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**MSRB**

**FORM G-36(OS) - FOR OFFICIAL STATEMENTS**

**MATERIALS SUBMITTED**

A. THIS FORM IS SUBMITTED IN CONNECTION WITH (check one):

1  A FINAL OFFICIAL STATEMENT RELATING TO A PRIMARY OFFERING OF MUNICIPAL SECURITIES (enclose two (2) copies)

(a) DATE RECEIVED FROM ISSUER: 06/22/2006

(b) DATE SENT TO MSRB: 06/22/2006

2 AN AMENDED OFFICIAL STATEMENT WITHIN THE MEANING OF RULE G-36(d) (enclose two (2) copies)

(a) DATE RECEIVED FROM ISSUER:

(b) DATE SENT TO MSRB:

B. IF MATERIALS SUBMITTED WITH THIS FORM CONSIST OF MORE THAN ONE DOCUMENT (e.g., preliminary official statement and wrap, even if physically attached), PLEASE CHECK HERE:

C. IF THIS FORM AMENDS PREVIOUSLY SUBMITTED FORM WITHOUT CHANGING MATERIALS SUBMITTED, PLEASE CHECK HERE (include copy of original Form G-36(OS)):

IF THIS SUBMISSION IS FOR COMMERCIAL PAPER, PLEASE CHECK HERE:

IF THIS SUBMISSION IS FOR MUNICIPAL FUND SECURITIES, PLEASE CHECK HERE:

**IDENTIFICATION OF ISSUES**

Each issue must be listed separately.

NAME OF ISSUER: County of San Diego Taxable Pension Obligation Bonds Series 2004B

STATE: CA

ISSUE DESCRIPTION: Series

DATED DATE: 08/15/2006

**CUSIP Information**

MSRB rule G-34 requires that CUSIP numbers be assigned to each new issue of municipal securities unless the issue is ineligible for CUSIP number assignment under the eligibility criteria of the CUSIP Service Bureau.

A. CUSIP-9 NUMBERS OF ISSUE

Maturity Date	CUSIP Number	Maturity Date	CUSIP Number	Maturity Date	CUSIP Number
08/15/2024	797398DU5				

B. IF ANY OF THE ABOVE SECURITIES HAS A "CUSIP-6" BUT NO "CUSIP-9", CHECK HERE AND LIST THEM BELOW: (Please see instructions in Form G-36 Manual)

LIST ALL CUSIP-6 NUMBERS ASSIGNED:

State the reason why such securities have not been assigned a 'CUSIP-9':

C. IF ANY OF THESE SECURITIES IS INELIGIBLE FOR CUSIP NUMBER ASSIGNMENT, PLEASE CHECK HERE:

State the reason why such securities are ineligible for CUSIP number assignment:

NAME OF ISSUER: County of San Diego Taxable Pension Obligation Bonds Series 2004B

STATE: CA

ISSUE DESCRIPTION: Series

DATED DATE: 08/15/2006

9-2

**CUSIP Information**

MSRB rule G-34 requires that CUSIP numbers be assigned to each new issue of municipal securities unless the issue is ineligible for CUSIP number assignment under the eligibility criteria of the CUSIP Service Bureau.

## A. CUSIP-9 NUMBERS OF ISSUE

Maturity Date	CUSIP Number	Maturity Date	CUSIP Number	Maturity Date	CUSIP Number
08/15/2024	797398DV3				

B. IF ANY OF THE ABOVE SECURITIES HAS A "CUSIP-6" BUT NO "CUSIP-9", CHECK HERE AND LIST THEM BELOW:  
(Please see instructions in Form G-36 Manual)

LIST ALL CUSIP-6 NUMBERS ASSIGNED:

State the reason why such securities have not been assigned a 'CUSIP-9':

C. IF ANY OF THESE SECURITIES IS INELIGIBLE FOR CUSIP NUMBER ASSIGNMENT, PLEASE CHECK HERE:

State the reason why such securities are ineligible for CUSIP number assignment:

**TRANSACTION INFORMATION**

- A. LATEST FINAL MATURITY DATE OF ALL SECURITIES IN OFFERING: 08/15/2024
- B. DATE OF FINAL AGREEMENT TO PURCHASE, OFFER OR SELL SECURITIES (Date of Sale): 06/15/2006
- C. ACTUAL OR EXPECTED DATE OF DELIVERY OF SECURITIES TO UNDERWRITER(S) (Bond Closing): 08/15/2006
- D. IF THESE SECURITIES ADVANCE REFUND ALL OR A PORTION OF ANOTHER ISSUE, PLEASE CHECK HERE:  
Form G-36(ARD) and copies of the advance refunding documents must be submitted for each issue advance refund.

**UNDERWRITING ASSESSMENT INFORMATION**

This information will be used by the MSRB to compute any rule A-13 underwriting assessment that may be due on this offering. The managing underwriter will be sent an invoice if a rule A-13 assessment is due on the offering.

- A. Managing Underwriter: Lehman Brothers SEC Reg Number: 8-12324
- B. TOTAL PAR VALUE OF ALL SECURITIES IN OFFERING: \$ 147,825,000.00
- C. PAR AMOUNT OF SECURITIES UNDERWRITTEN (if different from amount shown in item B above): \$
- D. CHECK ALL THAT APPLY:
- At the option of the holder thereof, all securities in this offering may be tendered to the issuer of such securities or its designated agent for redemption or purchase at par value or more at least as frequently as every nine months until maturity, earlier redemption, or purchase by the issuer or its designated agent.
  - At the option of the holder thereof, all securities in this offering may be tendered to the issuer of such securities or its designated agent for redemption or purchase at par value or more at least as frequently as every two years until maturity, earlier redemption, or purchase by the issuer or its designated agent.
  - This offering is exempt from SEC Rule 15c2-12 under section (d)(1)(i) of that rule. Section (d)(1)(i) of SEC Rule 15c2-12 states that an offering is exempt from the requirements of the rule if the securities offered have authorized denominations of \$100,000 or more and are sold to no more than 35 persons each of whom the participating underwriter believes: (1) has the knowledge and expertise necessary to evaluate the merits and risks of the investment; and (2) is not purchasing for more than one account, or with a view toward distributing the securities.

**MANAGING UNDERWRITER'S CERTIFICATION AND SIGNATURE**

THE SUBMITTER BELOW CERTIFIES THAT THE MATERIALS ACCOMPANYING THIS FORM ARE AS DESCRIBED ABOVE AND THAT ALL OTHER INFORMATION CONTAINED HEREIN IS TRUE AND CORRECT. THE SUBMITTER ACKNOWLEDGES THAT SAID MATERIALS WILL BE PUBLICLY DISSEMINATED.

ON BEHALF OF THE MANAGING UNDERWRITER IDENTIFIED ABOVE.

SIGNED: \_\_\_\_\_ SUBMITTED ELECTRONICALLY \_\_\_\_\_

Taxable (Federal)

Moody's: Aaa

Tax-Exempt (State of California)

Standard &amp; Poor's: AAA

Fitch : AAA

*In connection with the original issuance of the Series 2004B Bonds, Orrick, Herrington & Sutcliffe LLP, the 2004 Bond Counsel (the "2004 Bond Counsel"), delivered an opinion, dated June 29, 2004, that, based upon existing laws, regulations, rulings and court decisions, interest on the Series 2004B Bonds is exempt from State of California personal income taxes as in effect on June 29, 2004. Such opinion further stated that interest on the Series 2004B Bonds is not excluded from gross income for federal income tax purposes. The 2004 Bond Counsel expressed no opinion regarding any other tax consequences related to the ownership or disposition of, or the accrual or receipt of interest on, the Series 2004B Bonds. See "Tax Matters" herein.*

**\$147,825,000**

**COUNTY OF SAN DIEGO  
TAXABLE PENSION OBLIGATION BONDS  
SERIES 2004B**

**\$73,925,000 SERIES 2004B-1****\$73,900,000 SERIES 2004B-2**

Dated: Date of Delivery

Due: August 15, 2024

The County of San Diego (the "County") originally issued its Taxable Pension Obligation Bonds, Series 2004A, Taxable Pension Obligation Bonds, Series 2004B (the "Series 2004B Bonds") and Taxable Pension Obligation Bonds, Series 2004C on June 29, 2004 (the "Original Issue Date") in an aggregate principal amount of \$454,112,915.79 pursuant to Articles 10 and 11 (commencing with Section 53570) of Chapter 3, Division 2, Title 5 of the Government Code of the State of California and the Trust Agreement, dated as of January 1, 1994 (the "Original Trust Agreement"), as amended and supplemented by the First Supplemental Trust Agreement, dated as of September 1, 2002, and the Second Supplemental Trust Agreement, dated as of June 1, 2004, by and between the County and The Bank of New York Trust Company, N.A., as successor trustee (the "Trustee"). In connection with the interest rate conversion described herein, the Original Trust Agreement will be further amended and supplemented by the Third Supplemental Trust Agreement, dated as of August 1, 2006 (together with the Original Trust Agreement and the amendments and supplements thereto, the "Trust Agreement"), by and between the County and the Trustee.

The Series 2004B Bonds were originally issued as Auction Rate Securities and currently accrue interest at the Applicable Auction Rates established pursuant to the Auction Procedures, all as defined and set forth in the Trust Agreement. On August 15, 2006 (the "Fixed Rate Conversion Date"), the Series 2004B Bonds will convert from Auction Rate Securities to bonds bearing interest at fixed interest rates in accordance with the Trust Agreement. From the Fixed Rate Conversion Date through the stated maturity or prior redemption of the Series 2004B Bonds, interest on the Series 2004B Bonds will accrue at fixed interest rates and be payable semiannually on February 15 and August 15 of each year, commencing on February 15, 2007. See "The Series 2004B Bonds" herein.

The Series 2004B Bonds are fully registered bonds, registered in the name of Cede & Co., as nominee of The Depository Trust Company, New York, New York ("DTC") in the United States. DTC serves as securities depository of the Series 2004B Bonds. Individual purchases will be made in book-entry form only in denominations of \$5,000 principal amount or any integral multiple thereof. Purchasers will not receive certificates representing their beneficial ownership interest in the Series 2004B Bonds purchased. See Appendix F — "Book-Entry Only System and Global Clearance Procedures" attached hereto.

The Series 2004B Bonds are subject to optional and mandatory sinking fund redemption prior to maturity, as described herein under the caption "The Series 2004B Bonds."

The scheduled payment of principal of and interest on the Series 2004B Bonds when due is guaranteed under a financial guaranty insurance policy issued by XL Capital Assurance Inc. See "Bond Insurance" herein and Appendix G — "Specimen of 2004 Financial Guaranty Insurance Policy" attached hereto.



**The payments of interest and principal when due on the Series 2004B Bonds are obligations of the County imposed by law pursuant to the County Employees Retirement Law of 1937 (the "Retirement Law") and are absolute and unconditional, without any right of set-off or counterclaim. The Series 2004B Bonds do not constitute an obligation of the County for which the County is obligated or permitted to levy or pledge any form of taxation or for which the County has levied or pledged or will levy or pledge any form of taxation. Neither the Series 2004B Bonds nor the obligation of the County to make payments on the Series 2004B Bonds constitutes an indebtedness of the County, the State of California or any of its political subdivisions within the meaning of any Constitutional or statutory debt limitation or restriction. The Series 2004B Bonds are secured on a parity with the County's other outstanding taxable pension bonds and any additional bonds which hereafter may be issued under the Trust Agreement.**

This cover page contains information for quick reference only. It is not a summary of this issue. Potential purchasers must read the entire Reoffering Statement to obtain information essential to making an informed investment decision.

*The Series 2004B Bonds will be reoffered by the Remarketing Agents set forth below, subject to the approval of Orrick, Herrington & Sutcliffe LLP, Bond Counsel, and certain other conditions. Certain legal matters will be passed upon for the Remarketing Agents by their counsel, Hawkins Delafield & Wood LLP, Los Angeles, California and for the County by the County Counsel. It is anticipated that the reoffered Series 2004B Bonds will be delivered against payment therefor through DTC or Euroclear, as the case may be, on August 15, 2006.*

**Lehman Brothers**

**Citigroup**

**Backstrom McCarley Berry & Co., LLC**

**MATURITY SCHEDULE**  
**\$147,825,000**  
**COUNTY OF SAN DIEGO**  
**TAXABLE PENSION OBLIGATION BONDS**  
**Series 2004B**

<b>Subseries</b>	<b>Principal Amount</b>	<b>Maturity (August 15)</b>	<b>Interest Rate</b>	<b>Price</b>	<b>CUSIP*</b>	<b>ISIN</b>
B-1	\$73,925,000	2024	5.911%	100%	797398DU5	US797398DU51
B-2	\$73,900,000	2024	5.911	100	797398DV3	US797398DV35

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\* Copyright 2006, American Bankers Association. CUSIP data is provided by Standard & Poor's CUSIP Service Bureau, a Division of the McGraw-Hill Companies, Inc., and is set forth herein for convenience of reference only. The County and the Remarketing Agents do not assume responsibility for the accuracy of such numbers.

**COUNTY OF SAN DIEGO, STATE OF CALIFORNIA**

**COUNTY OF SAN DIEGO  
BOARD OF SUPERVISORS**

Greg Cox	First District
Dianne Jacob	Second District
Pam Slater-Price	Third District
Ron Roberts, Vice-Chairman	Fourth District
Bill Horn, Chairman	Fifth District

\*\*\*\*\*

Walter F. Ekard, *Chief Administrative Officer*  
Dan McAllister, *Treasurer – Tax Collector*  
Donald F. Steuer, *Chief Financial Officer*  
Tracy M. Sandoval, *Auditor & Controller*  
John J. Sansone, *County Counsel*

\*\*\*\*\*

**SPECIAL SERVICES**

<i>Bond Counsel</i>	<i>Trustee</i>
Orrick, Herrington & Sutcliffe LLP	The Bank of New York Trust Company, N.A.
Los Angeles, California	Los Angeles, California
<i>Financial Advisor</i>	
Public Financial Management	
San Francisco, California	

No dealer, broker, salesperson or other person has been authorized by the County of San Diego or the Remarketing Agents set forth on the cover to give any information or to make any representations other than those contained herein and, if given or made, such other information or representations must not be relied upon as having been authorized by the County or the Remarketing Agents. This Reoffering Statement does not constitute an offer to sell or the solicitation of an offer to buy nor shall there be any sale of the Series 2004B Bonds by a person in any jurisdiction in which it is unlawful for such person to make an offer, solicitation or sale.

This Reoffering Statement is not to be construed as a contract with the purchasers or owners of the Series 2004B Bonds. Statements contained in this Reoffering Statement which involve estimates, forecasts or matters of opinion, whether or not expressly so described herein, are intended solely as such and are not to be construed as a representation of facts.

The information set forth in this Reoffering Statement under the caption "Bond Insurance" has been provided and reviewed by XL Capital Assurance Inc. Neither the County, the Remarketing Agents nor any of their respective counsel, officers, agents or employees make any representations as to the accuracy or sufficiency of such information.

The information set forth in this Reoffering Statement has been obtained from the County, and other sources which are believed by the County to be reliable. The Remarketing Agents have provided the following sentence for inclusion in this Reoffering Statement. The Remarketing Agents have reviewed the information in this Reoffering Statement in accordance with, and as part of, their responsibilities to investors under the federal securities laws as applied to the facts and circumstances of this transaction, but the Remarketing Agents do not guarantee the accuracy or completeness of such information. Reference is hereby made to such documents on file with the County for further information in connection therewith.

