funds are included in governmental activities in the statement of net assets.		5,302,469
The City recognized uncollected property taxes that were earned but unavailable as of June 30, 2005.		2,630,157
Net assets of governmental activities (page 16)	\$	145,898,024

See accompanying notes to the basic financial statements.

**CITY OF VERNON, CALIFORNIA**  
**Statement of Revenues, Expenditures and Changes in Fund Balances**  
**Governmental Funds**  
**For the Fiscal Year Ended June 30, 2005**

	General Fund	Redevelopment Agency Funds	Other Governmental Funds	Total Governmental Funds
<b>REVENUES:</b>				
Taxes	\$ 10,235,267	\$ 5,354,989	\$ 5,596,289	\$ 21,186,545
Special assessments	721,155	-	-	721,155
Licenses and permits	933,261	-	639,302	1,572,563
Fines, forfeitures and penalties	195,044	-	-	195,044
Investment income	1,183,415	-	820	1,184,235
Net decrease in fair value of investments	(282,150)	-	-	(282,150)
Intergovernmental revenues	192,335	-	-	192,335
Charges for services to enterprise funds	8,924,185	-	-	8,924,185
Other revenues	745,039	53,958	-	798,997
<b>Total revenues</b>	<b>22,847,551</b>	<b>5,408,947</b>	<b>6,236,411</b>	<b>34,492,909</b>
<b>EXPENDITURES:</b>				
General government	12,105,745	373,355	413,968	12,893,068
Public safety	19,486,525	-	49,607	19,536,132
Public works	4,568,760	-	238,064	4,806,824
Health services	1,232,316	-	60,136	1,292,452
Capital outlay	7,067,980	17,464,707	7,310,611	31,843,298
Interest on advances	-	373,879	-	373,879
<b>Total expenditures</b>	<b>44,461,326</b>	<b>18,211,941</b>	<b>8,072,386</b>	<b>70,745,653</b>
Deficiency of revenues under expenditures	(21,613,775)	(12,802,994)	(1,835,975)	(36,252,744)
<b>Other financing sources (uses):</b>				
Sale of property	1,659,870	-	-	1,659,870
Transfers in	84,038,017	-	-	84,038,017
Transfers out	-	-	(11,522,447)	(11,522,447)
<b>Total other financing sources (uses)</b>	<b>85,697,887</b>	<b>-</b>	<b>(11,522,447)</b>	<b>74,175,440</b>
<b>NET CHANGE IN FUND BALANCES</b>	<b>64,084,112</b>	<b>(12,802,994)</b>	<b>(13,358,422)</b>	<b>37,922,696</b>
<b>FUND BALANCES, BEGINNING OF YEAR, restated</b>	<b>8,149,590</b>	<b>820,958</b>	<b>17,402,750</b>	<b>26,373,298</b>
<b>FUND BALANCES, END OF YEAR</b>	<b>\$ 72,233,702</b>	<b>\$ (11,982,036)</b>	<b>\$ 4,044,328</b>	<b>\$ 64,295,994</b>

See accompanying notes to the basic financial statements.

**CITY OF VERNON, CALIFORNIA**  
 Reconciliation of the Statement of Revenues, Expenditures, and  
 Changes in Fund Balances of Governmental Funds to the  
 Statement of Activities - Governmental Activities  
 For the Fiscal Year Ended June 30, 2005

Net change in fund balances - total governmental funds (page 20)	\$	37,922,696
Amounts reported for governmental activities in the statement of activities are different because:		
Expenditures for capital assets	\$ 31,843,298	
Less current year depreciation	<u>(2,032,201)</u>	29,811,097
Change in long-term compensated absences		256,725
Internal service funds are used by management to charge the costs of certain activities to individual funds. The net income of the internal service funds is reported with governmental activities.		227,297
In the Statement of Activities, the City recognized uncollected property taxes that were earned but unavailable as of June 30, 2005.		<u>(38,894)</u>
Change in net assets of governmental activities (page 17)	\$	<u>68,178,921</u>

See accompanying notes to the basic financial statements.

**CITY OF VERNON, CALIFORNIA**

Statement of Fund Net Assets

Proprietary Funds

June 30, 2005

	Business-type Activities Enterprise Funds			Governmental Activities - Internal Service Funds
	Light and Power	Other	Totals	
	Fund	Enterprise Funds		
<b>ASSETS:</b>				
Current assets:				
Cash and investments	\$ 66,455,358	\$ 6,464,634	\$ 72,919,992	\$ 10,458,175
Accounts receivable, net	11,416,744	69,270	11,486,014	-
Accrued unbilled revenue	7,143,572	381,928	7,525,500	-
Accrued interest receivable	2,169,217	-	2,169,217	-
Bond issuance costs	232,403	-	232,403	-
Due from other funds	-	296,648	296,648	-
Note receivable	249,803	-	249,803	-
Inventories	2,667	-	2,667	-
Deposits and prepaid expenses	199,444	-	199,444	-
Restricted cash and investments	45,815,845	-	45,815,845	-
Other assets	4,544,870	-	4,544,870	-
<b>Total current assets</b>	<b>138,239,923</b>	<b>7,212,480</b>	<b>145,442,403</b>	<b>10,458,175</b>
Noncurrent assets:				
Restricted cash and investments	27,928,700	-	27,928,700	-
Advances to other funds	44,963,917	-	44,963,917	-
Note receivable	4,101,194	-	4,101,194	-
Bond issuance costs	5,402,513	-	5,402,513	-
Capital assets:				
Nondepreciable	190,515,542	21,976,149	212,491,691	-
Depreciable, net	68,383,532	4,262,290	69,645,822	-
<b>Total noncurrent assets</b>	<b>338,295,398</b>	<b>26,238,439</b>	<b>364,533,837</b>	<b>-</b>
<b>Total assets</b>	<b>476,525,321</b>	<b>33,450,919</b>	<b>509,976,240</b>	<b>10,458,175</b>
<b>LIABILITIES:</b>				
Current liabilities:				
Accounts payable	15,147,279	1,581,042	16,728,321	88,634
Accrued wages and benefits	523,102	136,534	659,636	-
Claims payable	-	-	-	1,664,319
Accrued interest payable	1,757,919	-	1,757,919	-
Due to other funds	-	-	-	74,115
Bonds payable, due within one year	3,392,547	-	3,392,547	-
Customer deposits	971,782	281,122	1,252,904	-
Compensated absences	125,146	-	125,146	-
<b>Total current liabilities</b>	<b>21,917,775</b>	<b>1,998,698</b>	<b>23,916,473</b>	<b>1,827,068</b>
Noncurrent portion of long-term liabilities:				
Advances from other funds	-	30,179,686	30,179,686	-
Claims payable	-	-	-	3,328,638
Bonds payable	266,145,293	-	266,145,293	-
<b>Total noncurrent liabilities</b>	<b>266,145,293</b>	<b>30,179,686</b>	<b>296,324,979</b>	<b>3,328,638</b>
<b>Total liabilities</b>	<b>288,063,068</b>	<b>32,178,384</b>	<b>320,241,452</b>	<b>5,155,706</b>
<b>NET ASSETS:</b>				
Invested in capital assets, net of related debt	88,114,919	26,238,439	114,353,358	-
Restricted for special purpose	27,928,700	-	27,928,700	-
Restricted for debt service	15,007,185	-	15,007,185	-
Unrestricted (deficit)	57,411,449	(24,965,904)	32,445,545	5,302,469
<b>Total net assets</b>	<b>\$ 188,462,253</b>	<b>\$ 1,272,535</b>	<b>\$ 189,734,788</b>	<b>\$ 5,302,469</b>

See accompanying notes to the basic financial statements.

**CITY OF VERNON, CALIFORNIA**  
Statement of Revenues, Expenses and Changes in Fund Net Assets  
Proprietary Funds  
For the Fiscal Year Ended June 30, 2005

	Business-type Activities Enterprise Funds		Totals	Governmental Activities - Internal Service Funds
	Light and Power Fund	Other Enterprise Funds		
<b>OPERATING REVENUES:</b>				
Charges for services	\$ 110,484,895	\$ 6,196,758	\$ 116,681,653	\$ 9,183,399
Total operating revenues	<u>110,484,895</u>	<u>6,196,758</u>	<u>116,681,653</u>	<u>9,183,399</u>
<b>OPERATING EXPENSES:</b>				
Cost of sales	88,592,068	5,494,463	94,086,531	-
Depreciation and amortization	4,231,020	351,155	4,582,175	-
Claims expense	-	-	-	409,603
Employee benefits	-	-	-	8,546,499
Total operating expenses	<u>92,823,088</u>	<u>5,845,618</u>	<u>98,668,706</u>	<u>8,956,102</u>
Operating income	17,661,807	351,140	18,012,947	227,297
<b>NONOPERATING REVENUE (EXPENSES):</b>				
Investment income	5,221,357	-	5,221,357	-
Bond interest expense	(1,310,835)	-	(1,310,835)	-
Net decrease in fair value of investments	(450,344)	-	(450,344)	-
Legal settlement	(3,550,000)	-	(3,550,000)	-
Total nonoperating expenses	<u>(89,822)</u>	<u>-</u>	<u>(89,822)</u>	<u>-</u>
Income before transfers	17,571,985	351,140	17,923,125	227,297
Transfers out	<u>(72,327,046)</u>	<u>(188,524)</u>	<u>(72,515,570)</u>	<u>-</u>
Change in net assets	(54,755,061)	162,616	(54,592,445)	227,297
Net assets, beginning of the year	243,217,314	1,109,919	244,327,233	5,075,172
Net assets, end of the year	<u>\$ 188,462,253</u>	<u>\$ 1,272,535</u>	<u>\$ 189,734,788</u>	<u>\$ 5,302,469</u>

See accompanying notes to the basic financial statements.

**CITY OF VERNON**  
**Statement of Cash Flows**  
**Proprietary Funds**  
**For the Fiscal Year Ended June 30, 2005**

	Business-type			Governmental
	Activities - Enterprise Funds			Activities -
	Light & Power Fund	Other Enterprise Funds	Total	Internal Service Funds
<b>Cash flows from operating activities:</b>				
Cash received from customers/other funds	\$ 110,533,152	\$ 6,153,925	\$ 116,687,077	\$ 9,183,199
Cash paid to suppliers for goods and services	(81,941,925)	(4,792,295)	(86,734,120)	-
Cash paid to City general fund for services	(8,392,771)	(531,414)	(8,924,185)	-
Cash paid for claims expense and employee benefits	-	-	-	(9,244,391)
Cash paid for legal settlement	(3,550,000)	-	(3,550,000)	-
Net cash provided by (used in) operating activities	<u>16,648,556</u>	<u>830,216</u>	<u>17,478,772</u>	<u>(60,992)</u>
<b>Cash flows from noncapital financing activities:</b>				
Transfers paid	(72,327,046)	(188,524)	(72,515,570)	-
Advances from (to) other funds	(8,451,079)	1,443,059	(7,008,020)	-
Collection of note receivable	365,245	-	365,245	-
Net cash provided by noncapital financing activities	<u>(80,412,880)</u>	<u>1,254,535</u>	<u>(79,158,345)</u>	<u>-</u>
<b>Cash flows from capital and related financing activities:</b>				
Proceeds from 2004 bonds	271,172,371	-	271,172,371	-
Repayment of 2004 bonds	(3,475,000)	-	(3,475,000)	-
Repayment of 2003 bonds	(162,610,000)	-	(162,610,000)	-
Bond related costs	(4,611,672)	-	(4,611,672)	-
Bond interest paid	(3,969,778)	-	(3,969,778)	-
Acquisition and construction of capital assets	(65,277,657)	(1,917,657)	(67,195,314)	-
Net cash provided by (used in) capital and related financing activities	<u>31,228,234</u>	<u>(1,917,657)</u>	<u>29,310,577</u>	<u>-</u>
<b>Cash flows from investing activities:</b>				
Purchases and sales of investments, net	(87,903,534)	-	(87,903,534)	-
Investment income	3,709,077	-	3,709,077	-
Net cash used in investing activities	<u>(84,194,457)</u>	<u>-</u>	<u>(84,194,457)</u>	<u>-</u>
Net increase (decrease) in cash and cash equivalents	(116,200,547)	157,094	(116,043,453)	(60,992)
Cash and cash equivalents, beginning of year	163,551,916	6,297,540	171,849,456	10,519,167
Cash and cash equivalents, end of year	<u>\$ 47,351,369</u>	<u>\$ 6,454,634</u>	<u>\$ 53,806,003</u>	<u>\$ 10,458,175</u>
<b>Reconciliation of operating income to net cash provided by (used in) operating activities:</b>				
Operating income	\$ 17,661,807	\$ 351,140	\$ 18,012,947	\$ 227,297
Adjustments to reconcile operating income to net cash provided by (used in) operating activities:				
Depreciation	4,231,020	351,155	4,582,175	-
Legal settlement	(3,550,000)	-	(3,550,000)	-
Changes in operating assets and liabilities:				
Decrease (increase) in:				
Receivables	(709,078)	(833)	(709,911)	-
Other assets	762,890	-	762,890	-
Prepaid expenses and deposits	(5,555)	(42,000)	(47,555)	-
Increase (decrease) in:				
Accounts payable	(540,940)	130,529	(410,411)	(102,554)
Claims payable	-	-	-	(259,873)
Accrued wages and benefits	249,710	28,800	278,510	-
Due to other funds	(1,451,298)	11,425	(1,439,873)	74,215
Net cash provided by (used in) operating activities	<u>\$ 16,648,556</u>	<u>\$ 830,216</u>	<u>\$ 17,478,772</u>	<u>\$ (60,992)</u>
<b>Reconciliation of cash and cash equivalents in Statement of Net Assets</b>				
Cash and investments	\$ 66,455,338	\$ 6,464,634	\$ 72,919,972	\$ 10,458,175
Current restricted cash and investments	45,815,845	-	45,815,845	-
Noncurrent restricted cash and investments	27,928,700	-	27,928,700	-
Total	<u>140,199,903</u>	<u>6,464,634</u>	<u>146,664,537</u>	<u>10,458,175</u>
Less: Investments with maturities of more than 90 days	(91,378,534)	-	(91,378,534)	-
Total cash and cash equivalents	<u>\$ 48,821,369</u>	<u>\$ 6,464,634</u>	<u>\$ 55,286,003</u>	<u>\$ 10,458,175</u>
<b>Noncash Capital, Investing and Financing Activities</b>				
Acquisition of capital assets in accounts payable	\$ 1,201,457	\$ -	\$ 1,201,457	\$ -
Decrease in fair value of investments	450,344	-	450,344	-

See accompanying notes to the basic financial statements.



**CITY OF VERNON, CALIFORNIA**  
**Notes to Basic Financial Statements**  
**June 30, 2005**

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The financial statements of the City of Vernon, California (City) have been prepared in conformity with U.S. generally accepted accounting principles (GAAP). The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The more significant of the City's accounting policies are described below.

**Reporting Entity**

The City was incorporated on September 16, 1905 as a General Law City. Effective July 1, 1988, the City became a Charter City. The City operates under a Council-City Administrator form of government. As required by generally accepted accounting principles, the accompanying basic financial statements present the City of Vernon (primary government) and its component unit, an entity for which the primary government is considered to be financially accountable. In accordance with GASB Statement No. 14, the City's component unit is considered a blended component unit. Although a legally separate entity, it is, in substance, part of the City's operations, and therefore, data from this unit is combined with data of the primary government.

**Blended Component Unit**

Vernon Redevelopment Agency (RDA). The governing body of the RDA is comprised of members of the City Council and the Mayor. Among its duties, it approves the RDA's budget and appoints the management.

Separately issued financial statements for the RDA may be obtained through the City of Vernon, 4305 Santa Fe Avenue, Vernon, California, 90058.

**Basis of Presentation**

*Government-wide Financial Statements*

The statement of net assets and statement of activities display information about the primary government (the City) and its component unit. These statements include the financial activities of the overall government. It is the City's policy to make eliminations to minimize the double counting of internal activities, except for services rendered by governmental activities to business-type activities. These statements distinguish between the *governmental* and *business-type activities* of the City. Governmental activities, which normally are supported by taxes and intergovernmental revenues, are reported separately from business-type activities, which rely to a significant extent on fees charged to external parties.

The statement of activities presents a comparison between direct expenses and program revenues for each segment of the business-type activities of the City and for each function of the City's governmental activities. Direct expenses are those that are specifically associated with a program or function; and therefore, are clearly identifiable to a particular function. Expenses by function have been adjusted for any internal service profit/loss existing at fiscal year-end. Program revenues include (1) charges paid by the recipients of goods or services offered by the programs and (2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular program. Revenues that are not classified as program revenues, including all taxes, are presented instead as general revenues.

**CITY OF VERNON, CALIFORNIA**  
**Notes to Basic Financial Statements**  
**June 30, 2005**

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

*Fund Financial Statements*

The fund financial statements provide information about the City's funds and blended component unit. Separate statements for each fund category – *governmental and proprietary* – are presented. The emphasis of fund financial statements is on major governmental and enterprise funds, each displayed in a separate column. All remaining governmental and enterprise funds are separately aggregated and reported as nonmajor funds.

Proprietary funds distinguish *operating* revenues and expenses from *nonoperating* items. Proprietary fund *operating* revenues, such as charges for services, result from exchange transactions associated with the principal activity of the fund. Exchange transactions are those in which each party receives and gives up essentially equal values. *Nonoperating* revenues, such as subsidies and investment earnings, result from nonexchange transactions or ancillary activities. *Operating* expenses include the cost of sales and services, administrative expenses and depreciation on capital assets. All expenses not meeting this definition are reported as nonoperating expenses.

The City reports the following major governmental funds:

The *General Fund* is the City's primary operating fund. It is used to account for all revenues and expenditures necessary to carry out basic governmental activities of the City that are not accounted for through other funds. For the City, the General Fund includes such activities as general government, public safety, and public works.

The *Vernon Redevelopment Agency* was activated September 16, 1986, by action of the Vernon City Council pursuant to the Community Redevelopment Law of California. The Agency has the broad authority to acquire, rehabilitate, develop, administer, and sell or lease property. Additionally, the Agency has the right of eminent domain to facilitate acquisition of property. The principal objectives of the Agency are to improve the commercial environment, provide new public improvements, strengthen the City of Vernon's (City) economic base, generate added employment opportunities, and expand the City's industrial base.

The City reports the following major enterprise fund, which is also a segment:

- The *Light and Power Fund* accounts for the maintenance and operations of the City's electric utility plant. Revenue for this fund is primarily from charges for services.

Additionally, the City reports the following fund types:

- The City's *Special Revenue Funds* are used to account for the proceeds of specific revenue sources that are legally restricted to expenditures for specific purposes.
- The City's *Capital Projects Funds* are used to account for financial resources designated for the acquisition or construction of major capital facilities other than those financed by proprietary fund types.
- The City's *Internal Service Funds* are specifically designed to account for goods and services that are provided on a cost-reimbursement basis. That is, the goal of an internal service fund should be to measure the full cost of providing goods and services for the purpose of fully recovering that cost through fees or charges. Some examples of the City's services accounted for in the internal service funds are self-insurance activities for worker's compensation, general liability, group medical and dental, and vehicle replacement. The Internal Service Funds are presented in summary form as part of the proprietary fund financial statements. In the government-wide financial statements, the changes in net assets at the end of the fiscal year, as presented in the statements of activities, were allocated to the user functions of the governmental activities, to reflect the entire activity for the year. Since the predominant users of the internal services are the City's governmental activities, the asset and liability balances of the Internal Service Funds are consolidated into the governmental activities column at the government-wide level.

**CITY OF VERNON, CALIFORNIA**  
**Notes to Basic Financial Statements**  
**June 30, 2005**

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**Basis of Presentation (Continued)**

The government-wide and proprietary fund financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of when the related cash flows take place. Nonexchange transactions, in which the City gives (or receives) value without directly receiving (or giving) equal value in exchange, include property and sales taxes, grants, entitlements and donations. On an accrual basis, revenue from property taxes is recognized in the fiscal year for which the taxes are levied. Revenues from sales taxes are recognized when the underlying transactions take place. Revenues from grants, entitlements and donations are recognized in the fiscal year in which all eligible requirements have been satisfied.

Governmental fund type financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Under this method, revenues and other governmental fund type financial resources are recognized when they become susceptible to accrual – that is, when they become both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. Property, sales, and other taxes are considered available and are accrued when received within sixty days after fiscal year-end. Additionally, all other revenue sources are considered available and are accrued when received within 60 days of year-end. General capital assets acquisitions are reported as expenditures in governmental fund statements.

For the government-wide financial statements and proprietary fund financial statements, the City has elected under GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, to apply all applicable GASB pronouncements as well as any applicable pronouncements of the Financial Accounting Standards Board, the Accounting Principles Board or any Accounting Research Bulletins issued on or before November 30, 1989 unless those pronouncements conflict with or contradict GASB pronouncements. The City has elected not to adopt FASB pronouncements issued after November 30, 1989 for its government-wide and enterprise fund financial statements.

Because the governmental fund financial statements are presented on a different measurement focus and basis of accounting than the government-wide financial statements for governmental activities, reconciliations are presented which briefly explain the adjustments necessary to reconcile the fund financial statements to the governmental-wide statements.

When both restricted and unrestricted resources are available for use, it is the City's policy to use restricted resources first, and then unrestricted resources, as they are needed.

**Cash Deposits and Investments**

The City follows the practice of pooling cash and investments of all funds to maximize returns for all funds, except for funds held by trustee or fiscal agents. Interest income earned on pooled cash and investments is allocated to the various funds based on their monthly average cash balances.

For purposes of the statement of cash flows, the City considers all highly liquid investments (including restricted cash and investments) with an original maturity of three months or less when purchased to be cash equivalents. Investment transactions are recorded on the trade date. Investments in nonparticipating interest-earning investment contracts are reported at cost, and all other investments are reported at fair value. Fair value is defined as the amount that the City could reasonably expect to receive for an investment in a current sale between a willing buyer and a seller and is generally measured by quoted market prices.

**CITY OF VERNON, CALIFORNIA**  
**Notes to Basic Financial Statements**  
**June 30, 2005**

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**Interfund Receivables/Payables**

Short-term interfund receivables and payables are classified as “due from other funds” and “due to other funds” respectively on the balance sheet/statement of fund net assets. Long-term interfund receivables and payables are classified as “advances to/from other funds,” respectively, on the balance sheet/statement of fund net assets.

**Inventories**

Inventories consist of consumable supplies and fuel stock, which are stated at cost on a first-in, first-out basis. The cost of inventories is recorded as an expenditures/expense when the items are used.

**Capital Assets**

Capital assets (including infrastructure) are recorded at historical cost or at estimated historical cost if actual historical cost is not available. Contributed capital assets are valued at their estimated fair market value on the date contributed. Capital assets include public domain (infrastructure) general capital assets consisting of certain improvements including roads and bridges, sidewalks, curbs and gutters, and traffic light system. The capitalization threshold for all capital assets is \$5,000. Capital assets used in operations are depreciated using the straight-line method over their estimated useful lives in the government-wide statements and proprietary funds.

The estimated useful lives are as follows:

Infrastructure	10 to 50 years
Utility plant and buildings	25 to 50 years
Improvements	10 to 20 years
Machinery and equipment	3 to 35 years

Maintenance and repairs are charged to operations when incurred. Betterments and major improvements, which significantly increase values, change capacities or extend useful lives, are capitalized. Upon sale or retirement of capital assets, the cost and related accumulated depreciation are removed from the respective accounts and any resulting gain or loss is included in the changes in financial position. Interest income and expense associated with construction of capital assets is capitalized during the construction phase up until the capital asset is substantially complete and ready for its intended use.

**Compensated Absences**

Accumulated vacation is accrued when incurred in the government-wide and proprietary fund financial statements. A liability for accrued vacation is recorded in the governmental funds only to the extent that such amounts have matured (i.e., as a result of employee resignations and retirements). Upon termination of employment, the City will pay the employee all accumulated vacation leave at 100% of the employee’s base hourly rate.

**CITY OF VERNON, CALIFORNIA**  
**Notes to Basic Financial Statements**  
**June 30, 2005**

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**Deferred Revenue**

Deferred revenue arises when a potential revenue transaction does not meet both the “measurable” and “available” criteria for recognition in the current period. Deferred revenue also arises when resources are received before the City has a legal claim to them, as when grant monies are received in advance of incurring qualified expenditures.

**Long-term Obligations**

Certain of the City’s governmental fund obligations not currently due and payable at year-end are reported in the government-wide statement of net assets. Long-term debt and other obligations financed by proprietary funds are reported as liabilities in the appropriate proprietary fund and government-wide statement of net assets. Bond issuance costs, discounts and premiums and deferred amounts on refunding are amortized over the life of the bonds using the straight-line method.

**Net Assets**

The government-wide financial statements and proprietary fund financial statements utilize a net assets presentation. Net assets are categorized as invested in capital assets (net of related debt), restricted and unrestricted.

- ❑ Invested In Capital Assets, Net of Related Debt – This category groups all capital assets, including infrastructure, into one component of net assets. Accumulated depreciation and the outstanding balances of debt that are attributable to the acquisition, construction or improvement of these assets reduce the balance in this category.
- ❑ Restricted Net Assets – This category presents external restrictions imposed by creditors, grantors, contributors or laws or regulations of other governments and restrictions imposed by law through constitutional provisions or enabling legislation.
- ❑ Unrestricted Net Assets – This category represents net assets of the City, not restricted for any project or other purpose.

**Fund Equity**

In the fund financial statements, governmental funds report reservations of fund balance for amounts that are not appropriable or legally restricted for a specific purpose. Designations of fund balance represent tentative management plans that are subject to change.

**Use of Estimates**

The preparation of basic financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

**CITY OF VERNON, CALIFORNIA**  
**Notes to Basic Financial Statements**  
**June 30, 2005**

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**Property Taxes**

The County of Los Angeles (County) levies, collects and apportions property taxes for all taxing jurisdictions with the County. Property taxes are determined by applying approved rates to the properties' assessed values. The County remits property taxes applicable to the City less an administrative fee throughout the year.

Article XIII A of the State of California Constitution limits the property tax levy to support general government services of the various taxing jurisdictions to \$1.00 per \$100 of assessed value. Taxes levied to service voter-approved debt prior to June 30, 1978 are excluded from this limitation.

Secured property taxes are levied in two installments, November 1 and February 1. They become delinquent with penalties on December 10 and April 10, respectively. The lien date is January 1 of each year for secured and unsecured property taxes and the levy date occurs on the 4<sup>th</sup> Monday of September of the tax year. Unsecured property taxes on the tax roll as of July 31 become delinquent with penalties on August 31.

**NOTE 2 – CASH AND INVESTMENTS**

Effective July 1, 2004, the City implemented GASB Statement 40, "Deposit and Investment Risk Disclosures, an amendment of GASB Statement No. 3."

**Cash and Investments**

Cash and investments as of June 30, 2005 are classified in the accompanying financial statements as follows:

Statement of net assets:	
Cash and investments	\$ 163,921,121
Restricted cash and investments	<u>74,133,053</u>
Total cash and investments	<u>\$ 238,054,174</u>

Cash and investments as of June 30, 2005 consist of the following:

Cash on hand	\$ 1,300
Deposits with financial institutions	15,749,513
Investments	<u>222,303,361</u>
Total cash and investments	<u>\$ 238,054,174</u>

**CITY OF VERNON, CALIFORNIA**  
**Notes to Basic Financial Statements**  
**June 30, 2005**

**NOTE 2 – CASH AND INVESTMENTS (CONTINUED)**

*The City's Investment Policy*

The City's Investment Policy sets forth the investment guidelines for all funds of the City. The Investment Policy conforms to the California Government Code Section 53600 et. seq. The authority to manage the City's investment program is derived from the City Council. Pursuant to Section 53607 of the California Government Code, the City Council annually appoints the City Treasurer and approves the City's investment policy. The Treasurer is authorized to delegate this authority as deemed appropriate. No person may engage in investment transactions except as provided under the terms of the Investment Policy and the procedures established by the Treasurer.

This Policy requires that the investments be made with the prudent person standard, that is, when investing, reinvesting, purchasing, acquiring, exchanging selling or managing public funds, the trustee (Treasurer and staff) will act with care, skill, prudence, and diligence under the circumstances then prevailing, including but not limited to, the general economic conditions and the anticipated needs of the City.

The Investment Policy also requires that when following the investing actions cited above, that the primary objective of the trustee be to safeguard the principal, secondarily meet the liquidity needs of depositors, and then achieve a return on the funds under the trustee's control. Further, the intent of the Investment Policy is to minimize risk of loss on the City's held investments from:

- A. Credit risk
- B. Custodial credit risk
- C. Concentration of credit risk
- D. Interest rate risk

*Investments Authorized by the California Government Code and the City's Investment Policy*

The table below identifies the investment types that are authorized for the City by the California Government Code and the City's Investment Policy. The table also identifies certain provisions of the California Government Code that address interest rate risk, credit risk, and concentration of credit risk. This table does not address investment of debt proceeds held by bond trustee that are governed by the provisions of debt agreements of the City, rather than the general provisions of the California Government Code or the City's Investment Policy.

Authorized Investment Type	Maximum Maturity	Maximum Percentage of *Portfolio	Maximum Investment in One Issuer
Securities of the U.S. Government, or its agencies	None	None	None
Certain Asset-Backed Securities	None	None	None
Certificate of Deposit	None	30%	None
Bankers Acceptances	180 days	40%	None
Commercial Paper	270 days	25%	10%
Repurchase Agreements	1 year	None	None
Reverse Repurchase Agreements	92 days	20% of base value	None
Medium-Term Notes	None	30%	None
Mutual Funds	N/A	20%	10%
Money Market Mutual Funds	N/A	20%	10%
Mortgage Pass-Through Securities	None	20%	None
State Administered Pool Investment	N/A	None	None

\* Excluding amounts held by bond trustee that are not subject to California Government Code restrictions.

**CITY OF VERNON, CALIFORNIA**  
**Notes to Basic Financial Statements**  
**June 30, 2005**

**NOTE 2 – CASH AND INVESTMENTS (CONTINUED)**

**Investments Authorized by Debt Agreements**

Investments of debt proceeds held by bond trustee are governed by provisions of the debt agreements, rather than the general provisions of the California Government Code or the City's Investment Policy. The table below identifies the investment types that are authorized for investments held by bond trustee. The table also identifies certain provisions of these debt agreements that address interest rate risk, credit risk, and concentration of credit risk.

Authorized Investment Type	Maximum Maturity	Maximum Percentage of Portfolio	Maximum Investment in One Issuer
Securities of the U.S. Government, or its agencies	None	None	None
Certain Asset-Backed Securities	None	None	None
Certificate of Deposit	None	None	None
Bankers Acceptances	1 year	None	None
Commercial Paper	None	None	None
Money Market Mutual Funds	N/A	None	None
State Administered Pool Investment	N/A	None	None
Investment Contracts	None	None	None

**Disclosure Relating to Interest Rate Risk**

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. One of the ways that the City manages its exposure to interest rate risk is by purchasing a combination of shorter term and longer term investments and by timing cash flows from maturities so that a portion of the portfolio is maturing or coming close to maturity evenly over time as necessary to provide the cash flow and liquidity needed for operations. The City monitors the interest rate risk inherent in its portfolio by measuring the weighted average maturity of its portfolio. The City has no specific limitations with respect to this metric.

Investment Type	Amount	Weighted Average Maturity (in years)
Commercial Paper	\$ 24,597,731	0.01
Federal Home Loan Banks	1,773,575	2.10
Federal Home Loan Mortgage Corporation	2,470,900	2.30
Local Agency Investment Fund	2,030,000	0.45
Held by Bond Trustee	191,431,155	<u>2.74</u>
	<u>\$ 222,303,361</u>	2.41



**CITY OF VERNON, CALIFORNIA**  
**Notes to Basic Financial Statements**  
**June 30, 2005**

**NOTE 2 – CASH AND INVESTMENTS (CONTINUED)**

**Disclosures Relating to Credit Risk**

Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. Presented below is the minimum rating required by the California Government Code, the City's Investment Policy, or debt agreements, and the actual rating as of the year end for each investment type.

	Credit Rating Moody's/S&P	Fair Value as of June 30, 2005	% of Total
<b>In custody of Treasurer:</b>			
Cash on hand	N/A	\$ 1,300	0.00%
Deposits with financial institutions	N/A	15,749,513	6.62%
<b>Investments held by Treasurer:</b>			
Commercial Paper	P-1/A-1+	24,597,731	10.33%
Federal Home Loan Bank	Aaa/AAA	1,773,575	0.75%
FHLMC	Aaa/AAA	2,470,900	1.04%
Local Agency Investment Fund	N/A	2,030,000	0.85%
<b>Total in custody of Treasurer</b>		<b>46,623,019</b>	<b>19.59%</b>
<b>In custody of Trustee:</b>			
<b>Investments held by Trustee:</b>			
Commercial Paper	P-1/A-1	40,809,733	17.14%
Federal Farm Credit Bank	Aaa/AAA	4,970,313	2.09%
Federal Home Loan Bank	Aaa/AAA	43,762,813	18.38%
Federal National Mortgage Association	Aaa/AAA	19,943,739	8.38%
Federal Home Loan Mortgage Corporation	Aaa/AAA	18,400,944	7.73%
Medium-Term Corporate Notes	Aaa/AAA	5,053,125	2.12%
Government & Agency Investment Fund	N/A	16,099,411	6.76%
Investment Contracts	N/A	42,391,077	17.81%
<b>Total in custody of Trustee</b>		<b>191,431,155</b>	<b>80.41%</b>
<b>Total cash and investments held by Treasurer and Trustee</b>		<b>\$ 238,054,174</b>	<b>100.00%</b>

**CITY OF VERNON, CALIFORNIA**  
**Notes to Basic Financial Statements**  
**June 30, 2005**

**NOTE 2 – CASH AND INVESTMENTS (CONTINUED)**

**Concentration of Credit Risk**

The City's Investment Policy places no limit on the amount the City may invest in any one issuer excluding a 25% limitation on commercial paper and a 10% limitation on mutual funds, and money market mutual funds. As of June 30, 2005, the City had an investment in commercial paper issued by Rabobank USA Finance Corp. totaling \$19,298,220 or approximately 8.1% of the City's total investments.

**Custodial Credit Risk**

Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of its investment or collateral securities that are in the possession of another party. The California Government Code and the City's Investment Policy do not contain legal or policy requirement that would limit the exposure to custodial credit risk for deposits or investments.

At year-end, the carrying amount of the City's deposits was \$15,749,513 and the bank balance was \$15,848,123. The difference between the bank balance and the carrying amount represents outstanding checks and deposits in transit. Of the bank balance, \$200,000 was covered by federal depository insurance and \$15,648,123 was collateralized by the pledging financial institution as required by Section 53652 of the California Government Code. Under the California Government Code, a financial institution is required to secure deposits in excess of \$100,000 made by state or local governmental units by pledging government securities held in the form of an undivided collateral pool. The market value of the pledged securities in the collateral pool must equal at least 110% of the total amount deposited by the public agencies. California law also allows financial institutions to secure City deposits by pledging first trust deed mortgage notes having a value of 150% of the secured public deposits. Such collateral is held by the pledging financial institution's trust department or agent in the City's name.

As of June 30, 2005, the City did not participate in any investment that would result in any possible risk in this area.

**Investment in State Investment Pool**

The City is a voluntary participant in the Local Agency Investment Fund (LAIF) that is regulated by the California Government Code under the oversight of the Treasurer of the State of California. The fair value of the City's investment in this pool is reported in the accompanying financial statements at amounts based upon the City's pro-rata share of the fair value provided by LAIF for the entire LAIF portfolio (in relation to the amortized cost of that portfolio). The balance available for withdrawal is based on the accounting records maintained by LAIF, which are recorded on an amortized cost basis.

**CITY OF VERNON, CALIFORNIA**  
**Notes to Basic Financial Statements**  
**June 30, 2005**

**NOTE 3 - RECEIVABLES**

The City's receivables at June 30, 2005 are as follows:

<b>Receivables – Governmental Activities:</b>	General Fund	Redevelopment Agency Fund	Other Governmental Funds	Total Governmental Activities
Accounts	\$ 706,851	\$ -	\$ 213,287	\$ 920,138
Interest	62,883	-	-	62,883
Taxes	331,696	595,217	2,789,573	3,716,486
Notes or loans	86,340	-	-	86,340
Total receivables	<u>\$ 1,187,770</u>	<u>\$ 595,217</u>	<u>\$ 3,002,860</u>	<u>\$ 4,785,847</u>

<b>Receivables – Business-type Activities:</b>	Light and Power Fund	Other Enterprise Funds	Total Business-type Activities
Accounts	\$ 11,416,744	\$ 69,270	\$ 11,486,014
Note (see Note 13.B.)	4,350,997	-	4,350,997
Interest	2,169,217	-	2,169,217
Total receivables	<u>\$ 17,936,958</u>	<u>\$ 69,270</u>	<u>\$ 18,006,228</u>

**NOTE 4 – INTERFUND TRANSACTIONS**

The following tables summarize the City's interfund balances and transactions at June 30, 2005:

**Due To/From Other Funds**

<b>Receivable Fund</b>	<b>Payable Fund</b>	<b>Amount</b>
Nonmajor Enterprise Funds	General Fund	\$ 188,433
	Nonmajor Governmental Funds	34,100
	Internal Service Funds	74,115
		<u>\$ 296,648</u>

The above balances represent interfund borrowings payable due within one year.

**CITY OF VERNON, CALIFORNIA**  
**Notes to Basic Financial Statements**  
**June 30, 2005**

**NOTE 4 – INTERFUND TRANSACTIONS (CONTINUED)**

**Advances to/from other funds**

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
General Fund	Redevelopment Agency Fund	\$ 12,827,875
	Nonmajor Governmental Funds	5,979
	Nonmajor Enterprise Funds	<u>4,949,222</u>
		<u>\$ 17,783,076</u>
Light and Power Fund	Nonmajor Enterprise Funds	\$ 25,230,464
	Nonmajor Governmental Funds	<u>19,733,453</u>
		<u>\$ 44,963,917</u>

The above balances represent interfund borrowings payable beyond one year. These borrowings were for purchase of land and capital improvements.