The information and expressions of opinion herein are subject to change without notice, and neither the delivery of this Reoffering Statement nor any sale made hereunder shall under any circumstances create any implication that there has been no change in the affairs of the County since the date hereof. All summaries of the Series 2004B Bonds, the Trust Agreement and other documents summarized herein, are made subject to the provisions of such documents respectively and do not purport to be complete statements of any or all of such provisions.

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**\$147,825,000**  
**COUNTY OF SAN DIEGO**  
**TAXABLE PENSION OBLIGATION BONDS**  
**SERIES 2004B**

**\$73,925,000 SERIES 2004B-1**

**\$73,900,000 SERIES 2004B-2**

**INTRODUCTION**

*This introduction is not a summary of this Reoffering Statement. It is only a brief description of and guide to, and is qualified by, more complete and detailed information contained in the entire Reoffering Statement, including the cover page and appendices hereto, and the documents described herein. All statements contained in this introduction are qualified in their entirety by reference to the entire Reoffering Statement. References to, and summaries of, provisions of the Constitution and laws of the State of California and any documents referred to herein do not purport to be complete and such references are qualified in their entirety by reference to the complete provisions. All capitalized terms used in this Reoffering Statement and not otherwise defined herein have the meanings set forth in the Trust Agreement unless the context otherwise indicates. See Appendix C – “Summary of the Trust Agreement – Definitions” attached hereto.*

**General**

This Reoffering Statement, including the cover and the appendices attached hereto (the “Reoffering Statement”), provides certain information concerning the Taxable Pension Obligation Bonds, Series 2004B (the “Series 2004B Bonds”) originally issued by the County of San Diego (the “County”) on June 29, 2004 (the “Original Issue Date”) in an aggregate principal amount of \$147,825,000. The Series 2004B Bonds were issued together with the County’s Taxable Pension Obligation Bonds, Series 2004A and Taxable Pension Obligation Bonds, Series 2004C (together with the Series 2004B Bonds, the “Series 2004 Bonds”) pursuant to Articles 10 and 11 (commencing with Section 53570) of Chapter 3, Division 2, Title 5 of the Government Code of the State of California and the Trust Agreement, dated as of January 1, 1994 (the “Original Trust Agreement”), as amended and supplemented by the First Supplemental Trust Agreement, dated as of September 1, 2002, and the Second Supplemental Trust Agreement, dated as of June 1, 2004, by and between the County and The Bank of New York Trust Company, N.A., as successor trustee (the “Trustee”). In connection with the interest rate conversion described herein, the Original Trust Agreement will be further amended and supplemented by the Third Supplemental Trust Agreement, dated as of June 1, 2006 (together with the Original Trust Agreement and the amendments and supplements thereto, the “Trust Agreement”), by and between the County and the Trustee. The County has also issued under the Trust Agreement \$430,430,000 in original principal amount of its Taxable Pension Obligation Bonds, Series A and \$737,340,000 in original aggregate principal amount of its Taxable Pension Obligation Bonds, Series 2002A (Current Interest Bonds), its Taxable Pension Obligation Bonds, Series 2002B (Auction Rate Securities) and its Taxable Pension Obligation Bonds, Series 2002C (PINES®).

The Series 2004B Bonds were originally issued as Auction Rate Securities and currently accrue interest at the Applicable Auction Rates established pursuant to the Auction Procedures, all as defined and set forth in the Trust Agreement. On August 15, 2006 (the “Fixed Rate Conversion Date”), the Series 2004B Bonds will be converted from Auction Rate Securities (as defined in the Trust Agreement) to bonds bearing interest at fixed interest rates in accordance with the Trust Agreement. From the Fixed Rate Conversion Date through the stated maturity or prior redemption of the Series 2004B Bonds, interest on the Series 2004B Bonds will accrue at fixed interest rates and be payable semiannually on February 15 and August 15 of each year, commencing on February 15, 2007. See “The Series 2004B Bonds” herein. The Series 2004B Bonds will be reoffered to the public by Lehman Brothers Inc., Citigroup Global

Markets Inc. and Backstrom McCarley Berry & Co., LLC (collectively, the “Remarketing Agents”). See “– Security and Sources of Payment for the Series 2004B Bonds” herein for a description of the payments of interest and principal when due on the Series 2004B Bonds.

## **The County**

The County is the southernmost major metropolitan area in the State of California (the “State”). The County covers 4,255 square miles, extending 70 miles along the Pacific Coast from the Mexican border to Orange County, and inland 75 miles to Imperial County. Riverside and Orange Counties form the northern boundary. The County is approximately the geographic size of the State of Connecticut. The County’s Fiscal Year 2006-07 Proposed General Fund budget is approximately \$3.2 billion. See Appendix A – “County of San Diego Financial, Economic and Demographic Information” attached hereto.

## **Security and Sources of Payment for the Series 2004B Bonds**

The Series 2004B Bonds are secured on a parity with the County’s other outstanding taxable pension bonds and any additional bonds which hereafter may be issued under the Trust Agreement (collectively, the “Bonds”). The obligation of the County to make payments with respect to the Bonds is an absolute and unconditional obligation of the County imposed upon the County by law and enforceable against the County pursuant to the County Employees Retirement Law of 1937 (the “Retirement Law”). The Trust Agreement provides that the County is obligated to deposit or cause to be deposited with the Trustee the amount of the County’s obligations on the Bonds for each fiscal year within thirty days after the commencement of such fiscal year. See Appendix C – “Summary of the Trust Agreement – Funds and Accounts – Bond Fund; Deposits to Bond Fund.” In the event that the County fails or neglects to make appropriations and transfers in respect of its obligation to pay the Bonds, the judgment in the court action referred to in “Validation” below (the “Validation Action”) holds that the County Auditor-Controller will be obligated pursuant to Section 31584 of the Retirement Law to satisfy the County’s obligations under the Bonds from any money available in any fund in the County Treasury if the Board of Supervisors of the County (the “Board of Supervisors”) fails or neglects to make such appropriations.

THE PAYMENTS OF INTEREST AND PRINCIPAL WHEN DUE ON THE SERIES 2004B BONDS ARE OBLIGATIONS OF THE COUNTY IMPOSED BY LAW PURSUANT TO THE RETIREMENT LAW AND ARE ABSOLUTE AND UNCONDITIONAL, WITHOUT ANY RIGHT OF SET-OFF OR COUNTERCLAIM. THE SERIES 2004B BONDS DO NOT CONSTITUTE AN OBLIGATION OF THE COUNTY FOR WHICH THE COUNTY IS OBLIGATED OR PERMITTED TO LEVY OR PLEDGE ANY FORM OF TAXATION OR FOR WHICH THE COUNTY HAS LEVIED OR PLEDGED OR WILL LEVY OR PLEDGE ANY FORM OF TAXATION. NEITHER THE SERIES 2004B BONDS NOR THE OBLIGATION OF THE COUNTY TO MAKE PAYMENTS ON THE SERIES 2004B BONDS CONSTITUTES AN INDEBTEDNESS OF THE COUNTY, THE STATE OF CALIFORNIA OR ANY OF ITS POLITICAL SUBDIVISIONS WITHIN THE MEANING OF ANY CONSTITUTIONAL OR STATUTORY DEBT LIMITATION OR RESTRICTION. THE SERIES 2004B BONDS ARE SECURED ON A PARITY WITH THE COUNTY’S OTHER OUTSTANDING TAXABLE PENSION BONDS AND ANY ADDITIONAL BONDS WHICH HEREAFTER MAY BE ISSUED UNDER THE TRUST AGREEMENT.

THE ASSETS OF THE SAN DIEGO COUNTY EMPLOYEES’ RETIREMENT ASSOCIATION (THE “ASSOCIATION”) DO NOT SECURE AND ARE NOT AVAILABLE TO PAY PRINCIPAL OF OR INTEREST ON THE SERIES 2004B BONDS.

## **The Series 2004B Bonds**

Individual purchases of the Series 2004B Bonds will be made in denominations (“Authorized Denominations”) of \$5,000 principal amount or any integral multiple thereof. The Series 2004B Bonds are registered in the name of Cede & Co., as nominee of The Depository Trust Company, New York, New York (“DTC”). DTC serves as securities depository of the Series 2004B Bonds. Ownership interests in the Series 2004B Bonds are in book-entry form only. Principal of and interest on the Series 2004B Bonds will be paid by the Trustee to DTC or its nominee, which will in turn remit such payment to its Participants for subsequent disbursement to the beneficial owners of interests in the Series 2004B Bonds. Interest on the Series 2004B Bonds is payable semiannually on February 15 and August 15 of each year, commencing on February 15, 2007. See “The Series 2004B Bonds” herein. See Appendix F – “Book-Entry Only System and Global Clearance Procedures” herein.

## **Bond Insurance**

The scheduled payment of principal of and interest on the Series 2004B Bonds when due is guaranteed under a financial guaranty insurance policy issued by XL Capital Assurance Inc. (“XLCA”). See “Bond Insurance” herein and Appendix G – “Specimen of 2004 Financial Guaranty Insurance Policy” attached hereto.

## **Tax Matters**

In connection with the original issuance of the Series 2004B Bonds, Orrick, Herrington & Sutcliffe LLP, the 2004 Bond Counsel (the “2004 Bond Counsel”), delivered an opinion, dated June 29, 2004, that based upon existing laws, regulations, rulings and court decisions, interest on the Series 2004B Bonds is exempt from State of California personal income taxes as in effect on June 29, 2004. Such opinion further stated that interest on the Series 2004B Bonds is not excludable from gross income for federal income tax purposes. The 2004 Bond Counsel expressed no opinion regarding any other tax consequences related to the ownership or disposition of, or the accrual or receipt of interest on, the Series 2004B Bonds. See “Tax Matters” herein.

## **Continuing Disclosure**

The County agreed to provide, or cause to be provided, to each nationally recognized municipal securities information repository and any public or private repository or entity designated by the State as a state repository for purposes of Rule 15c2-12(b)(5) (“Rule 15c2-12”) adopted by the U.S. Securities and Exchange Commission (each, a “Repository”) certain annual financial information and operating data and, in a timely manner, notice of certain material events. These covenants have been made in order to assist the Remarketing Agents listed on the front cover page (collectively, the “Remarketing Agents”) in complying with Rule 15c2-12. See “Continuing Disclosure” herein and Appendix E – “2004 Continuing Disclosure Agreement” attached hereto.

## **Forward-Looking Statements**

Certain statements included or incorporated by reference in the Reoffering Statement constitute “forward-looking statements.” Such statements are generally identifiable by the terminology used such as “plan,” “expect,” “estimate,” “budget” or other similar words. The achievement of certain results or other expectations contained in such forward-looking statements involve known and unknown risks, uncertainties and other factors which may cause actual results, performance or achievements described to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Although such expectations reflected in such forward-looking

statements are believed to be reasonable, there can be no assurance that such expectations will prove to be correct. The County is not obligated to issue any updates or revisions to the forward-looking statements if or when its expectations, or events, conditions or circumstances on which such statements are based occur, whether or not they prove to be correct.

## **Miscellaneous**

The description herein of the Trust Agreement and any other agreements relating to the Bonds are qualified in their entirety by reference to such documents, and the descriptions herein of the Bonds are qualified in their entirety by the form thereof and the information with respect thereto included in the aforementioned documents. See Appendix C – “Summary of the Trust Agreement.” Copies of the documents are on file and available for inspection at the principal corporate trust office of the Trustee at 700 South Flower, Suite 500, Los Angeles, California 90017; Attention: Corporate Trust Department. All capitalized terms used in this Reoffering Statement and not otherwise defined herein have the same meanings as in the Trust Agreement. See Appendix C – “Summary of the Trust Agreement” for definitions of certain words and terms used but not otherwise defined herein.

The information and expressions of opinion herein speak only as of their date and are subject to change without notice. Neither the delivery of this Reoffering Statement nor any sale made hereunder nor any future use of this Reoffering Statement shall, under any circumstances, create any implication that there has been no change in the affairs of the County since the date hereof.

The presentation of information, including tables of receipt of revenues, is intended to show recent historical information and is not intended to indicate future or continuing trends in the financial position or other affairs of the County. No representation is made that past experience, as it might be shown by such financial and other information, will necessarily continue or be repeated in the future.

## **THE SERIES 2004B BONDS**

### **General**

The Series 2004B Bonds are fully registered bonds registered in the name of Cede & Co., as nominee of DTC, which serves as securities depository of the Series 2004B Bonds. Ownership interests in the Series 2004B Bonds may be purchased in book-entry form only. Principal of and interest on the Series 2004B Bonds will be paid by the Trustee to DTC or its nominee, which will in turn remit such payment to its Participants for subsequent disbursement to the beneficial owners of interests in the Series 2004B Bonds. See Appendix F – “Book-Entry Only System and Global Clearance Procedures” attached hereto.

The Series 2004B Bonds were issued in two subseries (each a “Subseries”), designated Subseries 2004B-1 and Subseries 2004B-2. The Series 2004B Bonds will be reoffered as fully registered bonds, without coupons, in book-entry only form, in denominations of \$5,000 principal amount or any integral multiple thereof. The Series 2004B Bonds will bear interest at the respective rates and mature on the dates set forth therefor on the inside cover page of this Reoffering Statement. Interest on the Series 2004B Bonds shall be payable semiannually on February 15 and August 15 of each year (each an “Interest Payment Date”), commencing on February 15, 2007. The Series 2004B Bonds will bear interest from the Interest Payment Date next preceding the date of registration thereof, unless such date of registration is after a Record Date and on or prior to an Interest Payment Date, in which event they shall bear interest from such Interest Payment Date; provided, however, that if at the time of registration of any Series 2004B Bond interest is then in default on the Outstanding Series 2004B Bonds, such Series 2004B Bond shall bear interest from the Interest Payment Date to which interest has previously been paid or made

available for payment on the Outstanding Series 2004B Bonds. Interest on the Series 2004B Bonds will be calculated on the basis of a 360-day year comprised of twelve 30-day months.

## **Redemption**

*Optional Redemption.* The Series 2004B Bonds are subject to redemption prior to their maturity, at the option of the County, from any source available for such purpose, in whole or in part on any date, at a redemption price equal to the greater of:

- (1) 100 percent of the principal amount of the Series 2004B Bonds to be redeemed; and
- (2) the sum of the present values of the remaining scheduled payments of principal and interest on the Series 2004B Bonds to be redeemed (exclusive of interest accrued to the date fixed for redemption) discounted to the date of redemption on a semiannual basis (assuming a 360-day year consisting of twelve 30-day months) at the Treasury Rate plus 12.5 basis points;

plus in each case, accrued and unpaid interest on the Series 2004B Bonds being redeemed to the date fixed for redemption.

For the purpose of determining the Treasury Rate, the following definitions will apply:

“Treasury Rate” means, with respect to any redemption date for a particular Series 2004B Bond, the rate per annum, expressed as a percentage of the principal amount, equal to the semiannual equivalent yield to maturity or interpolated maturity of the Comparable Treasury Issue, assuming that the Comparable Treasury Issue is purchased on the redemption date for a price equal to the Comparable Treasury Price, as calculated by the Designated Investment Banker.

“Comparable Treasury Issue” means, with respect to any redemption date for a particular Series 2004B Bond, the United States Treasury security or securities selected by the Designated Investment Banker which has an actual or interpolated maturity comparable to the remaining average life of the applicable Series 2004B Bonds to be redeemed, and that would be utilized in accordance with customary financial practice in pricing new issues of debt securities of comparable maturity to the remaining average life of the Series 2004B Bonds to be redeemed.

“Comparable Treasury Price” means, with respect to any redemption date for a particular Series 2004B Bond, (1) if the Designated Investment Banker receives at least four Reference Treasury Dealer Quotations, the average of such quotations for such redemption date, after excluding the highest and lowest Reference Treasury Deal Quotations, or (2) if the Designated Investment Banker obtains fewer than four such Reference Treasury Dealer Quotations, the average of all such quotations.

“Designated Investment Banker” means one of the Reference Treasury Dealers appointed by the County.

“Reference Treasury Dealer” means Citigroup Global Markets Inc. and its respective successors and three other firms, specified by the County from time to time, that are primary U.S. Government securities dealers in the City of New York (each a “Primary Treasury Dealer”); provided, however, that if any of them ceases to be a Primary Treasury Dealer, the County shall substitute another Primary Treasury Dealer.

“Reference Treasury Deal Quotations” means, with respect to each Reference Treasury Dealer and any redemption date for a particular Series 2004B Bond, the average, as determined by the

Designated Investment Banker, of the bid and asked prices for the Comparable Treasury Issue (expressed in each case as a percentage of its principal amount) quoted in writing to the Designated Investment Banker by such Reference Treasury Dealer at 3:30 p.m., New York City time, on the third business day preceding such redemption date.

*Mandatory Redemption.* The Series 2004B Bonds, Subseries B-1 (the “Series 2004B-1 Bonds”) are subject to mandatory sinking fund redemption prior to maturity at a prepayment price equal to the principal amount of the Series 2004B-1 Bonds to be redeemed, plus accrued interest with respect thereto to the redemption date, on August 15 of each year, commencing on August 15, 2022 in the principal amounts and on the redemption dates as follows:

<u>Redemption Date</u> <u>(August 15)</u>	<u>Principal Amount</u>
2022	\$19,425,000
2023	25,875,000
2024*	28,625,000

\* Stated Maturity.

The Series 2004B Bonds, Subseries B-2 (the “Series 2004B-2 Bonds”) are subject to mandatory sinking fund redemption prior to maturity at a prepayment price equal to the principal amount of the Series 2004B-2 Bonds to be redeemed, plus accrued interest with respect thereto to the redemption date, on August 15 of each year, commencing on August 15, 2022 in the principal amounts and on the redemption dates as follows:

<u>Redemption Date</u> <u>(August 15)</u>	<u>Principal Amount</u>
2022	\$19,400,000
2023	25,875,000
2024*	28,625,000

\* Stated Maturity.

## **Redemption Procedures**

*Sinking Fund Redemption of Term Bonds.* The Trustee will effect each mandatory sinking fund redemption of the Series 2004B Bonds (collectively, the “Term Bonds”) by redeeming from each person who is the registered owner of a Term Bond to be redeemed on the Record Date immediately preceding a redemption date, an amount of such Term Bonds determined by multiplying the principal amount of the Term Bonds to be redeemed on the applicable redemption date by a fraction, the numerator of which is the principal amount of the Term Bonds owned by such registered owner and the denominator of which is the principal amount of the Term Bonds outstanding immediately prior to such date of redemption, and then rounding the product down to the next lower integral multiple of \$5,000. The Trustee will apply, to the extent possible, any remaining amount of a sinking fund installment to redeem \$5,000 units of such Term Bonds and will select, by lot, the units to be redeemed from all such Term Bond registered owners, which selection shall be conclusive.

*Notice of Redemption.* Notice of the intended redemption shall be given by the Trustee by first class mail to the registered owner at the address of such owner. All such redemption notices shall be given not less than thirty (30) days nor more than sixty (60) days prior to the redemption date.

Each notice of redemption shall state the date of such notice, the redemption price, if any, the name and appropriate address of the Trustee, the CUSIP number (if any) of the maturity or maturities, and, if less than all of any such maturity is to be redeemed, the distinctive certificate numbers of the Series 2004B Bonds of such maturity, to be redeemed and, in the case of Series 2004B Bonds to be redeemed in part only, the respective portions of the principal amount thereof to be redeemed. Each such notice shall also state that on said date there will become due and payable on each of said Series 2004B Bonds the redemption price, if any, thereof and in the case of a Series 2004B Bond to be redeemed in part only, the specified portion of the principal amount thereof to be redeemed, together with interest accrued thereon to the redemption date, and that from and after such redemption date interest thereon shall cease to accrue, and shall require that such Series 2004B Bonds be then surrendered at the address of the Trustee specified in the redemption notice. Failure to receive such notice shall not invalidate any of the proceedings taken in connection with such redemption.

Notice of such redemption shall also be sent to the Insurer, to the Rating Agencies, to all municipal registered Securities Depositories and to at least two of the NRMSIRs, no later than simultaneously with the mailing of notices required by the first paragraph above; provided, that neither failure to receive such notice nor any defect in any notice so mailed shall affect the sufficiency of the proceedings for the redemption of such Series 2004B Bonds.

Failure to give notice by mailing to the registered owner of any Series 2004B Bonds designated for redemption or tender or to any depository or information service shall not affect the validity of the proceedings for the redemption of such Series 2004B Bonds if notice of such redemption shall have been mailed as herein provided.

*Effect of Notice of Redemption.* From and after the date fixed for redemption, if funds available for the payment of the principal of and interest with respect to the Series 2004B Bonds so called for redemption will have been duly provided, such Series 2004B Bonds so called will cease to be entitled to any benefit under the Trust Agreement other than the right to receive payment of the principal, interest accrued to the Redemption Date, and premium, if any, and no interest shall accrue with respect thereto from and after the Redemption Date specified in the notice of such redemption.

## **SECURITY AND SOURCES OF PAYMENT FOR THE BONDS**

Pursuant to the Retirement Law, the Board of Supervisors is obligated to appropriate and make payments to the Association for certain amounts arising as a result of retirement benefits accruing to members of the Association. The Trust Agreement provides that the County is obligated to deposit or cause to be deposited with the Trustee the amount of the County's obligations on the Bonds for each fiscal year within thirty days of the commencement of such fiscal year.

THE PAYMENTS OF INTEREST AND PRINCIPAL WHEN DUE ON THE SERIES 2004B BONDS ARE OBLIGATIONS OF THE COUNTY IMPOSED BY LAW PURSUANT TO THE RETIREMENT LAW AND ARE ABSOLUTE AND UNCONDITIONAL, WITHOUT ANY RIGHT OF SET-OFF OR COUNTERCLAIM. THE SERIES 2004B BONDS DO NOT CONSTITUTE AN OBLIGATION OF THE COUNTY FOR WHICH THE COUNTY IS OBLIGATED OR PERMITTED TO LEVY OR PLEDGE ANY FORM OF TAXATION OR FOR WHICH THE COUNTY HAS LEVIED OR PLEDGED OR WILL LEVY OR PLEDGE ANY FORM OF TAXATION. THE SERIES 2004B BONDS ARE SECURED ON A PARITY WITH THE COUNTY'S OTHER OUTSTANDING

TAXABLE PENSION BONDS AND ANY ADDITIONAL BONDS WHICH HEREAFTER MAY BE ISSUED UNDER THE TRUST AGREEMENT.

The Trust Agreement provides that the County reserves the right to enter into one or more other agreements or indentures for any of its corporate purposes, and reserves the right to issue other obligations for such purposes. See Appendix C – “Summary of the Trust Agreement.”

NEITHER THE SERIES 2004B BONDS NOR THE OBLIGATION OF THE COUNTY TO MAKE PAYMENTS ON THE SERIES 2004B BONDS CONSTITUTES AN INDEBTEDNESS OF THE COUNTY, THE STATE OF CALIFORNIA OR ANY OF ITS POLITICAL SUBDIVISIONS WITHIN THE MEANING OF ANY CONSTITUTIONAL OR STATUTORY DEBT LIMITATION OR RESTRICTION.

THE ASSOCIATION’S ASSETS DO NOT SECURE AND ARE NOT AVAILABLE TO PAY PRINCIPAL OF OR INTEREST ON THE SERIES 2004B BONDS.

### VALIDATION

On November 10, 1993, the County, acting pursuant to the provisions of Sections 860 *et seq.* of the California Code of Civil Procedure and Government Code Sections 53511 and 53589.5, filed a complaint in the Superior Court of the State of California for the County of San Diego seeking judicial validation of the proceedings and transactions relating to the issuance of the Debentures, the Prior Bonds and any future series of bonds to be issued by the County in connection therewith (collectively, the “Pension Obligations Bonds”) and certain other matters. On December 16, 1993, the court entered a default judgment to the effect, among other things, that the Pension Obligations Bonds are valid, legal and binding obligations of the County and in conformity with all applicable provisions of law. In issuing the opinion as to the validity of the Series 2004B Bonds, the 2004 Bond Counsel relied upon the entry of the foregoing default judgment.

### BOND INSURANCE

*The following information has been supplied by XLCA for inclusion in this Reoffering Statement. No representation is made by the County or the Remarketing Agents as to the accuracy or completeness of the information. See Appendix G – “Specimen of 2004 Financial Guaranty Insurance Policy” attached hereto.*

*XLCA accepts no responsibility for the accuracy or completeness of this Reoffering Statement or any other information or disclosure contained herein, or omitted herefrom, other than with respect to the accuracy of the information regarding XLCA and its affiliates set forth under this heading. In addition, XLCA makes no representation regarding the Bonds or the advisability of investing in the Bonds.*

#### General

XLCA is a monoline financial guaranty insurance company incorporated under the laws of the State of New York. XLCA is currently licensed to do insurance business in, and is subject to the insurance regulation and supervision by, all 50 states, the District of Columbia, Puerto Rico, the U.S. Virgin Islands and Singapore.

XLCA is an indirect wholly owned subsidiary of XL Capital Ltd, a Cayman Islands exempted company (“XL Capital Ltd”). Through its subsidiaries, XL Capital Ltd is a leading provider of insurance



and reinsurance coverages and financial products and services to industrial, commercial and professional service firms, insurance companies and other enterprises on a worldwide basis. The ordinary shares of XL Capital Ltd are publicly traded in the United States and listed on the New York Stock Exchange (NYSE: XL). **XL Capital Ltd is not obligated to pay the debts of or claims against XLCA.**

XLCA was formerly known as The London Assurance of America Inc. (“London”), which was incorporated on July 25, 1991 under the laws of the State of New York. On February 22, 2001, XL Reinsurance America Inc. (“XL Re”) acquired 100% of the stock of London. XL Re merged its former financial guaranty subsidiary, known as XL Capital Assurance Inc. (formed September 13, 1999) with and into London, with London as the surviving entity. London immediately changed its name to XL Capital Assurance Inc. All previous business of London was 100% reinsured to Royal Indemnity Company, the previous owner at the time of acquisition.

XL Capital Ltd announced on April 7, 2006 that Security Capital Assurance Ltd (“SCA”), a newly-created holding company for XL Capital Ltd’s financial guaranty insurance and reinsurance businesses conducted through XLCA and XL Financial Assurance Ltd. (“XLFA”), had filed a registration statement on Form S-1 with the U.S. Securities and Exchange Commission relating to a proposed initial public offering of a portion of its common shares. Through its operating subsidiaries of XLCA and XLFA, SCA will provide credit enhancement products to the public finance and structured finance markets throughout the U.S. and internationally.

Under the registration statement, a portion of SCA’s shares will be issued and sold by SCA and a portion will be sold by SCA’s parent, XL Insurance (Bermuda) Ltd, as selling shareholder. After the consummation of the offering, XL Capital Ltd is expected to beneficially own approximately 65% of SCA’s outstanding shares.

SCA expects to use the proceeds it receives from the offering primarily for capital contributions to its financial guaranty subsidiaries to support future business growth. SCA intends to apply to have its shares listed on the New York Stock Exchange under the ticker symbol “SCA”.

A copy of the registration statement is available on the U.S. Securities and Exchange Commission website at [www.sec.gov](http://www.sec.gov) under Filings & Forms (EDGAR).

## **Reinsurance**

XLCA has entered into a facultative quota share reinsurance agreement with XLFA, an insurance company organized under the laws of Bermuda, and an affiliate of XLCA. Pursuant to this reinsurance agreement, XLCA expects to cede up to 90% of its business to XLFA. XLCA may also cede reinsurance to third parties on a transaction-specific basis, which cessions may be any or a combination of quota share, first loss or excess of loss. Such reinsurance is used by XLCA as a risk management device and to comply with statutory and rating agency requirements and does not alter or limit XLCA’s obligations under any financial guaranty insurance policy. With respect to any transaction insured by XLCA, the percentage of risk ceded to XLFA may be less than 90% depending on certain factors including, without limitation, whether XLCA has obtained third party reinsurance covering the risk. As a result, there can be no assurance as to the percentage reinsured by XLFA of any given financial guaranty insurance policy issued by XLCA, including the Policy.

Based on the audited financials of XLFA, as of December 31, 2005, XLFA had total assets, liabilities, redeemable preferred shares and shareholders’ equity of \$1,394,081,000, \$704,007,000, \$39,000,000 and \$651,074,000, respectively, determined in accordance with generally accepted accounting principles in the United States (“US GAAP”). XLFA’s insurance financial strength is rated

“Aaa” by Moody’s and “AAA” by S&P and Fitch Inc. In addition, XLFA has obtained a financial enhancement rating of “AAA” from S&P.

The obligations of XLFA to XLCA under the reinsurance agreement described above are unconditionally guaranteed by XL Insurance (Bermuda) Ltd (“XLI”), a Bermuda exempted company and one of the world’s leading excess commercial insurers. XLI is a wholly owned indirect subsidiary of XL Capital Ltd. In addition to A.M. Best’s financial strength rating of “A+” and issuer credit rating of “aa-”, XLI’s insurance financial strength rating is “Aa3” (Stable Outlook) by Moody’s, “A+” by Standard & Poor’s and “AA-” (Outlook Stable) by Fitch.

The rating agencies have taken certain actions with respect to XL Capital Ltd and various insurance operating subsidiaries of XL Capital Ltd, as described below. On November 22, 2005, Moody’s downgraded the senior debt rating of XL Capital Ltd from “A2” to “A3” and downgraded the other insurance financial strength ratings of various insurance operating subsidiaries of XL Capital Ltd (other than XLCA and XLFA) from “Aa2” to “Aa3”. On November 28, 2005, Standard & Poor’s downgraded the senior debt rating of XL Capital Ltd from “A” to “A-” and downgraded the counterparty credit and financial strength ratings of various insurance operating subsidiaries of XL Capital Ltd (other than XLCA and XLFA) from “AA-” to “A+”. On February 28, 2006, Fitch revised the long term issuer rating of XL Capital Ltd from “A-” to “A”. On October 26, 2005, Fitch downgraded the insurer financial strength ratings of various insurance operating subsidiaries of XL Capital Ltd (other than XLCA and XLFA) from “AA” to “AA-”.

The ratings of XLFA, XLI or any other member of the XL Capital Ltd group of companies are not recommendations to buy, sell or hold securities, including the Bonds and are subject to revision or withdrawal at any time by Moody’s, Standard & Poor’s or Fitch.

Notwithstanding the capital support provided to XLCA described in this section, the Bondholders will have direct recourse against XLCA only, and neither XLFA nor XLI will be directly liable to the Bondholders.

### **Financial Strength and Financial Enhancement Ratings of XLCA**

XLCA’s insurance financial strength is rated “Aaa” by Moody’s and “AAA” by Standard & Poor’s and Fitch, Inc. (“Fitch”). In addition, XLCA has obtained a financial enhancement rating of “AAA” from Standard & Poor’s. These ratings reflect Moody’s, Standard & Poor’s and Fitch’s current assessment of XLCA’s creditworthiness and claims-paying ability as well as the reinsurance arrangement with XLFA described under “Reinsurance” above.