**Transfers**

<u>Transfers In</u>	<u>Transfers Out</u>	<u>Amount</u>
General Fund	Nonmajor Governmental Funds	\$ 11,522,447
	Light and Power Fund	72,327,046
	Nonmajor Enterprise Funds	188,524
		<u>\$ 84,038,017</u>

Transfers are used to move revenues from the fund that statute or budget requires to collect them to the fund that statute or budget requires to expend them, or move revenues collected in certain enterprise funds to the General Fund to cover overhead costs provided by the General Fund and for the payment of in-lieu franchise taxes.

For the year ended June 30, 2005, transfers from the Light and Power Fund to the General Fund included \$66,846,257 proceeds from the Light and Power Fund's issuance of the 2004 Series D Bonds. The 2004 Series D Bonds were issued to reimburse the General Fund for costs incurred by the City in connection with the City's Electric System since inception (1934).

**CITY OF VERNON, CALIFORNIA**  
**Notes to Basic Financial Statements**  
**June 30, 2005**

**NOTE 5 – CAPITAL ASSETS**

Capital asset activity of governmental activities for the year ended June 30, 2005 was as follows:

	Balance July 1, 2004	Additions	Deletions	Transfers & Adjustments	Balance June 30, 2005
<b><u>Governmental activities:</u></b>					
<i>Capital assets, not being depreciated:</i>					
Land	\$ 21,790,673	\$ 29,883,814	\$ -	\$ -	\$ 51,674,487
Construction in progress	3,723,283	503,060	-	(2,960,132)	1,266,211
Total capital assets, not being depreciated	<u>25,513,956</u>	<u>30,386,874</u>	<u>-</u>	<u>(2,960,132)</u>	<u>52,940,698</u>
<i>Capital assets, being depreciated</i>					
Infrastructure	23,343,533	338,127	-	2,400	23,684,060
Buildings and improvements	12,642,958	235,825	-	2,957,732	15,836,515
Machinery and equipment	10,490,498	882,472	-	-	11,372,970
Total capital assets, being depreciated	<u>46,476,989</u>	<u>1,456,424</u>	<u>-</u>	<u>2,960,132</u>	<u>50,893,545</u>
Less accumulated depreciation for:					
Infrastructure	(17,068,069)	(617,136)	-	-	(17,685,205)
Buildings and improvements	(5,223,526)	(333,193)	-	-	(5,556,719)
Machinery and equipment	(4,896,275)	(1,081,872)	-	-	(5,978,147)
Total accumulated depreciation	<u>(27,187,870)</u>	<u>(2,032,201)</u>	<u>-</u>	<u>-</u>	<u>(29,220,071)</u>
Total capital assets, being depreciated, net	<u>19,289,119</u>	<u>(575,777)</u>	<u>-</u>	<u>2,960,132</u>	<u>21,673,474</u>
Governmental activities capital assets, net	<u>\$ 44,803,075</u>	<u>\$ 29,811,097</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 74,614,172</u>

**Depreciation**

Depreciation expense was charged to governmental functions as follows:

General government	\$ 1,258,808
Public safety	704,054
Public works	50,312
Health services	19,027
Total depreciation expense – governmental functions	<u>\$ 2,032,201</u>

**CITY OF VERNON, CALIFORNIA**  
**Notes to Basic Financial Statements**  
**June 30, 2005**

**NOTE 5 – CAPITAL ASSETS (CONTINUED)**

Capital asset activity of business-type activities for the year ended June 30, 2005 was as follows:

	Balance July 1, 2004	Additions	Deletions	Transfers & Adjustments	Balance June 30, 2005
<b>Business-type activities:</b>					
<i>Capital assets, not being depreciated:</i>					
Land	\$ 45,000	\$ -	\$ -	\$ -	\$ 45,000
Construction in progress	154,815,941	57,630,750	-	-	212,446,691
Total capital assets, not being depreciated	<u>154,860,941</u>	<u>57,630,750</u>	<u>-</u>	<u>-</u>	<u>212,491,691</u>
<i>Capital assets, being depreciated</i>					
Production plant – Light and Power	9,862,171	153,284	-	-	10,015,455
Transmission plant – Light and Power	61,285,388	162,631	-	-	61,448,019
Distribution plant – Light and Power	40,696,037	8,956,468	-	-	49,652,505
General plant – Light and Power	3,966,169	10,250	-	-	3,976,419
Buildings - Light and Power	481,800	-	-	-	481,800
Water utility plant	14,199,172	234,992	-	-	14,434,164
Gas utility plant	-	46,970	-	-	46,970
Total capital assets, being depreciated	<u>130,490,737</u>	<u>9,564,595</u>	<u>-</u>	<u>-</u>	<u>140,055,332</u>
Less accumulated depreciation for:					
Production plant – Light and Power	(5,158,028)	(337,677)	-	-	(5,495,705)
Transmission plant – Light and Power	(32,374,637)	(2,071,759)	-	-	(34,446,396)
Distribution plant – Light and Power	(16,217,246)	(1,674,065)	-	-	(17,891,311)
General plant – Light and Power	(1,957,351)	(134,067)	-	-	(2,091,418)
Buildings - Light and Power	(252,384)	(13,452)	-	-	(265,836)
Water utility plant	(9,867,689)	(348,219)	-	-	(10,215,908)
Gas utility plant	-	(2,936)	-	-	(2,936)
Total accumulated depreciation	<u>(65,827,335)</u>	<u>(4,582,175)</u>	<u>-</u>	<u>-</u>	<u>(70,409,510)</u>
Total capital assets, being depreciated, net					
Production plant – Light and Power	4,704,143	(184,393)	-	-	4,519,750
Transmission plant – Light and Power	28,910,751	(1,909,128)	-	-	27,001,623
Distribution plant – Light and Power	24,478,791	7,282,403	-	-	31,761,194
General plant – Light and Power	2,008,818	(123,817)	-	-	1,885,001
Buildings - Light and Power	229,416	(13,452)	-	-	215,964
Water utility plant	4,331,483	(113,227)	-	-	4,218,256
Gas utility plant	-	44,034	-	-	44,034
Total	<u>64,663,402</u>	<u>4,982,420</u>	<u>-</u>	<u>-</u>	<u>69,645,822</u>
Business-type activities capital assets, net	<u>\$ 219,524,343</u>	<u>\$ 62,613,170</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 282,137,513</u>

**CITY OF VERNON, CALIFORNIA**  
**Notes to Basic Financial Statements**  
**June 30, 2005**

**NOTE 5 – CAPITAL ASSETS (CONTINUED)**

**Depreciation**

Depreciation expense was charged to the business-type functions as follows:

Light and Power depreciation	\$ 4,231,020
Other Enterprise Fund depreciation	351,155
Total depreciation expense – business-type functions	\$ 4,582,175

**Capitalized bond interest**

In 2005 the City capitalized interest paid in relation to the Series 2004A, 2004B, and 2004C bonds. These bonds were issued in 2004 in order to finance the construction of the Malburg Generating Station, which is still under construction. The City incurred \$4,821,309 of interest expense that was capitalized during the year ended June 30, 2005.

**NOTE 6 – LONG-TERM OBLIGATIONS**

During the fiscal year 2005, the City issued \$90,150,000, 2004 Series A, \$83,575,000, 2004 Series B, \$39,875,000, 2004 Series C, and \$69,100,000, 2004 Series D, Electric System Revenue Bonds. The 2004 Bonds were issued to provide funds (i) to refund \$162,610,000 of outstanding Electric System Revenue Bonds of the City; (ii) to finance the costs of improvements to the City's substation and distribution facilities and certain costs of completion of the City's Malburg Generating Station; (iii) to finance the reimbursement to the City of certain costs incurred in connection with the City's electric system facilities; (iv) to fund a deposit to the Debt Service Reserve Fund; and (v) to pay the costs of issuance of the 2004 Bonds.

A summary of bonds payable for business-type activities is as follows:

Electric System Revenue Bonds	Maturity	Interest Rates	Annual Principal Installments	Original Issue Amount	Outstanding at June 30, 2005
<i>2004 Series A</i>	04/01/37	Variable	To begin 04/01/29: \$2,000,000 - \$12,925,000	\$ 90,150,000	\$ 90,150,000
<i>2004 Series B</i>	04/01/29	Variable	To begin 04/01/18: \$50,000 - \$9,525,000	83,575,000	83,575,000
<i>2004 Series C</i>	04/01/39	Variable	To begin 04/01/37: \$11,500,000 - \$14,400,000	39,875,000	39,875,000
<i>2004 Series D</i>	04/01/18	Variable	\$3,800,000 - \$6,525,000	69,100,000	65,625,000
<i>Deferred amount on refunding</i>					(8,052,628)
<b>Total Revenue Bonds</b>				<b>\$ 282,700,000</b>	<b>\$ 271,172,372</b>

\* The variable rate is set periodically through an auction process. Rates on the 2004A and 2004B bonds are reset through an auction process every 7 days. Rates on the 2004C and 2004D bonds are reset through an auction process every 28 days.

**CITY OF VERNON, CALIFORNIA**  
**Notes to Basic Financial Statements**  
**June 30, 2005**

**NOTE 6 – LONG-TERM OBLIGATIONS (CONTINUED)**

As of June 30, 2005, annual debt service requirements of business-type activities to maturity are as follows:

Year ending June 30:	Electric System Revenue Bonds Payable	
	Principal	Interest*
2006	\$ 3,800,000	\$ 10,233,529
2007	3,975,000	10,066,959
2008	4,175,000	9,893,105
2009	4,350,000	9,710,301
2010	4,550,000	9,519,721
2011-2015	25,975,000	44,594,827
2016-2020	32,700,000	38,253,503
2021-2025	39,550,000	31,824,446
2026-2030	47,725,000	24,192,571
2031-2035	57,625,000	14,951,650
2036-2039	54,800,000	3,855,333
Total requirements	\$ 279,225,000	\$ 207,095,945

\* As of June 30, 2005, debt service for 2004 Series A and Series B was calculated at the actual swap rates of 3.637% and 3.572% respectively. Debt service for the 2004 Series C was assumed at 2.83% based on a ten-year average of BMA. Debt service for the 2004 Series D was assumed at 4.13% based on a ten-year average of one month LIBOR.

**Changes in long-term liabilities**

The following is a summary of long-term liabilities transactions for the fiscal year ended June 30, 2005:

	Balance July 1, 2004	Additions	Reductions	Balance June 30, 2005	Amounts Due Within One Year
<b><u>Governmental activities:</u></b>					
Claims payable	\$ 5,252,825	\$ 409,603	\$ (669,471)	\$ 4,992,957	\$ 1,664,319
Compensated absences	1,201,493	944,768	(1,201,493)	944,768	944,768
	<u>\$ 6,454,318</u>	<u>\$ 1,354,371</u>	<u>\$ (1,870,964)</u>	<u>\$ 5,937,725</u>	<u>\$ 2,609,087</u>
<b><u>Business-type activities:</u></b>					
Bonds payable	\$ 162,610,000	\$ 282,700,000	\$ (166,085,000)	\$ 279,225,000	\$ 3,800,000
Bond premium	174,761	-	(174,761)	-	-
Bond discount	-	(1,634,532)	-	(1,634,532)	(74,639)
Deferred amount on refunding	-	(8,219,036)	166,408	(8,052,628)	(332,814)
Compensated absences	147,024	125,146	(147,024)	125,146	125,146
	<u>\$ 162,931,785</u>	<u>\$ 272,971,578</u>	<u>\$ (166,240,377)</u>	<u>\$ 269,662,986</u>	<u>\$ 3,517,693</u>



**CITY OF VERNON, CALIFORNIA**  
**Notes to Basic Financial Statements**  
**June 30, 2005**

**NOTE 6 – LONG-TERM OBLIGATIONS (CONTINUED)**

**In-Substance Defeasance – 2003 Series A and B**

On December 22, 2004, the City issued \$90,150,000 Electric System Revenue Bonds - 2004 Series A with an average interest rate of 3.637% refunding revenue bonds. The proceeds of the bonds were used to refund in advance of their maturity, the Malburg Generating Station Project Electric System Revenue Bonds - 2003 Series A totaling \$50,000,000 with an average interest rate of 2.830% and the Malburg Generating Station Project Electric System Revenue Bonds - 2003 Series B totaling \$37,500,000 with an average interest rate of 2.830%.

This refunding was done to refund the 2003 Malburg Generating Station Project Electric System Revenue Bonds and to finance the costs of improvements to the City's substation and distribution facilities and certain costs of completion of the City's Malburg Generating Station. Proceeds of the bonds were used to establish an irrevocable escrow account. Funds in the escrow account were invested in special direct obligations of the United States Treasury or other obligations of the United States government or its agencies. The escrow securities and their earnings are structured to pay the principal and interest on the refunded bonds as such payment become due, until the call dates of the respective refunded bonds, at which time the escrow payment will pay the principal of the refunded bonds at a price of par plus accrued interest. Since these bonds have been placed in an irrevocable trust, they are considered defeased for these financial statements.

The advance refunding resulted in a difference between the reacquisition price and the net carrying amount of the old debt of \$1,047,288. The City increased its debt service payment by \$41,967,338 resulting in a net present value loss of \$3,796,023.

**In-Substance Defeasance – 2003 Series C**

On December 22, 2004, the City issued \$83,575,000 Electric System Revenue Bonds - 2004 Series B with an average interest rate of 3.572% refunding revenue bonds. The proceeds of the bonds were used to refund in advance of their maturity, the Malburg Generating Station Project Electric System Revenue Bonds - 2003 Series C totaling \$75,110,000 with an average interest rate of 5.403%.

This refunding was done to refund the 2003 Malburg Generating Station Project Electric System Revenue Bonds and to finance the costs of improvements to the City's substation and distribution facilities and certain costs of completion of the City's Malburg Generating Station. Proceeds of the bonds were used to establish an irrevocable escrow account. Funds in the escrow account were invested in special direct obligations of the United States Treasury or other obligations of the United States government or its agencies. The escrow securities and their earnings are structured to pay the principal and interest on the refunded bonds as such payment become due, until the call dates of the respective refunded bonds, at which time the escrow payment will pay the principal of the refunded bonds at a price of par plus accrued interest. Since these bonds have been placed in an irrevocable trust, they are considered defeased for these financial statements.

The advance refunding resulted in a difference between the reacquisition price and the net carrying amount of the old debt of \$7,171,748. The City decreased its debt service payment by \$3,070,977 resulting in a net present value savings of \$7,183,625.

**CITY OF VERNON, CALIFORNIA**  
**Notes to Basic Financial Statements**  
**June 30, 2005**

**NOTE 7 – BOND INTEREST RATE SWAP AGREEMENTS**

**Basis Swap – 2003 Series A and B**

*Objective of the interest rate swap:* As a means to mitigate its exposure to interest rate risk, the City entered into an interest basis swap in connection with its \$87.5 million 2003 Electric System Series A and Series B bonds (the "2003 Series AB Bonds").

*Terms:* As originally structured, the 2003 Series AB Bonds and the related swap agreement were scheduled to mature on April 1, 2033, and the swap's aggregate notional amount of \$87.5 million matched the par amount of the 2003 Series AB Bonds. The swap was entered into in July 2003. Under the swap, the City pays the counterparty payments equal to the average of the weekly Bond Market Association (BMA) variable rate index and receives payments equal to 80.2% of the London Interbank Offered Rate (LIBOR) one-month index.

*Fair value:* Because the differential between the BMA index and LIBOR index has decreased since execution of the swaps, the swap has an aggregate negative fair value of \$969,291 as of June 30, 2005. The fair value was estimated using the zero-coupon method. This method calculates the future net settlement payments required by the swap, assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These payments are then discounted using the spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the date of each future net settlement on the swap.

*Credit risk:* As the swap's fair value as of June 30, 2005 is negative, the City does not have any credit exposure to the counterparty. Should the swap's fair value become positive, the City would have credit exposure to the counterparty equal to the fair value amount. The swap counterparty Bank of America, was rated AA by Standard & Poor's and Aa by Moody's Investors Service as of June 30, 2005. To mitigate the potential for credit risk, if the counterparties credit quality falls below A+/Aa2, the fair value of the swap will be fully collateralized by the counterparty with U.S. government securities. Collateral would be posted with a third-party custodian.

*Basis risk:* The swap exposes the City to basis risk should the relationship between LIBOR and BMA converge to a ratio higher than that stated in the swap. If a change occurs that results in the rates moving to a convergence ratio greater than that stated in the swap, the swap may not provide the expected interest rate risk mitigation. As of June 30, 2005, the ratio was not greater than the ratio stated in the swap.

*Termination risk:* The City or its counterparty may terminate the swap if the other party fails to perform under the terms of the contract. The swap may be terminated by the City if the counterparty's credit quality rating falls below "A-" as issued by Standard & Poor's or "A3" as issued by Moody's Investors Service. If at the time of termination, the swap has a negative fair value, the City would be liable to the counterparty for a payment equal to the swap's fair value.

*Swap payments and associated debt:* In December 2004, the City defeased the 2003 Series AB Bonds with proceeds of its 2004 Series A bonds. Because interest payments on the 2004 Series A bonds are determined based on a variable rate short term basis, the City elected to retain the swap. The City expects that as interest rates rise the difference, or spread, between short-term tax-exempt rates and short-term taxable rates will increase. Under this expectation, the City will receive payments under the swap greater than its payments to the counterparty. As a net receiver on the swap, the City would then have such monies available to offset higher debt service requirements on its 2004 Series A bonds.

**CITY OF VERNON, CALIFORNIA**  
**Notes to Basic Financial Statements**  
**June 30, 2005**

**NOTE 7 – BOND INTEREST RATE SWAP AGREEMENTS (CONTINUED)**

**Basis Swap – 2003 Series C**

*Objective of the interest rate swap:* As a means to reduce its bond interest cost, the City entered into an interest basis swap in connection with its \$75.11 million 2003 Electric System Series C bonds (the "2003 Series C Bonds").

*Terms:* As originally structured, the 2003 Series C Bonds and the related swap agreement mature on April 1, 2033, and the swap's aggregate notional amount of \$75.11 million matches the par amount of the 2003 Series C Bonds. The swap was entered into in August 2003. Under the swap, the City pays the counterparty payments equal to the average of the weekly Bond Market Association (BMA) variable rate index and receives payments equal to 78.6% of the London Interbank Offered Rate (LIBOR) one-month index.

*Fair value:* Because the differential between the BMA index and LIBOR index has decreased since execution of the swaps, the swaps have an aggregate negative fair value of \$1,544,139 as of June 30, 2005. The fair value was estimated using the zero-coupon method. This method calculates the future net settlement payments required by the swap, assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These payments are then discounted using the spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the date of each future net settlement on the swap.

*Credit risk:* As the swap's fair value as of June 30, 2005 is negative, the City does not have any credit exposure to the counterparty. Should the swap's fair value become positive, the City would have credit exposure to the counterparty equal to the fair value amount. The swap counterparty, Wachovia, was rated AA- by Standard & Poor's and Aa2 by Moody's Investors Service as of June 30, 2005. To mitigate the potential for credit risk, if the counterparty's credit quality falls below A+/Aa2, the fair value of the swap will be fully collateralized by the counterparty with U.S. government securities. Collateral would be posted with a third-party custodian.

*Basis risk:* The swap exposes the City to basis risk should the relationship between LIBOR and BMA converge to a ratio higher than that stated in the swap. If a change occurs that results in the rates moving to a convergence ratio greater than that stated in the swap, the swap may not provide the expected interest cost savings. As of June 30, 2005, the ratio was not greater than the ratio stated in the swap.

*Termination risk:* The City or its counterparty may terminate the swap if the other party fails to perform under the terms of the contract. The swap may be terminated by the City if the counterparty's credit quality rating falls below "A-" as issued by Standard & Poor's or "A3" as issued by Moody's Investors Service. If at the time of termination, the swap has a negative fair value, the City would be liable to the counterparty for a payment equal to the swap's fair value.

*Swap payments and associated debt:* In December 2004, the City defeased the 2003 Series C with proceeds of its 2004 Series B bonds. Because interest payments on the 2004 Series B bonds are determined based on variable rate short term basis, the City elected to retain the swap. The City expects that as interest rates rise the difference, or spread, between short-term tax-exempt rates and short-term taxable rates will increase. Under this expectation, the City will receive payments under the swap greater than its payments to the counterparty. As a net receiver on the swap, the City would then have such monies available to offset higher debt service requirements on its 2004 Series B bonds.

**CITY OF VERNON, CALIFORNIA**  
**Notes to Basic Financial Statements**  
**June 30, 2005**

**NOTE 7 – BOND INTEREST RATE SWAP AGREEMENTS (CONTINUED)**

**Fixed to Variable Swap**

*Objective of the interest rate swap:* The City's asset/liability strategy is to have variable rate debt exposure consistent with its variable rate asset exposure; the result being that as interest rates increase, the City's investment income will offset its increased variable rate debt costs.

*Terms:* In April 2003, the City entered into a pay-variable, receive-fixed interest rate swap for the term of its \$75,110,000 2003 Series C Electric System revenue bonds. The notional amount of the swap was \$75,110,000. In June 2003, the City elected to terminate the portion of the swap through April 2008 in exchange for a payment of \$4,170,000 from the swap counterparty. Under the remaining terms of the swap, the swap becomes effective in April 2008 and terminates in April 2033; the City pays a variable rate equal to the Bond Market Association Municipal Swap Index (BMA), which was 2.28 percent at June 30, 2005, plus 0.84% and receives fixed-rate payments equal to the actual semi-annual interest payments due on the Series C bonds. In December 2004, the City defeased the 2003 Series C Bonds with proceeds of its 2004 Series B bonds. The City expects to terminate this swap prior to its effective date of April 2008.

*Fair value:* As of June 30, 2005, the swap had a negative fair value of \$165,616. The fair value was estimated using the zero-coupon method. This method calculates the future net settlement payments required by the swap, assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These payments are then discounted using the spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the date of each future net settlement on the swap.

*Credit risk:* As the swap's fair value as of June 30, 2005 is negative, the City does not have any credit exposure to the counterparty. Should the swap's fair value become positive, the City would have credit exposure to the counterparty equal to the fair value amount. As of June 30, 2005, the swap counterparty, Bank of America, was rated AA by Standard & Poor's and Aa by Moody's Investors Service. To mitigate the potential for credit risk, if the counterparty's credit quality falls below A+/Aa2, the fair value of the swap will be fully collateralized by the counterparty with U.S. government securities. Collateral would be posted with a third-party custodian.

*Interest rate risk:* Beginning in April 2008, if the swap is not previously terminated, the swap increases the City's exposure to interest rate risk. As BMA increases, the City's net payment on the swap increases.

*Termination risk:* The City or the counterparty may terminate the swap if the other party fails to perform under the terms of the contract. In addition, the City may optionally terminate the agreement on any date. If at the time of termination the swap has a negative fair value, the City would be liable to the counterparty for an amount equal to the negative fair value.

*Swap payments and associated debt:* The debt associated with the swap, 2003 C Bonds, has been defeased. The City expects to terminate this swap prior to its effective date of April 2008.

**CITY OF VERNON, CALIFORNIA**  
**Notes to Basic Financial Statements**  
**June 30, 2005**

**NOTE 7 – BOND INTEREST RATE SWAP AGREEMENTS (CONTINUED)**

**Variable to Fixed Swap**

*Objective of the interest rate swap:* As a means to reducing its overall exposure to interest rate risk and achieving a lower cost of capital relative to long term fixed rate bonds, the City elected to issue its \$90,150,000 2004 Series A Electric System revenue bonds (the "2004 Series A Bonds") in a variable rate mode and enter to a fixed payer swap to achieve synthetic fixed rate debt.

*Terms:* In December 2004, the City entered into a pay-fixed, receive-variable interest rate swap for the term of the 2004 Series A Bonds. The notional amount of the swap is \$90,150,000. Under the terms of the swap, the City pays the counterparty a fixed rate of 3.637% and receives from the counterparty variable-rate payments equal to 62.87% of the London Interbank Offered Rate (LIBOR) one-month index plus 0.119%. The City expects that the variable-rate payments from the swap will approximate the interest payments on the 2004 Series A Bonds, thereby creating synthetic fixed rate debt. The notional amount of the swap and the amortization of the principal of the 2004 A Bonds are exactly matched.

*Fair value:* As of June 30, 2005, the swap had a negative fair value of \$9,339,988. The fair value was estimated using the zero-coupon method. This method calculates the future net settlement payments required by the swap, assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These payments are then discounted using the spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the date of each future net settlement on the swap.

*Credit risk:* As the swap's fair value as of June 30, 2005 is negative, the City does not have any credit exposure to the counterparty. Should the swap's fair value become positive, the City would have credit exposure from the counterparty equal to the fair value amount. As of June 30, 2005, the swap counterparty, Morgan Stanley was rated A+ by Standard & Poor's and Aa3 by Moody's Investors Service. To mitigate the potential for credit risk, if the counterparty's credit quality falls below (BBB/Baa2), the fair value of the swap will be fully collateralized by the counterparty with U.S. government securities. Collateral would be posted with a third-party custodian.

*Interest rate risk:* The swap is structured to reduce the City's exposure to interest rate risk.

*Basis risk:* The swap exposes the City to basis risk should the relationship between LIBOR and BMA converge to a ratio higher than variable leg of the swap.

*Termination risk:* The City or the counterparty may terminate the swap if the other party fails to perform under the terms of the contract. In addition, the City may optionally terminate the agreement on any date. If at the time of termination the swap has a negative fair value, the City would be liable to the counterparty for an amount equal to the negative fair value.

*Swap payments and associated debt:* It is expected that the variable payments received by the City on the swap will approximate the variable interest payments on the 2004 Series A Bonds, resulting in the City's net interest exposure being equaled to the fixed payment on the swap to the counterparty. Because the variable payments on the 2004 Series A Bonds and the swap are on different bases, some basis differential is expected from time to time.

**CITY OF VERNON, CALIFORNIA**  
**Notes to Basic Financial Statements**  
**June 30, 2005**

**NOTE 7 – BOND INTEREST RATE SWAP AGREEMENTS (CONTINUED)**

The following table summarizes the expected net debt service if BMA remains constant at 2.28% (BMA rate as of June 30, 2005).

Year Ending June 30,	Principal Amount	Interest	Interest Rate Swap, Net	Total Debt Service
2006		\$ 2,055,420	\$ 1,223,336	\$ 3,278,756
2007		2,055,420	1,223,336	3,278,756
2008		2,055,420	1,223,336	3,278,756
2009		2,055,420	1,223,336	3,278,756
2010		2,055,420	1,223,336	3,278,756
2011-2015		10,277,100	6,116,678	16,393,778
2016-2020		10,277,100	6,116,678	16,393,778
2021-2025		10,277,100	6,116,678	16,393,778
2026-2030	\$ 17,600,000	10,010,885	5,958,233	15,969,117
2031-2035	57,625,000	5,416,797	3,223,945	8,640,742
2036-2037	14,925,000	301,763	179,602	481,365
	<u>\$ 90,150,000</u>	<u>\$ 56,837,845</u>	<u>\$38,828,494</u>	<u>\$90,666,338</u>

**Variable to Fixed Swap**

*Objective of the interest rate swap:* As a means to reducing its overall exposure to interest rate risk and achieving a lower cost of capital relative to long term fixed rate bonds, the City elected to issue its \$83,575,000 2004 Series B Electric System revenue bonds (the "2004 Series B Bonds") in a variable rate mode and enter to a fixed payer swap to achieve synthetic fixed rate debt.

*Terms:* In December 2004, the City entered into a pay-fixed, receive-variable interest rate swap for the term of its 2004 Series B Bonds. The notional amount of the swap is \$83,575,000. Under the terms of the swap, the City pays a fixed rate of 3.572% and receives variable-rate payments equal to 62.87% of the London Interbank Offered Rate (LIBOR) one-month index plus .119%. The City expects that the variable-rate payments from the swap will approximate the interest payments on the 2004 Series B Bonds. The notional amount of the swap and the amortization of the principal of the 2004 Series B Bonds are exactly matched.

*Fair value:* As of June 30, 2005, the swap had a negative fair value of \$6,811,009. The fair value was estimated using the zero-coupon method. This method calculates the future net settlement payments required by the swap, assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These payments are then discounted using the spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the date of each future net settlement on the swap.

*Credit risk:* As the swap's fair value as of June 30, 2005 is negative, the City does not have any credit exposure to the counterparty. Should the swap's fair value become positive, the City would have credit exposure from the counterparty equal to the fair value amount. As of June 30, 2005, the swap counterparty, Morgan Stanley was rated A+ by Standard & Poor's and Aa3 by Moody's Investors Service. To mitigate the potential for credit risk, if the counterparty's credit quality falls below (BBB/Baa2), the fair value of the swap will be fully collateralized by the counterparty with U.S. government securities. Collateral would be posted with a third-party custodian.

**CITY OF VERNON, CALIFORNIA**  
**Notes to Basic Financial Statements**  
**June 30, 2005**

**NOTE 7 – BOND INTEREST RATE SWAP AGREEMENTS (CONTINUED)**

*Interest rate risk:* The swap is structured to reduce the City's exposure to interest rate risk.

*Basis risk:* The swap exposes the City to basis risk should the relationship between LIBOR and BMA converge to a ratio higher than variable leg of the swap.

*Termination risk:* The City or the counterparty may terminate the swap if the other party fails to perform under the terms of the contract. In addition, the City may optionally terminate the agreement on any date. If at the time of termination the swap has a negative fair value, the City would be liable to the counterparty for an amount equal to the negative fair value.

*Swap payments and associated debt:* It is expected that the variable payments received by the City on the swap will approximate the variable interest payments on the 2004 Series B Bonds, resulting in the City's net interest exposure being equaled to the fixed payment on the swap to the counterparty. Because the variable payments on the 2004 Series A Bonds and the swap are on different bases, some basis differential is expected from time to time.

The following table summarizes the expected net debt service if BMA remains constant at 2.28% (BMA rate as of June 30, 2005).

Year Ending June 30,	Principal Amount	Interest	Interest Rate Swap, Net	Total Debt Service
2006		\$ 1,905,510	\$ 1,079,789	\$ 2,985,299
2007		1,905,510	1,079,789	2,985,299
2008		1,905,510	1,079,789	2,985,299
2009		1,905,510	1,079,789	2,985,299
2010		1,905,510	1,079,789	2,985,299
2011-2015		9,527,550	5,398,945	14,926,495
2016-2020	\$ 13,900,000	9,291,880	5,265,399	14,557,279
2021-2025	39,550,000	5,984,940	3,391,466	9,376,406
2026-2030	30,125,000	1,336,705	757,466	2,094,172
	<u>\$83,575,000</u>	<u>\$35,668,625</u>	<u>\$20,212,221</u>	<u>\$55,880,847</u>

**NOTE 8 – OTHER DERIVATIVE FINANCIAL INSTRUMENTS**

The City's Light and Power Fund (Fund), which accounts for the maintenance and operations of the City's electric utility plant, enters into contracts for electricity and natural gas to meet the expected needs of its retail customers. The Fund also sells excess electricity capacity during periods when it is not needed to meet its retail requirements. Derivative contracts (futures and options) designated as cash flow hedges are entered into by the Fund to hedge variable price risk associated with the purchase and sale of commodities and extend out to March 30, 2007. At June 30, 2005, the Fund's derivative contracts totaled \$1,913,105 and are recorded at fair value in the Fund's financial statements and are included with other assets. Changes in fair value are recognized immediately in earnings as a component of operating income. The Fund recognized a net loss of \$484,684 as a result of a change in fair value for the year ended June 30, 2005.

**CITY OF VERNON, CALIFORNIA**  
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**NOTE 9 – RISK MANAGEMENT**

The City is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; natural disasters; unemployment coverage, and providing health benefits to employees, retirees, and their dependents. The City is self-insured for its general liability, workers' compensation, and property liability. The City has chosen to establish risk financing Internal Service Funds, whereby assets are set aside for claim settlements associated with the above risks of loss up to certain limits.

The City has obtained various insurance policies that provide coverage for "Special Form Perils" against direct physical loss or damage, including earthquake and flood, to all real and personal property of the City, including equipment, business and revenue interruption, errors and omissions, boiler and machinery and pollution legal liability. The earthquake and flood portion of the policies have a 5% deductible of the total insurable values per building, structure or covered item at the time and place of loss. In the most recent "Statement of Values" for the City, real and personal property total insured values equaled \$110,181,233 and total insured earthquake/flood values equaled \$92,727,660.

Crime (Employee Theft and, Depositors Forgery and Alteration, and Computer and Funds Transfer Fraud) coverage is also in force with a limit \$100,000 for each line of coverage.

The City is self insured for the first \$300,000 of workers' compensation claims and for the first \$2,000,000 of its general liability coverage.

Excess coverage is provided by the Independent Cities Risk Management Authority (the "ICRMA"), a joint powers authority whose purpose is to develop and fund programs of excess insurance for its member cities. The ICRMA is governed by a board of directors consisting of representatives of its member cities. Excess coverage is provided by ICRMA. Self-insurance and ICRMA limits are as follows:

Type of Coverage	Self-Insurance	ICRMA
General Liability	Up to \$2,000,000	Not Applicable
Workers' Compensation	Up to \$300,000	\$300,000 to \$10,000,000
Property	Up to \$ 10,000	Not Applicable

Insured limits are:

Type of Coverage	Limits
Excess General Liability	\$10,000,000 excess of \$2,000,000 (self insured)
Excess General Liability	\$10,000,000 excess of \$10,000,000

The City is constructing and will be operating the Malburg Generating Station, a combined cycle power plant. A Builders Risk insurance policy is in place with limits of insurance of \$150,000,000 each and every loss/accident combined single limit. The deductible is \$100,000 except for \$250,000 on the GTX 100 Turbines, \$750,000 arising from Hot Testing Performance of GTX Turbines, \$500,000 arising out of Hot Testing of all other equipment. Earthquake coverage has an annual aggregate sub-limit of \$20,000,000 with a 5% deductible on Earthquake.

Amounts in excess of these limits are self-insured. There have been no significant reductions of coverage from the prior year. There have been no settlements exceeding insurance coverage for each of the past three fiscal years.



**CITY OF VERNON, CALIFORNIA**  
**Notes to Basic Financial Statements**  
**June 30, 2005**

**NOTE 9 – RISK MANAGEMENT (CONTINUED)**

The unpaid claims liabilities included in each of the self-insurance Internal Service Funds are based on the results of actuarial studies and third-party administrator claim reports and include amounts for claims incurred but not reported, including loss adjustment expenses. Claims liabilities are calculated considering the effects of inflation and recent claim settlement trends, including frequency and amount of payouts and other economic and social factors.

Changes in the balances of claims liabilities during the past two fiscal years for all self-insurance funds combined are as follows:

	Fiscal Year Ended June 30	
	2005	2004
Claims payable, beginning of fiscal year	\$ 5,252,825	\$ 5,124,267
Incurred claims	409,603	622,093
Claim payments	(669,471)	(493,535)
Claims payable, end of fiscal year	\$ 4,992,957	\$ 5,252,825

**NOTE 10 – PENSION PLAN**

The City contributes to the California Public Employees' Retirement System (PERS), an agent multiple-employer retirement system that acts as a common investment and administrative agent for participating public entities within the State of California.

All full-time safety (police and fire personnel) and miscellaneous personnel and temporary or part-time employees who have worked 1,000 hours in a fiscal year are eligible to participate in the PERS. Benefits vest after five years of service. Employees who retire at age 50 with five years of credited service are entitled to retirement benefits. Monthly retirement benefits are based on an employee's average compensation for his or her single highest year of compensation for each year of credited service.

Miscellaneous members with five years of credited service may retire at age 55 with full benefits based on a benefit factor derived from the "2% at 55 Miscellaneous Factor" benefit factor table and between age 50 and 54 with reduced retirement benefits. Safety members may retire at age 50 with full benefits based on a benefit factor derived from the "3% at 50 Safety Factor" benefit factor table with five years of credited service. The PERS also provides death and disability benefits. These benefit provisions and all other requirements are established by State statute and City ordinance.

The City's plan does not issue a stand-alone financial report but is included in the PERS report, which can be obtained from PERS at Lincoln Plaza, 400 P Street, Sacramento, California 95814.

The State-required City employee salary contributions of 7% for miscellaneous employees and 9% for safety members are subsidized by the City. The City is required to contribute the remaining amounts necessary to fund the benefits for its members, using the actuarial basis adopted by the PERS Board of Administration.

The City's total contribution to the PERS for the year ended June 30, 2005 was \$4,610,702. City contribution rates as a percentage of covered payroll were 1.926% for miscellaneous plan members and 25.200% for safety plan members.

The City's contribution was made in accordance with actuarially determined requirements based on an actuarial valuation performed as of June 30, 2002.

**CITY OF VERNON, CALIFORNIA**  
**Notes to Basic Financial Statements**  
**June 30, 2005**

**NOTE 10 – PENSION PLAN (CONTINUED)**

The PERS uses the entry age normal actuarial cost method, which is a projected benefit cost method that takes into account those benefits expected to be earned in the future as well as those already accrued. According to this cost method, the normal cost for an employee is the level amount that would fund the projected benefit if it were paid annually from the date of employment until retirement. The PERS uses a modification of the entry age normal cost method whereby the employer's total normal cost is expressed as a level percentage of payroll. PERS also uses the level percentage of payroll method to amortize any unfunded accrued actuarial liabilities.

Significant actuarial assumptions used in the valuation included (a) a rate of return on the investment of present and future assets of 7.75% a year, compounded annually; (b) overall payroll growth of 3.25%, compounded annually; and (c) a merit scale varying by duration of employment coupled with an assumed annual inflation growth of 3.00% and an annual production growth of 0.25%.

The actuarial value of assets was determined using techniques that smooth the effects of short-term volatility in the market value of investments over a three-year period.