The above ratings are not recommendations to buy, sell or hold securities, including the Bonds and are subject to revision or withdrawal at any time by Moody’s, Standard & Poor’s or Fitch. Any downward revision or withdrawal of these ratings may have an adverse effect on the market price of the Bonds. XLCA does not guaranty the market price of the Bonds nor does it guaranty that the ratings on the Bonds will not be revised or withdrawn.

### **Capitalization of XLCA**

Based on the audited financials of XLCA, as of December 31, 2005, XLCA had total assets, liabilities, and shareholder’s equity of \$953,706,000, \$726,758,000, and \$226,948,000, respectively, determined in accordance with U.S. GAAP.

Based on the unaudited statutory financial statements for XLCA as of December 31, 2005 filed with the State of New York Insurance Department, XLCA has total admitted assets of \$328,231,000, total liabilities of \$139,392,000, total capital and surplus of \$188,839,000 and total contingency reserves of \$13,031,000 determined in accordance with statutory accounting practices prescribed or permitted by insurance regulatory authorities (“SAP”). Based on the audited statutory financial statements for XLCA as of December 31, 2004 filed with the State of New York Insurance Department, XLCA had total admitted assets of \$341,937,000, total liabilities of \$143,494,000, total capital and surplus of \$198,443,000 and total contingency reserves of \$7,342,000 determined in accordance with SAP.

### **Incorporation by Reference of Financials**

For further information concerning XLCA and XLFA, see the financial statements of XLCA and XLFA, and the notes thereto, incorporated by reference in this Reoffering Statement. The financial statements of XLCA and XLFA are included as exhibits to the periodic reports filed with the Securities and Exchange Commission (the “Commission”) by XL Capital Ltd and may be reviewed at the EDGAR website maintained by the Commission. All financial statements of XLCA and XLFA included in, or as exhibits to, documents filed by XL Capital Ltd pursuant to Section 13(a), 13(c), 14 or 15(d) of the Securities Exchange Act of 1934 on or prior to the date of this Reoffering Statement, or after the date of this Reoffering Statement but prior to termination of the offering of the Bonds, shall be deemed incorporated by reference in this Reoffering Statement. Except for the financial statements of XLCA and XLFA, no other information contained in XL Capital Ltd’s reports filed with the Commission is incorporated by reference. Copies of the statutory quarterly and annual statements filed with the State of New York Insurance Department by XLCA are available upon request to the State of New York Insurance Department.

### **Regulation of XLCA**

XLCA is regulated by the Superintendent of Insurance of the State of New York. In addition, XLCA is subject to regulation by the insurance laws and regulations of the other jurisdictions in which it is licensed. As a financial guaranty insurance company licensed in the State of New York, XLCA is subject to Article 69 of the New York Insurance Law, which, among other things, limits the business of each insurer to financial guaranty insurance and related lines, prescribes minimum standards of solvency, including minimum capital requirements, establishes contingency, loss and unearned premium reserve requirements, requires the maintenance of minimum surplus to policyholders and limits the aggregate amount of insurance which may be written and the maximum size of any single risk exposure which may be assumed. XLCA is also required to file detailed annual financial statements with the New York Insurance Department and similar supervisory agencies in each of the other jurisdictions in which it is licensed.

The extent of state insurance regulation and supervision varies by jurisdiction, but New York and most other jurisdictions have laws and regulations prescribing permitted investments and governing the payment of dividends, transactions with affiliates, mergers, consolidations, acquisitions or sales of assets and incurrence of liabilities for borrowings.

**THE FINANCIAL GUARANTY INSURANCE POLICIES ISSUED BY THE INSURER, INCLUDING THE INSURANCE POLICY, ARE NOT COVERED BY THE PROPERTY/CASUALTY INSURANCE SECURITY FUND SPECIFIED IN ARTICLE 76 OF THE NEW YORK INSURANCE LAW.**

The principal executive offices of XLCA are located at 1221 Avenue of the Americas, New York, New York 10020 and its telephone number at this address is (212) 478- 3400.

## **TAX MATTERS**

In connection with the original issuance of the Series 2004B Bonds, Orrick, Herrington & Sutcliffe LLP, the 2004 Bond Counsel, delivered an opinion, dated June 29, 2004, that, based upon existing laws, regulations, rulings and court decisions, interest on the Series 2004B Bonds is exempt from State of California personal income taxes as in effect on June 29, 2004. Such opinion further stated that interest on the Series 2004B Bonds is not excludable from gross income for federal income tax purposes. The 2004 Bond Counsel expressed no opinion regarding any other tax consequences related to the ownership or disposition of, or the accrual or receipt of interest on, the Series 2004B Bonds.

The following is a summary of certain of the United States federal income tax consequences of the ownership of the Series 2004B Bonds as of the date hereof. Each prospective investor should consult with its own tax advisor regarding the application of United States federal income tax laws, as well as any state, local, foreign or other tax laws, to its particular situation.

This summary is based on the Internal Revenue Code of 1986, as amended (the "Code"), as well as Treasury regulations and administrative and judicial rulings and practice. Legislative, judicial and administrative changes may occur, possibly with retroactive effect, that could alter or modify the continued validity of the statements and conclusions set forth herein. This summary is intended as a general explanatory discussion of the consequences of holding the Series 2004B Bonds generally and does not purport to furnish information in the level of detail or with the investor's specific tax circumstances that would be provided by an investor's own tax advisor. For example, it generally is addressed only to original purchasers of the Series 2004B Bonds that are "U.S. holders" (as defined below), deals only with Series 2004B Bonds held as capital assets within the meaning of Section 1221 of the Code and does not address tax consequences to holders that may be relevant to investors subject to special rules, such as individuals, trusts, estates, tax-exempt investors, foreign investors, cash method taxpayers, dealers in securities, currencies or commodities, banks, thrifts, insurance companies, electing large partnerships, mutual funds, regulated investment companies, real estate investment trusts, FASITs, S corporations, persons that hold Series 2004B Bonds as part of a straddle, hedge, integrated or conversion transaction, and persons whose "functional currency" is not the U.S. dollar. In addition, this summary does not address alternative minimum tax issues or the indirect consequences to a holder of an equity interest in a holder of Series 2004B Bonds.

As used herein, a "U.S. holder" is a "U.S. person" that is a beneficial owner of a Series 2004B Bond. A "non-U.S. investor" is a holder (or beneficial owner) of a Series 2004B Bond that is not a U.S. Person. For these purposes, a "U.S. person" is a citizen or resident of the United States, a corporation or partnership created or organized in or under the laws of the United States or any political subdivision thereof (except, in the case of a partnership, to the extent otherwise provided in Treasury regulations), an estate the income of which is subject to United States federal income taxation regardless of its source or a trust if (i) a United States court is able to exercise primary supervision over the trust's administration and (ii) one or more United States persons have the authority to control all of the trust's substantial decisions.

### **Tax Status of the Series 2004B Bonds**

The Series 2004B Bonds will be treated, for federal income tax purposes, as a debt instrument. Accordingly, interest will be included in the income of the holder as it is paid (or, if the holder is an accrual method taxpayer, as it is accrued) as interest.

Holders of the Series 2004B Bonds that allocate a basis in the Series 2004B Bonds that is greater than the principal amount of the Series 2004B Bonds should consult their own tax advisors with respect to whether or not they should elect to amortize such premium under section 171 of the Code.

If a holder purchases the Series 2004B Bonds for an amount that is less than the principal amount of the Series 2004B Bonds, and such difference is not considered to be de minimis, then such discount will represent market discount that ultimately will constitute ordinary income (and not capital gain). Further, absent an election to accrue market discount currently, upon a sale or exchange of a Series 2004B Bond, a portion of any gain will be ordinary income to the extent it represents the amount of any such market discount that was accrued through the date of sale. In addition, absent an election to accrue market discount currently, the portion of any interest expense incurred or continued to carry a market discount bond that does not exceed the accrued market discount for any taxable year, will be deferred.

Although the Series 2004B Bonds are expected to trade “flat,” that is, without a specific allocation to accrued interest, for federal income tax purposes, a portion of the amount realized on sale attributed to the Series 2004B Bonds will be treated as accrued interest and thus will be taxed as ordinary income to the seller (and will not be subject to tax in the hands of the buyer).

### **Sale and Exchange of the Series 2004B Bonds**

Upon a sale or exchange of a Series 2004B Bond, a holder generally will recognize gain or loss on the Series 2004B Bonds equal to the difference between the amount realized on the sale and its adjusted tax basis in such Series 2004B Bond. Such gain or loss generally will be capital gain (although any gain attributable to accrued market discount of the Series 2004B Bond not yet taken into income will be ordinary). The adjusted basis of the holder in a Series 2004B Bond will (in general) equal its original purchase price increased by any original issue discount (other than original issue discount reduced due to acquisition premium) and decreased by any payments received on the Series 2004B Bond. In general, if the Series 2004B Bond is held for longer than one year, any gain or loss would be long term capital gain or loss, and capital losses are subject to certain limitations.

### **Defeasance**

Defeasance of any Series 2004B Bond may result in a reissuance thereof, in which event a holder will recognize taxable gain or loss equal to the difference between the amount realized from the sale, exchange or retirement (less any accrued qualified stated interest which will be taxable as such) and the holder’s adjusted tax basis in the Series 2004B Bond.

### **Foreign Investors**

Distributions on the Series 2004B Bonds to a non-U.S. holder that has no connection with the United States other than holding its Series 2004B Bond generally will be made free of withholding tax, as long as the holder has complied with certain tax identification and certification requirements.

## **CERTAIN LEGAL MATTERS**

Legal matters incident to the reoffering of the Series 2004B Bonds are subject to the approval of Orrick, Herrington & Sutcliffe LLP, Bond Counsel, and certain other conditions. Certain legal matters will be passed upon for the Remarketing Agents by their counsel, Hawkins Delafield & Wood LLP, Los Angeles, California and for the County by the County Counsel.

## **FINANCIAL STATEMENTS**

The general purpose financial statements of the County, pertinent sections of which are included in Appendix B to this Reoffering Statement, have been audited by Macias Gini & Company LLP, independent certified public accountants, as stated in their report appearing in Appendix B. Macias Gini & Company LLP has not consented to the inclusion of its report as Appendix B and has not undertaken to update its report or to take any action intended or likely to elicit information concerning the accuracy, completeness or fairness of the statements made in this Reoffering Statement, and no opinion is expressed by Macias Gini & Company LLP with respect to any event subsequent to its report dated December 19, 2005.

## **LITIGATION**

No litigation is pending or threatened concerning the validity of the Series 2004B Bonds. The County is not aware of any litigation pending or threatened questioning the political existence of the County or contesting the County's ability to issue and pay the Series 2004B Bonds.

There are a number of lawsuits and claims pending against the County. See Appendix A – "County of San Diego Financial, Economic and Demographic Information – County Financial Information – Litigation Relating to the Association" and "– Litigation" attached hereto. The County does not believe that any of these proceedings could have a material adverse impact upon the financial condition of the County or the County's ability to pay its obligation as and when due.

## **RATINGS**

It is a condition to the delivery of the reoffered Series 2004B Bonds that they be assigned a rating of "AAA" by Standard & Poor's ("S&P"), a rating of "Aaa" by Moody's Investors Service, Inc. ("Moody's") and a rating of "AAA" by Fitch Ratings ("Fitch"), which ratings reflect the continued effectiveness of the financial guaranty insurance policy issued by XLCA. Such ratings reflect only the views of such organizations and explanations of the significance of such ratings may be obtained only from the organizations at: Moody's Investors Service, Inc. 99 Church Street, New York, New York 10007-2796, telephone number (212) 553-0317; Standard and Poor's Ratings Services, 55 Water Street, New York, New York 10041, telephone number (212) 438-2000; and Fitch Ratings, One State Street Plaza, New York, New York 10004, telephone number (212) 908-0500. There is no assurance that such ratings will continue for any given period of time or that they will not be revised downward or withdrawn entirely by the rating agencies, if in the judgment of such rating agencies circumstances so warrant. Any such downward revision or withdrawal of such ratings may have an adverse effect on the market price of the Series 2004B Bonds.

## **REOFFERING**

The Series 2004B Bonds are being purchased by the Remarketing Agents. The Remarketing Agreement relating to the Series 2004B Bonds provides that the Remarketing Agents will purchase all of the Series 2004B Bonds if any are purchased, the obligation to make such purchase being subject to certain terms and conditions set forth in the Remarketing Agreement, the approval of certain legal matters by counsel and certain other conditions.

## **FINANCIAL ADVISOR**

Public Financial Management served as the Financial Advisor to the County in connection with the reoffering of the Series 2004B Bonds.

## **CONTINUING DISCLOSURE**

### **Material Events Undertaking**

Pursuant to a Continuing Disclosure Agreement with the Trustee (the “Disclosure Agreement”), the County agreed to provide, or cause to be provided with respect to each fiscal year of the County, by no later than six months after the end of the respective fiscal year, to each Repository the audited financial statements, if available, or unaudited financial statements, and the annual financial information and operating data with respect to the County, for each fiscal year of the County, as described in Appendix A – “County of San Diego Financial, Economic and Demographic Information” attached hereto. In addition, the County has agreed to provide, or cause to be provided, to each Repository in a timely manner notice of the following “Listed Events” if determined by the County to be material: (1) principal and interest payment delinquencies; (2) non-payment related defaults; (3) unscheduled draws on the debt service reserves reflecting financial difficulties; (4) unscheduled draws on credit enhancements reflecting financial difficulties; (5) substitution of credit or liquidity providers, or their failure to perform; (6) adverse tax opinions or events affecting the tax-exempt status of the security; (7) modifications to rights of security holders; (8) bond calls; (9) defeasances; (10) release, substitution, or sale of property securing repayment of the securities; and (11) rating changes. These covenants have been made in order to assist the Remarketing Agent in complying with Rule 15c2-12(b)(5). See Appendix E – “2004 Continuing Disclosure Agreement” attached hereto.

### **Additional Information**

The County agreed to provide, or cause to be provided, to each Repository annual reports, including its financial statements with respect to each fiscal year of the County, in connection with the issuance of certain of its outstanding debt obligations. The annual report for Fiscal Year 2001-02 with respect to the County’s Taxable Pension Obligation Bonds, Series 2002, including financial statements, was not submitted by the required deadline. In addition, the County did not provide financial statements with respect to Fiscal Years 2001-02 and 2002-03 for its outstanding obligations which are identified in the following table when it filed its annual reports by their respective required filing dates, most of which are December 27 and the latest of which is January 26 of each year, because the County’s financial statements were not available by such dates. The County filed notices of failure to provide required annual financial information as required by Rule 15c2-12 for each of these instances. The County subsequently provided to each Repository its unaudited and audited financial statements with respect to these fiscal years for these annual reports. The County has otherwise complied in all material respects in the last five years with each of its previous undertakings with regard to Rule 15c2-12 to provide annual reports or notices of material events.