Trend information for the current and two preceding fiscal years is as follows:

Fiscal Year Ended June 30	Annual Pension Cost (APC)	Amount Contributed	Percentage of APC Contributed	Net Pension Obligation
2005	\$ 4,610,702	\$ 4,610,702	100%	-
2004	2,742,685	2,742,685	100%	-
2003	1,954,358	1,954,358	100%	-

The following schedule represents the required supplemental information for the three most recent actuarial valuations. This schedule provides information about progress made in accumulating sufficient assets to pay benefits when due (dollar amounts in millions):

Actuarial Valuation Date June 30	Actuarial Accrued Liability (AAL) (a)	Actuarial Value of Assets (b)	Unfunded (Overfunded) UAAL (OAAL) (a)-(b)	Funded Ratio (b)/(a)	Annual Covered Payroll (c)	UAAL (OAAL) As a % of Covered Payroll [(a)-(b)]/(c)
2003	\$ 172.2	\$ 164.8	\$ 7.4	95.7%	\$ 21.6	34.1%
2002	161.6	166.3	(4.6)	102.9	19.9	(23.3)
2001	155.6	180.5	(24.8)	116.0	18.9	(131.7)

**NOTE 11 – LEGAL SETTLEMENT**

In late 2004, the City settled a dispute over a wholesale power purchase contract with Enron Power Marketing, Inc. (ENRON) for \$3,550,000. The controversy arose in connection with the delivery of power under the contract and the filing by ENRON of a petition in Bankruptcy Court.

**CITY OF VERNON, CALIFORNIA**  
**Notes to Basic Financial Statements**  
**June 30, 2005**

**NOTE 12 – DEFICITS IN FUND EQUITY**

The deficit fund balance of \$11,982,036 in the Redevelopment Agency Fund relates to recording the fund's loans from the City on its balance sheet, which will be repaid through future property tax increments.

The Gas Enterprise Fund has a negative net asset of \$6,078,275 at June 30, 2005, which will be recovered from customers once the fund commences operations as of June 30, 2006.

The Equipment Replacement Internal Service Fund has a negative net asset of \$162,749 at June 30, 2005. To the extent such deficit is attributed to shortfalls in charges to other funds, such deficit will be recovered through future rate increases. A deficit arising from decreases in fair value of pooled investments will not be recovered through charges to other funds.

**NOTE 13 – LIGHT AND POWER OPERATIONS AND COMMITMENTS**

**Deregulation**

Effective April 1, 1998, competition was introduced into California's electric utility market, and customers of the state's investor-owned utilities (IOUs) became eligible for direct access. The implementation of competition in accordance with State Assembly Bill 1890 (AB1890) resulted in significant structural changes to the electric power industry, including mandated direct access for IOU customers, energy sales through a Power Exchange, and management of transmission assets through an Independent System Operator (ISO). AB 1890 also legislated the recovery of stranded investment through the assessment of a non-by passable competition transition charge (CTC). The original deregulation legislation applied to the State's IOUs and did not compel participation by publicly owned utilities, such as the City's electric utility.

**Participating Transmission Owner**

On August 30, 2000, the City filed a petition for declaratory order with the Federal Energy Regulatory Commission (FERC) requesting a determination by the FERC that the City's Transmission Revenue Requirement (TRR), as approved by its rate setting body, the City Council, is proper for purposes of the City becoming a Participating Transmission Owner (PTO) in the California ISO. The FERC issued its order accepting the City's petition, with certain modification, on October 27, 2000. Certain aspects of the FERC order were challenged by some of the State's other PTOs. Recently, a federal appeals court ruled that the way the FERC arrived at its decision was improper and remanded the case back to the FERC for further proceedings. The City's expected outcome of these proceedings is discussed in Note 15. As a PTO, the City has turned over operational control of its transmission entitlements to the ISO effective January 1, 2001 and shall be reimbursed based upon its TRR by the ISO through the ISO's collection of a transmission access charge (TAC).

On December 21, 2000, the ISO filed, on behalf of itself and the Participating Transmission Owners (PTO), a number of changes to its Transmission Control Agreement (TCA) to recognize Vernon's application to become a Participating Transmission Owner. The ISO also filed revisions to identify the transmission interests that the City will be turning over to the ISO's operational control and the inclusion of an explicit contract provision to ensure that all PTOs, including an entity such as the City, which is not subject to the rate jurisdiction of FERC under section 205 and 206 of the Federal Power Act (FPA), make all refunds or payment adjustments to implement any relevant FERC order.

**CITY OF VERNON, CALIFORNIA**  
**Notes to Basic Financial Statements**  
**June 30, 2005**

**NOTE 13 – LIGHT AND POWER OPERATIONS AND COMMITMENTS (CONTINUED)**

**Project Commitments**

**A. Southern California Public Power Authority**

In 1980, the City entered into a joint powers agreement with nine (9) Southern California cities and an irrigation district to form the Southern California Public Power Authority (the "Authority"). The Authority's purpose is the planning, financing, acquiring, constructing and operating of projects that generate or transmit electric energy.

The Authority purchased a 5.91% interest in the Palo Verde Nuclear Generating Station (the "Station"), a nuclear-fired generating station near Phoenix, Arizona, from the Salt River Project Agricultural Improvement and Power District, and a 6.55% share of the right to use certain portions of the Arizona Nuclear Power Project Valley Transmission System. The City has a 4.9% entitlement share of the Authority's interest in the station.

Between 1983 and 2002, the Authority issued \$3.166 billion (with \$108 million currently outstanding) of Power Project Revenue Bonds to finance the purchase of the Authority's share of the Station and related transmission rights. The bonds are not obligations of any member of the Authority or public agency other than the Authority. Under a power sales contract with the Authority, the City is obligated on a "take or pay" basis for its proportionate share of power generated, as well as to make payments for its proportionate share of the operating and maintenance expenses of the Station, debt service on the bonds and any other debt, whether or not the project or any part thereof or its output is suspended, reduced or terminated. The City's proportionate share of costs during fiscal year 2005 was \$2,546,604.

**B. Hoover Dam Power Plant Upgrade Program**

In January 1987, the City entered into a contract with the Federal Bureau of Reclamation to fund part of an upgrading program of the Hoover Dam power plant to increase the plant's generating capacity. In exchange, the City will receive its pro rata share of the additional power produced. Total program costs are estimated to be \$155 million.

As of June 30, 2005, the City's total advances were \$6,736,123 for the upgrading program. At June 30, 2005, the outstanding note receivable was \$4,350,997. The City has no obligation to advance funds in the future. The note is being repaid with interest over a period of 30 years. The City must also make payments for its pro rata share of operating and maintenance costs not recovered by the plant through revenues. The amount paid during the current year for purchased power was reduced by principal and interest amounts totaling \$365,245 due the City on the outstanding note receivable. The contract expires in June 2017.

**C. California-Oregon Transmission Project**

In 1991, the City entered into the Interim Participation Agreement with several Northern California entities and the Western Area Power Administration. This agreement calls for the construction and operation of the project. Each party in the agreement has been allocated a respective share of the construction costs. The City's share is 8.05%. As of June 30, 2005, the City's share of total costs incurred for the project's planning and construction was \$37,412,346.

**CITY OF VERNON, CALIFORNIA**  
**Notes to Basic Financial Statements**  
**June 30, 2005**

**NOTE 13 – LIGHT AND POWER OPERATIONS AND COMMITMENTS (CONTINUED)**

**Power Purchase Commitments**

As of June 30, 2005, the City has entered into long-term commitments to purchase power subject to certain conditions. The following table summarizes the value of the commitments at June 30, 2005 (in thousands):

<u>Fiscal Year</u>	<u>Amount</u>
2005-06	\$ 19,038
2006-07	14,091
2007-08	14,091
2008-11	20,269
	<u>\$ 67,489</u>

**Construction Commitments**

As of June 30, 2005, the City's Light and Power Fund had commitments for construction contracts and open purchase orders totaling approximately \$1 million.

**NOTE 14 – POST-EMPLOYMENT BENEFITS**

The City Council approved a post-employment benefit plan for all employees with 20 years of service who retire at 60 or 30 years or more of service to the City. The plan pays for qualified employees' medical and dental insurance premiums and claims from age 60 to 65. Funding of the plan is on a pay-as-you-go basis. During the year ended June 30, 2005, approximately 43 employees were eligible to receive benefits. Amounts paid for the year ended June 30, 2005 totaled \$386,720.

**NOTE 15 – CONTINGENCIES**

At June 30, 2005, a number of lawsuits and claims were pending against the City that arose in the normal course of operations. Management estimates that certain pending lawsuits and claims may result in additional liabilities of approximately \$500,000.

The City is currently in proceedings with the FERC to determine the appropriate Transmission Revenue Requirement ("TRR") for the City. The City is currently receiving revenue from the ISO based on a TRR of approximately \$10.2 million annually. The City cannot predict the outcome of this proceeding, but it is possible that the outcome could affect the City's TRR in certain ways including, among others, the level of TRR. In addition, the FERC has ordered the City to pay refunds for certain electric energy sales made during the period October 2, 2000 through June 20, 2001 at prices above certain California markets. This order is currently under appeal in the United States Court of Appeals, and as such the City cannot predict the outcome of this case. The ultimate loss related to these matters, if any, is unknown at this time and no amount has been accrued in the accompanying financial statements.

Additionally, the City is in proceedings with a former wholesale electric energy supplier, Mirant Americas Energy Marketing ("MAEM") about a dispute over one of their energy delivery contracts. MAEM, currently under bankruptcy court jurisdiction, obtained a judgment against the City for approximately \$14 million regarding this long-term energy supply contract. The validity of the judgment is currently under appeal and the City has petitioned the FERC to exercise jurisdiction over the case. City management is unable to determine the ultimate loss related to this matter at this time.

**CITY OF VERNON, CALIFORNIA**  
**Notes to Basic Financial Statements**  
**June 30, 2005**

**NOTE 16 – RESTATEMENT OF BEGINNING FUND BALANCE**

For the fiscal year ended June 30, 2005, the City restated its General Fund's fund balance to reflect the proper application of GASB Interpretation No. 6, for compensated absences, as follows:

Fund balance July 1, 2004, as previously reported	\$6,948,097
Adjustment for compensated absences	<u>1,201,493</u>
Fund balance July 1, 2004, as restated	<u>\$8,149,590</u>

**NOTE 17 – FUTURE GASB PRONOUNCEMENTS**

The City is currently analyzing its accounting practices to determine the potential impact on the financial statements for the following GASB Statements:

In November 2003, GASB issued Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. This statement establishes accounting and financial reporting standards for impairment of capital assets. A capital asset is considered impaired when its service utility has declined significantly and unexpectedly. This statement also clarifies and establishes accounting requirements for insurance recoveries. This statement is effective for the City's fiscal year ending June 30, 2006.

In April 2004, GASB issued Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*. This statement establishes uniform financial reporting standards for other postemployment benefits (OPEB) plans. The approach followed in this statement generally is consistent with the approach adopted for defined benefit pension plans with modifications to reflect differences between pension plans and OPEB plans. The statement applies for OPEB trust funds included in the financial reports of plan sponsors or employers, as well as for the stand-alone financial reports of OPEB plans or the public employee retirement systems, or other third parties, that administer them. This statement also provides requirements for reporting of OPEB funds by administrators of multiple-employer OPEB plans, when the fund used to accumulate assets and pay benefits or premiums when due is not a trust fund. This statement is effective for the City's fiscal year ending June 30, 2007.

In June 2004, GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, which addresses how state and local governments should account for and report their costs and obligations related to postemployment healthcare and other nonpension benefits. Collectively, these benefits are commonly referred to as other postemployment benefits, or OPEB. The statement generally requires that employers account for and report the annual cost of OPEB and the outstanding obligations and commitments related to OPEB in essentially the same manner as they currently do for pensions. Annual OPEB cost for most employers will be based on actuarially determined amounts that, if paid on an ongoing basis, generally would provide sufficient resources to pay benefits as they come due. This statement's provisions may be applied prospectively and do not require governments to fund their OPEB plans. An employer may establish its OPEB liability at zero as of the beginning of the initial year of implementation; however, the unfunded actuarial liability is required to be amortized over future periods. This statement also establishes disclosure requirements for information about the plans in which an employer participates, the funding policy followed, the actuarial valuation process and assumptions, and, for certain employers, the extent to which the plan has been funded over time. This statement is effective for the City's fiscal year ending June 30, 2008.

**CITY OF VERNON, CALIFORNIA**  
**Notes to Basic Financial Statements**  
**June 30, 2005**

**NOTE 17 – FUTURE GASB PRONOUNCEMENTS (CONTINUED)**

In December 2004, GASB issued Statement No. 46, *“Net Assets Restricted Enabling Legislation – An amendment of GASB Statement No. 34.”* This Statement establishes and modifies requirements related to restrictions of net assets resulting from enabling legislation. It amends GASB Statement No. 34, *“Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments*, paragraph 34. GASB Statement No. 34, *Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments*, requires that limitations on the use of net assets imposed by enabling legislation be reported as restricted net assets. This Statement clarifies that a legally enforceable enabling legislation restriction is one that a party external to a government—such as citizens, public interest groups, or the judiciary—can compel a government to honor. The Statement states that the legal enforceability of an enabling legislation restriction should be reevaluated if any of the resources raised by the enabling legislation are used for a purpose not specified by the enabling legislation or if a government has other cause for reconsideration. Although the determination that a particular restriction is not legally enforceable may cause a government to review the enforceability of other restrictions, it should not necessarily lead a government to the same conclusion for all enabling legislation restrictions. This Statement also specifies the accounting and financial reporting requirements if new enabling legislation replaces existing enabling legislation or if legal enforceability is reevaluated. Finally, this Statement requires governments to disclose the portion of total net assets that is restricted by enabling legislation. This statement is effective for the City’s fiscal year ending June 30, 2006.

In June 2005, GASB issued Statement No. 47, *“Accounting for Termination Benefits”*. This Statement provides guidance to governmental employers for measuring, recognizing, and reporting liabilities and expense/expenditures related to all termination benefits, including voluntary termination benefits, without limitation as to the period of time during which the benefits are offered, and involuntary termination benefits. This statement is effective for the City’s fiscal year ending June 30, 2006.

**NOTE 18 – SUBSEQUENT EVENT**

In October 2005, the City’s Redevelopment Agency (Agency) issued \$49,420,000 in Industrial Redevelopment Project Tax Allocation Series 2005 Bonds (“Bonds”). The bond proceeds will be used to (i) finance various redevelopment projects for the Agency’s industrial redevelopment area; (ii) fund the reserve requirement of the Bonds; and (iii) pay the cost of issuance of the Bonds. The Bonds mature in various amounts at various dates from September 1, 2009 through September 1, 2035. The annual interest rates on the Bonds vary from 3.25% to 5.25%.

**REQUIRED SUPPLEMENTARY INFORMATION**



CITY OF VERNON, CALIFORNIA  
 Required Supplementary Information  
 Budgetary Comparison Schedule  
 General Fund  
 For the Fiscal Year Ended June 30, 2005

	Budgeted Amounts		Actual Amounts	Variance with Final Budget Positive (Negative)
	Original	Final		
<b>REVENUES:</b>				
Taxes	\$ 9,797,948	\$ 9,797,948	\$ 8,385,267	\$ (1,412,681)
Special assessments	650,000	650,000	721,155	71,155
Licenses and permits	1,211,000	1,211,000	933,261	(277,739)
Fines, forfeitures and penalties	267,000	267,000	195,044	(71,956)
Revenues from use of monies and properties	-	-	1,183,415	1,183,415
Net decrease in fair value of investments	-	-	(282,150)	(282,150)
Intergovernmental revenues	-	-	192,335	192,335
Charges for services	8,313,101	8,313,101	8,924,185	611,084
Other revenues	4,852,680	4,852,680	4,254,909	(597,771)
Total revenues	<u>25,091,729</u>	<u>25,091,729</u>	<u>24,507,421</u>	<u>(584,308)</u>
<b>EXPENDITURES:</b>				
General government	10,779,608	10,712,299	12,693,716	(1,981,417)
Public safety	21,314,315	21,314,315	19,486,525	1,827,790
Public works	6,781,475	6,781,475	4,568,760	2,212,715
Health services	1,425,108	1,425,108	1,232,316	192,792
Capital outlay	3,956,720	3,956,720	7,067,980	(3,111,260)
Total expenditures	<u>44,257,226</u>	<u>44,189,917</u>	<u>45,049,297</u>	<u>(859,380)</u>
Deficiency of revenues under expenditures	<u>(19,165,497)</u>	<u>(19,098,188)</u>	<u>(20,541,876)</u>	<u>(1,443,688)</u>
Other financing sources:				
Transfers in	8,431,157	8,431,157	84,038,017	75,606,860
Total other financing sources	<u>\$ 8,431,157</u>	<u>\$ 8,431,157</u>		
Reconciliation of GAAP basis fund balance				
Current year encumbrances			<u>587,971</u>	<u>587,971</u>
NET CHANGE IN FUND BALANCE			64,084,112	74,751,143
FUND BALANCE, BEGINNING OF YEAR, RESTATED			<u>8,149,590</u>	<u>8,149,590</u>
FUND BALANCE, END OF YEAR			<u>\$ 72,233,702</u>	<u>\$ 82,900,733</u>

See accompanying note to the required supplementary information.

**CITY OF VERNON, CALIFORNIA**  
**Notes to Required Supplementary Information**  
**June 30, 2005**

**NOTE 1 – BUDGET**

The City adheres to the following general procedures in establishing its annual budget, which is reflected in the accompanying General Fund budgetary comparison schedule.

- An annual budget is adopted by the City Council that provides for the general operation of the City. The budget includes authorized expenditures and estimated revenues of the General Fund, Special Revenue Funds and Capital Projects Funds;
- The budget is formally integrated into the accounting system and employed as a management control device during the year;
- Encumbrances, which are commitments related to executory contracts for goods and services, are recorded to assure effective budgetary control and accountability;
- Encumbrances outstanding at year-end do not constitute expenditures or liabilities under GAAP. Encumbrances outstanding at year-end are reported as reservations of fund balance for subsequent year expenditures. Unencumbered appropriations lapse at year-end;
- The budget is adopted on a modified accrual basis, except that encumbrances are treated as budgetary basis expenditures in the year of incurrence of the commitment to purchase;
- The City Administrator is authorized to transfer appropriations between activities within any fund. Expenditures may not exceed appropriations and transfers, at the fund level, including beginning fund balance. The final budgeted amounts used in the accompanying general fund budgetary comparison schedule include any amendments made during fiscal year 2005. Encumbrances carried forward from the prior year are reflected in the original budget.

**CITY OF VERNON, CALIFORNIA**  
**Notes to Basic Financial Statements**  
**June 30, 2005**

**NOTE 19 – EVENTS (UNAUDITED) SUBSEQUENT TO THE DATE OF THE  
INDEPENDENT AUDITOR’S REPORT**

In March 2006, three public utility companies and a State oversight board filed suit against the City of Vernon and several other public owned entities related to payment of refunds for certain electric energy sales. In June 2006, the Federal Energy Regulation Commission affirmed its earlier determination regarding the City’s Transmission Revenue Requirement. City management and legal counsel cannot predict the outcome of these matters and the ultimate loss is unknown at this time.

**CITY OF VERNON**

Management's Discussion and Analysis and  
Basic Financial Statements  
with Independent Auditor's Report

Fiscal Year Ended June 30, 2004

**CITY OF VERNON**  
**FISCAL YEAR ENDED JUNE 30, 2004**

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## MACIAS GINI & COMPANY LLP

515 S Figueroa Street, Ste. 225  
Los Angeles, California 90071

213.617.0300 PHONE  
213.286.6426 FAX

### INDEPENDENT AUDITOR'S REPORT

City Council  
City of Vernon, California

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Vernon, California (City) as of and for the fiscal year ended June 30, 2004, which collectively comprise the City's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the City's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City as of June 30, 2004, and the respective changes in financial position and cash flows, where applicable, thereof for the fiscal year then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis and budgetary comparison information on pages 3 through 14 and 48 and 49, are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

*Mason, Jiri & Company LLP*

Certified Public Accountants

Los Angeles, California  
October 22, 2004

**City of Vernon, California**  
**Management's Discussion and Analysis**  
**For the Fiscal Year Ended June 30, 2004**  
**(Unaudited)**

As management of the City of Vernon ("the City"), we offer readers of the financial statements this narrative overview and analysis of the financial activities of the City for the fiscal year ended June 30, 2004.

**Financial Highlights**

- The assets of the City exceeded its liabilities at the close of the most recent fiscal year by \$322,046,336 (*net assets*). Of this amount, \$157,820,375 (*unrestricted net assets*) may be used to meet the City's ongoing obligations to citizens and creditors
- The City's total net assets increased by \$20,394,156. Approximately 91% of this increase is attributable to the Light and Power Fund. This is a 33% drop from 2003.
- As of the close of the current fiscal year, the City's governmental funds reported combined ending fund balances of \$25,171,805, a decrease of \$3,815,045 in comparison with the prior year. Approximately 31% of the governmental funds balances, \$7,777,723, is *available for spending* at the City's discretion (*unreserved fund balances*).
- At the end of the current fiscal year, unreserved fund balance for the general fund had a deficit of \$(2,727,582), which shall be brought into balance going forward as the proceeds of a special parcel tax are used to defray general government expenditures for construction, improvement and maintenance of streets and bridges and for other public rights of way and land acquisition.

**Overview of the Financial Statements**

This discussion and analysis are intended to serve as an introduction to the City's basic financial statements. The City's basic financial statements comprise three components: 1) government-wide financial statements, 2) fund financial statements, and 3) notes to the basic financial statements.

**Government-wide financial statements.** The *government-wide financial statements* are designed to provide readers with a broad overview of the City's finances, in a manner similar to a private-sector business.

The *statement of net assets* presents information on all of the City's assets and liabilities, with the difference between the two reported as *net assets*. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the City is improving or deteriorating.

The *statement of activities* presents information showing how the City's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, *regardless of the timing of related cash flows*.



Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods (e.g., uncollected taxes and earned but unused vacation leave).

Both of the government-wide financial statements distinguish functions of the City that are principally supported by taxes and intergovernmental revenues (*governmental activities*) from other functions that are intended to recover all or a significant portion of their costs through user fees and charges (*business-type activities*). The governmental activities of the City include general government, public safety, public works, and health services. The business-type activities of the City include the Light and Power Department, Gas Department and Water Department.

The government-wide financial statements can be found on pages 15-16 of this report.

**Fund financial statements.** A *fund* is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The City, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of the City can be divided into two categories: governmental funds and proprietary funds.

**Governmental funds.** *Governmental funds* are used to account for essentially the same functions reported as *governmental activities* in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on *near-term inflows and outflows of spendable resources*, as well as on *balances of spendable resources* available at the end of the fiscal year. Such information may be useful in evaluating a government's near-term financing requirements.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for *governmental funds* with similar information presented for *governmental activities* in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the governmental funds balance sheet and the governmental funds statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between *governmental funds* and *governmental activities*.

The City adopts an annual appropriated budget for its general fund. A budgetary comparison schedule has been provided for the general fund to demonstrate compliance with this budget.

The basic governmental funds financial statements can be found on pages 17 and 19 of this report.

**Proprietary funds.** The City maintains two different types of proprietary funds. *Enterprise funds* are used to report the same functions presented as *business-type activities* in the government-wide financial statements. The City uses enterprise funds to account for its Light and Power Department, Gas Department and Water Department. *Internal service funds* are an accounting device used to accumulate and allocate costs internally among the City's various functions. The City uses internal service funds to account for its fleet of vehicles, insurance, and

retirement. Because these services predominantly benefit governmental rather than business-type functions, they have been included within *governmental activities* in the government-wide financial statements.

Proprietary funds provide the same type of information as the government-wide financial statements, only in more detail. The proprietary fund financial statements provide separate information for the Light and Power Fund, which is considered to be a major fund of the City. Conversely, the internal service funds are combined into a single, aggregated presentation in the proprietary fund financial statements.

The basic proprietary fund financial statements can be found on pages 21-24 of this report.

### **Reclassification of 2003 Investment Earnings**

In 2003, the City received \$4,170,000 as a gain for altering a bond interest swap arrangement. This gain was inadvertently classified as investment earnings instead of other revenue. We have reclassified this gain as other revenue in the comparative financial statements located on page 7 of this report.

### **Government-wide Financial Analysis**

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. In the case of the City, assets exceeded liabilities by \$322,046,336 at the close of the most recent fiscal year.

### **City's Net Assets**

At the end of the current fiscal year, the City is able to report positive balances in all categories of net assets, both for the government as a whole, as well as for its separate governmental and business-type activities.

The category of the City's net assets with the largest balance totaling \$157,820,375 (49%) represents unrestricted net assets that can be used to meet the City's ongoing obligations to its citizens and creditors.

The second largest category of net assets, \$153,819,846 (48%) represents resources that are invested in capital assets, net of related debt.

The last remaining category of net assets, totaling \$10,406,115 (3%) represents the City's restricted assets, which is restricted for special purposes and payment of long-term debt.

## Changes in Net Assets

The City's net assets increased by \$20,394,156. The Light and Power Fund was responsible for 91% of this increase, as the Light and Power fund had a change in net assets of \$18,462,066. The City experienced a drop in its change in net assets of \$10,232,979 or 33% from 2003. This decrease is due to: a decrease in intergovernmental revenues of \$4,657,797, and a decrease in investment earnings of \$3,717,865.

	City of Vernon Net Assets June 30, 2004					
	Governmental Activities		Business-type Activities		Total	
	2004	2003	2004	2003	2004	2003
<b>Assets:</b>						
Current and other assets	\$ 42,948,135	\$ 45,527,125	\$ 136,362,800	\$ 77,906,882	\$ 179,310,935	\$ 123,434,007
Restricted Assets	323,448	81,150	71,121,961	158,072,460	71,445,409	158,153,610
Capital Assets	44,803,075	39,924,860	219,524,343	164,550,430	264,327,418	204,475,290
Total Assets	<u>88,074,658</u>	<u>85,533,135</u>	<u>427,009,104</u>	<u>400,529,772</u>	<u>515,083,762</u>	<u>486,062,907</u>
<b>Liabilities</b>						
Current Liabilities	6,850,860	3,883,720	22,892,110	12,611,953	29,742,970	16,495,673
Long-term liabilities	3,504,695	5,124,267	159,789,761	162,790,787	163,294,456	167,915,054
Total Liabilities	<u>10,355,555</u>	<u>9,007,987</u>	<u>182,681,871</u>	<u>175,402,740</u>	<u>193,037,426</u>	<u>184,410,727</u>
<b>Net Assets:</b>						
Invested in capital Assets, net of related debt	44,803,075	39,924,860	109,016,771	149,812,580	153,819,846	189,737,440
Restricted	386,591	-	10,019,524	10,019,524	10,406,115	10,019,524
Unrestricted	32,529,437	36,600,288	125,290,938	65,294,928	157,820,375	101,895,216
Total Net Assets	<u>\$ 77,719,103</u>	<u>\$ 76,525,148</u>	<u>\$ 244,327,233</u>	<u>\$ 225,127,032</u>	<u>\$ 322,046,336</u>	<u>\$ 301,652,180</u>

City of Vernon  
Changes in Net Assets  
Fiscal Year Ended June 30, 2004

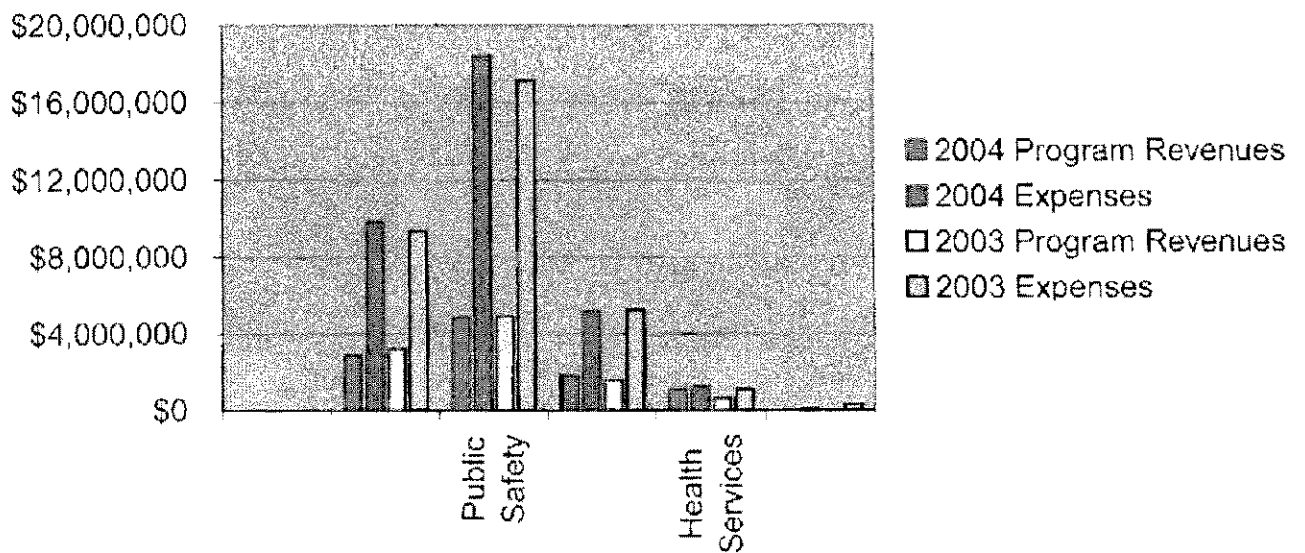
	Governmental Activities		Business-type Activities		Total	
	2004	2003	2004	2003	2004	2003
<b>Revenues:</b>						
<b>Program Revenues:</b>						
Charges for services	\$ 10,740,212	\$ 10,364,563	\$ 113,830,860	\$ 107,829,739	\$ 124,571,072	\$ 118,194,302
Operating grants and contributions	268,804	323,601	-	-	268,804	323,601
Capital grants and contributions	-	4,603,000	-	-	-	4,603,000
<b>General Revenues:</b>						
Taxes	14,561,904	15,907,207	-	-	14,561,904	15,907,207
State Allocations	4,965,801	4,260,525	-	-	4,965,801	4,260,525
Investment income	(163,338)	652,101	1,855,719	4,758,145	1,692,381	5,410,246
Other revenues	27,080	52,508	7,148,889	4,170,000	7,175,969	4,222,508
<b>Total Revenues</b>	<b>30,400,463</b>	<b>36,163,505</b>	<b>122,835,463</b>	<b>116,757,884</b>	<b>153,235,931</b>	<b>152,921,389</b>
<b>Program Expenses</b>						
<b>Governmental activities</b>						
General government	9,910,746	9,376,685	-	-	9,910,746	9,376,685
Public safety	18,443,338	17,160,735	-	-	18,443,338	17,160,735
Public works	5,207,892	5,286,988	-	-	5,207,892	5,286,988
Health services	1,266,686	1,096,595	-	-	1,266,686	1,096,595
Interest on long-term debt	96,612	310,236	-	-	96,612	310,236
<b>Business-type activities</b>						
Light and Power	-	-	92,071,398	83,655,798	92,071,398	83,655,798
Other	-	-	5,845,103	5,407,217	5,845,103	5,407,217
<b>Total expenses</b>	<b>34,925,374</b>	<b>33,231,239</b>	<b>97,916,501</b>	<b>89,063,015</b>	<b>132,841,775</b>	<b>122,294,254</b>
Increase (decrease) in net assets before transfers	(4,524,811)	2,932,266	24,918,967	27,694,869	20,394,156	30,627,135
Transfers	5,718,766	(10,238,192)	(5,718,766)	(10,238,192)	-	-
Increase in net assets	1,193,955	(7,305,926)	19,200,201	17,456,677	20,394,156	30,627,135
Net Assets- beginning of Year	76,525,148	63,354,690	225,127,032	207,670,355	301,652,180	271,025,045
Net assets- end of year	<u>\$ 77,719,103</u>	<u>\$ 76,525,148</u>	<u>\$ 244,327,233</u>	<u>\$ 225,127,032</u>	<u>\$ 322,046,336</u>	<u>\$ 301,652,180</u>

The City has reclassified the "In-Lieu Franchise Tax" for 2003 as a transfer to conform to the current year's presentation.

**Governmental activities.** Governmental activities increased the City's net assets by \$1,193,955. This is a decrease of \$11,976,503 from the prior year. Key reasons for this decrease in change in net assets are as follows:

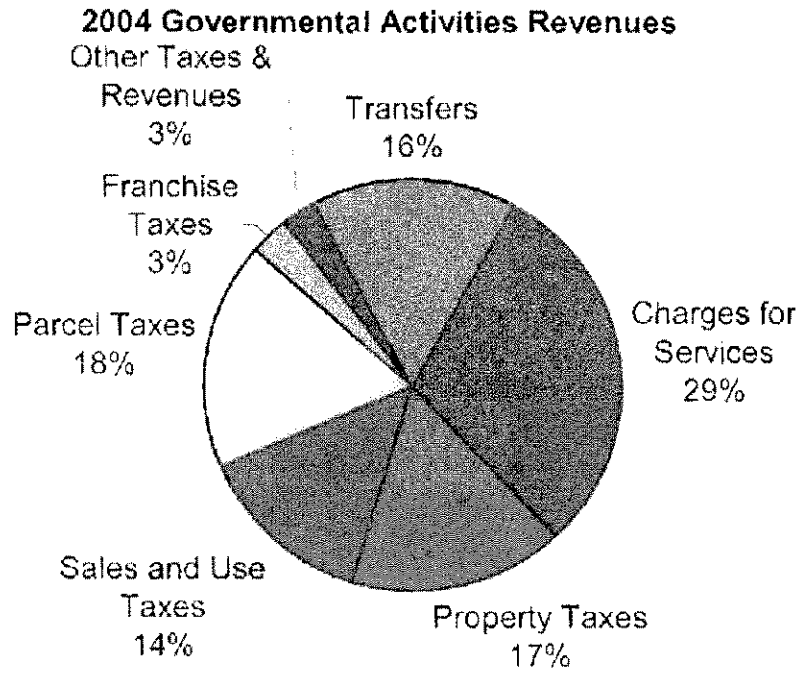
- The Light and Power Fund reduced its annual transfer to the General Fund by \$4,519,426.
- The City received a Capital Grant of \$4,603,000 in 2003, the City received no such grant in 2004.
- The City did not earn the same returns on its investments in 2004 as it did in 2003, this lower return coupled with a decrease in the fair market value of its investments caused a net decrease in investment earnings of \$815,439.

Expenses and Program Revenues — Governmental Activities  
For the Fiscal Years Ended June 30, 2003 and 2004



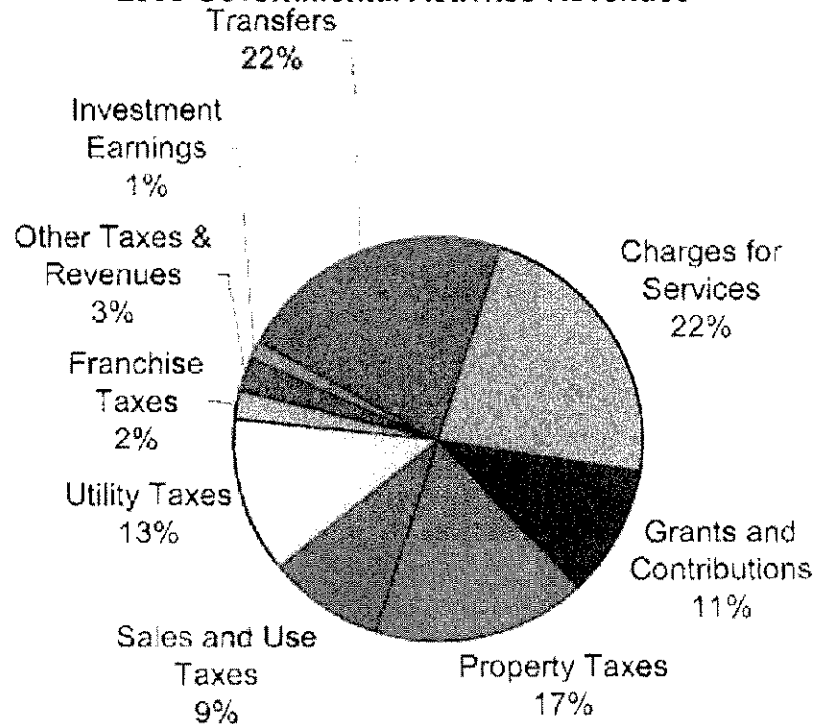
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Revenues by Source — Governmental Activities  
For the Fiscal Years Ended June 30, 2003 and 2004



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### 2003 Governmental Activities Revenues



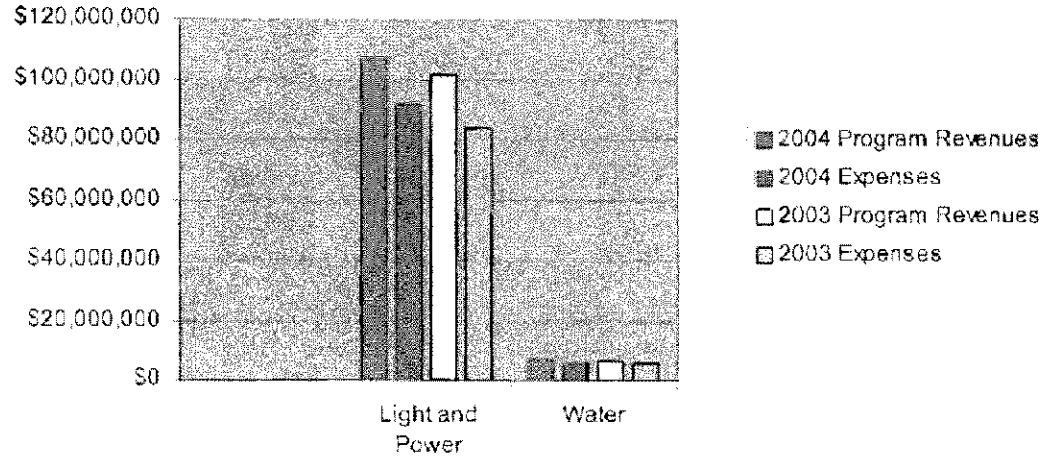
#### **Business-type activities.**

Business-type activities increased the City's net assets by \$19,200,201, accounting for 94% of the total growth in the City's net assets. This increase is primarily due to the Light and Power Fund. The Light and Power Fund had operating income of \$14,981,102.