Obligations for which the County Failed to Timely File Complete Annual Reports in  
Fiscal Years 2001-02 and 2002-03

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\$737,340,000 County of San Diego Taxable Pension Obligation Bonds, Series 2002  
\$26,060,000 Certificates of Participation (2002 Motorola Refunding)<sup>(1)</sup>  
\$40,000,000 Certificates of Participation (2001 MTS Tower Refunding)  
\$51,620,000 Certificates of Participation (2000 Information Technology System Financing)  
\$15,010,000 Certificates of Participation (1999 East Mesa Refunding)  
\$73,115,000 Certificates of Participation (1998 Downtown Courthouse Refunding)  
\$80,675,000 Certificates of Participation (1997 Central Jail Refunding)  
\$28,035,000 Certificates of Participation (1997 Master Refunding)  
\$37,580,000 Certificates of Participation (1996 North County Regional Center Expansion and East  
County Courthouse Detention Facility Conversion)  
\$52,230,000 Certificates of Participation (1996 Regional Communication System)  
Teeter Obligation Tax-Exempt Commercial Paper Notes, Series B  
\$21,755,000 Reassessment District No. 97-1 (4-S Ranch) Limited Obligation Improvement Bonds  
\$5,100,000 Redevelopment Agency of the County of San Diego Revenue Bonds, Series 1995  
(Gillespie Field Project)

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<sup>(1)</sup> The continuing disclosure obligation requirement for the Annual Report for this obligation began for Fiscal Year 2002-03. Accordingly, the County was late with respect to this Annual Report only for Fiscal Year 2002-03.

**MISCELLANEOUS**

Included herein are brief summaries of certain documents and reports, which summaries do not purport to be complete or definitive, and reference is made to such documents and reports for full and complete statements of the contents thereof. This Reoffering Statement is not to be construed as a contract or agreement between the County and the purchasers or owners of any of the Series 2004B Bonds. Any statements made in this Reoffering Statement involving matters of opinion, whether or not expressly so stated, are intended merely as an opinion and not as representations of fact. The information and expressions of opinion herein are subject to change without notice and neither the delivery of this Reoffering Statement nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in affairs in the County since the date hereof.

The execution and delivery of this Reoffering Statement have been duly authorized by the County.

**COUNTY OF SAN DIEGO**

By:           /s/ Donald Steuer            
Chief Financial Officer



**APPENDIX A**  
**COUNTY OF SAN DIEGO FINANCIAL, ECONOMIC**  
**AND DEMOGRAPHIC INFORMATION**

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## THE COUNTY

### General

The County of San Diego (the “County”) is the southernmost major metropolitan area in the State of California (the “State”). The County covers 4,255 square miles, extending 70 miles along the Pacific Coast from the Mexican border to Orange County, and inland 75 miles to Imperial County. Riverside and Orange Counties form the northern boundary. The County is approximately the geographic size of the State of Connecticut. The County’s Fiscal Year 2006-07 Proposed General Fund budget is approximately \$3.2 billion.

The County was incorporated on February 18, 1850, and functions under a charter adopted in 1933, as subsequently amended from time to time. The County is governed by a five-member Board of Supervisors (the “Board”) elected to four-year terms in district nonpartisan elections. The Board appoints the Chief Administrative Officer and the County Counsel. The Chief Administrative Officer appoints the Chief Financial Officer and the Auditor and Controller. Elected officials include the Assessor/Recorder/County Clerk, the District Attorney, the Sheriff and the Treasurer-Tax Collector.

Many of the County’s functions are required under County ordinances or by State or federal mandate. State and federally mandated programs, primarily in the social and health services areas, are directed to be maintained at certain minimum levels, which may, under some conditions, limit the County’s ability to control its budget. However, under designated State and federal programs, eligible costs are subject to reimbursement according to specific guidelines.

The County is the delivery system for federal, State and local programs. The County supports a wide range of services to its residents, including, regional services such as medical examiner, jails, elections and public health; health, welfare and human services such as mental health, senior citizen and child welfare services; basic local services such as planning, parks, libraries and Sheriff’s patrol to the unincorporated area, and law enforcement by contract and libraries by city’s request to incorporated cities; and infrastructure such as roads, waste disposal and flood control to the unincorporated area of the County.

## County of San Diego Employees

Table 1 below sets forth the number of County employees for the years 1997 through 2005:

**TABLE 1**

**TOTAL COUNTY EMPLOYEES<sup>(1)</sup>**

<u>Year</u>	<u>Total Employees</u>
1997 <sup>(2)</sup>	17,623
1998	17,790
1999	16,390
2000	16,617
2001	17,057
2002	18,208
2003	17,835
2004	16,949
2005	16,418

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Source: The County.

<sup>(1)</sup> Excludes temporary employees of the County.

<sup>(2)</sup> State legislation in 1997 provided that, effective July 1, 1997, financial responsibility for the Court employees was transferred to the State.

County employees are represented by eight unions representing 24 bargaining units. The unions represent approximately 88% of the County's approximately 16,418 employees and include the Deputy Sheriffs' Association of San Diego County; Social Services Union, SEIU, Local 535; Deputy District Attorneys Association; San Diego County Probation Officers' Association, SEIU, Local 2028, CLC; District Attorney Investigators Association; the Service Employees International Union, Local 2028, CLC; San Diego Deputy County Counsels Association, and the Public Defender Association of San Diego County.

The County is currently in the process of negotiating a new labor agreement with the Deputy District Attorneys Association and has negotiated new labor agreements with five unions: Social Services Union, SEIU, Local 535; San Diego County Probation Officers' Association, SEIU, Local 2028, CLC; Service Employees International Union, Local 2028, CLC; San Diego Deputy County Counsels Association, and the Public Defender Association of San Diego County, effective June 23, 2006 through June 18, 2009. The Deputy Sheriffs' Association and District Attorney Investigators Association have agreements through June 21, 2007. The remaining employees are unrepresented.

## COUNTY FINANCIAL INFORMATION

The following is a summary of certain financial information with respect to the County, including the County's property tax collections, General Fund Balance Sheet and Statement of Revenues, Expenditures and Changes in Fund Balance, adopted General Fund budgets for Fiscal Years 2004-05 and 2005-06, proposed General Fund budget for Fiscal Year 2006-07, pension plan, risk management program, pending litigation and outstanding indebtedness.

### **Assessed Valuations**

The assessed valuation of property in the County is established by the County Assessor, except for public utility property which is assessed by the State Board of Equalization. Assessed valuations are reported in compliance with the requirements of Proposition 13. Generally, property can only be reappraised to market value upon a change in ownership or completion of new construction. Pursuant to Article XIII A of the State Constitution, the assessed value of property that has not incurred a change of ownership or new construction shall be adjusted annually to reflect inflation at a rate not to exceed 2% per year based on the California consumer price index. In the event of declining property value caused by substantial damage, destruction, economic or other factors, Article XIII A of the State Constitution allows the assessed value to be reduced temporarily to reflect the lower market value. For the definition of full cash value and more information on property tax limitations and adjustments, see "Constitutional and Statutory Limitations on Taxes, Revenues and Appropriations – Article XIII A" herein.

The County Assessor determines and enrolls a value for each parcel of taxable real property in the County every year. The value review may result in the reinstatement of the indexed base value after a temporary reduction or it may result in a reduction in value. Taxpayers in the County also may appeal the determination of the County Assessor with respect to the assessed value of their property. In Fiscal Year 2005-06, the County Assessor received and processed approximately 2,500 appeals.

## Ad Valorem Property Taxation

Table 2 below sets forth the assessed valuation of property within the County subject to taxation for Fiscal Years 1996-97 through 2005-06:

**TABLE 2**  
**ASSESSED VALUATION OF PROPERTY**  
**SUBJECT TO AD VALOREM TAXATION**  
**Fiscal Years 1996-97 through 2005-06**  
**(In Thousands)**

<u>Fiscal Year</u>	<u>Land</u>	<u>Improvements</u>	<u>Personal Property</u>	<u>Gross Assessed Valuation</u>	<u>Exemption<sup>(1)</sup></u>	<u>Net Assessed Valuation for Tax Purposes<sup>(2)</sup></u>
1996-97	\$58,743,000	\$86,763,943	\$7,404,271	\$152,911,214	\$3,799,409	\$149,111,805
1997-98	59,965,573	87,226,803	10,222,561	157,414,937	4,512,558	152,902,379
1998-99	63,633,576	94,172,901	10,577,494	168,383,971	4,655,381	163,728,590
1999-00	70,120,054	105,048,079	10,221,397	185,389,530	4,840,799	180,548,731
2000-01	76,745,341	112,696,091	11,598,968	201,040,400	5,322,920	195,717,480
2001-02	84,852,228	122,629,979	12,675,787	220,157,994	5,674,325	214,483,669
2002-03	93,104,455	133,459,423	11,773,210	238,337,088	5,474,711	232,862,377
2003-04	103,818,122	145,973,945	11,949,627	261,741,694	6,742,042	254,999,652
2004-05	117,332,258	159,013,240	11,804,416	288,149,914	7,332,153	280,817,761
2005-06	137,276,347	175,791,219	12,807,092	325,874,658	7,916,172	317,958,485

Source: County of San Diego Auditor and Controller.

<sup>(1)</sup> Exemption figures include veterans, church, welfare, religious, college and cemetery exemptions.

<sup>(2)</sup> Net Assessed Valuation for Tax Purposes figures include local secured, unsecured, state unitary and redevelopment valuation.

Table 3 below sets forth the approximate tax levied against the ten largest taxpayers in the County for Fiscal Year 2005-06. These tax payments represent approximately 2.9% of the total secured property tax levied by the County for Fiscal Year 2005-06, which amount is \$3,565,874,923.

**TABLE 3**  
**TEN LARGEST TAXPAYERS**  
**Fiscal Year 2005-06**

<u>Property Owners</u>	<u>Business Area</u>	<u>Approximate Tax</u>
San Diego Gas & Electric Company	Gas & Electric Utility	\$33,299,455
Southern California Edison Co.	Electric Utility	19,178,590
Pacific Bell Telephone Company	Telecommunications	9,358,397
Kilroy Realty LP	Real Estate	7,840,822
Qualcomm, Inc.	Telecommunications	6,771,332
Pfizer Inc.	Pharmaceutical	6,461,172
San Diego Family Housing LLC	Real Estate	5,265,861
Irvine Co.	Real Estate	5,105,296
San Diego Ballpark Funding LLC	Developer	4,947,492
Fashion Valley Mall LLC	Retail	4,763,980

Source: County of San Diego Auditor and Controller.

Taxes are levied for each Fiscal Year on taxable real and personal property which is situated in the County as of the preceding January 1. However, upon a change in ownership of property or completion of new construction, State law permits an accelerated recognition and taxation of increases in real property assessed valuation. For assessment and collection purposes, property is classified either as “secured” or “unsecured” and is listed accordingly on separate assessment rolls. The “secured roll” is that assessment roll containing locally assessed property secured by a lien which is sufficient, in the opinion of the assessor, to secure payment of the taxes. Other property is assessed on the “unsecured roll.”

The County levies a 1% property tax on behalf of all taxing agencies in the County. The taxes collected are allocated on the basis of a formula established by State law enacted in 1979. Under this formula, the County and all other taxing entities receive a base year allocation plus an allocation on the basis of growth in situs assessed value (new construction, change of ownership, inflation) prorated among the jurisdictions which serve the tax rate areas within which the growth occurs. Tax rate areas are specifically defined geographic areas which were developed to permit the levying of taxes for less than county-wide or less than city-wide special and school districts. In addition, the County levies and collects additional voter approved debt service and fixed charge assessments on behalf of any taxing agency and special districts within the County.

Property taxes on the secured roll are due in two installments, on November 1 and February 1. If unpaid, such taxes become delinquent after 5:00 p.m. on December 10 and April 10, respectively, and a ten percent penalty attaches. A ten dollar cost also applies to all delinquent second installments. Property on the secured roll with unpaid delinquent taxes is declared tax-defaulted after 5:00 p.m. on June 30th. Such property may thereafter be redeemed by payment of the delinquent taxes, the ten percent delinquency penalty, the ten dollar cost, a fifteen dollar per parcel redemption fee (from which the State receives five dollars), and redemption penalty of one and one half percent per month starting July 1 and continuing until date of redemption (collectively, the “Redemption Amount”). If taxes remain unpaid after five years on the default roll, the property becomes subject to a tax sale by the County Treasurer - Tax Collector.

Property taxes on the unsecured roll are due as of the January 1 lien date and become delinquent, if unpaid, on August 31. A ten percent penalty attaches to delinquent taxes on property on the unsecured roll and an additional penalty of one and one-half percent per month begins to accrue on November 1. The taxing authority has four ways of collecting unsecured personal property taxes: (1) a civil action against the taxpayer; (2) filing a certificate in the office of the County Clerk specifying certain facts in order to obtain a judgment lien on certain property of the taxpayer; (3) filing a certificate of delinquency for recordation in the County Recorder’s office in order to obtain a lien on certain property of the taxpayer; and (4) seizure and sale of personal property, improvements or possessory interests belonging or assessed to the taxpayer.

In the 2005-06 Fiscal Year, the County collected \$6,603,222 in property tax administrative fees from cities, special districts and redevelopment agencies. State law exempts school districts from paying such fees.

## Secured Tax Rolls Statistics

Table 4 below sets forth information relating to the County's secured tax roll and assessed value of property for each of the last ten Fiscal Years, including an estimate for the Fiscal Year ending on June 30, 2006.

**TABLE 4**  
**SECURED TAX ROLL STATISTICS**  
**Fiscal Years 1996-97 through 2005-06**

<u>Fiscal Year</u>	<u>Total Bills</u>	<u>Total Assessed Value<sup>(1)</sup></u>	<u>Total Tax Amount<sup>(2)</sup></u>	<u>Delinquent Tax Bills</u>	<u>Delinquent Tax Amount<sup>(3)</sup></u>	<u>Delinquent Tax Amount as Percent of Total Tax Amount</u>
1996-97	815,818	\$146,000,629,437	\$1,640,179,294	28,924	\$37,476,117	2.28%
1997-98	823,332	149,611,690,276	1,685,104,282	28,715	31,933,378	1.90
1998-99	831,497	160,102,387,349	1,791,871,717	33,484	32,513,581	1.60
1999-00	842,959	176,113,891,329	1,962,926,237	36,820	39,059,369	1.70
2000-01	857,777	191,194,756,333	2,126,737,380	33,817	38,805,254	1.82
2001-02	871,191	209,281,264,375	2,335,927,431	31,198	39,156,006	1.68
2002-03	885,452	227,376,419,310	2,552,212,549	29,769	39,156,463	1.53
2003-04	898,222	250,071,362,845	2,831,188,116	30,244	41,183,548	1.45
2004-05	912,850	276,651,738,142	3,141,818,961	38,065	64,556,967	2.05
2005-06 <sup>(4)</sup>	934,416	313,592,785,425	3,565,874,923	42,000	71,000,000	2.00

Source: County of San Diego Auditor and Controller.

<sup>(1)</sup> Total Assessed Value figures include local secured and state unitary valuation.

<sup>(2)</sup> Amount excludes penalties.

<sup>(3)</sup> Delinquent Tax Amounts represent the dollar value of tax due for delinquencies in the year shown that had not been collected as of June 30 of that year.

<sup>(4)</sup> Total Bills, Total Assessed Value and Total Tax Amount figures are actual, remaining columns are estimated.

## Liens and Redemption

Properties may be redeemed under a five-year installment plan by paying current taxes plus a minimum annual payment of 20% of the original Redemption Amount. A delinquent taxpayer may enter into the installment plan at any time up to the June 30 occurring five years after the property becomes tax-defaulted. Redemption interest accrues at 1-1/2% per month on the unpaid balance of the Redemption Amount during the period of the installment plan. If taxes are unpaid after June 30 of the fifth year of default (or if an installment plan is in place, taxes are unpaid at the end of the plan), the property becomes subject to sale by the County Treasurer-Tax Collector.

## Financial Statements

Table 5 below sets forth the audited General Fund Balance Sheet for Fiscal Year ended June 30, 2004 and for Fiscal Year ended June 30, 2005. Table 6 below sets forth the audited General Fund Statement of Revenues, Expenditures, and Changes in Fund Balance for Fiscal Years 2001-02 through 2004-05.



**TABLE 5**  
**COUNTY OF SAN DIEGO**  
**GENERAL FUND BALANCE SHEET**  
**June 30, 2004 and June 30, 2005**  
**(In Thousands)**

<u>ASSETS</u>	(Audited) <u>2004</u> <sup>(3)</sup>	(Audited) <u>2005</u> <sup>(3)</sup>
Equity in Pooled Cash and Investments	\$310,870	\$496,759
Cash with Fiscal Agent	10,090	43,902
Collections in Transit	7,334	5,362
Imprest Cash	299	298
Investments	2	2
Taxes Receivable, net	34,488	105,009
Accounts and Notes Receivable, net	218,662	224,527
Due from Other Funds <sup>(1)</sup>	178,321	172,209
Prepaid Items	10	5
Advances to Other Funds	948	928
Inventories of Materials and Supplies	6,941	8,795
Restricted Assets - Investments <sup>(2)</sup>	--	360,000
TOTAL ASSETS	<u>\$767,965</u>	<u>\$1,417,796</u>
<u>LIABILITIES</u>		
Accounts Payable	\$ 57,300	\$101,766
Accrued Payroll	57,152	55,366
Amount Due for Tax and Revenue Anticipation Notes <sup>(2)</sup>	--	369,280
Due to Other Funds <sup>(1)</sup>	24,744	21,342
Deferred Revenue <sup>(3)</sup>	77,769	--
Deferred Credits and Other Liabilities	--	44,624
Amount for Commercial Paper Notes	--	74,990
Unearned Revenue	--	82,970
TOTAL LIABILITIES	<u>\$216,965</u>	<u>\$750,338</u>
<u>FUND BALANCE</u>		
Reserved for Encumbrances	\$ 84,031	\$131,356
Reserved for Notes Receivable and Advances	7,555	7,295
Reserved for Inactive Landfill Closure	16,170	16,170
Reserved for Inventory of Materials and Supplies	6,941	8,795
Reserved for Other Purposes	98,595	128,216
Unreserved:		
Designated for Subsequent Years' Expenditures	122,334	111,448
Undesignated	<u>215,374</u>	<u>264,178</u>
TOTAL FUND BALANCE	<u>\$551,000</u>	<u>\$ 667,458</u>
TOTAL LIABILITIES AND FUND BALANCES	<u>\$767,965</u>	<u>\$1,417,796</u>

Source: County of San Diego Auditor and Controller.

- (1) Amounts are receivables and payables between General Fund and other County funds based on actual or estimated claims outstanding.
- (2) Includes the tax and revenue anticipation notes outstanding at June 30, 2004 and June 30, 2005, respectively. The tax and revenue anticipation notes for Fiscal Year 2003-04 were paid in full by June 30, 2004; no amount was outstanding as of such date. The tax and revenue anticipation notes for Fiscal Year 2004-05 matured in July 2005; the amount outstanding as of such date is reflected above. Consistent with National Council on Governmental Accounting Interpretation No. 9, the liability for tax and revenue anticipation notes outstanding at June 30 is displayed in the General Fund and offset by a corresponding asset recorded as Restricted Assets-Investments representing the pledged amounts.
- (3) For Comprehensive Annual Financial Report reporting purposes to conform with Governmental Accounting Standards Board (GASB) Statements 33 and 34, activities from various Internal Agency Funds are included in the General Fund.

**TABLE 6**

**COUNTY OF SAN DIEGO  
GENERAL FUND  
STATEMENT OF REVENUES, EXPENDITURES  
AND CHANGES IN FUND BALANCE  
For Fiscal Years 2001-02 through 2004-05  
(In Thousands)**

	(Audited) <u>2001-02</u>	(Audited) <u>2002-03</u>	(Audited) <u>2003-04</u>	(Audited) <u>2004-05</u>
<b>Revenues:</b>				
Taxes <sup>(1)</sup>	\$ 369,199	\$ 396,415	\$ 457,062	\$ 671,850
Licenses, Permits and Franchises	28,250	28,840	31,233	32,015
Fines, Forfeitures and Penalties	33,978	36,246	40,363	51,000
Revenue From Use of Money and Property	22,020	16,691	12,721	29,308
Aid From Other Governmental Agencies:				
State <sup>(1)</sup>	646,680	709,693	649,829	511,830
Federal	495,775	533,562	588,815	620,477
Other	43,150	49,853	57,442	60,415
Charges for Current Services	211,727	243,125	246,381	254,585
Other Revenue	<u>37,092</u>	<u>25,389</u>	<u>32,058</u>	<u>38,057</u>
Total Revenues	<u>\$1,887,871</u>	<u>\$2,039,814</u>	<u>\$2,115,904</u>	<u>\$2,269,537</u>
<b>Expenditures:</b>				
Current:				
General <sup>(2)</sup>	\$ 148,326	\$ 192,720	\$ 207,600	\$ 204,566
Public Protection <sup>(2)</sup>	788,698	1,123,518	1,172,110	928,375
Public Ways and Facilities <sup>(2)</sup>	3,185	21,855	23,983	4,348
Health and Sanitation <sup>(2)</sup>	524,974	569,914	552,035	499,471
Public Assistance <sup>(2)</sup>	755,737	945,562	948,165	858,487
Education <sup>(2)</sup>	473	6,649	5,798	597
Recreational and Cultural <sup>(2)</sup>	14,734	19,884	23,709	18,300
Debt service:				
Interest	<u>5,495</u>	<u>12,735</u>	<u>5,776</u>	<u>12,310</u>
Total Expenditures	<u>\$2,241,622</u>	<u>\$2,892,837</u>	<u>\$2,939,176</u>	<u>\$2,544,382</u>
Excess (Deficiency) of Revenues over (under) Expenditures	(\$ 353,751)	(\$853,023)	(\$ 823,272)	(\$ 274,845)
<b>Other financing sources (uses):</b>				
Sale of Capital Assets	—	\$ 11	\$ 7	—
Long Term Debt Proceeds <sup>(2)</sup>	—	560,450	454,113	—
Refunding Bonds Issued <sup>(2)</sup>	—	176,890	—	—
Payment to Refunded Bond Escrow Agent	—	(176,890)	—	—
Transfers In <sup>(3)</sup>	\$ 465,910	\$478,806	\$ 483,333	\$ 568,677
Transfers (Out) <sup>(4)</sup>	<u>(159,825)</u>	<u>(156,879)</u>	<u>(162,035)</u>	<u>(179,228)</u>
Total Other Financing Sources (Uses)	<u>\$ 306,085</u>	<u>\$882,388</u>	<u>\$ 775,418</u>	<u>\$ 389,449</u>
Net Change in Fund Balance	(\$ 47,666)	\$ 29,365	(\$ 47,854)	\$ 114,604

(Table continued from prior page.)

	(Audited) <u>2001-02</u>	(Audited) <u>2002-03</u>	(Audited) <u>2003-04</u>	(Audited) <u>2004-05</u>
<b>Fund Balance - Beginning of Year</b>	618,284	570,352	598,661	551,000
Residual Equity Transfers (Out)	—	—	—	—
Increase (Decrease) In:				
Reserve For Inventory of	—	—	—	—
Materials and Supplies	<u>(266)</u>	<u>(1,056)</u>	<u>193</u>	<u>1,854</u>
<b>Fund Balance - End of Year</b>	<u>\$570,352</u>	<u>\$598,661</u>	<u>\$551,000</u>	<u>\$667,458</u>

Source: Comprehensive Annual Financial Report of the County.

- (1) The conversion of vehicle license fee revenues to property taxes in lieu of vehicle license fees resulted in a reclassification of such revenues from State aid to taxes. See “– Vehicle License Fee” herein.
- (2) The respective amounts in 2002-03 reflect the issuance of the 2002 Pension Obligation Bonds and the escrow and pledge of funds for the 1994 Pension Obligation Bonds in September 2004. The respective amounts in 2003-04 reflect the issuance of 2004 Pension Obligation Bonds in June 2004. The proceeds of these Pension Obligation Bonds were deposited with the San Diego County Retirement Association and were accounted for in Fiscal Years 2002-03 and 2003-04, respectively, as having been expended by each of the seven functional areas noted based on the payrolls attributable to these functional areas.
- (3) Beginning in Fiscal Year 2000-01, an accounting method change occurred creating the Special Revenue funds for the Safety Augmentation Sales Tax (Proposition 172), Health and Social Services’ Realignment monies and the tobacco securitization proceeds. Revenues from these three sources are recognized in the Special Revenue funds and treated as operating transfers when moved to the General Fund to reimburse expenses incurred, and these three sources accounted for substantially all of the transfers.
- (4) Represents contributions to capital funds for General Fund projects, County contributions to the library fund and other internal fund contributions.

## General Fund Budget

The Board of Supervisors is required by State law to adopt a balanced annual budget no later than August 30 of each year. The County General Fund finances the legally authorized activities of the County not provided for in other restricted funds. General Fund revenues are derived from such sources as taxes, licenses, permits and franchises, fines, forfeitures and penalties, use of money and property, aid from other governmental agencies, charges for current services and other revenue. General Fund expenditures and encumbrances are classified by the functions of public safety, health and human services, land use and environment, community services, finance and general government and other. Increases in the aggregate appropriations based on actual or anticipated increases in available financing can be made after the final budget has been adopted upon approval by a four-fifths vote of the Board of Supervisors.

To ensure that the expenditures do not exceed authorized levels or available financing sources, quarterly reviews are made covering actual and projected receipts and expenditures. In the event of any shortfall in projected revenue, immediate steps are taken to freeze or reduce appropriations. Similarly, if expenditures are projected to exceed appropriations, steps are taken to freeze expenditures in other areas or to transfer available resources to offset the added expenditure requirement. California counties are not permitted by State law to impose fees to raise general revenue, but only to recover the costs of regulation or provision of services. The Chief Financial Officer is responsible for monitoring and reporting expenditures within budgeted appropriations.

## 2005-06 Budget and Financial Position of the County

The Fiscal Year 2005-06 Adopted Budget (the “2005-06 Adopted Budget”) for the County’s General Fund included expenditures of approximately \$2.944 billion and revenues and other financing sources of approximately \$2.944 billion. In accordance with the normal practice of the County, the 2005-06 Adopted Budget has been adjusted to reflect carry-over appropriations from the prior fiscal year and program needs not included in the 2005-06 Adopted Budget. As of March 31, 2006, the County’s

Fiscal Year 2005-06 General Fund Adjusted Budget (the “2005-06 Adjusted Budget”) included expenditures of \$3.252 billion and revenues and other financing sources of \$3.252 billion. As of March 31, 2006, as reported in the Fiscal Year 2005-06 Second Quarter Operational Plan Status Report and Budget Adjustments (the “Third Quarter Report”) delivered to the Board of Supervisors from the County’s Chief Administrative Officer, which was based on the first nine months of Fiscal Year 2005-06, the County projects that its General Fund expenditures for Fiscal Year 2005-06 will be below the 2005-06 Adjusted Budget by \$252.5 million and its General Fund revenues and other financing sources will be below the 2005-06 Adjusted Budget by \$7.1 million. The net variance is a projected savings to the County’s General Fund of \$245.4 million, which will be added to any remaining unreserved and undesignated General Fund Balance as of June 30, 2006.

The lower than budgeted, projected expenditures of the General Fund are primarily attributable to the following:

- Lower than budgeted salaries and employee benefit costs due to turnover in departments, controlled staffing, and ongoing recruitment challenges in select classifications;
- Savings in services and supplies due to projected savings in contracted services and the extension of certain grants;
- Savings in other charges are due to reduced caseloads and aid payments, and due to projected delays in carrying out grant funded activities;
- Savings from unspent amounts in the Contingency reserves; and
- Savings from unspent amounts in the management reserves (*i.e.*, appropriations established for revenue and economic uncertainties or to fund unanticipated items, including one-time projects, during the fiscal year).

The projected revenue under-realization to budget consists of a positive revenue variance in current property taxes, in other than current secured taxes, in revenue from use of money and property, in license permits and franchises, and in charges for current services and miscellaneous revenues combined, offset by a negative variance in all other sources of revenues (primarily in intergovernmental revenues and largely the result of expenditure savings in caseload driven programs).

Table 7 below sets forth the expenditures and revenues and other financing sources of the County’s General Fund for Fiscal Year 2005-06 compared to Fiscal Year 2004-05. For Fiscal Year 2004-05, both the Adopted and final Adjusted Budgets are shown. For Fiscal Year 2005-06, the table sets forth the Adopted Budget, the Adjusted Budget as of March 31, 2006, the projected expenditures and revenues and other financing sources as reported in the Third Quarter Report, and the variance between the projected actual amounts and those contained in the 2005-06 Adjusted Budget. For Fiscal Year 2006-07, the table sets forth the Proposed Budget.

**TABLE 7**

**COMPARISON OF GENERAL FUND  
ADOPTED AND ADJUSTED BUDGET FOR FISCAL YEAR 2004-05,  
ADOPTED AND ADJUSTED BUDGET AND PROJECTED RESULTS FOR FISCAL YEAR  
2005-06 AND PROPOSED BUDGET FOR FISCAL YEAR 2006-07  
(In Thousands)**

	2004-05 Adopted Budget	2004-05 Adjusted Budget <sup>(1)</sup>	2005-06 Adopted Budget	2005-06 Adjusted Budget <sup>(2)</sup>	Projected Year End Results <sup>(3)</sup>	Variance From Adjusted Budget <sup>(4)</sup>	2006-07 Proposed Budget <sup>(5)</sup>
<b>EXPENDITURES</b>							
Public Safety	\$ 944,105	\$ 997,409	\$ 972,205	\$1,027,770	\$ 990,158	\$ 37,612	\$1,037,186
Health and Human Services	1,432,507	1,460,726	1,481,763	1,522,843	1,407,122	115,721	1,581,047
Land Use and Environment	127,505	171,676	130,557	183,053	163,028	20,025	127,020
Community Services	37,624	77,757	43,124	85,902	78,127	7,775	48,964
Finance and General							
Government and Other	309,627	451,434	300,638	416,591	360,770	55,821	430,986
Contingency Reserve and Designations	18,200	15,600	15,600	15,600	0	15,600	20,000
Total Expenditures <sup>(6)</sup>	<u>\$2,869,568</u>	<u>\$3,174,602</u>	<u>\$2,943,886</u>	<u>\$3,251,758</u>	<u>\$2,999,204</u>	<u>\$252,554</u>	<u>\$3,245,202</u>
<b>REVENUES</b>							
Current Property Taxes	\$ 561,626	\$ 359,553	\$ 400,483	\$ 400,483	\$ 429,090	\$ 28,607	\$ 499,278
Taxes Other Than Current							
Property Taxes	56,150	258,223	272,987	277,187	348,613	71,426	357,482
Licenses, Permits and Franchises	31,876	31,876	32,081	32,081	32,115	34	34,361
Fines, Forfeitures and Penalties	44,186	53,789	52,236	55,343	52,670	(2,673)	46,486
Use of Money and Property	20,067	26,338	25,780	25,881	28,918	3,037	25,725
Aid from Other Government Agencies	1,238,443	1,358,903	1,285,348	1,364,472	1,253,597	(110,875)	1,630,738
Charges for Current Services	243,641	251,541	254,050	257,396	260,799	3,403	263,559
Miscellaneous Revenues and Other Financing Sources	540,384	573,872	560,735	589,023	588,920	(103)	289,853
Total Revenues <sup>(6)</sup>	<u>\$2,736,372</u>	<u>\$2,914,095</u>	<u>\$2,883,699</u>	<u>\$3,001,866</u>	<u>\$2,994,721</u>	<u>(\$ 7,146)</u>	<u>\$3,147,483</u>
Estimated Use of Unreserved and Designated Fund Balance	\$ 3,986	\$ 3,986	\$ 3,690	\$ 3,690	\$ 3,690	\$ 0	\$ 2,614
Estimated Use of Unreserved and Undesignated Fund Balance	129,209	172,490	56,496	114,845	114,845	0	95,106
Estimated Use of Fund Balance Reserved for Encumbrances	0	84,031	0	131,356	131,356	0	0
Total Resources Utilized <sup>(6)</sup>	<u>\$2,869,568</u>	<u>\$3,174,602</u>	<u>\$2,943,886</u>	<u>\$3,251,757</u>	<u>\$3,244,612</u>	<u>(\$ 7,146)</u>	<u>\$3,245,202</u>
Net Savings from the 2005-06 Adjusted Budget	—	—	—	—	\$ 245,408	\$245,408	—

Source: County of San Diego Auditor and Controller

- (1) This amount reflects expenditures and revenues included in the 2004-05 Adopted Budget, as amended and adjusted to include all budgeted appropriations and revenues as of June 30, 2005.
- (2) This amount reflects expenditures and revenues included in the 2005-06 Adopted Budget, as amended and adjusted to include all budgeted appropriations and revenues as of March 31, 2006.
- (3) These amounts reflect, as of March 31, 2006, projections of the expenditures and revenues of the County's General Fund for Fiscal Year 2005-06.
- (4) These amounts reflect the difference between the budgeted expenditures, revenues and other financing sources of the County's General Fund in the 2005-06 Adjusted Budget as of March 31, 2006 and the projected expenditures, revenues and other financing sources of the County's General Fund for Fiscal Year 2005-06. Amounts without parentheses indicate a variance favorable to the County's General Fund. Amounts with parentheses indicate a variance unfavorable to the County's General Fund.
- (5) This amount reflects expenditures and revenues included in the 2006-07 Proposed Budget.
- (6) Total may not equal the sum of the line items due to rounding.