In 2003 the Light and Power Fund had operating income of \$17,737,503. The decrease in operating income for the Light and Power Department between 2003 and 2004 is due to an increase in wholesale electricity prices. The City spent 14% more on wholesale electricity in 2004, but only had a corresponding increase in operating revenues of approximately 5.6%. The operating revenue increase is due to a 4.5% increase in power supplied along with a 3% rate increase instituted in November 2003. This increase in the cost of wholesale electricity was the main cause of the drop in change in net assets from 2003

The Light and Power Fund received \$7,148,889 in revenue as a result of a legal settlement with El Paso Natural Gas. This settlement is further discussed in Note 10 of the disclosure notes.

Expenses and Program Revenues — Business-type Activities  
For the Fiscal Years Ended June 30, 2003 and 2004

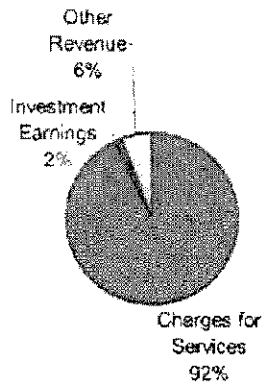




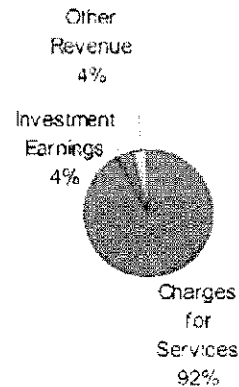
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Revenues by Source — Business-type Activities  
For the Fiscal Years Ended June 30, 2003 and 2004

2004 Business Type Activities Revenues



2003 Business Type Activities Revenues



### Financial Analysis of the Governmental Funds

As noted earlier, the City uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

**Governmental funds.** The focus of the City's *governmental funds* is to provide information on near-term inflows, outflows, and balances of *spendable* resources. Such information is useful in assessing the City's financing requirements. In particular, *unreserved fund balance* may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year.

At the end of the current fiscal year, the City's governmental funds reported combined ending fund balances of \$25,171,805, a decrease of \$3,815,045 in comparison with the prior year. 31% of this total amount, \$7,777,723, constitutes *unreserved fund balance*, which is available for spending at the City's discretion. The remainder of fund balance, \$17,394,082, is *reserved* to indicate that it is not available for new spending because it has already been committed 1) to liquidate contracts and purchase orders of the current period (\$11,066,728), 2) advances and loans receivable in the event of a default (\$5,146,577), 3) for a variety of other restricted purposes (\$1,180,777).

The general fund is the operating fund of the City. At the end of the current fiscal year, the total fund balance was \$6,948,097. Of this total balance there is an unreserved deficit of \$(2,727,582).

The balance of the City's general fund decreased by \$9,318,778. Over the past several years, general governmental expenditures have been increasingly used for the construction,

improvement and maintenance of streets, bridges and other public rights-of-way and land acquisitions.

In 1998, the City Council addressed this revenue imbalance by enacting a special parcel tax. The proceeds of this tax shall be used to fund these various infrastructure improvements. Challenges to this tax by various interested parties, including the railroads, were initiated. All of these now have been settled. The City's parcel tax fund has collected in excess of \$24 million to date.

**Proprietary funds.** The City's proprietary funds provide the same type of information found in the government-wide financial statements, but in more detail.

Unrestricted net assets for the Light and Power Fund at the end of the year amounted to \$148,852,956. Unrestricted net assets for the Gas, Water and Fiber Optic Funds amounted to a deficit of \$23,562,018. This deficit balance in unrestricted net assets for the nonmajor enterprise funds is primarily due to the Gas Fund. The Gas Department is currently building natural gas lines within the City to sell intragovernmentally as well as to customers. Once the natural gas lines are operational, the Gas Fund expects to eliminate this deficit balance through revenue from customer purchases.

Total growth in net assets for the Light and Power Fund and the Gas, Water and Fiber Optic Funds was \$18,462,066 and \$738,135, respectively. Other factors concerning the finances of the Light and Power fund have already been addressed in the discussion of the City's business-type activities.

### **Capital Asset and Debt Administration**

**Capital assets.** The City's investment in capital assets for its governmental and business-type activities as of June 30, 2004, amounts to \$264,327,418 (net of accumulated depreciation). This investment in capital assets includes land, buildings, utilities system improvements, machinery and equipment, and infrastructure such as roads. The total increase in the City's investment in capital assets for the current fiscal year was \$59,852,128 (net of depreciation).

Major capital asset events during the current fiscal year included the following:

- Construction on the Malburg Generating Station: construction in progress costs for the fiscal year were \$48,389,205.
- A variety of construction projects and widening and expansion projects for existing streets and bridges began; related construction in progress as of the end of the current fiscal year had reached \$3,723,283.
- Land was purchased for eventual City use as rights of way at a cost of \$ 2,154,399.

**Current Construction Commitments.** As of June 30, 2004, the City's Light and Power Fund had commitments for construction contracts and open purchase orders totaling approximately \$25 million. These commitments and purchase orders were made for the Malburg Generating Station.

Additional information on the City's capital assets can be found in Note 5 on pages 34-36 of this report.

### **Outstanding Debt**

The City did not incur any additional debt during fiscal year 2004. In 2003, the City issued \$162,610,000 in electric system revenue bonds in order to construct the Malburg Generating Station. The bonds include variable and fixed rate components. The 2003 Series A&B Variable Rate Demand Bonds were rated Aaa by Moody's and AA- by Standard and Poor's. The 2003 Series C Fixed Rate Bonds were rated A2 by Moody's and BBB+ by Standard and Poor's.

Additional information on the City's long-term debt can be found in Notes 6 and 7 on pages 36-40 of this report.

### **Economic Factors And Next Year's Budgets and Rates**

The City originally budgeted \$38,707,550 for general fund expenditures in 2004. The final budget for general fund expenditures was increased by \$76,249 to \$38,783,799 in order to add personnel to the legal department.

- The unemployment rate for the City and adjacent communities is currently 2.7%. This compares favorably to the state's average unemployment rate of 6.3% and the national average rate of 5.6%.
- The occupancy rate of the City's central business district has remained at 95% for the past four years.
- Inflationary trends in the region compare favorably to national indices.

All of these factors were considered in preparing the City's budget for the 2005 fiscal year.

### **Requests for Information**

This financial report is designed to provide a general overview of the City's finances for all those with an interest in the City's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Office of the Finance Director, 4305 Santa Fe Avenue, Vernon, California 90058.

## **Basic Financial Statements**

**CITY OF VERNON, CALIFORNIA**  
Statement of Net Assets  
June 30, 2004

	Governmental Activities	Business-type Activities	Total
<b>ASSETS:</b>			
Cash and investments	\$ 44,249,028	\$ 100,727,495	\$ 144,976,523
Receivables	4,473,353	16,679,383	21,152,736
Accrued unbilled revenue	-	7,445,742	7,445,742
Inventories	728,566	2,667	731,233
Internal balances	(6,632,986)	6,632,986	-
Deposits and prepaid items	-	71,952	71,952
Restricted cash and investments	323,448	71,121,961	71,445,409
Other assets	130,174	4,802,575	4,932,749
Capital assets:			
Nondepreciable	25,513,956	154,860,941	180,374,897
Depreciable, net	19,289,119	64,663,402	83,952,521
Total assets	<u>88,074,658</u>	<u>427,009,104</u>	<u>515,083,762</u>
<b>LIABILITIES:</b>			
Accounts payable	2,219,212	17,138,731	19,357,943
Accrued wages and benefits	2,313,804	506,272	2,820,076
Customer deposits and funds held for others	320,368	1,172,967	1,493,335
Accrued interest payable	-	1,079,140	1,079,140
Deferred revenue	249,346	-	249,346
Long-term liabilities:			
Due within one year	1,748,130	2,995,000	4,743,130
Due in more than one year	3,504,695	159,789,761	163,294,456
Total liabilities	<u>10,355,555</u>	<u>182,681,871</u>	<u>193,037,426</u>
<b>NET ASSETS:</b>			
Invested in capital assets, net of related debt	44,803,075	109,016,771	153,819,846
Restricted for:			
Special purpose grant	386,591	-	386,591
Debt service	-	10,019,524	10,019,524
Unrestricted	32,529,437	125,290,938	157,820,375
Total net assets	<u>\$ 77,719,103</u>	<u>\$ 244,327,233</u>	<u>\$ 322,046,336</u>

See accompanying notes to the basic financial statements.

**CITY OF VERNON, CALIFORNIA**  
**Statement of Activities**  
**For the Fiscal Year Ended June 30, 2014**

FUNCTION/PROGRAM ACTIVITIES	Expenses	Program Revenues			Net (Expenses) Revenues and Change in Net Assets		
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Governmental Activities	Business- type Activities	Total
<b>Governmental activities:</b>							
General government	\$ 9,910,746	\$ 2,884,256	\$ 268,804	\$ -	\$ (6,757,686)	\$ -	\$ (6,757,686)
Public safety	18,443,338	4,895,597	-	-	(13,547,741)	-	(13,547,741)
Public works	5,207,892	1,821,364	-	-	(3,386,528)	-	(3,386,528)
Health services	1,266,686	1,138,995	-	-	(127,691)	-	(127,691)
Interest on long-term debt	96,612	-	-	-	(96,612)	-	(96,612)
Total governmental activities	24,925,274	10,740,212	268,804	-	(23,916,258)	-	(23,916,258)
<b>Business-type activities:</b>							
Light and power	92,071,398	187,392,500	-	-	-	14,981,102	14,981,102
Other	5,845,103	6,775,360	-	-	-	931,257	931,257
Total business-type activities	97,916,501	113,830,860	-	-	-	15,914,359	15,914,359
<b>Total</b>	<b>\$ 132,841,775</b>	<b>\$ 124,571,072</b>	<b>\$ 268,804</b>	<b>\$ -</b>	<b>(23,916,258)</b>	<b>15,914,359</b>	<b>(8,001,899)</b>
<b>General Revenues:</b>							
Property taxes					5,942,177	-	5,942,177
Parcel taxes					6,410,301	-	6,410,301
Franchise taxes					1,124,089	-	1,124,089
Business license taxes					994,462	-	994,462
Other license taxes					90,875	-	90,875
Investment income					192,132	2,837,609	3,029,741
Net decrease in fair value of investments					(355,470)	(981,890)	(1,337,360)
State contribution - sales and use taxes					4,965,801	-	4,965,801
Other revenues					27,080	7,148,889	7,175,969
Transfers					5,218,766	(5,218,766)	-
Total general revenues and transfers					25,110,213	3,285,542	28,296,055
<b>Change in net assets</b>					<b>1,193,955</b>	<b>19,200,291</b>	<b>20,394,156</b>
<b>NET ASSETS, BEGINNING OF YEAR</b>					<b>76,525,148</b>	<b>225,127,032</b>	<b>301,652,180</b>
<b>NET ASSETS, END OF YEAR</b>					<b>\$ 77,719,103</b>	<b>\$ 244,327,233</b>	<b>\$ 322,046,336</b>

See accompanying notes to the basic financial statements

**CITY OF VERNON, CALIFORNIA**

Balance Sheet  
Governmental Funds  
June 30, 2004

	General Fund	Other Governmental Funds	Total Governmental Funds
<b>ASSETS:</b>			
Cash and investments	\$ 2,318,295	\$ 31,411,566	\$ 33,729,861
Receivables	1,889,499	2,583,854	4,473,353
Due from other funds	1,551,096	-	1,551,096
Advances to other funds	5,146,577	-	5,146,577
Inventories	720,108	8,458	728,566
Restricted cash and investments	323,448	-	323,448
Other assets	130,174	-	130,174
<b>Total assets</b>	<u>\$ 12,079,197</u>	<u>\$ 34,003,878</u>	<u>\$ 46,083,075</u>
<b>LIABILITIES AND FUND</b>			
<b>BALANCES:</b>			
Liabilities:			
Accounts payable	\$ 1,315,690	\$ 712,352	\$ 2,028,042
Accrued wages and benefits	2,270,203	43,601	2,313,804
Advances from other funds	-	12,922,787	12,922,787
Due to other funds	407,872	-	407,872
Customer deposits and funds held for others	320,368	-	320,368
Deferred revenue	816,967	2,101,430	2,918,397
<b>Total liabilities</b>	<u>5,131,100</u>	<u>15,780,170</u>	<u>20,911,270</u>
Fund balances:			
Reserved for:			
Federal forfeiture funds	386,591	-	386,591
Advances to other funds	5,146,577	-	5,146,577
Inventories	720,108	-	720,108
Encumbrances	3,348,325	7,718,403	11,066,728
Employee loans receivable	74,078	-	74,078
Unreserved	(2,727,582)	-	(2,727,582)
Unreserved, reported in nonmajor:			
Special revenue funds	-	28,277,635	28,277,635
Capital projects funds	-	(17,772,330)	(17,772,330)
<b>Total fund balances</b>	<u>6,948,097</u>	<u>18,223,708</u>	<u>25,171,805</u>
<b>Total liabilities and fund balances</b>	<u>\$ 12,079,197</u>	<u>\$ 34,003,878</u>	<u>\$ 46,083,075</u>

See accompanying notes to the basic financial statements.

**CITY OF VERNON, CALIFORNIA**  
 Reconciliation of the Governmental Funds Balance Sheet to  
 Statement of Net Assets - Governmental Activities  
 June 30, 2004

Fund balances - total governmental funds (page 17)	\$	25,171,805
Amounts reported for governmental activities in the statement of net assets are different because:		
Capital assets used in governmental activities are not financial resources and therefore are not reported in the governmental funds.		44,803,075
Internal service funds are used by management to charge the costs of employee benefits for health insurance, workers compensation, etc., to individual funds. The assets and liabilities of these funds are included in governmental activities in the statement of net assets.		5,075,172
In the Statement of Net Assets, the City recognized \$2,669,051 of uncollected property taxes that were earned but unavailable in FY03-04.		2,669,051
Net assets of governmental activities (page 15)	\$	77,719,103

See accompanying notes to the basic financial statements.



**CITY OF VERNON, CALIFORNIA**  
Statement of Revenues, Expenditures and Changes in Fund Balances  
Governmental Funds  
For the Fiscal Year Ended June 30, 2004

	General Fund	Other Governmental Funds	Total Governmental Funds
<b>REVENUES:</b>			
Taxes	\$ 8,725,072	\$ 10,022,990	\$ 18,748,062
Special assessments	595,985	-	595,985
Licenses and permits	1,009,254	377,229	1,386,483
Fines, forfeitures and penalties	191,177	-	191,177
Investment income	159,777	32,355	192,132
Net decrease in fair value of investments	(355,470)	-	(355,470)
Intergovernmental revenues	268,804	-	268,804
Charges for services to enterprise funds	8,313,101	-	8,313,101
Other revenues	853,715	27,110	880,825
Total revenues	<u>19,761,415</u>	<u>10,459,684</u>	<u>30,221,099</u>
<b>EXPENDITURES:</b>			
General government	7,655,113	998,939	8,654,052
Public safety	17,696,976	70,660	17,767,636
Public works	4,939,263	220,343	5,159,606
Health services	1,201,822	46,603	1,248,425
Capital outlay	3,295,250	3,533,329	6,828,579
Interest on advances	-	96,612	96,612
Total expenditures	<u>34,788,424</u>	<u>4,966,486</u>	<u>39,754,910</u>
Excess (deficiency) of revenues over (under) expenditures	(15,027,009)	5,493,198	(9,533,811)
<b>Other financing sources (uses):</b>			
Transfers in	5,718,766	10,535	5,729,301
Transfers out	(10,535)	-	(10,535)
Total other financing sources (uses)	<u>5,708,231</u>	<u>10,535</u>	<u>5,718,766</u>
<b>NET CHANGE IN FUND BALANCES</b>	<b>(9,318,778)</b>	<b>5,503,733</b>	<b>(3,815,045)</b>
Fund balances, beginning of year	<u>16,266,875</u>	<u>12,719,975</u>	<u>28,986,850</u>
<b>FUND BALANCES, END OF YEAR</b>	<b>\$ 6,948,097</b>	<b>\$ 18,223,708</b>	<b>\$ 25,171,805</b>

See accompanying notes to the basic financial statements.

**CITY OF VERNON, CALIFORNIA**  
 Reconciliation of the Statement of Revenues, Expenditures, and  
 Changes in Fund Balances of Governmental Funds to the  
 Statement of Activities - Governmental Activities  
 For the Fiscal Year Ended June 30, 2004

Net change in fund balances - total governmental funds (page 19) \$ (3,815,045)

Amounts reported for governmental activities in the statement of activities are different because:

Governmental funds report capital outlay as expenditures. However, in the statement of activities the cost of those assets is allocated over their estimated useful lives and is charged to depreciation expense.

Expenditures for capital assets	\$	6,828,579	
Less current year depreciation		<u>(1,950,368)</u>	4,878,211

Property tax revenues earned in FY 03-04 but unavailable in the current year are recorded as revenues in the Statement of Activities.			179,396
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Internal service funds are used by management to charge the costs of certain activities to individual funds. The net loss of the internal service funds is reported with governmental activities.			<u>(48,607)</u>
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Change in net assets of governmental activities (page 16)	\$	<u>1,193,955</u>	
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See accompanying notes to the basic financial statements.

**CITY OF VERNON, CALIFORNIA**  
**Statement of Fund Net Assets**  
**Proprietary Funds**  
**June 30, 2004**

	Business-type Activities		Totals	Governmental Activities - Internal Service Funds
	Light and Power Fund	Other Enterprise Funds		
<b>ASSETS:</b>				
<b>Current assets:</b>				
Cash and investments	\$ 94,429,955	\$ 6,297,540	\$ 100,727,495	\$ 10,519,167
Accounts receivable	10,794,578	61,283	10,855,861	-
Accrued unbilled revenue	7,056,660	389,082	7,445,742	-
Accrued interest receivable	1,107,281	-	1,107,281	-
Due from other funds	-	407,872	407,872	-
Note receivable	352,847	-	352,847	-
Inventories	2,667	-	2,667	-
Deposits and prepaid items	71,952	-	71,952	-
Restricted cash and investments	61,102,437	-	61,102,437	-
Other assets	2,648,817	-	2,648,817	-
<b>Total current assets</b>	<b>172,567,194</b>	<b>7,155,777</b>	<b>184,722,971</b>	<b>10,519,167</b>
<b>Noncurrent assets:</b>				
Restricted cash and investments	10,019,524	-	10,019,524	-
Advances to other funds	36,512,838	-	36,512,838	-
Note receivable	4,363,394	-	4,363,394	-
Bond issuance costs	2,153,758	-	2,153,758	-
<b>Capital assets:</b>				
Nondepreciable	134,520,487	20,340,454	154,860,941	-
Depreciable, net	60,331,519	4,331,483	64,663,002	-
<b>Total noncurrent assets</b>	<b>247,901,920</b>	<b>24,671,937</b>	<b>272,573,857</b>	<b>-</b>
<b>Total assets</b>	<b>425,469,114</b>	<b>31,827,714</b>	<b>457,296,828</b>	<b>10,519,167</b>
<b>LIABILITIES:</b>				
<b>Current liabilities:</b>				
Accounts payable	15,688,218	1,450,513	17,138,731	191,170
Accrued wages and benefits	251,514	107,734	359,248	-
Claims payable	-	-	-	1,748,130
Accrued interest payable	1,079,140	-	1,079,140	-
Due to other funds	1,451,298	99,798	1,551,096	-
Bonds payable, due within one year	2,995,000	-	2,995,000	-
Customer deposits	849,845	323,122	1,172,967	-
Compensated absences	147,024	-	147,024	-
<b>Total current liabilities</b>	<b>22,462,039</b>	<b>1,981,167</b>	<b>24,443,206</b>	<b>1,939,300</b>
<b>Noncurrent portion of long-term liabilities:</b>				
Advances from other funds	-	28,736,628	28,736,628	-
Claims payable	-	-	-	3,504,695
Premium on bonds payable	174,761	-	174,761	-
Bonds payable	159,615,000	-	159,615,000	-
<b>Total noncurrent liabilities</b>	<b>159,789,761</b>	<b>28,736,628</b>	<b>188,526,389</b>	<b>3,504,695</b>
<b>Total liabilities</b>	<b>182,251,800</b>	<b>30,717,795</b>	<b>212,969,595</b>	<b>5,443,995</b>
<b>NET ASSETS:</b>				
Invested in capital assets, net of related debt	84,344,834	24,671,937	109,016,771	-
Restricted for debt service	10,019,524	-	10,019,524	-
Unrestricted (deficit)	148,852,956	(23,562,018)	125,290,938	5,075,172
<b>Total net assets</b>	<b>\$ 243,217,314</b>	<b>\$ 1,109,919</b>	<b>\$ 244,327,233</b>	<b>\$ 5,075,172</b>

See accompanying notes to the basic financial statements

**CITY OF VERNON, CALIFORNIA**  
**Statement of Revenues, Expenses and Changes in Fund Net Assets**  
**Proprietary Funds**  
**For the Fiscal Year Ended June 30, 2004**

	Business-type Activities Enterprise Funds			Governmental Activities - Internal Service Funds
	Light and Power Fund	Other Enterprise Funds	Totals	
<b>OPERATING REVENUES</b>				
Charges for services	\$ 107,052,500	\$ 6,778,360	\$ 113,830,860	\$ 6,772,187
Total operating revenues	<u>107,052,500</u>	<u>6,778,360</u>	<u>113,830,860</u>	<u>6,772,187</u>
<b>OPERATING EXPENSES</b>				
Cost of sales	88,755,276	5,573,066	94,328,282	-
Depreciation and amortization	3,316,122	272,097	3,588,219	-
Claims expense	-	-	-	622,093
Employees benefits	-	-	-	6,198,700
Total operating expenses	<u>92,071,398</u>	<u>5,845,163</u>	<u>97,916,561</u>	<u>6,820,793</u>
Operating income (loss)	14,981,102	933,257	15,914,359	(48,607)
<b>NONOPERATING REVENUES</b>				
Investment income	2,837,699	-	2,837,699	-
Net decrease in fair value of investments	(981,890)	-	(981,890)	-
Legal settlement	7,148,889	-	7,148,889	-
Total nonoperating revenues	<u>9,004,698</u>	<u>-</u>	<u>9,004,698</u>	<u>-</u>
Income (loss) before transfers	23,985,710	933,257	24,918,967	(48,607)
transfers out	<u>(5,523,644)</u>	<u>(195,122)</u>	<u>(5,718,766)</u>	<u>-</u>
Change in net assets	18,462,066	738,135	19,200,201	(48,607)
Net assets, beginning of the year	224,755,248	371,784	225,127,032	5,123,779
Net assets, end of the year	<u>\$ 243,217,314</u>	<u>\$ 1,109,919</u>	<u>\$ 244,327,233</u>	<u>\$ 5,075,172</u>

See accompanying notes to the basic financial statements

**CITY OF VERNON**  
**Statement of Cash Flows**  
**Proprietary Funds**  
**For the Fiscal Year Ended June 30, 2004**

	Business-type Activities - Enterprise Funds			Governmental Activities - Internal Service Funds
	Light & Power Fund	Other Enterprise Funds	Total	
<b>Cash flows from operating activities:</b>				
Cash received from customers/other funds	\$ 107,495,792	\$ 6,760,045	\$ 114,255,837	\$ 6,772,186
Cash paid to suppliers for goods and services	(74,557,128)	(2,257,769)	(76,814,897)	-
Cash paid to City general fund for services	(8,313,101)	(195,122)	(8,508,223)	-
Cash paid for claims expenses and employees benefits	(1,738,054)	(1,090,972)	(2,829,026)	(6,692,233)
Other receipts	7,148,889	-	7,148,889	56,324
Net cash provided by operating activities	<u>30,036,398</u>	<u>3,216,182</u>	<u>33,252,580</u>	<u>136,277</u>
<b>Cash flows from noncapital financing activities:</b>				
Transfers paid	(5,523,644)	(195,122)	(5,718,766)	-
Advances to other funds	(2,842,084)	(390,389)	(3,232,473)	-
Collection of note receivable	207,087	-	207,087	-
Net cash used in noncapital financing activities	<u>(8,158,641)</u>	<u>(585,511)</u>	<u>(8,744,152)</u>	<u>-</u>
<b>Cash flows from capital and related financing activities:</b>				
Bond interest paid	(4,695,631)	-	(4,695,631)	-
Acquisition and construction of capital assets	(50,020,887)	(4,539,821)	(54,560,708)	-
Net cash provided by (used in) capital and related financing activities	<u>(54,716,518)</u>	<u>(4,539,821)</u>	<u>(59,256,339)</u>	<u>-</u>
<b>Cash flows from investing activities:</b>				
Purchases of investments, net	(149,442,597)	-	(149,442,597)	-
Interest received	1,315,115	-	1,315,115	-
Net cash provided by (used in) investing activities	<u>(148,127,482)</u>	<u>-</u>	<u>(148,127,482)</u>	<u>-</u>
Net increase (decrease) in cash and cash equivalents	<u>(180,965,443)</u>	<u>(1,909,150)</u>	<u>(182,874,593)</u>	<u>136,277</u>
Cash and cash equivalents, beginning of year	<u>197,074,762</u>	<u>8,206,690</u>	<u>205,281,452</u>	<u>10,382,890</u>
Cash and cash equivalents, end of year	<u>\$ 16,109,319</u>	<u>\$ 6,297,540</u>	<u>\$ 22,406,859</u>	<u>\$ 10,519,167</u>

See accompanying notes to the basic financial statements

**CITY OF VERNON**  
**Statement of Cash Flows**  
**Proprietary Funds**  
For the Fiscal Year Ended June 30, 2004

	Business-type Activities - Enterprise Funds			Governmental Activities - Internal Service Funds
	Light & Power Fund	Other Enterprise Funds	Total	
Cash flows from operating activities:				
Reconciliation of operating income (loss) to net cash provided by operating activities:				
Operating income (loss)	\$ 14,981,102	\$ 933,237	\$ 15,914,339	\$ (48,607)
Adjustments to reconcile operating income (loss) to net cash provided by operating activities:				
Depreciation	3,316,122	272,097	3,588,219	-
Legal settlement	7,148,889	-	7,148,889	-
Changes in operating assets and liabilities:				
Decrease (increase) in:				
Receivables	(234,869)	(18,315)	(253,184)	-
Inventories	370	-	370	-
Other assets	560,203	-	560,203	-
Prepaid items and deposits	117,958	(33,151)	84,807	-
Increase (decrease) in:				
Accounts payable	6,390,221	622,962	7,013,183	-
Claims payable	-	-	-	184,884
Accrued wages and benefits	148,296	18,863	167,159	-
Due to other funds	(2,391,894)	1,420,469	(971,425)	-
Net cash provided by operating activities	<u>\$ 30,036,398</u>	<u>\$ 3,216,182</u>	<u>\$ 33,252,580</u>	<u>\$ 136,277</u>
Reconciliation of cash and cash equivalents to Statement of Net Assets:				
Cash and investments	\$ 94,420,955	\$ 6,297,540	\$ 100,727,495	\$ 10,519,167
Current restricted cash and investments	61,102,437	-	61,102,437	-
Noncurrent restricted cash and investments	10,019,524	-	10,019,524	-
Total	165,551,916	6,297,540	171,849,456	10,519,167
Less: Investments with maturities of more than 90 days	(149,442,597)	-	(149,442,597)	-
Total cash and cash equivalents	<u>\$ 16,109,319</u>	<u>\$ 6,297,540</u>	<u>\$ 22,406,859</u>	<u>\$ 10,519,167</u>
Noncash Capital, Investing and Financing Activities:				
Acquisition of capital assets or accounts payable	\$ 3,796,092	\$ -	\$ 3,796,092	\$ -
Decrease in fair value of investments	981,890	-	981,890	-

See accompanying notes to the basic financial statements

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**Notes to the Basic Financial Statements**



**CITY OF VERNON, CALIFORNIA**  
**Notes to Basic Financial Statements (Continued)**  
**June 30, 2004**

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The financial statements of the City of Vernon, California (City) have been prepared in conformity with U.S. generally accepted accounting principles (GAAP). The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The more significant of the City's accounting policies are described below.

**A. Reporting Entity**

The City was incorporated on September 16, 1905 as a General Law City. Effective July 1, 1988, the City became a Charter City. The City operates under a Council-City Administrator form of government. As required by generally accepted accounting principles, the accompanying basic financial statements present the City of Vernon (primary government) and its component unit, an entity for which the primary government is considered to be financially accountable. In accordance with GASB Statement No. 14, the City's component unit is considered a blended component unit. Although a legally separate entity, it is, in substance, part of the City's operations, and therefore, data from this unit is combined with data of the primary government.

**Blended Component Unit**

**Vernon Redevelopment Agency (RDA)**. The governing body of the RDA is comprised of members of the City Council and the Mayor. Among its duties, it approves the RDA's budget and appoints the management. The financial activities of the RDA are included within the redevelopment agency capital projects fund as part of nonmajor governmental funds.

Separately issued financial statements for the RDA may be obtained through the City of Vernon, 4305 Santa Fe Avenue, Vernon, California, 90058.

**Basis of Presentation**

*Government-wide Financial Statements*

The statement of net assets and statement of activities display information about the primary government (the City) and its component unit. These statements include the financial activities of the overall government. It is the City's policy to make eliminations to minimize the double counting of internal activities, except for services rendered by governmental activities to business-type activities. These statements distinguish between the *governmental* and *business-type activities* of the City. Governmental activities, which normally are supported by taxes and intergovernmental revenues, are reported separately from business-type activities, which rely to a significant extent on fees charged to external parties.

The statement of activities presents a comparison between direct expenses and program revenues for each segment of the business-type activities of the City and for each function of the City's governmental activities. Direct expenses are those that are specifically associated with a program or function; and therefore, are clearly identifiable to a particular function. Expenses by function have been adjusted for any internal service profit/loss existing at fiscal year-end. Program revenues include (1) charges paid by the recipients of goods or services offered by the programs and (2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular program. Revenues that are not classified as program revenues, including all taxes, are presented instead as general revenues.

**CITY OF VERNON, CALIFORNIA**  
**Notes to Basic Financial Statements (Continued)**  
**June 30, 2004**

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

*Fund Financial Statements*

The fund financial statements provide information about the City's funds and blended component unit. Separate statements for each fund category – *governmental and proprietary* – are presented. The emphasis of fund financial statements is on major governmental and enterprise funds, each displayed in a separate column. All remaining governmental and enterprise funds are separately aggregated and reported as nonmajor funds.

Proprietary funds distinguish *operating* revenues and expenses from *nonoperating* items. Proprietary fund *operating* revenues, such as charges for services, result from exchange transactions associated with the principal activity of the fund. Exchange transactions are those in which each party receives and gives up essentially equal values. *Nonoperating* revenues, such as subsidies and investment earnings, result from nonexchange transactions or ancillary activities. *Operating* expenses include the cost of sales and services, administrative expenses and depreciation on capital assets. All expenses not meeting this definition are reported as nonoperating expenses.

The City reports the following major governmental fund:

The *General Fund* is the City's primary operating fund. It is used to account for all revenues and expenditures necessary to carry out basic governmental activities of the City that are not accounted for through other funds. For the City, the General Fund includes such activities as general government, public safety, and public works.

The City reports the following major enterprise fund, which is also a segment:

- The *Light and Power Fund* accounts for the maintenance and operations of the City's electric utility plant. Revenue for this fund is primarily from charges for services.

Additionally, the City reports the following fund types:

- The City's *Special Revenue Funds* are used to account for the proceeds of specific revenue sources that are legally restricted to expenditures for specific purposes.
- The City's *Capital Projects Funds* are used to account for financial resources designated for the acquisition or construction of major capital facilities other than those financed by proprietary fund types.
- The City's *Internal Service Funds* are specifically designed to account for goods and services that are provided on a cost-reimbursement basis. That is, the goal of an internal service fund should be to measure the full cost of providing goods and services for the purpose of fully recovering that cost through fees or charges. Some examples of the City's services accounted for in the internal service funds are self-insurance activities for worker's compensation, general liability, group medical and dental and vehicle replacement. The Internal Service Funds are presented in summary form as part of the proprietary fund financial statements. In the government-wide financial statements, the changes in net assets at the end of the fiscal year, as presented in the statements of activities, were allocated to the user functions of the governmental activities, to reflect the entire activity for the year. Since the predominant users of the internal services are the City's governmental activities, the asset and liability balances of the Internal Service Funds are consolidated into the governmental activities column at the government-wide level.

**CITY OF VERNON, CALIFORNIA**  
**Notes to Basic Financial Statements (Continued)**  
**June 30, 2004**

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**Basis of Presentation (Continued)**

The government-wide and proprietary fund financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of when the related cash flows take place. Nonexchange transactions, in which the City gives (or receives) value without directly receiving (or giving) equal value in exchange, include property and sales taxes, grants, entitlements and donations. On an accrual basis, revenue from property taxes is recognized in the fiscal year for which the taxes are levied. Revenues from sales taxes are recognized when the underlying transactions take place. Revenues from grants, entitlements and donations are recognized in the fiscal year in which all eligible requirements have been satisfied.

Governmental fund type financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Under this method, revenues and other governmental fund type financial resources are recognized when they become susceptible to accrual – that is, when they become both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. Property, sales, and other taxes are considered available and are accrued when received within sixty days after fiscal year-end. Additionally, all other revenue sources are considered available and are accrued when received within 60 days of year-end. General capital assets acquisitions are reported as expenditures in governmental fund statements.

For the government-wide financial statements and proprietary fund financial statements, the City has elected under GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, to apply all applicable GASB pronouncements as well as any applicable pronouncements of the Financial Accounting Standards Board, the Accounting Principles Board or any Accounting Research Bulletins issued on or before November 30, 1989 unless those pronouncements conflict with or contradict GASB pronouncements. The City has elected not to adopt FASB pronouncements issued after November 30, 1989 for its government-wide and enterprise fund financial statements.

Because the governmental fund financial statements are presented on a different measurement focus and basis of accounting than the government-wide financial statements for governmental activities, reconciliations are presented which briefly explain the adjustments necessary to reconcile the fund financial statements to the governmental-wide statements.

When both restricted and unrestricted resources are available for use, it is the City's policy to use restricted resources first, then unrestricted resources, as they are needed.

**Cash Deposits and Investments**

The City follows the practice of pooling cash and investments of all funds to maximize returns for all funds, except for funds required to be held by trustee or fiscal agents. Interest income earned on pooled cash and investments is allocated to the various funds based on their monthly average cash balances.

For purposes of the statement of cash flows, the City considers all highly liquid investments (including restricted cash and investments) with an original maturity of three months or less when purchased to be cash equivalents. Investment transactions are recorded on the trade date. Investments in nonparticipating interest-earning investment contracts are reported at cost, and all other investments are reported at fair value. Fair value is defined as the amount that the City could reasonably expect to receive for an investment in a current sale between a willing buyer and a seller and is generally measured by quoted market prices.

**CITY OF VERNON, CALIFORNIA**  
**Notes to Basic Financial Statements (Continued)**  
**June 30, 2004**

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**Interfund Receivables/Payables**

Short-term interfund receivables and payables are classified as “due from other funds” and “due to other funds” respectively on the balance sheet/statement of fund net assets. Long-term interfund receivables and payables are classified as “advances to/from other funds,” respectively, on the balance sheet/statement of fund net assets.

**Inventories**

Inventories consist of consumable supplies and fuel stock, which are stated at cost on a first in, first out basis. The cost of inventories is recorded as an expenditures/expense when the items are used.

**Capital Assets**

Capital assets (including infrastructure) are recorded at historical cost or at estimated historical cost if actual historical cost is not available. Contributed capital assets are valued at their estimated fair market value on the date contributed. Capital assets include public domain (infrastructure) general capital assets consisting of certain improvements including roads and bridges, sidewalks, curbs and gutters, and traffic light system. The capitalization threshold for all capital assets is \$5,000. Capital assets used in operations are depreciated using the straight-line method over their estimated useful lives in the government-wide statements and proprietary funds.

The estimated useful lives are as follows:

Infrastructure	10 to 50 years
Utility plant and buildings	25 to 50 years
Improvements	10 to 20 years
Machinery and equipment	3 to 35 years

Maintenance and repairs are charged to operations when incurred. Betterments and major improvements, which significantly increase values, change capacities or extend useful lives, are capitalized. Upon sale or retirement of capital assets, the cost and related accumulated depreciation are removed from the respective accounts and any resulting gain or loss is included in the changes in financial position. Interest associated with construction of capital assets is capitalized during the construction phase up until the capital asset is substantially complete and ready for its intended use. Interest expense offset by related interest earnings capitalized during fiscal year ended June 30, 2004 totaled \$4,523,397.

**Compensated Absences**

Accumulated vacation is accrued when incurred in the government-wide and proprietary fund financial statements. A liability for accrued vacation is recorded in the governmental funds only to the extent that such amounts have matured (i.e., as a result of employee resignations and retirements). Upon termination of employment, the City will pay the employee all accumulated vacation leave at 100% of the employee’s base hourly rate.

**CITY OF VERNON, CALIFORNIA**  
**Notes to Basic Financial Statements (Continued)**  
**June 30, 2004**

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**Deferred Revenue**

Deferred revenue arises when a potential revenue transaction does not meet both the “measurable” and “available” criteria for recognition in the current period. Deferred revenue also arises when resources are received before the City has a legal claim to them, as when grant monies are received in advance of incurring qualified expenditures.

**Long-term Obligations**

Certain of the City’s governmental fund obligations not currently due and payable at year-end are reported in the government-wide statement of net assets. Long-term debt and other obligations financed by proprietary funds are reported as liabilities in the appropriate proprietary fund and government-wide statement of net assets. Bond premiums and issuance costs are deferred and amortized over the life of the bonds using the straight-line method. Bonds payable are reported net of the applicable bond premium.

**Net Assets**

The government-wide financial statements and proprietary fund financial statements utilize a net assets presentation. Net assets are categorized as invested in capital assets (net of related debt), restricted and unrestricted.