The unreserved and undesignated portion of the General Fund Balance as of June 30, 2005 was \$264.2 million. See the table entitled "General Fund Balance Sheet" herein for a description of the fund balance of the General Fund for the Fiscal Years ending June 30, 2004 and June 30, 2005, respectively. Included in the 2005-06 Adopted Budget were appropriations based on the unreserved and undesignated portion of the General Fund Balance of approximately \$56.5 million. Accordingly, the available unreserved and undesignated portion of the General Fund Balance was reduced to \$207.7 million. The General Fund balance was used as the funding source for various one-time or project specific purposes in the 2005-06 Adopted Budget, including temporary staffing, the purchase of safety and other equipment including the rebudget of appropriations for a mugshot replacement system and the Jail Information Management System retrofit project, management reserves, offsets for the costs of processing building permits for victims of Firestorm 2003, the rebudget of Firestorm 2003 appropriations to rebuild parks and trails, the rebudget of appropriations for the Fire Safety and Fuels Reduction Program, a set aside for the multi-year cost of the enterprise-wide Documentum document management system, the required match for the multi-year stormwater grant, one-time technology projects, County Administration Center major maintenance projects, and awarding Community Projects grants.

Subsequently, the Board of Supervisors approved the appropriation of an additional \$105.1 million in unreserved and undesignated General Fund Balance for various items including employee incentive compensation payments, information technology contract transition costs, increases to management reserves, a new web-based training tool, auditing software, major maintenance projects, and unanticipated election costs, split payroll costs, the Medical Examiner design completion, San Elijo Lagoon Nature Center expansion, Central Avenue drainage work, and for the Edgemoor Skilled Nursing Facility construction project. The Board of Supervisors also approved the designation of fund balance in three instances: \$2.1 million for Environmental Health, \$1.3 million for a prepaid lease purchase payment for the Housing Authority building, and \$3.0 million for future capital projects related to the Sheriff's Department. It is also anticipated that the Board of Supervisors will approve the appropriation of \$3.5 million for Land Use and Environmental Group fire services in June 2006 from the unreserved and undesignated General Fund Balance. The total of these actual or anticipated adjustments reduces the available unreserved and undesignated fund balance to \$92.7 million. The use of fund balance is considered to be a one-time resource and the County adheres to its policy of not spending one-time resources on any on-going operational needs. As noted above, the County projects that the General Fund expenditures will be \$252.5 million less than budgeted in the 2005-06 Adjusted Budget and General Fund revenues will be \$7.1 million less than budgeted in the 2005-06 Adjusted Budget for a net savings of \$245.4 million. This projected positive variance would be added to any remaining unreserved and undesignated General Fund Balance as of June 30, 2006. Therefore, the County projects that if there were to be no further uses of available unreserved and undesignated General Fund Balance and no changes in net projected variances for 2005-06, the unreserved and undesignated portion of the General Fund Balance as of June 30, 2006 would be approximately \$338.1 million (representing the \$92.7 million remaining available fund balance plus the \$245.4 million General Fund projected net savings), which would result in an increase of approximately \$73.9 million from the General Fund Balance as of June 30, 2005.

The County does not prepare any formal update of its General Fund Balance projections after the Third Quarter Report. The next formal update of the County's General Fund Balance will occur in connection with the audit of the general purpose financial statements of the County for Fiscal Year ended June 30, 2006, which is expected to be completed by January 2007.

## **Vehicle License Fee**

The Vehicle License Fee (“VLF”) is an annual fee collected by the State for any vehicle subject to registration in California. Prior to the State’s Fiscal Year 2004-05 budget, revenue from or equal to the VLF was appropriated by the State to cities and counties for use in health, mental health and social services programs pursuant to certain State statutory mandates and as general purpose revenue.

Cities’ and counties’, including the County’s, share of VLF general purpose revenues was eliminated by the State’s Fiscal Year 2004-05 budget and replaced with money shifted from the Educational Revenue Augmentation Fund (the “ERAF”). The ERAF was a fund originally created by the State in Fiscal Year 1992-93 to deposit certain prescribed amounts of property tax to be shifted from local governmental agencies to local schools. Beginning in Fiscal Year 2004-05, the State directed that certain amounts be shifted (the “ERAF Shift”) from the ERAF and deposited in the VLF Property Tax Compensation Fund (the “VLF Property Tax Compensation Fund”). In Fiscal Year 2004-05, the State established initial allocations from the VLF Property Tax Compensation Fund to cities and counties, including the County. The State has provided for an allocation from the VLF Property Tax Compensation Fund in Fiscal Year 2005-06 to be based on a formula that takes into account adjusted actual allocations for Fiscal Year 2004-05 and the increase in gross taxable assessed value of property within the County. The County has continued to receive VLF revenues from the State for health, mental health and social services programs. Based on information released by the State in October 2005, the County received a \$17.7 million positive adjustment for Fiscal Year 2004-05 and the County’s Fiscal Year 2005-06 property tax in lieu of vehicle license fee base was set at \$247.3 million, resulting in VLF-related revenues to the County in excess of the budgeted amount by approximately \$64 million in Fiscal Year 2005-06.

On March 17, 2005, the County sold, on a non-recourse basis, its rights to VLF receivables from the State relating to Fiscal Year 2003-04 and used the proceeds of such sale to pay for the design and installation of a replacement computer system to administer the County’s property tax collection system and to reduce the UAAL (herein defined) associated with the County’s pension program. See “– San Diego County Employees Retirement Association” below. The State made an early payment in full of the VLF receivables, which payment was applied to the defeasance of the VLF-related obligations, which produced unbudgeted interest income of approximately \$2.6 million for the County.

## **County’s 2006-07 Proposed Budget and the Operational Plan**

The County annually prepares a two-year operational plan, the most recent of which was proposed to the County’s Board on May 16, 2006 (the “Proposed Operational Plan”). Once approved by the County’s Board, the first year of the Operational Plan is the Proposed County Budget for the 2006-07 Fiscal Year (the “2006-07 Proposed Budget”) and the second year will represent a projection of the revenues and expenditures of the County for Fiscal Year 2007-08.

The County’s Proposed Budget for the County General Fund for Fiscal Year 2006-07 is approximately \$3.245 billion, with proposed Total Appropriations of approximately \$3.245 billion, proposed Total Revenues of approximately \$3.147 billion, and total estimated use of the Unreserved and Designated Fund Balance and the Unreserved and Undesignated Fund Balance of approximately \$2.61 billion and \$95.1 million, respectively. See table entitled “COMPARISON OF GENERAL FUND ADOPTED AND ADJUSTED BUDGET FOR FISCAL YEAR 2004-05, ADOPTED AND ADJUSTED BUDGET AND PROJECTED RESULTS FOR FISCAL YEAR 2005-06 AND PROPOSED BUDGET FOR FISCAL YEAR 2006-07” herein for a summary of the County’s 2006-07 Proposed Budget.

### ***Summary of General Fund Financing Sources.***

General Fund Financing Sources are expected to total approximately \$3.245 billion for Fiscal Year 2006-07, a \$301.3 million or a 10.2% increase from the adopted General Fund budget for Fiscal Year 2005-06. The high growth rates in General Fund Financing Sources for Fiscal Year 2006-07 are primarily due to significant growth in general purpose revenues as well as growth in certain program revenues and use of fund balance. Overall, the previous three fiscal years saw growth rates of 4.4% or \$116.6 million in Fiscal Year 2003-04, 3.0% or \$84.5 million in Fiscal Year 2004-05, and 2.6% or \$74.3 million in Fiscal Year 2005-06. General Fund Financing Sources can be categorized as one of three types: Program Revenues, General Purpose Revenues, or Fund Balance (including reserve/designation decreases).

*Program Revenues.* Program Revenues are expected to total approximately \$2.2 billion in Fiscal Year 2006-07. These revenues make up 69.1% of General Fund Financing Sources in Fiscal Year 2006-07, and are derived from State and federal subventions and grants, charges and fees earned from specific programs, Proposition 172 - Public Safety Sales Tax, State Realignment Funds, and Tobacco Settlement funds, among others. Program Revenues, which as the name implies, are dedicated to and can be used only for the specific programs with which they are associated, are expected to increase by 3.6% over the Fiscal Year 2005-06 Adopted Budget. The average annual growth for the last four years was 3.0%. State, federal, and other intergovernmental funds of \$1.63 billion in Fiscal Year 2005-06 comprise 73% of Program Revenues.

*General Purpose Revenues.* General Purpose Revenues, which are expected to total approximately \$906.3 million in Fiscal Year 2006-07, comprise approximately 27.9% of General Fund Financing Sources. The revenues come from property taxes, property tax in lieu of VLF, sales taxes (and property tax in lieu of sales tax), real property transfer tax, and miscellaneous other sources. They may be used for any purpose that is a legal expenditure of County funds. The Board, therefore, has the greatest flexibility in allocating these revenues.

The growth in these revenues is principally affected by the local and State economies. In recent years, San Diego's economy has outperformed both State and national growth. The growth in general purpose revenues has averaged 6.2% annually since Fiscal Year 2000-01, but for Fiscal Year 2006-07, an overall growth rate of 25.7% (\$185.3 million) is estimated compared to the 2005-06 Adopted Budget. This increase is due in part to conservative revenue estimates for 2005-06 in both property taxes and property tax in lieu of vehicle license fees (see "Vehicle License Fee" above), as well as the restoration of \$27.5 million in property taxes that the State required to be shifted to the Educational Revenue Augmentation Fund ("ERAF") in fiscal years 2004-05 and 2005-06, and continued strong growth in real estate values.

*Use of Fund Balance.* Use of Fund Balance, which is expected to total approximately \$97.7 million in Fiscal Year 2006-07, including reserve/designation decreases, represents 3.0% of General Fund Financing Sources in Fiscal Year 2006-07. This resource is used for one-time expenses, not for the support of ongoing operations. This compares with \$60.2 million in uses of fund balance in the Fiscal Year 2005-06 Adopted Budget, which equaled 2.0% of total General Fund Financing Sources.

In the Proposed Operational Plan, a portion of the projected General Fund Balance is proposed to be used as the funding source for various one-time or project specific purposes such as park maintenance and development, management reserves, offsets for the costs of processing building permits for victims of the 2003 fires in the County, Emergency Operations Center upgrades, a set aside for the multi-year cost of the enterprise-wide document management system, the required match for the multi-year storm water grant, one-time technology projects, and awarding community projects grants.



### ***Summary of Total Appropriations.***

Appropriations total approximately \$4.33 billion in the Proposed Operational Plan for Fiscal Year 2006-07. This is an increase of \$142.6 million or 3.4% from the Fiscal Year 2005-06 Adopted Budget. Of the Total Appropriations of \$4.33 billion, an amount equal to approximately \$3.245 billion represents appropriations for the General Fund, which constitutes 75% of the Total Appropriations of the County.

Looking at the Proposed Operational Plan by Group/Agency, appropriations are increasing in Public Safety, Community Services, Finance & General Government, the Capital Program, and Finance-Other. Appropriations are decreasing in the Health and Human Services Agency and Land Use and Environment. The Health and Human Services Agency, at \$1.61 billion, continues to be the largest share of the budget, 37%, followed by the Public Safety Group at \$1.29 billion or 30%.

*Public Safety Group.* A net increase of 7.0% or \$84.2 million over the Fiscal Year 2005-06 Adopted Budget. The proposed budget provides resources to: increase jail capacity and the security of detentions operations; address an increase in operating costs, including energy costs, in detention and in court facilities; increase the ability to investigate and prosecute certain crimes such as gang activity and domestic violence; re-open a dorm at the Probation Department's Camp Barrett Facility to expand sentencing alternatives for youthful offenders; add public defenders to better respond to community needs; add medical examiner investigators to decrease response times; and provide an allowance for negotiated or anticipated cost of living adjustments. Appropriations for Child Support Services are decreasing due to lower federal funding for the program.

*Health and Human Services Agency.* A net decrease of 11.4% or \$207.4 million over the Fiscal Year 2005-06 Adopted Budget. The net decrease is primarily the result of an accounting change that eliminated the Realignment Special Revenue Fund and the dual fund (Special Revenue Fund and General Fund) treatment of these revenues. Increases reflect an allowance for negotiated or anticipated increases in salaries and benefits; caseload increases and the rising cost of doing business within the In-Home Supportive Services program; increased funding for County medical services for hospital and clinic services; ongoing costs for Adult/Older Adult Mental Health Services, Children's Mental Health Services and the California Work Opportunities Information Network (CalWIN); and implementation of the Mental Health Services Act (Proposition 63).

*Land Use and Environment Group.* A net decrease of 2.0% or \$6.7 million from the Fiscal Year 2005-06 Adopted Budget. The decrease is primarily due to the completion of the grant funded tree removal program and one-time projects in Parks and Recreation, Airports and Sanitation Districts. The Proposed Budget provides: an allowance for negotiated or anticipated cost of living adjustments; the addition of staff in various departments for public health protection, parks and recreation programs, fire prevention services in the unincorporated area, watershed protection and road projects; and for repaving roads in County parks.

*Community Services Group.* A net increase of 7.9% or \$18.8 million from the Fiscal Year 2005-06 Adopted Budget. The increase is due to an allowance for negotiated or anticipated cost of living adjustments, funding for one-time projects including County real estate management and maintenance, increasing the efficiency of Library operations, and increased costs for utilities, fuel, parts and major maintenance projects.

*Finance and General Government Group.* A net increase of 5.0% or \$14.5 million from the Fiscal Year 2005-06 Adopted Budget. The increase is due to an allowance for negotiated or anticipated cost of living adjustments, enhanced internal auditing support, a one-time transition cost related to the

selection of a new information technology vendor for the County, major maintenance projects, increases in insurance costs and the implementation of new employee development programs.