- ❑ Invested In Capital Assets, Net of Related Debt – This category groups all capital assets, including infrastructure, into one component of net assets. Accumulated depreciation and the outstanding balances of debt that are attributable to the acquisition, construction or improvement of these assets reduce the balance in this category.
- ❑ Restricted Net Assets – This category presents external restrictions imposed by creditors, grantors, contributors or laws or regulations of other governments and restrictions imposed by law through constitutional provisions or enabling legislation.
- ❑ Unrestricted Net Assets – This category represents net assets of the City, not restricted for any project or other purpose.

**Fund Equity**

In the fund financial statements, governmental funds report reservations of fund balance for amounts that are not appropriable or legally restricted for a specific purpose. Designations of fund balance represent tentative management plans that are subject to change.

**Use of Estimates**

The preparation of basic financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

**CITY OF VERNON, CALIFORNIA**  
**Notes to Basic Financial Statements (Continued)**  
**June 30, 2004**

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**Property Taxes**

The County of Los Angeles (County) levies, collects and apportions property taxes for all taxing jurisdictions with the County. Property taxes are determined by applying approved rates to the properties' assessed values. The County remits property taxes applicable to the City less an administrative fee throughout the year.

Article XIII A of the State of California Constitution limits the property tax levy to support general government services of the various taxing jurisdictions to \$1.00 per \$100 of assessed value. Taxes levied to service voter-approved debt prior to June 30, 1978 are excluded from this limitation.

Secured property taxes are levied in two installments, November 1 and February 1. They become delinquent with penalties on December 10 and April 10, respectively. The lien date is January 1 of each year for secured and unsecured property taxes and the levy date occurs on the 4<sup>th</sup> Monday of September of the tax year. Unsecured property taxes on the tax roll as of July 31 become delinquent with penalties on August 31.

**NOTE 2 – CASH AND INVESTMENTS**

The City follows the practice of pooling cash and investments of all funds to maximize returns for all funds, except for funds required to be held by trustee or fiscal agents. Interest income earned on pooled cash and investments is allocated to the various funds based on their monthly average cash balances. The following table summarizes the carrying amount of deposits and investments as of June 30, 2004:

	Carrying Amount
Cash deposits	\$ 3,875,380
Investments	212,546,552
Total	\$ 216,421,932

At year-end, the carrying amount of the City's deposits was \$3,875,380 and the bank balance was \$3,960,265. The difference between the bank balance and the carrying amount represents outstanding checks and deposits in transit. Of the bank balance, \$200,000 was covered by federal depository insurance and \$3,760,265 was collateralized by the pledging financial institution as required by Section 53652 of the California Government Code. Under the California Government Code, a financial institution is required to secure deposits in excess of \$100,000 made by state or local governmental units by pledging government securities held in the form of an undivided collateral pool. The market value of the pledged securities in the collateral pool must equal at least 110% of the total amount deposited by the public agencies. California law also allows financial institutions to secure City deposits by pledging first trust deed mortgage notes having a value of 150% of the secured public deposits. Such collateral is held by the pledging financial institution's trust department or agent in the City's name.

**CITY OF VERNON, CALIFORNIA**  
**Notes to Basic Financial Statements (Continued)**  
**June 30, 2004**

**NOTE 2 – CASH AND INVESTMENTS (CONTINUED)**

**Authorized Investments**

Under provisions of the City's investment policy, and in accordance with California Government Code, beginning with Section 53601, the City may invest or deposit in the following types of investments:

- Securities of the U.S. Government, or its agencies
- Certain Asset-Backed Securities
- Certificates of Deposit and Negotiable Certificates of Deposit
- Bankers' Acceptances
- Commercial Paper of "prime" quality
- Passbook Savings Account Demand Deposits
- Repurchase Agreements
- Reverse Repurchase Agreements
- Mutual Funds
- Medium-Term Corporate Notes
- County Pooled Funds

In addition, the City is authorized to participate in the State of California Local Agency Investment Fund (LAIF) pursuant to Government Code Section 16429.1. The City's investment in LAIF is \$7.8 million. A total of \$57.6 billion is invested by all public agencies in LAIF, which is managed by the State Treasurer. Of that amount, 100 percent is invested in non-derivative financial products. The Local Investment Advisory Board (Board) has oversight responsibility for LAIF. The Board consists of five members as designated by State statute.

The value of the pool shares in LAIF, which may be withdrawn upon demand, is determined on an amortized cost basis, which is different than the fair value of the City's position in the pool. At June 30, 2004, the City had no investments in repurchase agreements. At no time during the fiscal year did the City borrow funds through reverse repurchase agreements, even though such transactions are authorized by the City's investment policy.

**Cash and Investments with Fiscal Agent**

The City also has funds that are held by trustees or fiscal agents and pledged to the payment of certain bonds. The California Government Code provides that these monies, unless otherwise required by statute, may be invested in accordance with the ordinances, resolutions or indentures specifying the types of investments the trustees or fiscal agents may make.

**Custodial Credit Risk and Fair Value**

Investments at June 30, 2004 are categorized by the level of custodial credit risk assumed by the City. The risk categories are defined as follows:

Category 1: includes investments that are insured or registered or for which the securities are held by the City or its agent in the City's name.

Category 2: includes uninsured and unregistered investments for which the securities are held by the counterparty's trust department or agent in the City's name.

Category 3: includes uninsured and unregistered investments for which the securities are held by the counterparty, or by its trust department or agent, but not in the City's name.

**CITY OF VERNON, CALIFORNIA**  
**Notes to Basic Financial Statements (Continued)**  
**June 30, 2004**

**NOTE 2 – CASH AND INVESTMENTS (CONTINUED)**

Total investments as of June 30, 2004 are as follows:

	Fair Value
<b>Category 1 investments:</b>	
Corporate notes.....	\$ 54,098,854
U.S. government securities.....	80,512,501
<b>Category 2 investments:</b>	
U.S. government securities.....	49,107,428
<b>Uncategorized investments:</b>	
State Treasurer's Local Agency Investment Fund.....	7,830,000
<b>Investments held by fiscal agents</b>	
Mutual fund treasury obligations.....	10,978,245
Guaranteed investment agreements.....	10,019,524
<b>Total investments.....</b>	<b>\$ 212,546,552</b>

Total City cash and investments are reported as follows:

	Total Governmental Activities	Total Business-type Activities	Total
Cash and investments	\$ 44,249,028	\$ 100,727,495	\$ 144,976,523
Restricted cash and investments	323,448	71,121,961	71,445,409
<b>Total cash and investments</b>	<b>\$ 44,572,476</b>	<b>\$ 171,849,456</b>	<b>\$ 216,421,932</b>

**NOTE 3 - RECEIVABLES**

The City's receivables at June 30, 2004 are as follows:

<b>Receivables – Governmental Activities:</b>	General Fund	Other Governmental Funds	Total Governmental Activities
Accounts	\$ 1,143,239	\$ 224,851	\$ 1,368,090
Interest	585	-	585
Taxes	671,596	2,359,003	3,030,599
Notes or loans	74,079	-	74,079
<b>Total receivables</b>	<b>\$ 1,889,499</b>	<b>\$ 2,583,854</b>	<b>\$ 4,473,353</b>
<b>Receivables – Business-type Activities:</b>	Light and Power Fund	Other Enterprise Funds	Total Business-type Activities
Accounts	\$ 10,794,578	\$ 61,282	\$ 10,855,860
Note (see Note 12.B.)	4,716,241	-	4,716,241
Interest	1,107,281	-	1,107,281
<b>Total receivables</b>	<b>\$ 16,618,100</b>	<b>\$ 61,282</b>	<b>\$ 16,679,382</b>



**CITY OF VERNON, CALIFORNIA**  
**Notes to Basic Financial Statements (Continued)**  
**June 30, 2004**

**NOTE 4 – INTERFUND TRANSACTIONS**

The following tables summarize the City's interfund balances and transactions at June 30, 2004:

*Due To/From Other Funds*

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
General Fund	Nonmajor Enterprise Fund	\$ 99,798
	Light and Power Fund	1,451,298
		<u>\$ 1,551,096</u>
Nonmajor Enterprise Fund	General Fund	\$ 407,872

The balances above represent in-lieu franchise taxes due to the General Fund from the various enterprise funds as well as amounts due to the water enterprise fund from the General Fund to cover cash shortfalls.

*Advances to/from other funds*

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
General Fund	Nonmajor Governmental Fund	\$ 387,340
	Nonmajor Enterprise Funds	4,759,237
		<u>\$ 5,146,577</u>
Light and Power Fund	Nonmajor Enterprise Funds	\$ 23,977,391
	Nonmajor Governmental Fund	12,535,447
		<u>\$ 36,512,838</u>

The above balances represent interfund borrowings payable beyond one year. These borrowings were for capital improvements in the gas and water enterprise funds and the RDA fund.

*Transfers*

<u>Transfers In</u>	<u>Transfers Out</u>	<u>Amount</u>
General Fund	Light and Power Fund	\$ 5,523,644
	Nonmajor Enterprise Funds	195,122
		5,718,766
Other Governmental Funds	General Fund	10,535
Total		<u>\$ 5,729,301</u>

Transfers are used to move revenues from the fund that statute or budget requires to collect them to the fund that statute or budget requires expend them, or move revenues collected in certain enterprise funds to the general fund to cover overhead costs provided by the general fund and for the payment of in-lieu franchise taxes.

**CITY OF VERNON, CALIFORNIA**  
**Notes to Basic Financial Statements (Continued)**  
**June 30, 2004**

**NOTE 5 – CAPITAL ASSETS**

Capital asset activity of governmental activities for the year ended June 30, 2004 was as follows:

	Balance July 1, 2003	Additions	Deletions	Transfers & Adjustments	Balance June 30, 2004
<b><u>Governmental activities:</u></b>					
<i>Capital assets, not being depreciated:</i>					
Land	\$ 19,636,274	\$ 2,154,399	\$ -	\$ -	\$ 21,790,673
Construction in progress	1,826,650	2,983,888	-	(1,087,255)	3,723,283
Total capital assets, not being depreciated	<u>21,462,924</u>	<u>5,138,287</u>	<u>-</u>	<u>(1,087,255)</u>	<u>25,513,956</u>
<i>Capital assets, being depreciated:</i>					
Infrastructure	21,984,601	271,677	-	1,087,255	23,343,533
Buildings and improvements	12,543,403	99,555	-	-	12,642,958
Machinery and equipment	9,171,434	1,319,064	-	-	10,490,498
Total capital assets, being depreciated	<u>43,699,438</u>	<u>1,690,296</u>	<u>-</u>	<u>1,087,255</u>	<u>46,476,989</u>
Less accumulated depreciation for:					
Infrastructure	(16,465,087)	(602,982)	-	-	(17,068,069)
Buildings and improvements	(4,922,783)	(300,743)	-	-	(5,223,526)
Machinery and equipment	(3,849,632)	(1,046,643)	-	-	(4,896,275)
Total accumulated depreciation	<u>(25,237,502)</u>	<u>(1,950,368)</u>	<u>-</u>	<u>-</u>	<u>(27,187,870)</u>
Total capital assets, being depreciated, net	<u>18,461,936</u>	<u>(260,072)</u>	<u>-</u>	<u>1,087,255</u>	<u>19,289,119</u>
Governmental activities capital assets, net	<u>\$ 39,924,860</u>	<u>\$ 4,878,215</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 44,803,075</u>

**Depreciation**

Depreciation expense was charged to governmental functions as follows:

General government	\$ 1,208,119
Public safety	675,702
Public works	48,286
Health services	18,261
Total depreciation expense – governmental functions	<u>\$ 1,950,368</u>

**CITY OF VERNON, CALIFORNIA**  
**Notes to Basic Financial Statements (Continued)**  
**June 30, 2004**

**NOTE 5 – CAPITAL ASSETS (CONTINUED)**

Capital asset activity of business-type activities for the year ended June 30, 2004 was as follows:

	Balance July 1, 2003	Additions	Deletions	Transfers & Adjustments	Balance June 30, 2004
<b>Business-type activities:</b>					
<i>Capital assets, not being depreciated:</i>					
Land	\$ 45,000	\$ -	\$ -	\$ -	\$ 45,000
Construction in progress	104,603,068	50,236,580	-	(23,707)	154,815,941
Total capital assets, not being depreciated	104,648,068	50,236,580	-	(23,707)	154,860,941
<i>Capital assets, being depreciated</i>					
Production plant – Light and Power	9,862,171	-	-	-	9,862,171
Transmission plant – Light and Power	61,178,643	106,745	-	-	61,285,388
Distribution plant – Light and Power	34,610,198	6,085,839	-	-	40,696,037
General plant – Light and Power	3,784,260	181,909	-	-	3,966,169
Buildings	481,800	-	-	-	481,800
Water utility plant	12,298,674	1,900,498	-	-	14,199,172
Total capital assets, being depreciated	122,215,746	8,274,991	-	-	130,490,737
Less accumulated depreciation for:					
Production plant – Light and Power	(4,890,803)	(267,225)	-	-	(5,158,028)
Transmission plant – Light and Power	(30,623,626)	(1,751,011)	-	-	(32,374,637)
Distribution plant – Light and Power	(15,114,547)	(1,102,699)	-	-	(16,217,246)
General plant – Light and Power	(1,849,884)	(107,467)	-	-	(1,957,351)
Buildings	(238,932)	(13,452)	-	-	(252,384)
Water utility plant	(9,595,592)	(272,097)	-	-	(9,867,689)
Total accumulated depreciation	(62,313,384)	(3,513,951)	-	-	(65,827,335)
Total capital assets, being depreciated, net					
Production plant – Light and Power	4,971,368	(267,225)	-	-	4,704,143
Transmission plant – Light and Power	30,555,017	(1,644,266)	-	-	28,910,751
Distribution plant – Light and Power	19,495,651	4,983,140	-	-	24,478,791
General plant – Light and Power	1,934,376	74,442	-	-	2,008,818
Buildings	242,868	(13,452)	-	-	229,416
Water utility plant	2,703,082	1,628,401	-	-	4,331,483
Total	59,902,362	4,761,040	-	-	64,663,402
Business-type activities capital assets, net	\$ 164,550,430	\$ 54,997,620	\$ -	\$ (23,707)	\$ 219,524,343

**CITY OF VERNON, CALIFORNIA**  
**Notes to Basic Financial Statements (Continued)**  
**June 30, 2004**

**NOTE 5 – CAPITAL ASSETS (CONTINUED)**

**Depreciation and Amortization**

Depreciation and amortization expense was charged to the business-type functions as follows:

Light and Power depreciation	\$ 3,241,854
Other Enterprise Fund depreciation	272,097
Total depreciation expense – business-type functions	\$ 3,513,951
Light and Power amortization of bond issuance costs	74,268
Total depreciation and amortization expense- business-type functions	\$ 3,588,219

**Capitalized bond interest**

In 2004 the City capitalized all interest paid in relation to the Series 2003A, 2003B, and 2003C bonds. These bonds were issued in 2003 in order to finance construction of the Malburg Generating Station, which is still under construction. In 2004 the City incurred \$4,715,097 in bond related interest.

**NOTE 6 – LONG-TERM OBLIGATIONS**

During the fiscal year 2003, the City issued \$50,000,000, 2003 Series A, \$37,500,000, 2003 Series B, and \$75,110,000, 2003 Series C, Malburg Generating Station Project Electric System Revenue Bonds to finance construction of the City's Malburg Generating Station, a 134 MW combined cycle combustion turbine project. The Series A and Series B bear interest at weekly interest rates (1.06% at June 30, 2004), and are adjusted weekly as determined by the applicable remarketing agent.

A summary of bonds payable for business-type activities is as follows:

Malburg Generating Station Project Electric System Revenue Bonds	Maturity	Interest Rates	Annual Principal Installments	Original Issue Amount	Outstanding at June 30, 2004
<i>2003 Series A</i>	04/01/33	Variable	\$ 50,000,000	\$ 50,000,000	\$ 50,000,000
<i>2003 Series B</i>	04/01/33	Variable	37,500,000	37,500,000	37,500,000
<i>2003 Series C</i>	04/01/03- 04/01/33	4.00% -5.50%	\$ 1,210,000 -29,420,000	75,110,000	75,110,000
<i>Unamortized premium</i>				180,787	174,761
<b>Total Revenue Bonds</b>				<b>\$162,790,787</b>	<b>\$ 162,784,761</b>

**CITY OF VERNON, CALIFORNIA**  
**Notes to Basic Financial Statements (Continued)**  
**June 30, 2004**

**NOTE 6 – LONG-TERM OBLIGATIONS (CONTINUED)**

As of June 30, 2004, annual debt service requirements of business-type activities to maturity are as follows (1.06% variable rate used at June 30, 2004):

Year ending June 30:	Malburg Generating Station Project Electric System Revenue Bonds Payable	
	Principal	Interest
2005	\$ 2,995,000	\$ 4,895,783
2006	3,105,000	4,847,383
2007	3,220,000	4,796,983
2008	3,335,000	4,744,583
2009	3,460,000	4,690,183
2010-2014	19,590,000	22,311,863
2015-2019	24,120,000	19,934,263
2020-2024	29,805,000	16,791,250
2025-2029	36,975,000	12,658,285
2030-2033	36,005,000	6,271,350
Total requirements	<u>\$ 162,610,000</u>	<u>\$ 101,941,926</u>

**Changes in long-term liabilities**

The following is a summary of long-term liabilities transactions for the fiscal year ended June 30, 2004:

	Balance July 1, 2003	Additions	Reductions	Balance June 30, 2004	Amounts Due Within One Year
<b><u>Governmental activities:</u></b>					
Claims payable	\$ 5,124,267	\$ 622,093	\$ (493,535)	\$ 5,252,825	\$ 1,748,130
<b><u>Business-type activities:</u></b>					
Bonds payable	\$162,610,000	\$ -	\$ -	\$162,610,000	\$ 2,995,000
Bond premium	180,787	-	(6,026)	174,761	-
	<u>\$162,790,787</u>	<u>\$ -</u>	<u>\$ (6,026)</u>	<u>\$162,784,761</u>	<u>\$ 2,995,000</u>

In prior years, resources in the City's general and enterprise funds have liquidated the claims liabilities.

**CITY OF VERNON, CALIFORNIA**  
**Notes to Basic Financial Statements (Continued)**  
**June 30, 2004**

**NOTE 7 – BOND INTEREST RATE SWAP AGREEMENTS**

**Basis Swap**

*Objective of the interest rate swap:* As a means to limit its exposure to interest rate risk, the City entered into two interest basis swaps in connection with its \$87.5 million Electric System Series A and Series B bonds. The intention of the swaps was to mitigate the risks against higher future interest rates and an expansion of the differential between variable rate tax-exempt rates and variable taxable rates.

*Terms:* The bonds and the related swap agreements mature on April 1, 2033, and the swaps' aggregate notional amount of \$87.5 million matches the \$87.5 million bonds. The swaps were entered into in July 2003 and August 2003, respectively. The notional value of the swap and the principal amount of the associated debt have an identical amortization schedule. Under the swaps, the City pays the counterparties payments equal to the average of the weekly Bond Market Association (BMA) variable rate index and receives payments equal to 80.2%, and 78.6% respectively, of the London Interbank Offered Rate (LIBOR) one-month index.

*Fair value:* Because the differential between the BMA index and LIBOR index has increased since execution of the swaps, the swaps have an aggregate positive fair value of \$550,200 as of June 30, 2004. The fair value was estimated using the zero-coupon method. This method calculates the future net settlement payments required by the swap, assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These payments are then discounted using the spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the date of each future net settlement on the swap.

*Credit risk:* As of June 30, 2004, the City was exposed to credit risk because the swaps had a positive fair value. The swap counterparties, Bank of America and Wachovia, were rated A+ by Standard & Poor's and Aa2 by Moody's Investors Service and A+ by Standard & Poor's and Aa2 by Moody's Investors Service, respectively, as of June 30, 2004. To mitigate the potential for credit risk, if the counterparties credit quality falls below A+/Aa2, the fair value of the swap will be fully collateralized by the counterparty with U.S. government securities. Collateral would be posted with a third-party custodian.

*Basis risk:* The swap exposes the City to basis risk should the relationship between LIBOR and BMA converge to a ratio higher than that stated in the swaps. As of June 30, 2004, the ratio was not greater than the ratios stated in the swaps. If a change occurs that results in the rates moving to a convergence ratio greater than that stated in the swaps, the swaps may not provide the expected interest rate risk mitigation.

*Termination risk:* The City or its counterparties may terminate the swaps if the other party fails to perform under the terms of the contract. The swaps may be terminated by the City if the counterparties' credit quality rating falls below "A-" as issued by Standard & Poor's or "A3" as issued by Moody's Investors Service. If at the time of termination, the swaps have a negative fair value, the City would be liable to the counterparties for a payment equal to the swaps' fair value.

*Swap payments and associated debt:* As the swaps are intended solely to mitigate the City's exposure to interest rates, the City does not expect to realize interest rate savings from the swaps. As interest rates rise, it is expected that the difference, or spread, between short-term tax-exempt rates and short-term taxable rates will increase. Under this expectation, the City will receive payments under the swaps greater than its payments to the counterparties. As a net receiver on the swaps, the City would then have such monies available to offset higher debt service requirements on its long-term bonds.

**Fixed to Variable Swap**

*Objective of the interest rate swap:* The City's asset/liability strategy is to have variable rate debt exposure consistent with its variable rate asset exposure; the result being that as interest rates increase, the City's investment income will offset its increased variable rate debt costs.

**CITY OF VERNON, CALIFORNIA**  
**Notes to Basic Financial Statements (Continued)**  
**June 30, 2004**

**NOTE 7 – BOND INTEREST RATE SWAP AGREEMENTS (CONTINUED)**

*Terms:* In April 2003, the City entered into a pay-variable, receive-fixed interest rate swap for the term of its \$75,110,000 2003 Series C Electric System revenue bonds. The notional amount of the swap is \$75,110,000. In June 2003, the City elected to terminate the portion of the swap through April 2008 in exchange for a payment of \$4,170,000 from the swap counterparty. Under the remaining terms of the swap, (i) the swap becomes effective in April 2008 and terminates in April 2033; the City pays a variable rate equivalent to the Bond Market Association Municipal Swap Index (BMA), which was 1.06 percent at June 30, 2004, plus 0.84% and receives fixed-rate payments equal to the actual semi-annual interest payments due on the Series C bonds. The notional amount of the swap and the amortization of the principal of the Series C Bonds are exactly matched. As of June 30, 2004, the Series C Bonds are fixed rate bonds. Beginning in April 2008, the Series C bonds will become synthetic variable-rate bonds as follows:

Terms	Rates
Interest rate swap:	
Variable payment to counterparty	BMA + 0.84%
Fixed payment from counterparty	Equal to the fixed bond coupon payment (approximately 5.4%)

*Fair value:* As of June 30, 2004, the swap had a negative fair value of \$2,592,000. The fair value of the swap was calculated using the par-value method: the fixed rate on the swap was compared with the current fixed rates that could be achieved in the marketplace should the swap be unwound. The fixed-rate component was valued by discounting the fixed-rate cash flows using the current yield to maturity of a comparable bond. The variable-rate component was assumed to be at par-value because the interest rate resets to the market rate at every reset date. The fair value was then calculated by subtracting the established market value of the fixed component from the established market value of the variable component (the par-value of the bond).

*Credit risk:* As the swap's fair value as of June 30, 2004 is negative, the City does not have any credit exposure to the counterparty. Should the swap's fair value become positive, the City would have credit exposure to the counterparty equal to the fair value amount. As of June 30, 2004, the swap counterparty, Bank of America, was rated A+ by Standard & Poor's and Aa2 by Moody's Investors Service. To mitigate the potential for credit risk, if the counterparty's credit quality falls below A+/Aa2, the fair value of the swap will be fully collateralized by the counterparty with U.S. government securities. Collateral would be posted with a third-party custodian.

*Interest rate risk:* Beginning in April 2008, the swap increases the City's exposure to interest rate risk. As BMA increases, the City's net payment on the swap increases.

*Termination risk:* The City or the counterparty may terminate the swap if the other party fails to perform under the terms of the contract. In addition, the City may optionally terminate the agreement on any date. If at the time of termination the swap has a negative fair value, the City would be liable to the counterparty for an amount equal to the negative fair value.

*Swap payments and associated debt:* Using interest rates as of June 30, 2004, principal and interest requirements of the debt and net swap payments for the term of the swap and the debt are as follows. As rates vary, net swap payments will vary.

**CITY OF VERNON, CALIFORNIA**  
**Notes to Basic Financial Statements (Continued)**  
**June 30, 2004**

**NOTE 7 – BOND INTEREST RATE SWAP AGREEMENTS (CONTINUED)**

The following table summarizes the savings the City will realize if BMA remains constant at 1.06%.

Year Ending June 30	Principal Amount	Interest	Interest Rate Swap, Net	Total Debt Service
2005	\$ 1,210,000	\$ 3,968,283	\$ -	\$ 5,178,283
2006	1,260,000	3,919,883	-	5,179,883
2007	1,310,000	3,869,483	-	5,179,483
2008	1,360,000	3,817,083	(1,250,906)	3,946,177
2009	1,415,000	3,762,683	(2,433,253)	2,744,430
2010-2014	8,215,000	17,674,363	(11,458,419)	14,430,944
2015-2019	10,595,000	15,296,763	(9,946,173)	15,945,590
2020-2024	13,735,000	12,153,750	(7,921,880)	17,966,870
2025-2029	17,865,000	8,519,773	(5,243,080)	21,141,693
2030-2033	18,145,000	2,062,363	(1,676,520)	18,530,843
<b>Total</b>	<b>\$ 75,110,000</b>	<b>\$ 75,044,427</b>	<b>\$ (39,910,231)</b>	<b>\$ 110,244,196</b>

**NOTE 8 – RISK MANAGEMENT**

The City is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; natural disasters; unemployment coverage, and providing health benefits to employees, retirees, and their dependents. The City is self-insured for its general liability, workers' compensation, and property liability. The City has chosen to establish risk financing Internal Service Funds, whereby assets are set aside for claim settlements associated with the above risks of loss up to certain limits.

The City has obtained various insurance policies that provide coverage for "Special Form Perils" against direct physical loss or damage, including earthquake and flood, to all real and personal property of the City, including equipment, business and revenue interruption, errors and omissions, boiler and machinery and pollution legal liability. The earthquake and flood portion of the policies have a 5% deductible of the total insurable values per building, structure or covered item at the time and place of loss. In the most recent "Statement of Values" for the City, real and personal property total insured values equaled \$98,553,142 and total insured earthquake/flood values equaled \$81,100,439.

Crime (Employee Theft and Depositors Forgery and Alteration, and Computer and Funds Transfer Fraud) coverage is also in force with a limit \$100,000 for each line of coverage.

The City is self insured for the first \$300,000 of Workers' Compensation claims and for the first \$2,000,000 of its General Liability Coverage.



**CITY OF VERNON, CALIFORNIA**  
**Notes to Basic Financial Statements (Continued)**  
**June 30, 2004**

**NOTE 8 – RISK MANAGEMENT (CONTINUED)**

Excess coverage is provided by the Independent Cities Risk Management Authority (the "ICRMA"), a joint powers authority whose purpose is to develop and fund programs of excess insurance for its member cities. The ICRMA is governed by a board of directors consisting of representatives of its member cities. Excess coverage is provided by ICRMA. Self-insurance and ICRMA limits are as follows:

Type of Coverage	Self-Insurance	ICRMA
General Liability	Up to \$2,000,000	Not Applicable
Workers' Compensation	Up to \$300,000	\$300,000 to \$10,000,000
Property	Up to \$ 10,000	Not Applicable

Insured limits are:

Type of Coverage	Limits
Excess General Liability	\$10,000,000 excess of \$2,000,000 (self insured)
Excess General Liability	\$10,000,000 excess of \$10,000,000

The City is constructing and will be operating the Malburg Generating Station, a combined cycle power plant. A Builders Risk insurance policy is in place with limits of insurance of \$150,000,000 each and every loss/accident combined single limit. The deductible is \$100,000 all other perils, except \$250,000 for the GTX 100 Turbines. Earthquake coverage has an annual aggregate sublimit of \$20,000,000 with a 5% on Earthquake.

Amounts in excess of these limits are self-insured. There have been no significant reductions of coverage from the prior year. There have been no settlements exceeding insurance coverage for each of the past three fiscal years. Health benefits risks are covered on an occurrence basis for amounts in excess of \$75,000 per person up to \$2,000,000 per person by commercial insurance purchased from independent third parties.

The unpaid claims liabilities included in each of the self-insurance Internal Service Funds are based on the results of actuarial studies and third-party administrator claim reports and include amounts for claims incurred but not reported, including loss adjustment expenses. Claims liabilities are calculated considering the effects of inflation and recent claim settlement trends, including frequency and amount of payouts and other economic and social factors.

Changes in the balances of claims liabilities during the past two fiscal years for all self-insurance funds combined are as follows:

	Fiscal Year Ended June 30	
	2004	2003
Claims payable, beginning of fiscal year	\$ 5,124,267	\$ 4,609,778
Incurred claims	622,093	1,567,693
Claim payments	(493,535)	(1,053,204)
Claims payable, end of fiscal year	<u>\$ 5,252,825</u>	<u>\$ 5,124,267</u>

**CITY OF VERNON, CALIFORNIA**  
**Notes to Basic Financial Statements (Continued)**  
**June 30, 2004**

**NOTE 9 – PENSION PLAN**

The City contributes to the California Public Employees' Retirement System (PERS), an agent multiple-employer retirement system that acts as a common investment and administrative agent for participating public entities within the State of California.

All full-time safety (police and fire personnel) and miscellaneous personnel and temporary or part-time employees who have worked 1,000 hours in a fiscal year are eligible to participate in the PERS. Benefits vest after five years of service. Employees who retire at age 50 with five years of credited service are entitled to retirement benefits. Monthly retirement benefits are based on an employee's average compensation for his or her single highest year of compensation for each year of credited service.

Miscellaneous members with five years of credited service may retire at age 55 with full benefits based on a benefit factor derived from the "2% at 55 Miscellaneous Factor" benefit factor table and between age 50 and 54 with reduced retirement benefits. Safety members may retire at age 50 with full benefits based on a benefit factor derived from the "2% at 55 Safety Factor" benefit factor table with five years of credited service. The PERS also provides death and disability benefits. These benefit provisions and all other requirements are established by State statute and City ordinance.

The City's plan does not issue a stand-alone financial report but is included in the PERS report, which can be obtained from PERS at Lincoln Plaza, 400 P Street, Sacramento, California 95814.

The State-required City employee salary contributions of 7% for miscellaneous employees and 9% for safety members are subsidized by the City. The City is required to contribute the remaining amounts necessary to fund the benefits for its members, using the actuarial basis adopted by the PERS Board of Administration.

The City's total contribution to the PERS for the year ended June 30, 2004 was \$2,742,685. City contribution rates as a percentage of covered payroll were 0% for miscellaneous plan members and 9.562% for safety plan members.

The City's contribution was made in accordance with actuarially determined requirements based on an actuarial valuation performed as of June 30, 2002.

The PERS uses the entry age normal actuarial cost method, which is a projected benefit cost method that takes into account those benefits expected to be earned in the future as well as those already accrued. According to this cost method, the normal cost for an employee is the level amount that would fund the projected benefit if it were paid annually from the date of employment until retirement. The PERS uses a modification of the entry age normal cost method whereby the employer's total normal cost is expressed as a level percentage of payroll. PERS also uses the level percentage of payroll method to amortize any unfunded accrued actuarial liabilities. The amortization period of the unfunded accrued actuarial liability ends on June 30, 2011.

Significant actuarial assumptions used in the valuation included (a) a rate of return on the investment of present and future assets of 8.25% a year, compounded annually; (b) projected salary increases of 3.75% a year, compounded annually, and 3.50% attributable to inflation; (c) additional projected salary increases of 0.0% a year, attributable to cost-of-living increases; and (d) merit raises that vary by length of service and age of entry.

The actuarial value of assets was determined using techniques that smooth the effects of short-term volatility in the market value of investments over a two- to five-year period.

**CITY OF VERNON, CALIFORNIA**  
**Notes to Basic Financial Statements (Continued)**  
**June 30, 2004**

**NOTE 9 – PENSION PLAN (CONTINUED)**

Trend information for the current and two preceding fiscal years is as follows:

Fiscal Year Ended June 30	Annual Pension Cost (APC)	Amount Contributed	Percentage of APC Contributed	Net Pension Obligation
2004	\$ 2,742,685	\$ 2,742,685	100%	-
2003	1,954,358	1,954,358	100%	-
2002	1,726,373	1,726,373	100%	-

The following schedule represents the required supplemental information for the three most recent actuarial valuations. This schedule provides information about progress made in accumulating sufficient assets to pay benefits when due (dollar amounts in millions):

Actuarial Valuation Date June 30	Actuarial Accrued Liability (AAL)	Actuarial Value of Plan Assets	Overfunded AAL (OAAL)	Funded Ratio	Annual Covered Payroll	OAAL as % of Covered Payroll
2002	\$ 161.7	\$ 165.7	\$ 4.0	102.5%	\$ 19.9	20.3%
2001	155.7	179.8	24.1	115.5	18.9	127.9%
2000	142.4	177.3	35.0	124.6	18.5	188.8%

**NOTE 10 – LEGAL SETTLEMENT**

In 2004, the City settled an antitrust lawsuit with El Paso Natural Gas Company for \$7,148,889. The lawsuit was brought against El Paso Natural Gas for manipulating gas supplies and pipeline deliveries during the 2001 energy crisis. The City was not party to the class action lawsuit brought against EL Paso and settled independently of the class.

**NOTE 11 – DEFICITS IN FUND EQUITY**

The deficit fund balance of \$10,929,908 in the Capital Projects Fund relates to recording the fund's loans from the City on its balance sheet, which will be repaid through future property tax increments.

The Gas Enterprise Fund has negative net assets of \$6,068,704 at June 30, 2004, which will be recovered from customers once the fund commences operations in 2005.

The Equipment Replacement Internal Service Fund has negative net assets of \$155,011 at June 30, 2004. To the extent such deficit is attributed to shortfalls in charges to other funds, such deficit will be recovered through future rate increases. A deficit arising from decreases in fair value of pooled investments will not be recovered through charges to other funds.

**CITY OF VERNON, CALIFORNIA**  
**Notes to Basic Financial Statements (Continued)**  
**June 30, 2004**

**NOTE 12 – LIGHT AND POWER OPERATIONS AND COMMITMENTS**

**Deregulation**

Effective April 1, 1998, competition was introduced into California's electric utility market, and customers of the state's investor-owned utilities (IOUs) became eligible for direct access. The implementation of competition in accordance with State Assembly Bill 1890 (AB1890) resulted in significant structural changes to the electric power industry, including mandated direct access for IOU customers, energy sales through a Power Exchange, and management of transmission assets through an Independent System Operator (ISO). AB 1890 also legislated the recovery of stranded investment through the assessment of a non-by passable competition transition charge (CTC). The original deregulation legislation applied to the State's IOUs and did not compel participation by publicly owned utilities, such as the City's electric utility.

**Participating Transmission Owner**

On August 30, 2000, the City filed a petition for declaratory order with the Federal Energy Regulatory Commission (FERC) requesting a determination by the FERC that the City's Transmission Revenue Requirement (TRR), as approved by its rate setting body, the City Council, is proper for purposes of the City becoming a Participating Transmission Owner (PTO) in the California ISO. The FERC issued its order accepting the City's petition, with certain modification, on October 27, 2000. Certain aspects of the FERC order were challenged by some of the State's other PTOs. Recently, a federal appeals court ruled that the way the FERC arrived at its decision was improper and remanded the case back to the FERC for further proceedings. The City expects the outcome to remain the same. As a PTO, the City has turned over operational control of its transmission entitlements to the ISO effective January 1, 2001 and shall be reimbursed based upon its TRR by the ISO through the ISO's collection of a transmission access charge (TAC).

On December 21, 2000, the ISO filed, on behalf of itself and the Participating Transmission Owners (PTO), a number of changes to its Transmission Control Agreement (TCA) to recognize Vernon's application to become a Participating Transmission Owner. The ISO also filed revisions to identify the transmission interests that the City will be turning over to the ISO's operational control and the inclusion of an explicit contract provision to ensure that all PTOs, including an entity such as the City, which is not subject to the rate jurisdiction of FERC under section 205 and 206 of the Federal Power Act (FPA), make all refunds or payment adjustments to implement any relevant FERC order.

**Project Commitments**

**A. Southern California Public Power Authority**

In 1980, the City entered into a joint powers agreement with nine (9) Southern California cities and an irrigation district to form the Southern California Public Power Authority (the "Authority"). The Authority's purpose is the planning, financing, acquiring, constructing and operating of projects that generate or transmit electric energy.

**CITY OF VERNON, CALIFORNIA**  
**Notes to Basic Financial Statements (Continued)**  
**June 30, 2004**

**NOTE 12 – LIGHT AND POWER OPERATIONS AND COMMITMENTS (CONTINUED)**

The Authority purchased a 5.91% interest in the Palo Verde Nuclear Generating Station (the "Station"), a nuclear-fired generating station near Phoenix, Arizona, from the Salt River Project Agricultural Improvement and Power District, and a 6.55% share of the right to use certain portions of the Arizona Nuclear Power Project Valley Transmission System. The City has a 4.9% entitlement share of the Authority's interest in the station.

Between 1983 and 2002, the Authority issued \$3.166 billion (with \$609 million currently outstanding) of Power Project Revenue Bonds to finance the purchase of the Authority's share of the Station and related transmission rights. The bonds are not obligations of any member of the Authority or public agency other than the Authority. Under a power sales contract with the Authority, the City is obligated on a "take or pay" basis for its proportionate share of power generated, as well as to make payments for its proportionate share of the operating and maintenance expenses of the Station, debt service on the bonds and any other debt, whether or not the project or any part thereof or its output is suspended, reduced or terminated. The City's proportionate share of costs during fiscal year 2004 was \$8,610,372. The City estimates its proportionate share of costs will be approximately \$3,000,000 for fiscal year 2005.

**B. Hoover Dam Power Plant Upgrade Program**

In January 1987, the City entered into a contract with the Federal Bureau of Reclamation to fund part of an upgrading program of the Hoover Dam power plant to increase the plant's generating capacity. In exchange, the City will receive its pro rata share of the additional power produced. Total program costs are estimated to be \$155 million.

As of June 30, 2004, the City's total advances were \$6,736,123 for the upgrading program. At June 30, 2004, the outstanding note receivable was \$4,716,241. The City has no obligation to advance funds in the future. The note is being repaid with interest over a period of 30 years. The City must also make payments for its pro rata share of operating and maintenance costs not recovered by the plant through revenues. The amount paid during the current year for purchased power was reduced by principal amounts totaling \$207,087 due the City on the outstanding note receivable. The contract expires in June 2017.

**C. California-Oregon Transmission Project**

In 1991, the City entered into the Interim Participation Agreement with several Northern California entities and the Western Area Power Administration. This agreement calls for the construction and operation of the project. Each party in the agreement has been allocated a respective share of the construction costs. The City's share is 8.05%. As of June 30, 2004, the City's share of total costs incurred for the project's planning and construction was \$36,917,002.

**CITY OF VERNON, CALIFORNIA**  
**Notes to Basic Financial Statements (Continued)**  
**June 30, 2004**

**NOTE 12 - LIGHT AND POWER OPERATIONS AND COMMITMENTS (CONTINUED)**

**Power Purchase Commitments**

As of June 30, 2004, the City has entered into long-term commitments to purchase power subject to certain conditions. The following table summarizes the value of the commitments at June 30, 2004 (in thousands):

<u>Fiscal Year</u>	<u>Amount</u>
2004-05	\$ 36,054
2005-06	19,038
2006-07	14,091
2007-08	14,091
2008-11	20,269
	<u>\$ 103,543</u>

**Construction Commitments**

As of June 30, 2004, the City's Light and Power Fund had commitments for construction contracts and open purchase orders totaling approximately \$25 million.

**NOTE 13 - POST-RETIREMENT BENEFITS**

The City Council approved a post-retirement benefit plan for all employees with 20 years of service who retire at 60 or 30 years or more of service to the City. The plan pays for qualified employees' medical and dental insurance premiums and claims from age 60 to 65. Funding of the plan is on a pay-as-you-go basis. During the year ended June 30, 2004, approximately 43 employees were eligible to receive benefits. Amounts paid for the year ended June 30, 2004 totaled \$312,300.

**NOTE 14 - CONTINGENCIES**

At June 30, 2004, a number of lawsuits and claims were pending against the City that arose in the normal course of operations. Management estimates that certain pending lawsuits and claims may result in additional liabilities of approximately \$500,000.

The City is currently in proceedings with the FERC to determine the appropriate Transmission Revenue Requirement ("TRR") for the City. The City is currently receiving revenue from the ISO based on a TRR of approximately \$10.2 million annually. The City cannot predict the outcome of this proceeding, but it is possible that the outcome could affect the City's TRR in certain ways including, among others, the level of TRR. This process may result in additional liabilities approximating \$5 million. In addition, the FERC has ordered the City to pay refunds for certain electric energy sales made during the period October 2, 2000 through June 20, 2001 at prices above certain California markets. This order is currently under appeal in the United States Court of Appeals, and as such the City cannot predict the outcome of this case. This order may result in liabilities approximating \$500,000. The ultimate loss related to these matters, if any, is unknown at this time and no amount has been accrued in the accompanying financial statements.

Additionally, other significant lawsuits pending against the City involving breach of contract concerning wholesale power supply may result in liabilities approximating \$10 million. However, the ultimate loss, if any, is unknown at this time and no amount has been accrued in the accompanying financial statements.

**CITY OF VERNON, CALIFORNIA**  
**Notes to Basic Financial Statements (Continued)**  
**June 30, 2004**

**NOTE 15 – FUTURE GASB PRONOUNCEMENTS**

In March 2003, GASB issued Statement No. 40, *Deposit and Investment Risk Disclosures – an amendment of GASB Statement No. 3*. This statement addresses common deposit and investment risks related to credit risk, concentration of credit risk, interest rate risk, and foreign currency risk. As an element of interest rate risk, this statement requires certain disclosures of investments that have fair values that are highly sensitive to changes in interest rates. Deposit and investment policies related to the risk identified in this statement also should be disclosed. The City will implement the new reporting requirements in the fiscal year 2004-05 financial statements.

The City is currently analyzing its accounting practices to determine the potential impact on the financial statements for the following GASB Statements:

In November 2003, GASB issued Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. This statement establishes accounting and financial reporting standards for impairment of capital assets. A capital asset is considered impaired when its service utility has declined significantly and unexpectedly. This statement also clarifies and establishes accounting requirements for insurance recoveries. This statement is effective for the City's fiscal year ending June 30, 2006.

In April 2004, GASB issued Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*. This statement establishes uniform financial reporting standards for other postemployment benefits (OPEB) plans. The approach followed in this statement generally is consistent with the approach adopted for defined benefit pension plans with modifications to reflect differences between pension plans and OPEB plans. The statement applies for OPEB trust funds included in the financial reports of plan sponsors or employers, as well as for the stand-alone financial reports of OPEB plans or the public employee retirement systems, or other third parties, that administer them. This statement also provides requirements for reporting of OPEB funds by administrators of multiple-employer OPEB plans, when the fund used to accumulate assets and pay benefits or premiums when due is not a trust fund. This statement is effective for the City's fiscal year ending June 30, 2007.

In June 2004, GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, which addresses how state and local governments should account for and report their costs and obligations related to postemployment healthcare and other nonpension benefits. Collectively, these benefits are commonly referred to as other postemployment benefits, or OPEB. The statement generally requires that employers account for and report the annual cost of OPEB and the outstanding obligations and commitments related to OPEB in essentially the same manner as they currently do for pensions. Annual OPEB cost for most employers will be based on actuarially determined amounts that, if paid on an ongoing basis, generally would provide sufficient resources to pay benefits as they come due. This statement's provisions may be applied prospectively and do not require governments to fund their OPEB plans. An employer may establish its OPEB liability at zero as of the beginning of the initial year of implementation; however, the unfunded actuarial liability is required to be amortized over future periods. This statement also establishes disclosure requirements for information about the plans in which an employer participates, the funding policy followed, the actuarial valuation process and assumptions, and, for certain employers, the extent to which the plan has been funded over time. This statement is effective for the City's fiscal year ending June 30, 2008.

**Required Supplementary Information**



**CITY OF VERNON, CALIFORNIA**  
**Required Supplementary Information**  
**Budgetary Comparison Schedule**  
**General Fund**  
**For the Fiscal Year Ended June 30, 2004**

	Budgeted Amounts		Actual Amounts	Variance with Final Budget Positive (Negative)
	Original	Final		
<b>REVENUES:</b>				
Taxes	\$ 12,179,105	\$ 12,179,105	\$ 8,725,072	\$ (3,454,033)
Special assessments	-	-	595,985	595,985
Licenses and permits	1,211,000	1,211,000	1,009,254	(201,746)
Fines, forfeitures and penalties	267,000	267,000	191,177	(75,823)
Revenues from use of monies and properties	5,000,000	5,000,000	(195,693)	(5,195,693)
Intergovernmental revenues	-	-	268,804	268,804
Charges for services	8,081,443	8,081,443	8,313,101	231,658
Other revenues	4,852,680	4,852,680	853,715	(3,998,965)
Total revenues	<u>31,591,228</u>	<u>31,591,228</u>	<u>19,761,415</u>	<u>(11,829,813)</u>
<b>EXPENDITURES:</b>				
General government	8,808,621	8,884,870	8,314,200	570,670
Public safety	23,014,468	23,014,468	20,209,791	2,804,677
Public works	6,528,559	6,528,559	5,072,386	1,456,173
Health services	1,334,189	1,334,189	1,245,122	89,067
Capital outlay	2,939,303	2,939,303	3,295,250	(355,947)
Total expenditures	<u>42,625,140</u>	<u>42,701,389</u>	<u>38,136,749</u>	<u>4,568,640</u>
Excess (deficiency) of revenues over (under) expenditures	<u>(11,033,912)</u>	<u>(11,110,161)</u>	<u>(18,375,334)</u>	<u>(7,265,173)</u>
<b>Other financing sources (uses):</b>				
Transfers in	7,116,322	7,116,322	5,718,766	(1,397,556)
Transfers out	-	-	(10,535)	(10,535)
Total other financing sources (uses)	<u>7,116,322</u>	<u>7,116,322</u>	<u>5,708,231</u>	<u>(1,408,091)</u>
<b>Reconciliation of GAAP basis fund balance</b>				
Current year encumbrances	-	-	3,348,325	3,348,325
<b>NET CHANGE IN FUND BALANCE</b>			<b>(9,318,778)</b>	<b>(5,324,939)</b>
<b>FUND BALANCE, BEGINNING OF YEAR</b>	<b>-</b>	<b>-</b>	<b>16,266,875</b>	<b>16,266,875</b>
<b>FUND BALANCE, END OF YEAR</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 6,948,097</b>	<b>\$ 10,941,936</b>

See accompanying note to the required supplementary information.

**CITY OF VERNON, CALIFORNIA**  
**Note to Required Supplementary Information**  
**June 30, 2004**

**NOTE 1 – BUDGET**

The City adheres to the following general procedures in establishing its annual budget, which is reflected in the accompanying General Fund budgetary comparison schedule.

- An annual budget is adopted by the City Council that provides for the general operation of the City. The budget includes authorized expenditures and estimated revenues of the General Fund, Special Revenue Funds and Capital Projects Funds;
- The budget is formally integrated into the accounting system and employed as a management control device during the year;
- Encumbrances, which are commitments related to executory contracts for goods and services, are recorded to assure effective budgetary control and accountability;
- Encumbrances outstanding at year-end do not constitute expenditures or liabilities under GAAP. Encumbrances outstanding at year-end are reported as reservations of fund balance for subsequent year expenditures. Unencumbered appropriations lapse at year-end;
- The budget is adopted on a modified accrual basis, except that encumbrances are treated as budgetary basis expenditures in the year of incurrence of the commitment to purchase;
- The City Administrator is authorized to transfer appropriations between activities within any fund. Expenditures may not exceed appropriations at the fund level. Excess expenditures over appropriations are financed by beginning fund balances. The final budgeted amounts used in the accompanying general fund budgetary comparison schedule include any amendments made during fiscal year 2004. Encumbrances carried forward from the prior year are reflected in the original budget.

## APPENDIX C

### CERTAIN DEFINITIONS

“Additional Gas Payment” means any payment to be made by the City, on behalf of the Authority, on or before each date provided in or pursuant to the Gas Purchase Agreement for the payment of any amount by the Authority other than the Prepayment, including without limitation Imbalance Charges (as defined in the Gas Purchase Agreement), taxes, and indemnification payments, all amounts payable by the Authority on such date under the Gas Purchase Agreement other than the Prepayment. The City will make all Additional Gas Payments for the account of the Authority directly to the party entitled to such payment.

“Alternate Liquidity Facility” means a bond insurance policy, financial guaranty, letter of credit, line of credit, standby purchase agreement or similar agreement or any combination thereof issued by a commercial bank or other financial institution and delivered to the Tender Agent in accordance with the terms of the Indenture and replaces a Liquidity Facility then in effect.

“Auction Rate” means a variable interest rate determined in accordance with certain auction procedures.

“Available Amounts” means, except as provided in the next succeeding sentence, (a) funds paid under a Bank Facility, (b) moneys which have been continuously on deposit with the Trustee or the Tender Agent and (i) held in any separate and segregated fund, account or subaccount established hereunder in which no other moneys which are not Available Amounts are held, and (ii) which have been so on deposit for at least 123 days from their receipt by the Trustee or the Tender Agent, as applicable, and not commingled with any funds so held for less than said period and during and prior to which no Event of Bankruptcy of the City or the Authority has occurred; (c) proceeds from the sale of bonds, notes, or other evidences of indebtedness received by the Trustee directly and contemporaneously with the issuance or sale or remarketing of such bonds, notes or other evidences of indebtedness and held in any separate and segregated fund, account or subaccount hereunder in which no other moneys which are not Available Amounts are held; (d) any other moneys if there is delivered to the Trustee and each Credit Provider an Opinion of Counsel (which may assume that no Owner of Bonds is an "insider" within the meaning of the Federal Bankruptcy Code) from a law firm experienced in bankruptcy matters to the effect that the use of such moneys to pay amounts due on the Bonds would not be recoverable from the Owners of the Bonds pursuant to Section 550 of the Federal Bankruptcy Code as avoidable preference payments under Section 547 of the Federal Bankruptcy Code in the event of the occurrence of an Event of Bankruptcy of the City or the Authority; and (e) proceeds of the investment of funds qualifying as Available Amounts under the foregoing clauses. With respect to Bonds which are not Variable Rate Bonds, including after the Fixed Rate Conversion Date for a Series of Bonds which were issued as Variable Rate Bonds, and during each interest rate period during which Variable Rate Bonds are Auction Rate Bonds, Available Amounts means any moneys.

“Available Commitment” as of any day, means the sum of the Available Principal Commitment and the Available Interest Commitment with respect to each of the 2006B Bonds and the 2006C Bonds, in each case as of such day.

“Available Interest Commitment” initially means, (i) with respect to the 2006B Bonds, \$1,328,351 (an amount equal to 35 days’ interest on the 2006B Bonds, computed as if the 2006B Bonds bore interest at the rate of 12% per annum), and (ii) with respect to the 2006C Bonds, \$1,327,948 (an amount equal to 35 days’ interest on the 2006C Bonds, computed as if the 2006C Bonds bore interest at the rate of 12% per annum). The Available Interest Commitment with respect to each of the 2006B Bonds or the 2006C Bonds may be adjusted from time to time as follows: (a) downward by an amount that bears the same proportion to such amount as the amount of a reduction in the respective Available Principal Commitment pursuant to the definition of “Available Principal Commitment” bears to the Available Principal Commitment prior to such reduction; and (b) upward by an amount that bears the same proportion to such amount as the amount of any increase in the respective Available Principal Commitment pursuant to clause (c) of the definition of “Available Principal Commitment” bears to the Available Principal Commitment prior to such increase; provided that after giving effect to such adjustment the available interest commitment shall never exceed, with respect to the 2006B Bonds, \$1,328,351, and with respect to the 2006C Bonds,

\$1,327,948. Any adjustments pursuant to clauses (a) and (b) above shall occur simultaneously with the event requiring such adjustment.

“Available Principal Commitment” initially means, with respect to the 2006B Bonds, \$115,440,000, and with respect to the 2006C Bonds, \$115,405,000, and thereafter shall mean such initial amount adjusted from time to time as follows:

- (a) Upon any reduction in the applicable Available Principal Commitment pursuant to the terms of the related Liquidity Facility, downward by the amount of such reduction;
- (b) Downward by the principal amount of any 2006B Bonds or 2006C Bonds purchased by the Bank pursuant to the applicable Liquidity Facility; and
- (c) Upward by the principal amount of any 2006B Bonds or 2006C Bonds previously purchased by the Bank pursuant to the related Liquidity Facility, which a Bank Bondholder elects to retain or that are sold or deemed sold by a Bank Bondholder under such Liquidity Facility (regardless of the Purchase Price received for such Bonds).

Any adjustment to the Available Principal Commitment pursuant to clause (a), (b) or (c) above shall occur simultaneously with the occurrence of the events described in such clauses.

“Bank Base Rate” means, for any day, a rate per annum equal to the higher of (a) the Fed Funds Rate plus .50% per annum, and (b) the Prime Rate.

“Bank Bond” means each 2006B Bond or 2006C Bond purchased by the Bank pursuant to the related Liquidity Facility and held by or for the account of a Bank Bondholder in accordance with the terms of such Liquidity Facility, until purchased from the Bank Bondholder or retained by the Bank Bondholder or redeemed in accordance with the related Liquidity Facility or otherwise.

“Bank Bond Rate” means, for each date of determination, the rate per annum specified below with respect to each period:

<b>Period</b>	<b>Rate</b>
Purchase Date to 180 <sup>th</sup> day following the Purchase Date	Base Rate
On and after the 181 <sup>st</sup> day following the Purchase Date	Base Rate plus 2.00%

Notwithstanding the foregoing, from and after the earlier of (i) the date amounts are owed hereunder but only so long as not paid when due and (ii) during the occurrence and continuance of an Event of Default under a Liquidity Facility, all amounts owed hereunder shall bear interest at the Bank Default Rate.

“Bank Bondholder” means the Bank, (but only in its capacity as owner (which as used herein shall mean beneficial owner if at the relevant time Bank Bonds are held in book-entry form) of Bank Bonds pursuant to the related Liquidity Facility) and any other Person to whom a Bank Bondholder has sold Bank Bonds pursuant to and subject to the terms of the applicable Liquidity Facility.

“Bank Default Rate” means a per annum rate of interest equal to the Bank Base Rate plus 3.00%.

“Bank Facility” means, as of any time, collectively each Credit Facility and each Liquidity Facility then in effect.

“Bank Payment” means any payment to be made by the City to the Trustee, as assignee of the Authority’s rights with respect thereto, on or before each date provided in or pursuant to each Bank Agreement for the payment of any amount by the Authority, all amounts payable by the Authority on such date under each Bank Agreement.

“Bankruptcy” shall be deemed to have occurred with respect to a Person if such Person (a) files a petition for relief under Title 11 of the United States Code, as amended, and any successor statute or statutes having substantially the same function or any other insolvency law or seeking to adjudicate it a bankrupt or insolvent, or seeking dissolution, winding up, liquidation, reorganization, arrangement, adjustment or composition of it or its

debts under any law relating to bankruptcy, insolvency or reorganization or relief of debtors or fails to file an answer or other pleading denying the material allegations of any such proceeding filed against it; (b) takes any corporate action to authorize or effect any of the foregoing actions; (c) generally fails to pay, or admits in writing its inability to pay, its debts as such debts become due; (d) applies for, seeks or consents to, or acquiesces in, the appointment of a custodian, receiver, trustee, examiner, liquidator or similar official for it or for any material portion of its assets; (e) benefits from or is subject to the entry of an order for relief under any bankruptcy or insolvency law; (f) makes an assignment for the benefit of creditors; (g) fails, within sixty (60) days after the commencement of any proceeding against it seeking any reorganization, arrangement, composition, readjustment, liquidation, dissolution or similar relief under any present or future statute, law or regulation, to have such proceeding dismissed, or to have all orders or proceedings thereunder affecting the operations or the business of the Person stayed; or (h) fails, within sixty (60) days after the appointment, without the consent or acquiescence of the Person, of any custodian, receiver, trustee, examiner, liquidator or similar official for it or for any material portion of its assets, to have such appointment vacated.

“BMA Index” means the “BMA Municipal Swap Index” announced by Municipal Market Data on the rate determination date and based upon the weekly interest rate resets of Tax-Exempt variable rate issues included in a database maintained by Municipal Market Data which meets specified criteria established by the BMA. The BMA Index shall be based upon current yields of high-quality weekly adjustable variable rate demand bonds which are subject to tender upon seven days notice, the interest on which is Tax-Exempt and not subject to any personal “alternative minimum tax” or similar tax under the Code unless all tax-exempt securities are subject to such tax.

“Bond Insurer Event of Insolvency” means the occurrence and continuance of one or more of the following events: (a) the issuance, under Article 74 of the Insurance Law of New York or any successor provision thereof (or any other law to which the Insurer is at the time subject), of an order for relief, rehabilitation, reorganization, conservation, liquidation or dissolution of the Insurer that is not dismissed within ninety (90) days; (b) the commencement by the Insurer of a voluntary case or other proceeding seeking an order for relief, liquidation, supervision, rehabilitation, conservation, reorganization or dissolution with respect to itself or its debts under the laws of the state of incorporation or formation of the Insurer or any bankruptcy, insolvency or other similar law now or hereafter in effect including, without limitation, the appointment of a trustee, receiver, liquidator, conservator, custodian or other similar official for itself or any substantial part of its property; (c) the consent of the Insurer to any relief referred to in the preceding clause (b) in an involuntary case or other proceeding commenced against it; (d) the making by the Insurer of an assignment for the benefit of creditors; (e) the failure of the Insurer generally to pay its debts or claims as they become due; *provided* that any failure by the Insurer to make payment on any financial guaranty insurance policy (i) that is being contested in good faith or (ii) with respect to which thirty (30) days have not elapsed, shall not constitute a failure by the Insurer generally to pay its debts or claims as they become due; (f) the Insurer shall admit in writing its inability to pay its debts when due; or (g) the initiation by the Insurer in writing of any actions to authorize any of the foregoing.

“Bond Interest Term Rate” means a non-variable interest rate established periodically by the Remarketing Agent with respect to the 2006B Bonds or the 2006C Bonds, as applicable.

“Bond Payment” means any payment to be made by the City to the Trustee, as assignee of the Authority’s rights with respect thereto, at the times and in an amount sufficient to pay the principal of and interest on the 2006B Bonds and the 2006C Bonds on or before the date on which the same becomes due and payable.

“Bond Register” means the registration books for the ownership of Bonds maintained by the Trustee.

“Bonds” means the 2006A Bonds, the 2006B Bonds, the 2006C Bonds and any other series of bonds issued and outstanding under the terms of the Indenture.

“Book-Entry Bonds” means Bonds registered in the name of a nominee of DTC or any successor Securities Depository for the Bonds, or a nominee thereof, as the registered owner thereof.

“British Thermal Unit” or “Btu” means the international BTU, also called the BTU (IT).

“Business Day” means any day other than (i) a Saturday or Sunday or (ii) a day on which banks located (A) in the city in which the Principal of the Trustee is located, (B) in the Authority in which drawings under the applicable Liquidity Facility are to be honored is located, (C) in the city in which the Principal Office of the Tender Agent at which the 2006B Bonds or 2006C Bonds may be tendered for purchase by the owners thereof is located, or (D) in the city in which the Principal Office of the Remarketing Agent is located, or (iii) a day on which The New York Stock Exchange is closed.

“City Bond Indenture” means the Indenture of Trust, dated as of December 1, 2004, between the City and The Bank of New York Trust Company, N.A., as the same may be amended and supplemented, relating to certain bonds previously issued by the City.

“City Gas Tariff” means Southern California Gas Company Gas Tariff GW-VRN, as the same may be amended or replaced from time to time.

“City Gas Tariff Delivery Restriction” means the adoption or imposition by Transporter after the Effective Date of the Gas Purchase Agreement of any amendment, supplement or other modification of the City Gas Tariff (including the tariffs or rules of general applicability to customers of Transporter) that (A) changes the availability of transportation, the form of transportation or the rate structure applicable to transportation to one or more border delivery or receipt points on Transporter’s system, such that Gas Supplier’s ability to deliver (or the terms of such delivery), or Purchaser’s ability to receive (or the terms of such receipt), gas under the Gas Purchase Agreement at any such delivery or receipt point is materially restricted or (B) changes the availability of transportation, the form of transportation or the rate structure applicable to transportation from a Delivery Point to City, other than any such change which is generally applicable to all receipt points on Transporter’s System.

“Covered Rate” means, with respect to any 2006B Bond or 2006C Bond, the Weekly Interest Rate and the Daily Interest Rate.

“Credit Facility” means a policy of insurance, a letter of credit, a stand-by purchase agreement, revolving credit agreement or other credit arrangement pursuant to which a Credit Provider provides credit and/or liquidity support with respect to the payment of interest, principal, Redemption Price or Purchase Price of any Bonds but shall not include a Reserve Financial Guaranty.

“Credit Provider” means, as of any time, any entity providing a municipal bond insurance policy, bank or other financial institution or organization which is then providing a Credit Facility for some or all of the Bonds.

“Credit Rating” means, with respect to a Person, any public rating of the senior, unsecured, unenhanced indebtedness or deposits of such Person from any Rating Agency.

“Daily Interest Rate” means a variable interest rate with respect to the 2006B and 2006C Bonds which is reset by the Remarketing Agent on a daily basis.

“Debt Service Reserve Fund” means the Vernon Natural Gas Financing Authority Revenue Bonds (Vernon Gas Project) Debt Service Reserve Fund established pursuant the Indenture.

“Debt Service Reserve Requirement” means, as of any date of calculation, an amount equal to the least of (a) ten percent (10%) of the initial offering price to the public of the Bonds as determined under the Code, or (b) the greatest amount of debt service on the Outstanding Bonds in any Fiscal Year during the period commencing with the Fiscal Year in which the determination is being made and terminating with the last Fiscal Year in which any Outstanding Bond is due, or (c) one hundred twenty-five percent (125%) of the sum of the debt service for all Fiscal Years during the period commencing with the Fiscal Year in which such calculation is made (or if appropriate, the first full Fiscal Year following the execution and delivery of any Bonds) and terminating with the last Fiscal Year in which any debt service on an Outstanding Bond is due, divided by the number of such Fiscal Years, all as computed and determined by the Authority and specified in writing to the Trustee; provided, however that in determining debt service with respect to any Bonds that constitute variable rate Bonds, the interest rate on such Bonds for any period as to which such interest rate has not been established shall be assumed to be (i) with respect to Bonds which are

tax-exempt, the ten year historical average of the BMA Index ending with the week preceding the date of calculation, and (ii) with respect to Bonds which are not tax-exempt, the ten year historical average of the One Month USD LIBOR Rate ending with the month preceding the date the calculation is made or if the One Month USD LIBOR Rate is not available for such period, another similar rate or index selected by the Authority.

“Debt” means with respect to any Person, all items that would be classified as a liability in accordance with generally accepted accounting principles, including, without limitation, (a) indebtedness or liability for borrowed money, or for the deferred purchase price of property or services (including trade obligations); (b) obligations as lessee under leases which should have been, or should be, recorded as capital leases in accordance with generally accepted accounting principles; (c) current liabilities in respect of unfunded benefits under employee benefit, retirement or pension plans; (d) all guarantees, endorsements (other than for collection or deposit in the ordinary course of business) and other contingent obligations to purchase, to provide funds for payment, to supply funds to invest in any other Person or otherwise to assure a creditor against loss; (e) obligations secured by any mortgage, lien, pledge, security interest or other charge or encumbrance on property, whether or not the obligations have been assumed and (f) obligations of such Person under Interest Rate Protection Agreements.

“Debt Service Reserve Valuation Date” means the Business Day preceding each July 1, commencing July 1, 2007.

“Electric Service” means the services, commodities and products furnished, made available or provided by the Electric System.

“Electric System” means the electrical energy generation, transmission and distribution system of the City established pursuant to Ordinance No. 1022 of the City (codified as Section 2.91 of the City's Administrative Code) and referred to in the City Administrative Code as the Vernon Electric System, comprising all electric generation, transmission and distribution facilities and all general plant facilities related thereto now owned by the City and all other facilities properties, structures or works for the generation, transmission or distribution of electricity hereafter acquired by the City, including all contractual rights for electricity or the transmission thereof, together with all additions, betterments, extensions or improvements to such facilities, properties, structures or works or any part thereof, and any additional contract rights for electricity or the transmission thereof, hereafter acquired.

“Electric System Revenues” mean: (i) all Bond Payments, all Bank Payments and all Qualified Swap Payments paid by the City pursuant to the Supply Agreement; (ii) all Net Payments and Termination Payments paid by the counterparty to the Authority pursuant to each Qualified Swap Agreement; (iii) during such time as a Supply Agreement Event of Default shall have occurred and is continuing: (A) all amounts paid by the Gas Supplier pursuant to the Gas Purchase Agreement; (B) all amounts paid by Citigroup Inc. or any other Person pursuant to, or in connection with, the Guarantee, including all collateral, letters of credit and other security in connection with the Guarantee or the Gas Purchase Agreement; and (C) all amounts received in connection with the Authority's security interest in, and pledge of the City's interest in, the Purchased Gas, the Gas Purchase Agreement and the Guarantee.

“Eligible Bonds” means any Bonds Outstanding under and entitled to the benefits of the Indenture which bear interest at a Covered Rate and that are tendered or deemed tendered for purchase pursuant the Indenture other than any such Bond which (a) is a Bank Bond or (b) is owned by or on behalf of or is held for the account or for the benefit of the Authority or the City.

“Event of Insolvency” means, with respect to any Person, the occurrence of one or more of the following events:

- (a) the issuance, under the laws of any state or under the laws of the United States of America, of an order of rehabilitation, liquidation or dissolution of such Person;
- (b) the commencement by or against such Person of a case or other proceeding seeking liquidation, reorganization or other relief with respect to the such Person or its debts under any bankruptcy, insolvency or other similar state or federal law now or hereafter in effect, including, without limitation, the appointment of a trustee, receiver, liquidator, custodian or other similar official for such Person or any substantial part of its property or there shall be appointed or designated with respect to it, an entity such as an organization, board, commission, authority, agency or body to monitor, review, oversee, recommend or

declare a financial emergency or similar state of financial distress with respect to it or there shall be declared by it or by any legislative or regulatory body with competent jurisdiction over it, the existence of a state of financial emergency or similar state of financial distress in respect of it;

- (c) the making of an assignment for the benefit of creditors by such Person;
- (d) the failure of such Person to generally pay its debts as they become due;
- (e) the declaration of a moratorium with respect to the payment of the debts of such Person;
- (f) such Person shall admit in writing its inability to pay its debts when due; or
- (g) the initiation of any actions to authorize any of the foregoing by or on behalf of such Person.

“Expiration Date of the Liquidity Facility” means, with respect to each Liquidity Facility, June 27, 2009, as such date may be extended from time to time by the Bank pursuant to the terms of the Liquidity Facility.

“Facility Fee” means the annual fee payable from the Authority to the Bank in consideration of the Bank’s provision of the each Liquidity Facility.

“Favorable Opinion of Bond Counsel” means, with respect to any action requiring such an opinion, an opinion of Bond Counsel to the effect that such action shall not, in and of itself, adversely affect the tax-exempt status of interest on the Bonds or such portion thereof as shall be specified in the provisions of the Indenture requiring such an opinion.

“Fed Funds Rate” means, for any day a fluctuating interest rate per annum equal to the weighted average (rounded to the next higher 1/100 of 1%) of the rates on overnight Federal funds transactions with members of the Federal Reserve System arranged by Federal funds brokers, as published for such day (or, if such day is not a Business Day, for the next preceding Business Day) by the Federal Reserve Bank of New York, or, if such rate is not so published for any day which is a Business Day, the average (rounded to the next higher 1/100 of 1%) of the quotations for such day on such transactions received by the Bank from three Federal funds brokers of recognized standing selected by the Bank. Each determination of the Fed Funds Rate by the Bank shall be made at 11:00 a.m. (New York City time) and shall be conclusive and binding on the Authority absent manifest error.

“Firm” means the parties may only interrupt performance of their obligations to deliver or receive gas under the Gas Purchase Agreement to the extent such performance is excused as a *Force Majeure* under the Gas Purchase Agreement.

“First Supplemental Indenture” means the First Supplemental Indenture of Trust, dated as of June 1, 2006, between the Authority and the Trustee.

“Fiscal Year” means the period beginning on July 1 of each year and ending on the next succeeding June 30, or any other twelve-month period selected and designated as the official Fiscal Year of the Authority.

“Fitch” means Fitch, Inc., or any successor thereto.

“Gas Purchase Agreement” means the Agreement For Purchase and Sale of Natural Gas, to be dated the date of issuance and delivery of the 2006 Bonds, between the Authority and the Gas Supplier, as the same may be amended and supplemented.

“Gas Supply Agreement” means the Natural Gas Purchase Agreement, dated as of June 1, 2006 between the Authority and the City, as the same may be amended and supplemented.

“Generally Accepted Accounting Principles” means generally accepted accounting principles applied on a consistent basis set forth in the opinions and pronouncements of the Accounting Principles Board of the American Institute of Certified Public Accountants applicable to a government-owned utility applying all statements and interpretations issued by the Governmental Accounting Standards Board and statements and pronouncements of the



Financial Accounting Standards Board which are not in conflict with the statements and interpretations issued by the Governmental Accounting Standards Board or in such other statements by such other entity as may be approved by a significant segment of the accounting profession, that are applicable to the circumstances as of the date of determination.

“Guarantee” means the Guarantee, to be dated the date of issuance and delivery of the 2006 Bonds, from Citigroup Inc. to the Authority, as the same may be supplemented and amended, and shall include any successor or additional guarantee, surety or other security for the obligations of Citigroup Inc. thereunder and/or the obligations of the Gas Supplier under the Gas Purchase Agreement.

“Independent Certified Public Accountant” means any firm of certified public accountants selected by the Authority which is independent pursuant to the Statement on Auditing Standards No. 1 of the American Institute of Certified Public Accountants.

“Interest Rate Protection Agreement” means the 2006 Swap Agreement or any other interest rate swap, cap or collar agreement or similar arrangement between the Authority or the City and a financial institution, providing for the transfer or mitigation of interest rate risks either generally or under specific contingencies, which in the case of the City shall only include any such agreement under which the obligations of the City are payable solely from the Electric System Revenues.

“Initial Liquidity Facility” means each of (i) the Standby Bond Purchase Agreement, to be dated the date of issuance and delivery of the 2006B Bonds between the Authority and Citibank, N.A., relating to the 2006B Bonds and (ii) the Standby Bond Purchase Agreement, to be dated the date of issuance and delivery of the 2006C Bonds, between the Authority and Citibank, N.A., relating to the 2006C Bonds.

“Interest Accrual Date” means, for any Weekly Interest Rate Period, the first day thereof, and thereafter, the first Wednesday of each month during that Weekly Interest Rate Period.

“Light and Power Fund” means the Light and Power Department Fund established pursuant to Ordinance No. 950 of the City (codified as Section 2.65 of the City Administrative Code) and shall include any successor or replacement fund established by the City for the collection of revenues and the payment of expenses of the Electric System.

“Liquidity Facility” means the Initial Liquidity Facility and any other letter of credit, standby bond purchase agreement, line of credit, loan, guaranty or similar agreement of a Liquidity Facility Provider by a Liquidity Facility Provider to provide liquidity support to pay the Purchase Price of a 2006B Bond or 2006C Bonds tendered for purchase in accordance with the provisions of the Indenture, and any Alternate Liquidity Facility, with terms that are not inconsistent with the terms of the Indenture and which is approved in writing by the Insurer.

“Liquidity Provider” means Citibank, N.A., and any other provider of a Liquidity Facility approved in writing by the Insurer and its successors and permitted assigns, and, upon the effective date of an Alternate Liquidity Facility, the bank or banks or other financial institution or financial institutions or other person or persons issuing such Alternate Liquidity Facility, their successors and assigns. If any Alternate Liquidity Facility is issued by more than one bank, financial institution or other person, notices required to be given to the Liquidity Provider may be given to the bank, financial institution or other Person under such Alternate Liquidity Facility appointed to act as agent for all such banks, financial institutions or other persons.

“Long-Term Interest Rate” means, with respect to the 2006B or 2006C Bonds, a term, non-variable interest rate.

“Master Indenture” means the Indenture of Trust, dated as of June 1, 2006, between the Authority and the Trustee.

“Maximum Rate” means, except with respect to a Series of the 2006 Bonds in an ARS Interest Rate Period and Bank Bonds, the rate of 12% per annum, calculated for each Interest Rate Period as provided in the First Supplemental Indenture.

“MMBtu” means one million (1,000,000) Btu.

“Moody’s” means Moody’s Investors Service, Inc., or any successor thereto.

“Net Payment” means with respect to a Qualified Swap Agreement, the amount payable by the Authority on each scheduled payment date under such Qualified Swap Agreement net of the amount payable by the counterparty under such Qualified Swap Agreement on such scheduled payment date.

“Notice of Bank Purchase” means a written notice from the Tender Agent to the Bank requesting the Bank provide funds for the purchase of tendered and unremarketed 2006B Bonds or 2006C Bonds.

“Operation and Maintenance Expenses” mean the costs paid or incurred by the City for operating and maintaining the Electric System including, but not limited to (a) all costs of electric energy and power generated or purchased by the City for resale, costs of transmission, fuel supply and water supply in connection with the foregoing; (b) all costs and expenses of management of the Electric System; (c) all costs and expenses of maintenance and repair, and other expenses necessary or appropriate in the judgment of the City to maintain and preserve, the Electric System in good repair and working order; (d) all administrative costs of the several departments of the City that are charged directly or apportioned to the operation or maintenance of the Electric System, such as salaries and wages (including retirement benefits) of employees, overhead, taxes (if any) and insurance premiums; (e) payments in-lieu of taxes to the City or any other public agency in connection with the Electric System; (f) all costs, expenses and charges of the City required to be paid by it to comply with the terms of any Issuing Instrument authorizing the issuance of Obligations (as such terms are defined in the City Bond Indenture), such as compensation, reimbursement and indemnification of the trustee, remarketing agent, broker-dealer or auction agent or fees and expenses of Independent Certified Public Accountants and other consultants; (g) the fees, expenses and indemnification of Credit Providers and Reserve Guaranty Providers (as such terms are defined in the City Bond Indenture); (h) all amounts required to be paid by the City under contracts with a joint powers agencies for the purchase of capacity, rights in an electric generating station or electric transmission facilities, transmission capability or any other commodity right, or service in connection with the Electric System, which contracts require payments to be made by the City thereunder to be treated as operation and maintenance expenses of the Electric System; (i) all deposits to be made to a rebate fund established with respect to Bonds issued under the City Bond Indenture to provide for any rebate to the United States required to maintain the tax-exempt status of interest on bonds issued under the City Bond Indenture; (j) any cost or expense paid by the City to comply with requirements of law applicable to the Electric System or the City’s ownership or operation thereof or in any capacity with respect thereto or any activity in connection therewith, including without limitation the Public Benefits uses required by Section 385 of the California Public Utilities Code; and (k) any other cost or expense which, in accordance with Generally Accepted Accounting Principles, is to be treated as a cost of operating or maintaining the Electric System; but excluding in all cases depreciation, replacement and obsolescence charges or reserves therefor, and amortization of intangibles. Except as provided in clause (d) or clause (e) of this paragraph, no transfer of Electric System Revenues to the City shall constitute an Operation and Maintenance Expense.

“Outstanding” when used as of any particular time with respect to Bonds, means, except with respect to Bonds owned or held by or for the account of the Authority or the City, all Bonds theretofore or thereupon being issued by the Authority, except (a) Bonds theretofore cancelled or surrendered for cancellation; (b) Bonds paid or deemed to be paid pursuant to Article IX of the Master Indenture; and (c) Bonds in lieu of or in substitution for which replacement Bonds have been issued.

“Owner” means, with respect to a Bond, the registered owner of such Bond as set forth in the Bond Register.

“Participants” means, with respect to a Securities Depository for Book-Entry Bonds, those participants listed in such Securities Depository’s book-entry system as having an interest in such Bonds.

“Permitted Minimum Bond Insurer Rating” means a debt, claims paying or financial strength rating by Moody’s of Aa3 (or its equivalent) or higher, by S&P of AA- (or its equivalent) or higher and by Fitch of AA- (or its equivalent) or higher.

“Person” means an individual, corporation, firm, association, partnership, trust or other legal entity or group of entities, including a governmental entity or any agency or political subdivision thereof.

“Prepayment” means the prepayment of the purchase price of the Gas Supply using the proceeds of the 2006 Bonds.

“Prime Rate” means the rate established by the Bank from time to time as its prime rate; the Bank may lend to its customers at rates that are at, above or below the Prime Rate.

“Purchase Date” means the date on which 2006B Bonds or 2006C Bonds are to be purchased pursuant to an optional or mandatory tender.

“Purchase Period” means the period from the effective date of each Liquidity Facility to and including the earlier of the close of business on (a) the Expiration Date of such Liquidity Facility, (b) the date on which no Eligible Bonds are Outstanding, or (c) the date on which the applicable Available Commitment and the Bank’s obligation to purchase Eligible Bonds has been terminated in its entirety pursuant to the applicable Liquidity Facility.

“Purchase Price” means the purchase price to be paid to the Owners of 2006B Bonds or 2006C Bonds purchased pursuant to the terms of the Indenture, which shall be equal to the principal amount thereof tendered for purchase, plus accrued interest from the immediately preceding Interest Accrual Date to the Purchase Date (if the Purchase Date is not a date between a Record Date and the related Interest Payment Date, both dates inclusive).

“Principal Office” means, (i) with respect to the Remarketing Agent, the address for the Remarketing Agent designated in the Remarketing Agreement; and (ii) with respect to the Tender Agent, the office thereof designated in writing to the Authority, the Trustee and the Remarketing Agent.

“Public Finance Contract” means (i) any contract with a Qualified Counterparty providing for payments based on levels of, or changes in, interest rates, currency exchange rates, stock or other indices, (ii) any contract with a Qualified Counterparty to exchange cash flows or a series of payments, or (iii) any contract with a Qualified Counterparty to hedge payment, currency, rate spread or similar exposure, including but not limited to interest, any interest rate swap agreement, currency swap agreement, forward payment conversion agreement or futures contract, any contract providing for payments based on levels of, or changes in, interest rates, currency exchange rates, stock or other indices, any contract to exchange cash flows or a series of payments, or any contract, including, without limitation, an interest rate floor or cap, or an option, put or call, to hedge payment, currency, rate, spread or similar exposure, between the Authority and a Qualified Counterparty.

“Purchased Gas” means the natural gas purchased by the Authority from the Gas Supplier pursuant to the Gas Purchase Agreement and sold by the Authority to the City pursuant to the Supply Agreement.

“Qualified Counterparty” means, with respect to a Public Finance Contract, an entity as to which one of the following criteria are satisfied at the time of entering into the applicable Public Finance Contract and each transaction thereunder: (i) the long-term, unenhanced obligations of the entity are rated at least A3 by Moody’s and A- by S&P; or (ii) the obligations of the entity under the applicable contract are unconditionally guaranteed by an entity the long-term, unenhanced obligations of which are rated at least A3 by Moody’s and A- by S&P.

“Qualified Swap Agreement” means: (i) the 2006 Swap Agreement; and (ii) a Public Finance Contract between the Authority and a Qualified Counterparty with the consent of the Insurer and as to which the Authority’s payment obligations are payable as Swap Payments.

“Qualified Swap Fund” means the Vernon Natural Gas Financing Authority Revenue Bonds (Vernon Gas Project) Qualified Swap Fund established pursuant to the Indenture.

“Qualified Swap Payment” means any payment to be made by the City to the Trustee, as assignee of the of the Authority’s rights with respect thereto, in satisfaction of all amounts payable by the Authority pursuant to each

Qualified Swap Agreement, including the 2006 Swap Agreement, on or before the date such payment is due, including without limitation Net Payments and Termination Payments.

“Rating Agency” means Moody’s, Fitch or S&P.

“Record Date” means the Business Day immediately preceding the next Interest Payment Date.

“Related Document” means any of the Liquidity Facilities, the 2006B Bonds, the 2006C Bonds, the Master Indenture, the First Supplemental Indenture, the Remarketing Agreement, the Policy, the Gas Purchase Agreement, the Supply Agreement, the 2006 Swap Agreement, the Letter of Representations of the City, and any exhibits, instruments or agreements relating thereto, as the same may be amended from time to time in accordance with their respective terms and the terms of the related Liquidity Facility.

“Reserved Rights” means the Authority’s rights under the Supply Agreement to payment of certain fees and expenses and to notices, indemnities, consultations, approvals, consents and opinions.

“S&P” means Standard & Poor’s Ratings Services, a Division of The McGraw-Hill Companies, Inc., or any successor thereto.

“Securities Depository” means a trust company or other entity which provides a book-entry system for the registration of ownership interests of Participants in securities and which is acting as security depository for Book-Entry Bonds.

“Series” means Bonds issued at the same time or sharing some other common term or characteristic and designated in the Supplemental Indenture pursuant to which such Bonds were issued as a separate series of Bonds.

“Supply Agreement Event of Default” means the occurrence and continuation of one or more of the events of default under the Supply Agreement.

“Tendered Bond” means any 2006B Bond or 2006C Bond tendered or deemed tendered for purchase under the Indenture.

“Termination Payment” means, with respect to a Qualified Swap Agreement, including the 2006 Swap Agreement, the amount payable by or to the Authority as a result of the termination of such Qualified Swap Agreement prior to its scheduled expiration date, and any other amount due under such Qualified Swap Agreement which is not a Net Payment. Termination Payments received by the Authority shall be used to fund a Qualified Replacement Swap unless the Credit Provider otherwise agrees, in which case such Termination Payments shall be Revenues.

“2006 Swap Agreement” means the transaction entered into pursuant to that certain Master Agreement, dated as of June 27, 2006, as supplemented by the Schedule and the Credit Support Annex thereto, and evidenced by the five Confirmations, each dated June 27, 2006, and each between the Authority and Citibank, N.A., New York.

“Trust Estate” means, subject to the provisions of the Indenture permitting the application thereof for the purposes and on the terms and conditions set forth therein (i) the Electric System Revenues; (ii) all amounts on deposit in the funds and accounts held by the Trustee under the Indenture, other than the Rebate Fund, including the investments, if any, thereof; (iii) all of the Authority’s right, title and interest in and to the Supply Agreement other than Reserved Rights; and (iv) subject to the rights of the City in the Gas Purchase Agreement and the Guarantee pursuant to the Supply Agreement, all of the Authority’s right, title and interest in and to the Purchased Gas, the Gas Purchase Agreement and the Guarantee.

“Undelivered Bond” means, with respect to each of the 2006B Bonds and 2006C Bonds and each Purchase Date therefor, each Tendered Bond of such Series subject to purchase on such Purchase Date as to which Proper Delivery of such Tendered Bond to the Tender Agent is not made on such Purchase Date; provided, however, no such Tendered Bond shall be considered an Undelivered Bond on such Purchase Date unless the Tender Agent holds

sufficient available moneys in trust for the Owners of the Tendered Bonds of the applicable Series to pay in full the Purchase Price of all the Tendered Bonds of such Series due on such Purchase Date.

“Variable Rate Bonds” means any Bond, the interest rate on which to the maturity thereof is not established at a rate which is not subject to fluctuation or subsequent adjustment, either at the time of issuance of such Bond or some subsequent date.

“Weekly Interest Rate” means a variable interest rate for the 2006B and 2006C Bonds established in the manner described under “THE 2006B BONDS AND 2006C BONDS - Determination of the Weekly Interest Rate.”

“Weekly Interest Rate Period” means each period during which Weekly Interest Rates are in effect.

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## APPENDIX D

### SUMMARY OF CERTAIN PROVISIONS OF THE INDENTURE

*The following is a brief summary of certain provisions of the Indenture not previously discussed in this Official Statement. Such summary is not intended to be definitive, and reference is made to the Indenture in its entirety for the complete terms thereof. Capitalized terms used in this summary which are not otherwise defined in this Official Statement have the meanings ascribed to such terms in the Indenture.*

**Authorization of Bonds.** The Master Indenture provides certain terms and conditions upon which Bonds of the Authority to be designated as “Vernon Natural Gas Financing Authority Revenue Bonds (Vernon Gas Project)” may be issued from time to time as authorized by Supplemental Indentures. The aggregate principal amount of Bonds which may be executed, authenticated and delivered under the Indenture is not limited except as may hereafter be provided in the Indenture or as may be limited by law.

**Bonds Constitute Special Bonds.** The Bonds shall not constitute a charge against the general credit of the Authority but shall constitute and evidence special obligations of the Authority payable as to principal, Redemption Price and interest solely from the Revenues and the other funds pledged therefor under the Master Indenture and, with respect to any particular Series of Bonds, from such other sources as shall be specified in the Supplemental Indenture authorizing the issuance of such Series. The Purchase Price for the Bonds of any Series which are Tender Bonds shall be payable from such sources as are specified in the Supplemental Indenture authorizing the issuance of such Series. The provisions of the Indenture shall not preclude the payment or redemption of Bonds, at the election of the Authority, from any other legally available funds. The Bonds are not secured by a legal or equitable pledge of, or lien or charge upon, any property of the Authority or any of its income or receipts except the Revenues and the other funds pledged therefor pursuant to the Indenture, which pledge is subject to the provisions of the Indenture permitting the application of the Revenues and such other funds for the purposes and on the terms and conditions set forth in the Indenture. Neither the faith and credit nor the taxing power of the State, the Authority, the City or any other public agency is pledged to the payment of the principal, Redemption Price or Purchase Price of, or the interest on, the Bonds. The issuance of the Bonds shall not directly, indirectly or contingently obligate the Authority, the State or any political subdivision thereof, including the City, to levy or pledge any form of taxation or to make any appropriation for the payment of the Bonds. The payment of the principal, Redemption Price or Purchase Price of, or interest on, the Bonds does not constitute a debt, liability or obligation of the State or any public agency, including the City (other than the special obligation of the Authority as provided in the Indenture).

**No Recourse on Bonds.** None of the members of the Authority, the members of the Board of Directors of the Authority, any person executing a Bond, or any officer or employee of the Authority shall be liable personally for the principal, Redemption Price or Purchase Price of, or interest on, the Bonds or be subject to any personal liability or accountability by reason of the issuance of the Bonds or in respect of any undertaking by the Authority under the Indenture.

**Indenture to Constitute Contract.** In consideration of the purchase and acceptance of each Bond issued under the Indenture by those who shall own the same from time to time, the provisions of each Bond and the provisions of the Indenture applicable to such Bond, and unless otherwise provided in the Supplemental Indenture authorizing such Bond, the provisions of the Act and any other laws of the State applicable to such Bond or the Indenture shall be deemed to be and shall constitute a contract between the Authority and the Owner of such Bond.

**General Provisions for Issuance of Bonds.** All (but not less than all) the Bonds of each Series shall be upon the receipt by the Trustee of the following items (upon which the Trustee may conclusively rely in determining whether the conditions precedent for the issuance and authentication of such Series of Bonds have been satisfied): An executed counterpart of the Master Indenture, as amended to the date of the initial delivery of such Series of Bonds, and an executed counterpart of the Supplemental Indenture authorizing the issuance of such Series of Bonds, which Supplemental Indenture shall specify the specific terms of such Series of Bonds, including the purpose of issuing such Series which shall be one of the following: (i) making the Prepayment, (ii) paying the cost of additional gas under the Acquisition Agreement to be sold to the City under the Agreement, and (iii) refunding all or a portion of the Outstanding Bonds; (b) an Opinion of Bond Counsel to the effect that the Master Indenture, as amended and

supplemented to the date of issuance of such Series of Bonds, constitutes the valid and binding Bonds of the Authority; (c) with respect to any Bonds other than the 2006 Series Bonds, the Trustee shall have received the written request of an Authorized City Representative to issue such Series of Bonds for the purpose and in the principal amount set forth in the Supplemental Indenture authorizing such Series; (d) with respect to any each Series of Bonds other than the 2006 Series Bonds, any necessary Amendments to the Security Documents; and (e) such further documents, moneys and securities as are required by the Supplemental Indenture authorizing the issuance of such Series of Bonds. After the original issuance of Bonds of any Series, no Bonds of such Series shall be issued except in lieu of or in substitution for other Bonds of such Series pursuant to the Indenture.

**Bank Bonds.** Notwithstanding any other provision contained in the Indenture to the contrary, Bonds which are Bank Bonds shall have terms and conditions, including terms of maturity, payment, prepayment and interest rate, as shall be specified in the applicable Bank Agreement and Supplemental Indenture.

**Termination of Book-Entry Program.** In the event that the resignation or removal of a Securities Depository has become effective pursuant to Section 3.04(g), then the Authority shall thereupon discontinue the current book-entry program for the Book-Entry Bonds with such Securities Depository. In such event, the Authority shall cause the Trustee to obtain from the former Securities Depository a list showing the interests of the Participants in the Book-Entry Bonds and shall cause such Book-Entry Bonds to be surrendered to the Trustee on or before the date any replacement Bonds are to be issued. Furthermore, in such event the Authority determines to use a substitute Securities Depository, the Authority shall so notify the Trustee. If, prior to the termination of the current Securities Depository's book-entry system for the Book-Entry Bonds, the Authority fails to identify another qualified Securities Depository to replace the current Securities Depository, then the Book-Entry Bonds shall no longer be required to be registered in the name of a Securities Depository or its Nominee and the Authority shall issue, and the Trustee shall authenticate, replacement Bonds in the appropriate amounts and in whatever name or names the Owners of the Book-Entry Bonds shall designate pursuant to the Representation Letter with the former Securities Depository. In the event the Authority determines that the Beneficial Owners of the Bonds shall be able to obtain physical Bonds through a Securities Depository, the Authority may notify the Participants identified by the Securities Depository as having an interest in the Bonds of the availability of such physical Bonds and the Trustee shall authenticate, transfer and exchange Bonds as required by the Securities Depository in the appropriate names and amounts, which shall be in Authorized Denominations.

**Bond Register.** The Trustee shall keep or cause to be kept, at its Principal Office, the Bond Register for the registration and transfer of the Bonds of each Series which shall at all times be open to inspection during regular business hours by the Authority, and, upon presentation for such purpose, the Trustee shall, under such reasonable regulations as it may prescribe, register or transfer or cause to be registered or transferred on said Bond Register, Bonds of each Series as provided in the Indenture.

The Authority and the Trustee may rely on the address of the Owner of each Bond as it appears on the Bond Register for any and all purposes. It shall be the duty of the Owner of each Bond to give written notice to the Trustee of any change in the Owner's address so that the Bond Register may be revised accordingly.

**Interchangeability of Bonds.** Upon surrender of a Bond at the Principal Office of the Trustee, together with a written instrument of transfer satisfactory to the Trustee and duly executed by the Owner or the Owner's attorney duly authorized in writing, may, at the option of the Owner thereof, and upon payment by such Owner of any charges which the Trustee may make as provided in the Indenture, be exchanged for an equal aggregate principal amount of Bonds of the same Series, Subseries (if applicable), terms and maturity of any other Authorized Denominations; provided that the Trustee shall not be required to make any such exchange within fifteen days of the selection of Bonds for redemption or with respect to any Bonds selected for redemption.

**Negotiability, Transfer and Registry.** Each Bond shall be transferable only upon the Bond Register, upon surrender thereof, together with a written instrument of transfer satisfactory to the Trustee, duly executed by the Owner or the Owner's attorney duly authorized in writing; provided that the Trustee shall not be required to make any such transfer within fifteen days of the selection of Bonds for redemption or with respect to any Bonds selected for redemption. Upon the transfer of any Bond, the Authority shall execute and the Trustee shall authenticate, deliver and register in the Bond Register in the name of the transferee a new Bond or Bonds of the same aggregate principal amount, Series, Subseries (if applicable), terms and maturity as the surrendered Bond.



**Regulations With Respect to Exchanges and Transfers.** Subject to the terms of a Representation Letter with a Securities Depository for Book-Entry Bonds, in all cases in which the privilege of exchanging Bonds or transferring Bonds is exercised, the Authority shall execute and the Trustee shall authenticate and deliver Bonds in accordance with the provisions of the Indenture relating to such Bonds. All Bonds surrendered in any such exchanges or transfers shall forthwith be delivered to the Trustee and cancelled by the Trustee. Unless the Supplemental Indenture relating to such Bonds provides that such transfer or exchange shall be made without charge to the Owner, for every such exchange or transfer of Bonds, whether temporary or definitive, the Authority or the Trustee may make a charge sufficient to reimburse it for any tax, fee or other governmental charge required to be paid and any other cost incurred by the Authority or the Trustee with respect to such exchange or transfer.

**Bonds Mutilated, Destroyed, Stolen or Lost.** Subject to the terms of a Representation Letter with a Securities Depository for Book-Entry Bonds, if any Bond becomes mutilated or is lost, stolen or destroyed, the Authority may execute and the Trustee shall authenticate and deliver a new Bond of like date of Series, Subseries (if applicable), maturity, principal amount and terms as the Bond so mutilated, lost, stolen or destroyed; provided that (i) in the case of such mutilated Bond, such Bond is first surrendered to the Trustee, (ii) in the case of any such lost, stolen or destroyed Bond, there is first furnished evidence of such loss, theft or destruction satisfactory to the Trustee together with indemnity satisfactory to the Trustee, (iii) all other reasonable requirements of the Authority and the Trustee are complied with, and (iv) expenses in connection with such transaction are paid by the Owner. Any Bond surrendered for exchange shall be cancelled. Any such new Bond issued pursuant to the Indenture in substitution for a Bond alleged to be destroyed, stolen or lost shall constitute original additional contractual Bonds on the part of the Authority, whether or not the Bond so alleged to be destroyed, stolen or lost be at any time enforceable by anyone, and shall be equally payable from the Trust Estate on a parity with and entitled to equal and proportionate benefits with, all other Bonds.

**Pledge of Trust Estate.** Subject to the application thereof on the terms and conditions provided in the Indenture, to secure the Secured Obligations according to their respective tenor, purport and effect, the Authority hereby irrevocably grants a lien on and a security interest in, and pledges, the Trust Estate to the Trustee, for the benefit of the Owners of the Outstanding Bonds, including Bank Bonds, each issuer of a Bank Agreement, each issuer of a Debt Service Reserve Fund Surety Bond and each counterparty under a Qualified Swap Agreement. The lien on and security interest in and pledge of the Trust Estate granted and made in the Indenture shall constitute a first pledge of and charge and lien upon the Trust Estate, shall immediately attach and be effective, binding, and enforceable against the Authority, its successors, purchasers of any of the Trust Estate, creditors, and all others asserting rights in the Indenture to the extent set forth in, and in accordance with, the Indenture, irrespective of whether those parties have notice of the lien on, security interest in and pledge of the Trust Estate and without the need for any physical delivery, recordation, filing or further act. The grant of a lien on and security interest in, and pledge of, the Trust Estate pursuant to the Indenture is made pursuant to Chapter 5.5 of Division 6 of Title 1 (commencing with Section 5450) of the Government Code of the State.

**Funds.** The Indenture or upon redemption or upon acceleration, of the Secured Obligations, there are hereby establishes the following funds, to be held and maintained by the Trustee and applied as provided in the Indenture: the Vernon Natural Gas Financing Authority Revenue Bonds (Vernon Gas Project) Revenue Fund; the Vernon Natural Gas Financing Authority Revenue Bonds (Vernon Gas Project) Rebate Fund; the Vernon Natural Gas Financing Authority Revenue Bonds (Vernon Gas Project) Debt Service Fund, consisting of the Interest Account and the Principal Account; the Vernon Natural Gas Financing Authority Revenue Bonds (Vernon Gas Project) Redemption Fund; the Vernon Natural Gas Financing Authority Revenue Bonds (Vernon Gas Project) Debt Service Reserve Fund; the Vernon Natural Gas Financing Authority Revenue Bonds (Vernon Gas Project) Credit Enhancement Fund; and the Vernon Natural Gas Financing Authority Revenue Bonds (Vernon Gas Project) Qualified Swap Fund.

**Revenue Fund.** The Revenue Fund is described under “SECURITY AND SOURCES OF PAYMENT - Application of Amounts in the Revenue Fund.”

**Rebate Fund.** The Trustee shall apply amounts in the Rebate Fund to the payment when due of the Rebate Requirements as provide in the Indenture. Within the Rebate Fund, the Trustee shall maintain such accounts as shall be directed by the Authority as necessary in order for the Authority and the City to comply with the terms and requirements of the Tax Agreement. Subject to the transfer provisions provided in the Indenture, all money at any

time deposited in the Rebate Fund shall be held by the Trustee in trust, to the extent required to satisfy the Rebate Requirement, for payment to the United States of America, and none of the Authority, the City or the Owners shall have any rights in or claim to such moneys. All amounts deposited into or on deposit in the Rebate Fund shall be governed by the Indenture, by the tax covenants of the Agreement and by the Tax Agreement.

**Debt Service Fund.** The Trustee shall apply amounts in the Principal Account to the payment when due of the principal and Sinking Fund Installment redemption (or payment at maturity) of the Outstanding Bonds. The Trustee shall apply amounts in the Interest Account to the payment when due of interest on the Outstanding Bonds. In the event that Bonds of a Series, Subseries (if applicable) and maturity for which Sinking Fund Installments are established are purchased or redeemed at the option of the Authority and such purchased or optionally redeemed Bonds are deposited with the Trustee for credit against any such Sinking Fund Installments not less than forty-five (45) days prior to the due date for any Sinking Fund Installment for such Bonds, such deposit shall satisfy (to the extent of 100% of the principal amount of such Bonds) any obligation of the Authority to make a payment to the Trustee with respect to such Sinking Fund Installments.

**Redemption Fund.** Moneys in the Redemption Fund shall be applied to the payment when due of the Redemption Price of the Bonds to be redeemed and, except as otherwise provided in the Indenture, shall be used only for that purpose. If, after all of the Bonds designated for redemption on a specified date have been redeemed and cancelled, there are moneys remaining in the Redemption Fund with respect to the Bonds to be redeemed on such date, said moneys shall be transferred to the Accounts in the Debt Service Fund specified by the Authority; provided, however, that if said moneys are part of the proceeds of Bonds said moneys shall be applied as provided in the Supplemental Indenture authorizing the issuance of such Bonds.

**Debt Service Reserve Fund.** If on any date on which the principal of or, in connection with a redemption from Sinking Fund Installments the Redemption Price of, or interest on, Bonds is due, the amount in the applicable Account in the Debt Service Fund available for such payment is less than the amount of the principal and Redemption Price of and interest on the Bonds due on such date, the Trustee shall apply amounts from the Debt Service Reserve Fund to the extent necessary to make good the deficiency.

In the event of the refunding of one or more Bonds (or portions thereof), the Trustee shall, upon the written direction of an Authorized Authority Representative, withdraw from the Debt Service Reserve Fund any or all of the amounts on deposit in the Indenture (excluding Reserve Financial Guaranties) and deposit such amounts with itself as Trustee to be held for the payment of the principal or Redemption Price, if any, of, and interest on, the Bonds (or portions thereof) being refunded; provided that such withdrawal shall not be made unless (a) immediately thereafter the Bonds (or portions thereof) being refunded shall be deemed to have been paid pursuant to the Indenture, and (b) the amount remaining in the Debt Service Reserve Fund after such withdrawal, taking into account any deposits to be made in the Debt Service Reserve Fund in connection with such refunding, shall not be less than the Debt Service Reserve Requirement.

In lieu of the deposits and transfers to the Debt Service Reserve Fund required by the Indenture, the Authority may cause to be deposited in the Debt Service Reserve Fund a Reserve Financial Guaranty or Reserve Financial Guaranties in an amount equal to the difference between the Debt Service Reserve Requirement and the sums, if any, then on deposit in the Debt Service Reserve Fund or being deposited in such Fund concurrently with such Reserve Financial Guaranty or Guaranties. The Trustee shall draw upon or otherwise take such action as is necessary in accordance with the terms of the Reserve Financial Guaranties to receive payments with respect to the Reserve Financial Guaranties (including the giving of notice as required under the Indenture) on any date on which moneys shall be required to be withdrawn from the Debt Service Reserve Fund and applied to the payment of principal or Redemption Price of, or interest on, any Bonds and such withdrawal cannot be met by amounts on deposit in the applicable accounts in the Debt Service Reserve Fund and as otherwise provided in the Indenture.

If at any time the obligations insured or issued by a Reserve Guaranty Provider shall no longer maintain the required ratings set forth in the definition of "Reserve Financial Guaranty" in the Indenture, the Authority shall provide or cause to be provided cash or a substitute Reserve Financial Guaranty meeting such requirements to the extent necessary to satisfy the Debt Service Reserve Requirement with either cash, qualified Reserve Financial Guaranties or a combination thereof.

**Credit Enhancement Fund.** Subject to the priorities established in the Indenture, moneys in the Credit Enhancement Fund shall be applied to the payment of the amounts that are due and payable under each Bank Agreement to the extent not paid as principal of or interest on related Bank Bonds and, except as otherwise provided in the Indenture, shall be used only for that purpose. If, after the payment of all amounts that are due and payable under each Bank Agreement, there are moneys remaining in the Credit Enhancement Fund, said moneys shall be transferred to the Accounts in the Debt Service Fund specified by the Authority; provided, however, that if said moneys are part of the proceeds of Bonds said moneys shall be applied as provided in the Supplemental Indenture authorizing the issuance of such Bonds.

**Qualified Swap Fund.** Moneys in the Qualified Swap Fund shall be applied to the payment of the amounts that are due and payable by the Authority under each Qualified Swap Agreement, including Net Payments or Termination Payments, and, except as otherwise provided in the Indenture, shall be used only for that purpose. If, after the payment of all amounts that are due and payable by the Authority under each Qualified Swap Agreement, there are moneys remaining in the Qualified Swap Fund, said moneys shall be transferred to the Accounts in the Debt Service Fund specified by the Authority; provided, however, that if said moneys are part of the proceeds of Bonds said moneys shall be applied as provided in the Supplemental Indenture authorizing the issuance of such Bonds.

**Investment of Certain Funds.** In the absence of any written investment directions from an Authorized City Representative, the Trustee shall, unless otherwise provided in the Indenture, invest moneys in the Funds and Accounts held by the Trustee under the Indenture, other than the Rebate Fund, in money market funds described in clause (d) of the definition of "Permitted Investments." Moneys held in the Revenue Fund, the Debt Service Fund, the Redemption Fund, the Credit Enhancement Fund and the Qualified Swap Fund shall be invested and reinvested by the Trustee to the fullest extent practicable in securities described in clauses (a) through (c) of the definition of "Permitted Investments" in the Indenture which mature not later than such times as shall be necessary to provide moneys when reasonably expected to be needed for payments to be made from such Funds. Moneys held in the Debt Service Reserve Fund shall be invested and reinvested by the Trustee to the fullest extent practicable in securities described in clauses (a), (b), (c), (g), (j) and (m) of the definition of "Permitted Investments" in the Indenture which mature, or which may be drawn upon, not later than such times as shall be necessary to provide moneys when reasonably expected to be needed for payments to be made from such Fund, but, except for investments which permit the Trustee to make withdrawals without penalty, at any time upon not more than two Business Days notice, to provide moneys for payments to be made from such Fund to the Debt Service Fund, not later than five years from the time of such investment. Moneys held in the Rebate Fund may be as provided in the Tax Agreement.

Interest or other income (net of that which (i) represents a return of accrued interest paid in connection with the purchase of any investment or (ii) is required to effect the amortization of any premium paid in connection with the purchase of any investment) earned on any moneys or investments in the Funds created under the Indenture shall be transferred to the Interest Account; provided that no such transfer shall be made from the Debt Service Reserve Fund to the extent the amount remaining in the Debt Service Reserve Fund would be less than the Debt Service Reserve Requirement. In making an investment in any Permitted Investments with moneys in any Fund established under the Indenture, the Trustee may combine such moneys with moneys in any other Fund but solely for the purposes of making such investment in such Permitted Investments and provided that any amount so combined shall be separately accounted for.

## COVENANTS OF THE AUTHORITY

**Compliance with Indenture.** The Authority covenants not to issue any bonds, notes, debentures, or other evidences of indebtedness or incur any payment obligations, payable out of or secured by a pledge or assignment of the Trust Estate or any portion thereof, nor shall it create or cause to be created any lien or charge on the Trust Estate or any portion thereof prior to or on a parity with the lien of the pledge made pursuant to the Indenture to secure the payment of the Secured Obligations; provided, however, that nothing contained in the Indenture shall prevent the Authority from issuing, if and to the extent permitted by law, bonds, notes, or other evidences of indebtedness payable out of, or secured by a pledge and assignment of, the Revenues to be derived on and after such date as the pledge of the Revenues made pursuant to the Indenture shall be discharged and satisfied as provided in the Indenture or payable from and secured by Revenues on a basis which shall be, and shall be expressed, to be in all

respects junior and subordinate in all respects to the payment of amounts then due with respect to the Secured Obligations or otherwise payable under the Indenture.

Security Documents. The Authority shall receive and forthwith deposit in the Revenue Fund all amounts payable to it pursuant to the Security Documents or payable to it pursuant to any other contract related to its interest in the Security Documents. The Authority shall enforce or cause to be enforced the provisions of the Security Documents and duly perform its covenants and agreements under the Indenture. The Authority shall not waive any provision of any Security Document or take any action to interfere with or impair the pledge and assignment under the Indenture of Revenues and the assignment to the Trustee of rights under the Security Documents assigned to the Trustee under the Indenture, or the Trustee's enforcement of any such rights under the Indenture, or consent or agree to or permit any rescission of or amendment to, or otherwise take any action under or in connection with, any Security Document which shall in any manner materially impair or materially adversely affect the rights of the Authority under the Indenture, in each case without the prior written consent of each Provider; however, nothing in the Indenture shall be construed so as to prohibit any other amendment of the Security Documents.

Payment of Principal and Interest. The Authority shall punctually pay, but only from the Trust Estate, the principal of and interest on every Bond issued under the Indenture at the times and places and in the manner provided in the Indenture and in the Bonds according to the true intent and meaning thereof. All such payments shall be made by the Trustee as provided in the Indenture. When and as paid in full, all Bonds shall be delivered to the Trustee and shall forthwith be cancelled by the Trustee, who shall deliver a certificate evidencing such cancellation to the Authority and, if requested, the City the Trustee may retain or destroy such cancelled Bonds.

Extension or Funding of Claims for Interest. In order to prevent any accumulation of claims for interest after maturity, the Authority covenants not to, directly or indirectly, extend or assent to the extension of the time for the payment of any claim for interest on any of the Bonds, and not to, directly or indirectly, be a party to or approve any such arrangement by purchasing or funding such claims or in any other manner. In case any such claim for interest shall be extended or funded, whether or not with the consent of the Authority, such claim for interest so extended or funded shall not be entitled, in case of default under the Indenture, to the benefits of the Indenture, except subject to the prior payment in full of the principal of all of the Bonds then Outstanding and of all claims for interest which shall not have been so extended or funded.

Arbitrage Covenants. The Authority covenants with all Persons who hold or at any time held Bonds that the Authority will not directly or indirectly use the proceeds of any of the Bonds or any other funds of the Authority or permit the use of the proceeds of any of the Bonds or any other funds of the Authority or take or omit to take any other action which will cause any of the Bonds to be "arbitrage bonds" or otherwise subject to federal income taxation by reason of Sections 103 and 141 through 150 of the Code and any applicable regulations promulgated thereunder. To that end the Authority covenants to comply with all covenants set forth in the Tax Agreement, which is incorporated in the Indenture by reference as though fully set forth in the Indenture.

Notwithstanding any provisions of the Indenture or the Agreement, if the City shall provide to the Authority and the Trustee an Opinion of Bond Counsel that any specified action required under the Indenture, the Agreement or the Tax Agreement which respect to the Tax-Exempt nature of interest on the Bonds is no longer required or that some further or different action is required to maintain the Tax-Exempt status of interest on the Bonds, the City, the Trustee and the Authority may conclusively rely on such opinion in complying with the requirements of its tax covenants and the covenants under the Indenture shall be deemed to be modified to that extent.

Further Assurances. Whenever and so often as requested so to do by the Trustee, the Authority covenants to promptly execute and deliver or cause to be executed and delivered all such other and further instruments, documents or assurances, and promptly do or cause to be done all such other and further things, as may be necessary or reasonably required in order to further and more fully vest in the Trustee and the Owners all of the rights, interests, powers, benefits, privileges and advantages conferred or intended to be conferred upon them by the Indenture and to perfect and maintain as perfected such rights, interests, powers, benefits, privileges and advantages.

Amendments Permitted. (a) Subject to the provisions of sections (d) and (e) below and to the receipt of the consent of the Insurer, the provisions of the Indenture and the rights and obligations of the Authority and of the

Owners of the Outstanding Bonds and of the Trustee may be modified, amended or supplemented by a Supplemental Indenture or Supplemental Indentures, with the written consent of each Credit Provider whose consent is required by a Supplemental Indenture or a Credit Agreement, when the written consent of the Owners of at least a majority in aggregate principal amount of the Bonds then Outstanding shall have been filed with the Trustee; or if less than all of the Outstanding Bonds are affected, the written consent of the Owners of at least a majority in aggregate principal amount of all affected Outstanding Bonds; provided that if such modification, amendment or supplement shall, by its terms, not take effect so long as any Bonds of any particular Series and maturity remain Outstanding, and, with respect to Bonds which are Tender Bonds if the conditions of section (d) below are satisfied, the consent of the Owners of such Bonds shall not be required and such Bonds shall not be deemed to be Outstanding for the purpose of any the calculation of Outstanding Bonds for purposes of the Indenture. No such modification, amendment or supplement shall (1) reduce the aforesaid percentage of Bonds the consent of the Owners of which is required to effect any such modification, amendment or supplement without the consent of the Owners of all of the Bonds then Outstanding; or (2) modify the rights or Bonds of the Trustee without the consent of the Trustee.

It shall not be necessary for the consent of the Owners to approve the particular form of any Supplemental Indenture, but it shall be sufficient if such consent shall approve the substance thereof. Prior to the entry into any Supplemental Indenture by the Authority and the Trustee for any of the purposes of this Section, the Authority shall cause notice of the proposed Supplemental Indenture to be mailed, by first class mail, postage prepaid, to the Owners of all Outstanding Bonds (or the affected Outstanding Bonds) at their addresses appearing on the Bond Register. Such notice shall briefly set forth the nature of the proposed Supplemental Indenture and shall state that copies thereof are on file at the office of the Trustee for inspection by each Owner of an Outstanding Bond.

Whenever, at any time after the date of the mailing of notice of the proposed entry into a Supplemental Indenture pursuant to this subsection, the Authority shall have received an instrument or instruments in writing executed in accordance with the Indenture by or on behalf of the Owners of not less than a majority in aggregate principal amount of the Bonds then Outstanding, or if less than all of the Outstanding Bonds are affected, by the Owners of not less than a majority in aggregate principal amount of the affected Outstanding Bonds, which instrument or instruments shall refer to the proposed Supplemental Indenture described in the notice of the proposed Supplemental Indenture and shall consent to such Supplemental Indenture in substantially the form referred to in such notice, thereupon, but not otherwise, the Authority and the Trustee may enter into such Supplemental Indenture in substantially such form, without liability or responsibility to any Owner of any Bond, whether or not such Owner shall have consented thereto.

(b) The Indenture may be supplemented from time to time and at any time by a Supplemental Indenture or Supplemental Indentures, which the Authority and the Trustee may enter into with the consent of each Credit Provider whose consent is required by a Supplemental Indenture or a Credit Agreement but without the consent of the Owner of any Bond, to provide for the issuance of a Series of additional Bonds or refunding Bonds in accordance with the terms and conditions of the Indenture, and establishing the terms and conditions thereof, including the rights of any Credit Provider for such additional Bonds or refunding Bonds, which may include permitting such Credit Provider to act for and on behalf of the Owners of such Bonds for any or all purposes of the Indenture except that no such Credit Provider shall be authorized to extend the fixed maturity of any Bond, or reduce the principal amount thereof, or reduce the amount of any Sinking Fund Installment therefor, or extend the due date of any such Sinking Fund Installment, or reduce the rate of interest on any Bond or extend the time of payment of interest thereon, without the consent of the Owner of each Bond so affected; or except as otherwise provided with respect to a Bond constituting a Tender Bond in the Supplemental Indenture authorizing such Bond and subject to the satisfaction of the conditions of section (f) below, reduce the Redemption Price due on the redemption of any Bond or change the date or dates when any Bond is subject to redemption.

(c) The Indenture and the rights and obligations of the Authority, the Trustee and the Owners of the Outstanding Bonds may also be modified, amended or supplemented by a Supplemental Indenture, which the Authority and the Trustee may enter into with the consent of each Credit Provider whose consent is required by a Supplemental Indenture or a Credit Agreement but without the consent of any Owners of Bonds (but with the consent of any affected Trustee), so long as such modification, amendment or supplement shall not materially, adversely affect the interests of the Owners of the Outstanding Bonds, including without limitation, for any one or more of the following purposes: to add to the covenants and agreements of the Authority contained in the Indenture

other covenants and agreements thereafter to be observed, to pledge, provide or assign any security for the Secured Obligations (or any portion thereof), or to surrender any right or power in the Indenture reserved to or conferred upon the Authority; to make such provisions for the purpose of curing any ambiguity, inconsistency or omission, or of curing or correcting any defective provision, contained in the Indenture, or in regard to matters or questions arising under the Indenture, as the Authority may deem necessary or desirable; or to modify, amend or supplement the Indenture in such manner as to permit the qualification of the Indenture under the Trust Indenture Act of 1939, as amended, or any similar federal statute hereafter in effect, and to add such other terms, conditions and provisions as may be permitted by said act or similar federal statute.

(d) Notwithstanding anything to the contrary in the Indenture, the provisions of the Indenture may also be modified, amended or supplemented, including amendments which would otherwise be described in section (a) above, without the consent of the Owners of Bonds constituting Tender Bonds if either (i) the effective date of such Supplemental Indenture is a date on which such Bonds are subject to mandatory tender for purchase pursuant to the Indenture or (ii) the notice described in section (a) above is given to Owners of such Bonds at least thirty (30) days before the effective date of such Supplemental Indenture, and on or before such effective date, the Owners of such Bonds have the right to demand purchase of such Bonds pursuant to the Indenture.

(e) If the Supplemental Indenture authorizing the issuance of a Series of Bonds provides that a Credit Provider for all or any portion of the Bonds of such Series shall have the right to consent to Supplemental Indentures which require the consent of the Owners of the Bonds of such Series pursuant to the Indenture, then for the purposes of sending notice of any proposed Supplemental Indenture and for determining whether the Owners of the requisite percentage of Bonds have consented to such Supplemental Indenture, but subject to the provisions of subsection (b) of the Indenture, references to the Owners of such Bonds shall be deemed to be to the applicable Credit Provider. The First Supplemental Indenture provides that the Insurer has the right to consent to Supplemental Indentures which require the consent of the Owners of the 2006 Bonds.

(f) For purposes of the Indenture, it shall not be necessary that consents of the Owners of any particular percentage of Outstanding Bonds of any affected Series be obtained but it shall be sufficient if the consent of the Owners of a majority in aggregate principal amount of the combination of affected Outstanding Bonds shall be obtained.

(g) For purposes of the Indenture, Bonds owned or held by or for the account of the Authority or the City, or any funds of the Authority or the City, shall not be deemed Outstanding for the purpose of consent or other action or any calculation of Outstanding Bonds, and neither the Authority nor the City shall be entitled with respect to such Bonds to give any consent or take any other action provided for in the Indenture as an Owner of Bonds. At the time of any consent or other action taken under the Indenture, the Authority shall furnish the Trustee a certificate upon which the Trustee may rely, describing all Bonds so to be excluded.

**Effect of Supplemental Indenture.** Upon the Authority and the Trustee entering into any Supplemental Indenture pursuant to the Indenture, the Indenture shall be deemed to be modified, amended or supplemented in accordance therewith, and the respective rights, duties and obligations under the Indenture of the Authority, the Trustee and all Owners of Outstanding Bonds shall thereafter be determined, exercised and enforced subject in all respects to such modification, amendment and supplement, and all the terms and conditions of any such Supplemental Indenture shall be deemed to be part of the terms and conditions of the Indenture for any and all purposes. Upon the Authority and the Trustee entering into any Supplemental Indenture pursuant to the Indenture, no Owner of any Bond shall have any right to object to the entry into such Supplemental Indenture by the Authority and the Trustee, or to object to any of the terms and provisions contained in the Indenture or the operation thereof or in any manner to question the propriety of the entry into such Supplemental Indenture, or to enjoin or restrain the Authority or the Trustee from entering into the same or to enjoin or restrain the Authority or the Trustee from taking any action pursuant to the provisions thereof whether or not such Owner gave his consent to such Supplemental Indenture.

**Discharge of Indenture.** If the Authority shall pay, or cause to be paid, or there shall otherwise be paid, to the Owners of all Bonds the principal amount or Redemption Price, if applicable, of the Bonds, and interest due on the Bonds, at the times and in the manner stipulated in the Indenture and in the Indenture, together with all other sums payable by the Authority under the Indenture and the Bank Agreements, including all fees and expenses of the

Trustee, then and in that case the Indenture, and the pledge of and lien on the Trust Estate under the Indenture and all covenants, agreements and obligations of the Authority contained in the Indenture, shall cease and terminate and shall be completely discharged and satisfied and the Authority shall be released therefrom and the Trustee shall assign and transfer to or upon the order of the City all property and all funds (in excess of the amounts required for the foregoing) then held by the Trustee under the Indenture free and clear of any liens or encumbrances pursuant to the Indenture and shall execute such documents as may be reasonably required by the Authority in this regard.

**Bonds Deemed Paid.** (a) Bonds (or portions of Bonds) for the payment or redemption of which moneys shall have been set aside and shall be held in trust by the Trustee (through deposit pursuant to a deposit of funds for such payment or redemption or otherwise) at the maturity or redemption date thereof, as applicable, shall be deemed to have been paid within the meaning and with the effect expressed in section (c) below.

(b) Any Outstanding Bond (or any portion thereof such that both the portion thereof which is deemed paid and the portion which is not deemed paid pursuant to the Indenture shall be in an Authorized Denomination) shall prior to the maturity or redemption date thereof be deemed to have been paid within the meaning and with the effect expressed in subsection (c) below (except as provided in section (d) below) if (i) in case said Bond (or portion thereof) is to be redeemed on any date prior to maturity, the Authority shall have given the Trustee irrevocable instructions to give notice of redemption of such Bond (or portion thereof) on said date as provided in the Indenture, (ii) there shall have been deposited with the Trustee either moneys constituting Available Amounts in an amount which shall be sufficient, or Defeasance Securities purchased with Available Amounts, the principal of and the interest on which when due shall provide moneys which, together with the other moneys, if any, held by the Trustee for such purpose, shall be sufficient, in each case as evidenced by an Accountant's Certificate, to pay when due the principal amount of, and any redemption premiums on, said Bond (or portion thereof) and interest due and to become due on said Bond (or portion thereof) on and prior to the redemption date or maturity date thereof, as the case may be, and (iii) if such Bond (or portion thereof) is not to be paid or redeemed within 60 days of the date of the deposit required by (ii) above, the Authority shall have given the Trustee, in form satisfactory to it, instructions to mail, as soon as practicable, by first class mail, postage prepaid, to the Owner of such Bond, at the last address, if any, appearing upon the Bond Register, a notice that the deposit required by (ii) above has been made with the Trustee and that said Bond (or the applicable portion thereof) is deemed to have been paid in accordance with the Indenture and stating such maturity or redemption date upon which moneys are to be available for the payment of the principal amount of, and any redemption premiums on, said Bond. Any notice given pursuant to clause (iii) of this section (b) with respect to Bonds which constitute less than all of the Outstanding Bonds of any Series, Subseries and maturity shall specify the letter and number or other distinguishing mark of each such Bond. Any notice given pursuant to clause (iii) of this subsection (b) with respect to less than the full principal amount of a Bond shall specify the principal amount of such Bond which shall be deemed paid pursuant to the Indenture and notify the Owner of such Bond that such Bond must be surrendered as provided in the Indenture. The receipt of any notice required by the Indenture shall not be a condition precedent to any Bond being deemed paid in accordance with the Indenture and the failure of any Owner to receive any such notice shall not affect the validity of the proceedings for the payment of Bonds in accordance with the Indenture. Neither Defeasance Securities nor moneys deposited with the Trustee pursuant to the Indenture, nor principal or interest payments on any such Defeasance Securities, shall be withdrawn or used for any purpose other than, and shall be held in trust for, the payment of the principal amount of, and any redemption premiums on, said Bonds and the interest thereon; provided that any cash received from principal or interest payments on such Defeasance Securities deposited with the Trustee, (A) to the extent such cash shall not be required at any time for such payment, as evidenced by an Accountant's Certificate, shall be paid over upon the written direction of an Authorized Authority Representative, including a transfer to the Authority free and clear of any trust, lien, pledge or assignment securing said Bonds, and (B) to the extent such cash shall be required for such payment at a later date, shall, to the extent practicable, at the written direction of an Authorized Authority Representative, be reinvested in Defeasance Securities maturing at times and in amounts, which together with the other funds to be available to the Trustee for such purpose, shall be sufficient to pay when due the principal amount of, and any redemption premiums on, said Bonds and the interest to become due on said Bonds on and prior to such redemption date or maturity date thereof, as the case may be, as evidenced by an Accountant's Certificate.

(c) Upon the deposit with the Trustee, in trust, at or before maturity or the applicable redemption date, of money or Defeasance Securities in the necessary amount (as provided in the Indenture) to pay or redeem a Bond (or a portion thereof), and to pay the interest thereto to such maturity or redemption date, as applicable, and making

provision for the giving of the notices required by the Indenture, all liability of the Authority in respect of such Bonds shall cease, terminate and be completely discharged, and the pledge of and lien on the Trust Estate under the Indenture and all covenants, agreements and obligations of the Authority contained in the Indenture for the benefit of such Bond (or the applicable portion thereof) shall cease and terminate and shall be completely discharged and satisfied and the Authority shall be released therefrom except that the Authority shall remain liable for such payment but only from, and the Owners shall thereafter be entitled only to payment (without interest accrued thereon after such redemption date or maturity date, as applicable) out of, the money and Defeasance Securities deposited with the Trustee for their payment as provided in the Indenture; provided that no Bond which constitutes a Covered Tender Bond shall be deemed to be paid within the meaning of the Indenture unless the Purchase Price of such Bond, if tendered for purchase in accordance with the Indenture, could be paid when due from such moneys or Defeasance Securities (as evidenced by an Accountant's Certificate) or a Bank Facility is provided in connection with such Purchase Price.

(d) Notwithstanding the termination, satisfaction and discharge of the Indenture in respect of any Bonds, those provisions of the Indenture relating to the maturity of the Bonds, interest payments and dates thereof, tender and exchange provisions, exchange and transfer of Bonds, replacement of mutilated, destroyed, lost or stolen Bonds, the safekeeping and cancellation of Bonds, nonpresentation of Bonds, compliance by the Authority of the tax covenants contained in the Indenture and the duties of the Trustee in connection with all of the foregoing, shall remain in effect and shall be binding upon the Authority, the Trustee and the Owners and the Trustee shall continue to be obligated to hold in trust any monies and investments then held by the Trustee for the payment of the principal or Redemption Price of, and interest on, the Bonds, to pay to the Owners, but only from the monies and investments so held by the Trustee, the principal or Redemption Price of, and interest on, the Bonds as and when such payment becomes due.

(e) Prior to the defeasance of any Bond constituting a Variable Rate Bond becoming effective under the Indenture, the Trustee shall have received a Rating Confirmation from each Rating Agency.

(f) Nothing in the Indenture shall prevent the Authority from substituting for the Defeasance Securities held for the payment or redemption of Bonds (or portions thereof) other Defeasance Securities which, together with the moneys held by the Trustee for such purpose, as evidenced by an Accountant's Certificate, shall be sufficient to pay when due the principal amount of, and any redemption premiums on, the Bonds (or portions thereof) to be paid or redeemed, and the interest due on the Bonds (or portions thereof) to be paid or redeemed at the times established with the initial deposit of Defeasance Securities for such purpose; provided that the Authority shall deliver to the Trustee a Favorable Opinion of Bond Counsel with respect to such substitution.

(g) If there shall be deemed paid pursuant to the Indenture less than the full principal amount of a Bond, the Authority shall execute and the Trustee shall authenticate and deliver, upon the surrender of such Bond, without charge to the Owner of such Bond, a new Bond or Bonds for the principal amount of the Bond so surrendered which is deemed paid and another new Bond or Bonds for the balance of the principal amount of the Bond so surrendered, in each case of like Series, Subseries maturity and other terms, and in any of the Authorized Denominations.

**Events of Default.** Each of the following shall constitute an Event of Default under the Indenture: if default shall be made in the payment of the interest on any Outstanding Bond when and as the same shall become due and payable, whether on an Interest Payment Date or otherwise; if default shall be made in the payment of the principal or Redemption Price of any Outstanding Bond when and as the same shall become due and payable, whether at the stated maturity thereof, or upon proceedings for redemption thereof or upon the maturity thereof by declaration; if default shall be made by the Authority in the performance or observance of any other of the covenants, agreements or conditions on its part in the Indenture or in the Outstanding Bonds contained, and such default shall continue for a period of 60 days after written notice thereof to the Authority by the Trustee or to the Authority and to the Trustee by a Credit Provider or the Owners of not less than 10% in principal amount of the Bonds Outstanding; provided, however, if such default is such that it can be corrected by the Authority but not within the applicable period specified above, it shall not constitute an Event of Default if corrective action is instituted by the Authority within thirty (30) days of the Authority's receipt of the notice of the default required by this paragraph and diligently pursued until the default is corrected but in no event shall this period exceed 120 days;



an Agreement Event of Default shall have occurred and be continuing; or an Event of Default under the Insurance Agreement.

**Right to Accelerate Maturity Upon Default.** Notwithstanding anything contrary in the Indenture or in the Bonds, upon the occurrence and continuance of an Event of Default, the Trustee may, with the consent of each Credit Provider whose consent is required by a Supplemental Indenture or a Credit Agreement, and shall, at the direction of the Owners of a majority in principal amount of Outstanding Bonds (other than Bonds owned by or on behalf of the Authority or the City) by written notice to the Authority, with the consent of each Credit Provider whose consent is required by a Supplemental Indenture or a Credit Agreement, declare the principal of the Outstanding Bonds to be immediately due and payable, whereupon the principal of the Outstanding Bonds thereby coming due and the interest thereon accrued to the date of payment shall, without further action, become and be immediately due and payable.

**Enforcement Proceedings.** If an Event of Default under the Indenture shall happen and shall not have been remedied, then and in every such case, the Trustee, by its agents and attorneys, may, with the consent of each Credit Provider whose consent is required by a Supplemental Indenture or a Credit Agreement, proceed, and upon the written request of the Owners of not less than a majority in principal amount of the Bonds at the time Outstanding, with the consent of each Credit Provider whose consent is required by a Supplemental Indenture or a Credit Agreement, shall proceed, to protect and enforce its rights and the rights of the Owners of the Outstanding Bonds by a suit or suits in equity or at law, whether for damages or the specific performance of any covenant contained in the Indenture, to enforce the security interest in, pledge of and lien on the Trust Estate granted pursuant to the Indenture, or in aid of the execution of any power granted in the Indenture or any remedy granted under applicable provisions of the laws of the State, or for an accounting by the Authority as if the Authority were the trustee of an express trust, or in the enforcement of any other legal or equitable right as the Trustee, being advised by counsel, shall deem most effectual to enforce any of its rights or to perform any of its duties under the Indenture.

All rights of action under the Indenture may be prosecuted and enforced by the Trustee without the possession of any of the Bonds or the production thereof in the trial or other proceedings, and any such suit or proceedings instituted by the Trustee shall be brought in its own name as trustee of an express trust.

Upon commencing a suit at law or in equity or upon commencement of other judicial proceedings by the Trustee to enforce any right under the Indenture, the Trustee shall be entitled to exercise any and all rights and powers conferred in the Indenture and provided to be exercised by the Trustee upon the occurrence of any Event of Default.

Regardless of the happening of an Event of Default, the Trustee shall have power to, but unless requested in writing to proceed by the Owners of a majority in principal amount of the Bonds then Outstanding or a Credit Provider (which has the authority to make such request pursuant to a Supplemental Indenture or a Credit Agreement) and unless furnished with reasonable security and indemnity, shall be under no obligation to, institute and maintain such suits and proceedings as it may be advised shall be necessary or expedient to prevent any impairment of the security under the Indenture by any acts which may be unlawful or in violation of the Indenture, and such suits and proceedings as the Trustee may be advised shall be necessary or expedient to preserve or protect its interests and the interests of the Owners of the Bonds.

If the Trustee or any Owner or Owners of Outstanding Bonds have instituted any proceeding to enforce any right or remedy under the Indenture and such proceeding has been discontinued or abandoned for any reason, or has been determined adversely to the Trustee or to such Owner or Owners, then and in every such case the Authority, the Trustee and the Owners shall, subject to any determination in such proceeding, be restored severally and respectively to their former positions under the Indenture, and thereafter all rights and remedies of the Trustee and the Owners shall continue as though no such proceeding had been instituted.

**Remedies Not Exclusive.** No remedy by the terms of the Indenture conferred upon or reserved to the Trustee or the Owners of the Bonds is intended to be exclusive of any other remedy, but each and every such remedy shall be cumulative and shall be in addition to every other remedy given under the Indenture or existing at law or in equity or by statute whether effective on or after the effective date of the Master Indenture. The assertion

or employment of any right or remedy, under the Indenture or otherwise, shall not prevent the concurrent assertion or employment of any other appropriate right or remedy.

**Restriction on Owner's Action.** Except as otherwise provided in paragraph (b) below, no Owner of any Bond shall have any right to institute any suit, action or proceeding at law or in equity for the enforcement of any provision of the Indenture or the execution of any trust under the Indenture or for any remedy under the Indenture unless such Owner shall have previously given to the Trustee written notice of the happening of an Event of Default, as provided in the Indenture, and the Owners of at least 25% in principal amount of the Bonds then Outstanding shall have filed a written request with the Trustee, and shall have offered it reasonable opportunity, either to exercise the powers granted in the Indenture or by the applicable laws of the State or to institute such action, suit or proceeding in its own name, and unless such Owners shall have offered to the Trustee adequate security and indemnity against the costs, expenses and liabilities to be incurred in the Indenture or thereby, and the Trustee shall have refused to comply with such request for a period of 60 days after receipt by it of such notice, request and offer of indemnity, it being understood and intended that no one or more Owners of Bonds shall have any right in any manner whatever by his or their action to affect, disturb or prejudice the pledge created by the Indenture, or to enforce any right under the Indenture, except in the manner in the Indenture provided; and that all proceedings at law or in equity to enforce any provision of the Indenture shall be instituted, had and maintained in the manner provided in the Indenture and for the ratable benefit of all Owners of the Outstanding Bonds, subject only to the provisions of the Indenture relating to the extension of claims for interest on Bonds.

Nothing in the Indenture or in the Bonds contained shall affect or impair the obligation of the Authority, which is absolute and unconditional, to pay on the respective due dates thereof and at the places in the Indenture expressed, but solely from the Revenues and the other security pledged under the Indenture, the principal amount, or Redemption Price if applicable, of the Bonds, and the interest thereon, to the respective Owners thereof, or affect or impair the right, which is also absolute and unconditional, of any Owner to institute suit for the enforcement of any such payment.

**Notice of Default.** The Trustee shall, within thirty (30) days after obtaining knowledge thereof, mail written notice of the occurrence of any Event of Default of which the Trustee has knowledge to each Provider, each Reserve Guaranty Provider and each Owner of Bonds then Outstanding at such Owner's address, if any, appearing in the Bond Register.

**Waivers.** The Owners of not less than sixty percent in principal amount of the Bonds at the time Outstanding, or their attorneys-in-fact duly authorized, may on behalf of the Owners of all of the Bonds, waive any Event of Default and its consequences. No such waiver shall extend to any subsequent or Event of Default or impair any right consequent thereon.

**Providers.** Except as limited by the Indenture with respect to reduction in principal amounts of Bonds or the interest thereon and the modification of payment dates, a Supplemental Indenture authorizing a Series of Bonds may provide that any Credit Provider providing a Credit Facility with respect to Bonds of such Series may exercise any right under the Master Indenture or the Supplemental Indenture authorizing the issuance of such Series of Bonds given to the Owners of the Bonds to which such Credit Facility relates in lieu of such Owners. The First Supplemental Indenture provides that the Insurer may exercise any right under the Indenture given to the Owners of the 2006 Bonds in lieu of such Owners.

Anything in the Indenture to the contrary notwithstanding, all provisions under the Indenture authorizing the exercise of rights by a Provider with respect to Bonds, including without limitation actions relating to consents, approvals, directions, waivers, appointments and requests, shall be deemed not to require or permit such consents, approvals, directions, waivers, appointments, requests or other actions and shall be read as if the Provider were not mentioned in the Indenture (i) during any period during which there is a default by such Provider under the applicable Bank Facility or (ii) after the applicable Bank Facility shall at any time for any reason cease to be valid and binding on the Provider, or shall be declared to be null and void by final judgment of a court of competent jurisdiction, or after the Bank Facility has been rescinded, repudiated or terminated (other than in accordance with its terms), or after a receiver, conservator or liquidator has been appointed for the Provider; provided, however, that the payment of amounts due or that may become due (including without limitation all indemnity payments) to the Provider or any other Person identified under such Provider's Bank Agreement pursuant to the terms of the

Indenture and/or such Bank Agreement shall continue in full force and effect. The foregoing shall not affect any other rights of a Provider. In addition all provisions in the Indenture relating to the rights of a Provider shall be of no force and effect if there is no Bank Facility of such Provider in effect and all amounts owing to the Provider under the Bank Agreement have been paid.

**Unclaimed Moneys.** Anything in the Indenture to the contrary notwithstanding, any moneys held by the Trustee in trust for the payment and discharge of any of the Bonds which remain unclaimed for two years after the date when such Bonds have become due and payable, either at their stated maturity dates, tender for purchase or by call for redemption, if such moneys were held by the Trustee at such date, or for two years after the date of deposit of such moneys if deposited with the Trustee after the date when such Bonds, the Redemption Price or the Purchase Price thereof became due and payable, shall, at the written request of an Authorized City Representative be repaid by the Trustee to the City, as its absolute property and free and clear of any trust, lien, pledge or assignment securing said Bonds, and the Trustee shall thereupon be released and discharged with respect thereto and the Owners of such Bonds shall look only to the Electric Revenues of the City available for such purpose for the payment of such Bonds; provided, however, that before being required to make any such payment to the City, the Trustee shall, at the expense of the Authority, mail, postage prepaid to the Owners of such Bonds, at the last address, if any, appearing on the Bond Register a notice that said moneys remain unclaimed and that, after a date named in said notice, which date shall be not less than 30 days after the date of the mailing of such notice, the balance of such moneys then unclaimed shall be returned to the City.

#### **2006 Series Bond Insurance Provisions**

*Insurer Deemed Owner.* Notwithstanding any provision of the Indenture to the contrary, so long as the Insurer is not in default in its payment obligations under the Insurance Policies, the Insurer shall at all times be deemed the sole and exclusive Owner of the Outstanding 2006 Bonds for the purposes of all approvals, consents, waivers, institution of any action and the direction of all remedies; provided, however, that the Insurer shall not be deemed to be the sole and exclusive Owner of the Outstanding 2006 Bonds with respect to any amendment or supplement to the Indenture which seeks to amend or supplement the Indenture to extend the maturity of or reduce the amount of interest on or principal of any 2006 Bond or otherwise alter or impair the obligation of the Authority to pay principal or interest at the time and place and at the rate and in the currency provided therein.

*Third Party Beneficiary.* The Insurer is explicitly recognized as being a third party beneficiary under the Indenture and may enforce any right, remedy or claim conferred, given or granted under the Indenture.

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## APPENDIX E

### PROPOSED FORM OF OPINION OF BOND COUNSEL

*Upon delivery of the 2006 Bonds, Orrick, Herrington & Sutcliffe LLP, Bond Counsel, proposes to render its final opinion in substantially the following form:*

[ Date of Delivery ]

Board of Directors  
Vernon Natural Gas Financing Authority  
4305 Santa Fe Avenue  
Vernon, California 90058

Re: Vernon Natural Gas Financing Authority Variable Rate Revenue Bonds  
(Vernon Gas Project), 2006 Series A, 2006 Series B and 2006 Series C  
(Final Opinion)

Ladies and Gentlemen:

We have acted as bond counsel to the Vernon Natural Gas Financing Authority (the "Authority") in connection with the issuance of \$ \_\_\_\_\_ aggregate principal amount of its Variable Rate Revenue Bonds (Vernon Gas Project), 2006 Series A, \$ \_\_\_\_\_ aggregate principal amount of its Variable Rate Revenue Bonds (Vernon Gas Project), 2006 Series B and \$ \_\_\_\_\_ aggregate principal amount of its Variable Rate Revenue Bonds (Vernon Gas Project), 2006 Series C (collectively, the "2006 Bonds"). The 2006 Bonds have been issued pursuant to the provisions of Article 4 the Joint Exercise of Powers Act, constituting Chapter 5 of Division 7 of Title 1 the California Government Code, and an Indenture of Trust, as supplemented by the First Supplemental Indenture of Trust (collectively, the "Indenture"), each dated as of June 1, 2006 and each between the Authority and The Bank of New York Trust Company, N.A., as trustee (the "Trustee"). Capitalized terms not otherwise defined herein shall have the meanings ascribed thereto in the Indenture.

In such connection, we have reviewed the Indenture, the Natural Gas Purchase Agreement (the "Agreement"), dated as of June 1, 2006 between the Authority and the City of Vernon (the "City"), the Tax Agreement, dated the date hereof, relating to the 2006 Bonds (the "2006 Tax Agreement"), certificates of the Authority, the City, the Trustee and others, opinions of counsel to the Authority, the City, the Trustee and others, and such other documents, opinions and matters to the extent we deemed necessary to render the opinions set forth herein.

The Indenture provides that the 2006 Bonds are special obligations of the Authority payable solely from the Revenues, including payments by the City made pursuant to the Agreement, and the other funds pledged therefor pursuant to the Indenture. The Indenture further provides that the 2006 Bonds are not secured by a legal or equitable pledge of, or lien or charge upon, any property of the Authority or any of its income or receipts except the Revenues and the other funds pledged therefor pursuant to the Indenture. The Agreement provides that the City's payment obligations under the Agreement are special obligations payable solely from amounts in its Light and Power Department Fund.

The interest rate mode for each respective Series of the 2006 Bonds and certain agreements, requirements and procedures contained or referred to in the Indenture, the 2006 Tax Agreement and other relevant documents may be changed and certain actions (including, without limitation, defeasance of 2006 Bonds) may be taken or omitted under the circumstances and subject to the terms and conditions set forth in such documents. No opinion is expressed herein as to any 2006 Bond or the interest thereon if any such change occurs or action is taken or omitted upon the advice or approval of counsel other than ourselves.

The opinions expressed herein are based on an analysis of existing laws, regulations, rulings and court decisions and cover certain matters not directly addressed by such authorities. Such opinions may be affected by

actions taken or omitted or events occurring after the date hereof. We have not undertaken to determine or to inform any person whether any such actions are taken or omitted or events do occur or any other matters come to our attention after the date hereof. Our engagement with respect to the 2006 Bonds has concluded with their issuance, and we disclaim any obligation to update this letter. We have assumed the genuineness of all documents and signatures presented to us (whether as originals or as copies) and the due and legal execution and delivery thereof by, and validity against, any parties other than the Authority and, with respect to the Agreement, the City. We have assumed, without undertaking to verify, the accuracy of the factual matters represented, warranted or certified in the documents and certificates, and of the legal conclusions contained in the opinions, referred to in the second paragraph hereof. Furthermore, we have assumed compliance with all covenants and agreements contained in the Indenture, the Agreement and the 2006 Tax Agreement, including without limitation covenants and agreements compliance with which is necessary to assure that future actions, omissions or events will not cause interest on the 2006 Bonds to be included in gross income for federal income tax purposes. We call attention to the fact that the rights and obligations under the 2006 Bonds, the Indenture, the Agreement and the 2006 Tax Agreement and their enforceability may be subject to bankruptcy, insolvency, reorganization, arrangement, fraudulent conveyance, moratorium and other laws relating to or affecting creditors' rights, to the application of equitable principles, to the exercise of judicial discretion in appropriate cases and to the limitations on legal remedies against public entities in the State of California. We express no opinion with respect to any indemnification, contribution, penalty, choice of law, choice of forum or waiver provisions contained in the foregoing documents, nor do we express any opinion with respect to the state or quality of title to or interest in any of the assets described in or as subject to the lien of the Indenture or the accuracy of the description contained therein of, or the remedies available to enforce liens on, any of such assets. Finally, we undertake no responsibility for the accuracy, completeness or fairness of the Official Statement or other offering material relating to the 2006 Bonds and express no opinion with respect thereto.

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

1. The 2006 Bonds constitute valid and binding special obligations of the Authority.
2. The Indenture has been duly executed and delivered by, and constitutes the valid and binding obligation of, the Authority. The Indenture creates a valid pledge, to secure the payment of the principal of and interest on the 2006 Bonds, of the Trust Estate which pledge is on a parity with the pledge of the Trust Estate securing the payment of amounts due under Bank Agreements and Net Payments due under Qualified Swap Agreements and which pledge is subject to the provisions of the Indenture permitting the application of the Trust Estate for the purposes and on the terms and conditions set forth therein.
3. The Agreement has been duly executed and delivered by, and constitutes a valid and binding agreement of, the Authority and the City.
4. Interest on the 2006 Bonds is excluded from gross income for federal income tax purposes under section 103 of the Internal Revenue Code of 1986 and is exempt from State of California personal income taxes. Interest on the 2006 Bonds is not a specific preference item for purposes of the federal individual or corporate alternative minimum taxes, although we observe that it is included in adjusted current earnings when calculating corporate alternative minimum taxable income. We express no opinion regarding other tax consequences relating to the ownership or disposition of, or the accrual or receipt of interest on, the 2006 Bonds.

**APPENDIX F**

**SPECIMEN MUNICIPAL BOND INSURANCE POLICY**

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# FINANCIAL GUARANTY INSURANCE POLICY

## MBIA Insurance Corporation Armonk, New York 10504

Policy No. [NUMBER]

MBIA Insurance Corporation (the "Insurer"), in consideration of the payment of the premium and subject to the terms of this policy, hereby unconditionally and irrevocably guarantees to any owner, as hereinafter defined, of the following described obligations, the full and complete payment required to be made by or on behalf of the Issuer to [PAYING AGENT/TRUSTEE] or its successor (the "Paying Agent") of an amount equal to (i) the principal of (either at the stated maturity or by any advancement of maturity pursuant to a mandatory sinking fund payment) and interest on, the Obligations (as that term is defined below) as such payments shall become due but shall not be so paid (except that in the event of any acceleration of the due date of such principal by reason of mandatory or optional redemption or acceleration resulting from default or otherwise, other than any advancement of maturity pursuant to a mandatory sinking fund payment, the payments guaranteed hereby shall be made in such amounts and at such times as such payments of principal would have been due had there not been any such acceleration, unless the Insurer elects in its sole discretion, to pay in whole or in part any principal due by reason of such acceleration); and (ii) the reimbursement of a such payment which is subsequently recovered from any owner pursuant to a final judgment by a court of competent jurisdiction that such payment constitutes an avoidable preference to such owner within the meaning of any applicable bankruptcy law. The amounts referred to in clauses (i) and (ii) of the preceding sentence shall be referred to herein collectively as the "Insured Amounts." "Obligations" shall mean:

[PAR]

[LEGAL NAME OF ISSUE]

Upon receipt of telephonic or telegraphic notice, such notice subsequently confirmed in writing by registered or certified mail, or upon receipt of written notice by registered or certified mail, by the Insurer from the Paying Agent or any owner of an Obligation the payment of an Insured Amount for which is then due, that such required payment has not been made, the Insurer on the due date of such payment or within one business day after receipt of notice of such nonpayment, whichever is later, will make a deposit of funds, in an account with U.S. Bank Trust National Association, in New York, New York, or its successor, sufficient for the payment of any such Insured Amounts which are then due. Upon presentment and surrender of such Obligations or presentment of such other proof of ownership of the Obligations, together with any appropriate instruments of assignment to evidence the assignment of the Insured Amounts due on the Obligations as are paid by the Insurer, and appropriate instruments to effect the appointment of the Insurer as agent for such owners of the Obligations in any legal proceeding related to payment of Insured Amounts on the Obligations, such instruments being in a form satisfactory to U.S. Bank Trust National Association, U.S. Bank Trust National Association shall disburse to such owners, or the Paying Agent payment of the Insured Amounts due on such Obligations, less any amount held by the Paying Agent for the payment of such Insured Amounts and legally available therefor. This policy does not insure against loss of any prepayment premium which may at any time be payable with respect to any Obligation.

As used herein, the term "owner" shall mean the registered owner of any Obligation as indicated in the books maintained by the Paying Agent, the Issuer, or any designee of the Issuer for such purpose. The term owner shall not include the Issuer or any party whose agreement with the Issuer constitutes the underlying security for the Obligations.

Any service of process on the Insurer may be made to the Insurer at its offices located at 113 King Street, Armonk, New York 10504 and such service of process shall be valid and binding.

This policy is non-cancellable for any reason. The premium on this policy is not refundable for any reason including the payment prior to maturity of the Obligations.

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

IN WITNESS WHEREOF, the Insurer has caused this policy to be executed in facsimile on its behalf by its duly authorized officers, this [DAY] day of [MONTH, YEAR].

MBIA Insurance Corporation

\_\_\_\_\_  
President  
**SPECIMEN**

Attest:

\_\_\_\_\_  
Assistant Secretary

STD-R-CA-7  
01/05

ENDORSEMENT

Attached to Policy No. \_\_\_\_\_ (the "Policy") issued by the MBIA Insurance Corporation (the "Insurer"), to the Paying Agent, as defined in the Policy issued with respect to the Obligations:

[BOND CAPTION]

Notwithstanding the terms and conditions contained in the Policy, it is understood that (a) the Policy shall guarantee the full and complete payment required to be made by or on behalf of the Issuer to the Paying Agent of an amount equal to principal of and interest accrued on the Series 2006B Bank Bonds (as such terms are defined in the Series 2006B First Supplemental Indenture dated as of \_\_\_\_\_, 2006 (the "Indenture")) which are mandatorily redeemed in accordance with Section \_\_\_\_\_ of the Indenture; and (b) the Policy shall guarantee the payment of Differential Interest Amount (as defined in the Indenture) on the Series 2006B Bank Bonds no more frequently than once a month.

This Endorsement forms a part of the Policy, effective on the inception date of the Policy.

IN WITNESS WHEREOF, the Insurer has caused this Endorsement to be executed in facsimile on its behalf by its President and its Assistant Secretary, this \_\_\_\_ day of June 2006.

MBIA INSURANCE CORPORATION

By \_\_\_\_\_  
President  
Attest \_\_\_\_\_  
By \_\_\_\_\_  
Assistant Secretary

**SPECIMEN**

## APPENDIX G

### DESCRIPTION OF THE LIQUIDITY PROVIDER

#### CITIBANK, N.A.

Citibank, N.A. (“Citibank”) was originally organized on June 16, 1812, and now is a national banking association organized under the National Bank Act of 1864. Citibank is an indirect wholly-owned subsidiary of Citigroup Inc. (“Citigroup”), a Delaware holding company. As of March 31, 2006, the total assets of Citibank and its consolidated subsidiaries represented approximately 47% of the total assets of Citigroup and its consolidated subsidiaries.

The long term ratings of Citibank and its consolidated subsidiaries are Aa1, AA and AA+ by Moody’s, S&P and Fitch, respectively. The short term ratings of Citibank and its consolidated subsidiaries are A-1+, P-1 and F1+ by Moody’s, S&P and Fitch, respectively.

Citibank is a commercial bank that, along with its subsidiaries and affiliates, offers a wide range of banking and trust services to its customers throughout the United States and the world. As a national bank, Citibank is a regulated entity permitted to engage only in banking and activities incidental to banking. Citibank is primarily regulated by the Office of the Comptroller of the Currency (the “Comptroller”), which also examines its loan portfolios and reviews the sufficiency of its allowance for credit losses.

Citibank’s deposits at its U.S. branches are insured by the Federal Deposit Insurance Corporation (the “FDIC”) and are subject to FDIC insurance assessments. The Liquidity Facilities for the 2006B Bonds and the 2006C Bonds are not insured by the FDIC or any other regulatory agency of the United States or any other jurisdiction. Citibank may, under certain circumstances, be obligated for the liabilities of its affiliates that are FDIC-insured depository institutions.

Legislation enacted as part of the Omnibus Budget Reconciliation Act of 1993 provides that deposits in U.S. offices and certain claims for administrative expenses and employee compensation against a U.S. insured depository institution which has failed will be afforded a priority over other general unsecured claims, including deposits in non-U.S. offices and claims under non-depository contracts in all offices, against such an institution in the “liquidation or other resolution” of such an institution by any receiver. Such priority creditors (including the FDIC, as the subrogee of insured depositors) of such FDIC-insured depository institution will be entitled to priority over unsecured creditors in the event of a “liquidation or other resolution” of such institution.

For further information regarding Citibank, reference is made to the Annual Report on Form 10-K of Citigroup and its subsidiaries for the year ended December 31, 2005, and the Quarterly Report on Form 10-Q of Citigroup and its subsidiaries for the quarter ended March 31, 2006, filed by Citigroup with the Securities and Exchange Commission (the “SEC”). Further information regarding Citibank subsequent to December 31, 2005, will be included in the Form 10-Qs (quarterly) and Form 10-Ks (annually) subsequently filed by Citigroup with the SEC. Copies of such material may be obtained, upon payment of a duplicating fee, by writing to the SEC at 100 F Street, N.E., Washington, D.C. 20549. In addition, such reports are available at the SEC’s web site (<http://www.sec.gov>).

In addition, Citibank submits quarterly to the Comptroller certain reports called “Consolidated Reports of Condition and Income for a Bank With Domestic and Foreign Offices” (“Call Reports”). The Call Reports are on file with and publicly available at the Comptroller’s offices at 250 E Street, S.W., Washington, D.C. 20219 and are also available on the web site of the FDIC (<http://www.fdic.gov>). Each Call Report consists of a Balance Sheet, Income Statement, Changes in Equity Capital and other supporting schedules at the end of and for the period to which the report relates.

Any of the reports referenced above are available upon request, without charge, by writing or calling Citigroup Document Services, 140 58<sup>th</sup> Street, Brooklyn, New York 11220, (718) 765-6514.

The information contained in this Appendix G relates to and has been obtained from Citibank. The information concerning Citibank contained herein is furnished solely to provide limited introductory information regarding Citibank and does not purport to be comprehensive. Such information is qualified in its entirety by the detailed information appearing in the documents and financial statements referenced above.

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