*Capital.* A net increase of \$94.6 million or 1,344.7% from Fiscal Year 2005-06. The net increase includes \$80.0 million for a new Medical Examiner/County Veterinarian Facility, as well as increased ongoing funding for land acquisitions for the Multiple Species Conservation Program (MSCP) and one-time funds for development of sports fields and trails, park land acquisition and other park improvements including Americans with Disabilities Act upgrades.

*Finance-Other.* A net increase of \$144.6 million or 48.1.0% from Fiscal Year 2005-06. This group of programs includes miscellaneous funds and programs that are predominantly Countywide in nature, have no staffing associated with them, or exist for proper budgetary accounting purposes. Included in this Group are such programs as the Contingency Reserve, the General Fund's Contribution to the Capital Outlay Fund and the Library Fund, lease-purchase payments on the County's certificates of participation issued by the San Diego County Capital Asset Leasing Corporation, the Employee Benefits Internal Service Fund (ISF), the Public Liability Internal Service Fund, the Pension Obligation Bond Fund, the Community Enhancement Program, and the Community Projects Program. The proposed increase reflects the General Fund contribution for the capital projects noted above, raising the Contingency Reserve to \$20.0 million from \$15.6 million, higher anticipated costs in the public liability fund, and higher scheduled payments for pension obligation bonds. Scheduled lease purchase payments have decreased and there is a slight decrease in the Employee Benefits ISF for Workers' Compensation and Unemployment Insurance claims.

***Impact of Governor's 2006-07 Proposed Budget on the County's 2006-07 Proposed Budget.***

On January 10, 2006, Governor Schwarzenegger released his 2006-07 Proposed Budget (the "Governor's 2006-07 Proposed Budget"), which included the following items:

**ERAF** – The Governor's 2006-07 Proposed Budget is consistent with the two year budget agreement reached between the State and local governments with respect to the ERAF Shift. See "County Financial Information – Vehicle License Fee" herein.

**State Mandated Costs** – The Governor's 2006-07 Proposed Budget includes \$98.1 million for the first year of a 15-year payment plan to reimburse counties for mandated costs for which funding was deferred in years prior to 2004-05. Separately, the County of San Diego had sought relief through the courts with respect to the State's non-payment of mandated costs and in March, 2006 received a judgment that established that the State owed \$41.6 million to the County and that it was to be paid the amount owed plus interest over a 15-year period. The estimated annual payment is \$3.0 million. In addition, as in Fiscal Year 2005-06, the Governor's 2006-07 Proposed Budget includes funding to reimburse current mandated cost claims.

**Transfer of Fees** – The 2005-06 Budget Act required counties to transfer revenues from certain court imposed fees, fines, and forfeitures to the local trial court that would otherwise have gone to the counties, extending the transfers for Fiscal Years 2003-04 and 2004-05 for four more years. The County's share was \$2.1 million for Fiscal Years 2003-04 and 2004-05 and \$0.8 million in Fiscal Year 2005-06. For Fiscal Years 2006-07 and 2007-08, the County's share each year is expected to be \$0.6 million and \$0.4 million, respectively. One-time resources will be used to fund this requirement.

**Property Tax Administration Grant** – The Governor's 2006-07 Proposed Budget continues the suspension for a second year of the State Property Tax Administration Grant program that has assisted counties in maintaining timely property assessments. The County's revenue loss of \$5.4 million was not

anticipated in the Fiscal Year 2005-06 Adopted Operational Plan, and was offset mid-year by unanticipated additional General Purpose Revenues. For 2006-07, it is proposed that General Purpose Revenues continue to replace the loss of these grant funds.

### ***Impact of 2006-07 May Revision on the County's 2006-07 Proposed Budget.***

On May 12, 2006, the Governor released the May Revision (the "May Revision") to the 2006-07 Proposed Budget (the "State 2006-07 Proposed Budget"). The May Revision generally contains proposals that would have minor impact on the County's 2006-07 Proposed Budget. Overall, the revenue forecast has improved substantially, and the May Revision includes additional funding for the Citizen's Option for Public Safety, the Juvenile Justice Crime Prevention Act, Methamphetamine Suppression and the Mentally Ill Offender Crime Reduction Grant Program. The May Revision also includes proposals to replace the existing booking fee authority with a newly-created trust fund in each county dedicated to local detention facilities, reduce the reimbursement for deferred mandates by \$15.1 million, under-fund the anticipated CalWORKs Single Allocation by \$100 million and increase funding for Emergency Preparedness to implement a broad statewide public health and emergency preparedness plan.

The May Revision contains certain items that require clarification, including the 2005 Special Election Reimbursement and its relation to a proposal to reimburse counties \$45 million for costs related to the November 2005 special election, which was referenced in a note in the Governor's 2006-07 Proposed Budget.

### **Information Technology Outsourcing Program**

The County outsourced its telecommunications and information technology services under a seven-year agreement, valued at approximately \$644 million, in December 1999. The current contract with Computer Sciences Corporation and their partners, collectively referred to as the Pennant Alliance, will expire on December 31, 2006. The County awarded a contract to Northrop Grumman Information Technology ("NGIT"), effective January 24, 2006. NGIT is partnering with three other primary companies, Electronic Data Systems, Bearing Point and AT&T, to provide a full range of information technology services. The contract term is seven years, with a five year extension. The contract costs for Fiscal Year 2006-07 are included in the County's 2006-07 Proposed Budget.

### **Teeter Plan**

In Fiscal Year 1993-94, the County adopted the alternative method of secured property tax apportionment available under Chapter 3, Part 8, Division 1, of the Revenue and Taxation Code of the State of California (also known as the "Teeter Plan"). This alternative method provides for funding each taxing entity included in the Teeter Plan with its total secured property taxes during the year the taxes are levied, including any amount uncollected at Fiscal Year end. Under this plan, the County assumes an obligation to advance funds to these entities to cover expected delinquencies. The County's general fund benefits from future collections of penalties and interest on delinquent taxes collected on behalf of participants in this alternative method of apportionment.

From June 1996 through June 2005, the County issued on an annual basis its Teeter Obligation Commercial Paper Notes ("Teeter Notes") to finance delinquent property tax receivables. As of May 31, 2006, there were approximately \$19.7 million in aggregate principal amount of the Teeter Notes outstanding. The County does not intend to issue Teeter Notes for June 15, 2006 delinquencies (the statutory payout date for participating entities). The County will pay in full its outstanding Teeter Notes by June 20, 2006.

Pursuant to the Law, the County is required to establish a tax losses reserve fund to cover losses that may occur in the amount of tax liens as a result of special sales of tax-defaulted property (i.e., if the sale price of the property is less than the amount owed). The amount required to be on deposit in the tax losses reserve fund is, at the election of the County, one of the following amounts: (1) an amount not less than 1% of the total amount of taxes and assessments levied on the secured roll for a particular year for entities participating in the Teeter Plan, or (2) an amount not less than 25% of the total delinquent secured taxes and assessments calculated as of the end of the Fiscal Year for entities participating in the Teeter Plan. The County's tax losses reserve fund is fully funded, in accordance with the County's election to be governed by the second alternative, with a \$10,281,000 balance for Fiscal Year 2005-06. Accordingly, any additional penalties and interest that otherwise would be credited to the tax losses reserve fund are credited to the County's General Fund.

### **Temporary Transfers**

Section 6 of Article XVI of the California Constitution provides for temporary transfers of funds by the Treasurer-Tax Collector of the County (the "Temporary Transfers"; such transfers are referred to as Treasurer's Loans from time to time) to cover short-term operational deficits occurring as a result of imbalances between receipts and expenditures. The California Constitution prohibits Temporary Transfers by participants of the Treasury Pool (herein defined) (including the County) prior to the first day of the Fiscal Year or after the last Monday of April of each Fiscal Year, and of amounts in excess of 85% of the school district taxes levied by a county under Section 21 of Article XIII of the California Constitution and of amounts apportioned to such school district under Section 6 Article IX of the California Constitution. Treasury Pool participants may utilize Temporary Transfers from time to time for various purposes. A Temporary Transfer must be repaid from the Treasury Pool participant's first revenues received thereafter before any other obligation and thus, in the case of the County, would have a priority over the County's general fund debt obligations. The only Temporary Transfer utilized by the County in the past ten years was in Fiscal Year 1996-97 in the amount of \$25,000,000.

### **San Diego County Employees Retirement Association**

#### *General*

The San Diego County Employees Retirement Association (the "Association"), which was established July 1, 1939 under provisions of the County Employees Retirement Law of 1937 (the "Retirement Law"), is a contributory defined benefit plan covering substantially all compensated employees of the County. Benefits under the County's pension plan are paid in finite amounts, derived from a formula based on age, service credit and levels of compensation, as calculated by the Association in accordance with applicable law and agreements. As of June 30, 2005, there were 16,980 active members, 11,436 retired members and beneficiaries and 4,673 deferred members. Deferred members are those members whose employment has terminated with a participating employer and who left their respective retirement contributions with the Association. The System operates on a fiscal year basis, with its year ending June 30.

The County is one of the employers that participates in the Association. In addition to the County, participating employers include the San Diego Superior Court (the "Courts"), the Local Agency Formation Commission, the San Dieguito River Valley Joint Powers Authority, and the San Diego County Office of Education. The County and these other participating employers are collectively referred to herein as the "Employers" and contributions to the Association made by such Employers are referred to herein as "Employer Contributions". The County is obligated to make 91.5% of the annual Employer Contributions to the Association, the County's General Fund is obligated to make 84.7% of the annual Employer Contributions to the Association and the other participating employers are obligated to make

8.5% of the annual Employer Contributions to the Association, based on the estimated relative percentage of payroll of the County, the County General Fund and the other participating employers for Fiscal Year 2006-07.

There are numerous measures in the State Legislature proposing changes to or reform of pension plans. No prediction can be made as to whether any of these proposals will become effective or, if adopted and implemented, whether the impact upon local agencies, such as the County, would be adverse. In addition, in light of the significant current political interest to reform pension practices of the State and of local agencies, other proposals may be suggested which, if adopted, may be adverse to the County's financial condition.

### ***General Funding Practices of the Association***

*Introduction.* An actuarial valuation is required under the Retirement Law at least every three years. The Association's practice has been to conduct an actuarial valuation on an annual basis as of June 30 of each year, which is the end of the Association's fiscal year. The valuation must be completed by an Enrolled Actuary, covering the mortality, service, and compensation experience of the members and beneficiaries, and must evaluate the valuation assets and actuarially determined liabilities of the Association. The Retirement Law requires the Retirement Board of the Association (the "Retirement Board") to recommend to the Board of Supervisors and the other Employers such changes in rates of interest, in the rate of contribution of members, and in the County's and the other Employers' appropriations as necessary. Once the Retirement Board recommends any such changes, the Retirement Law requires the Employers (including the County) to implement such changes. The most recent actuarial valuation is as of June 30, 2005. The Segal Company (the "Actuary") has been retained as the Association's actuary.

*UAAL and its Calculation.* Currently, the Association uses the "entry age normal cost method" to calculate the Employers' annual rates of contribution. The actuarially required contribution has two components, the "normal cost" and the amortized amount of the unfunded actuarial accrued liability ("UAAL"). Normal cost represents the portion of the actuarial present value of the benefits that the Employers and their respective employees will be expected to fund that are attributable to a current year's employment. The amortization of the UAAL represents the current year's portion of the unfunded accrued costs (*i.e.*, the UAAL) attributable to past years' employment. The UAAL may increase or decrease as a result of changes in actuarial assumptions, benefit improvements and other experience which differs from that anticipated by the actuarial assumptions. There is a lag between the point in time at which the actuary completes the actuarial valuation and the date that the contribution rates calculated in the valuation go into effect. This lag is typically 12 months. For example, the recommended contributions contained in the actuarial report as of June 30, 2005 would apply to contributions to be made by the County and the other Employers for the fiscal year beginning July 1, 2006.

The UAAL is an estimate based on a series of assumptions that operate on demographic data of the Association's membership. This process is necessary to determine, as of the date of the calculation, how sufficient the assets in the Association are to fund, as of the date of calculation, the accrued costs attributable to currently active, deferred vested members and retired members. The funding sufficiency is typically expressed as the ratio of the valuation assets to the actuarial accrued liabilities. If the actuarially calculated funding level of a plan is less than 100%, the plan has a UAAL. Examples of the actuarial assumptions that are used in this process are the assumed rate of earnings on the assets of the plan into the future, the assumed future pay increases for current employees, assumed rates of disability, the assumed retirement ages of active employees, the assumed marital status at retirement, and the post-employment life expectancies of retirees and beneficiaries.

When measuring assets for determining the UAAL, many pension plans, including the Association, “smooth” gains and losses to reduce volatility. If in any year the actual investment return on the Association’s assets is lower or higher than the actuarial assumed rate of return (which is 8.25%, net of expenses), then the shortfall or excess is smoothed or spread over a five-year period. The impact of this will result in “smoothed” assets which are lower or higher than the market value of assets depending upon whether the remaining amount to be smoothed is either a net gain or a net loss. In the case of the Association, as a consequence of this smoothing practice, as of June 30, 2005, there were approximately \$602.3 million of gains and approximately \$191.1 million of losses yet to be smoothed in, leaving a total net unsmoothed gain of \$411.2 million remaining to be spread over the four years ending June 30, 2009.

Further, various plans use differing amortization periods for paying off (or “amortizing”) a UAAL. Some plans use different rolling periods and still others use “fixed” periods such as a 30-year fixed period, meaning that the actuarially required contribution in a particular year would be the unfunded actuarial accrued liability amortized over the remaining years in the fixed period. On June 17, 2004, the Retirement Board changed the Association’s amortization period from a 15-year rolling amortization period to a 20-year fixed layered amortization period. The amortization period remaining will be decreasing for the first 20-year layer. The 20-year amortization layer as of June 30, 2005 consists of the outstanding balance of UAAL from the June 30, 2004 valuation, plus all actuarial gains and losses during the 2004-2005 plan year. The outstanding balance from this layer will be amortized over 19 years in the June 30, 2006 valuation. Each subsequent year’s increase or decrease in UAAL, as compared to the immediately prior year’s UAAL, will be amortized over separate 20-year fixed amortization periods. The Retirement Board, as with other assumptions, may change the amortization period from time to time, which would result in the Employer’s obligations to pay the Association in a particular year being higher or lower. The reduction of the UAAL principal does not occur until the fixed period reduces to approximately 17 years because the 20-year amortization schedule contains annually increasing payments at a rate of 4% per year. See “County Financial Information – San Diego County Employees Retirement Association – Prospective Funding Status of the Association” herein. The County has transferred to the Association over the last two Fiscal Years an aggregate \$66 million above the County’s annual required contribution that has offset any effect of negative amortization. See “County Financial Information – San Diego County Employees Retirement Association – Litigation Relating to the Association” herein.

Investors are cautioned that, in considering the amount of the UAAL as reported by the Association and the resulting amounts of required contributions by the County and the other Employers, this is “forward looking” information in that it reflects the judgment of the Retirement Board and the Association’s actuary as to the amount of assets which the Association will be required to accumulate to fund future benefits over the lives of the currently active employees, vested terminated members and existing retired members. These judgments are based upon a variety of assumptions, one or more which may prove to be inaccurate or be changed in the future, and will change with the future experience of the Association.

*Assumptions.* As required by the Retirement Law, the Retirement Board and the Association’s actuary periodically review the various assumptions that are employed in calculating the UAAL against actual experience. The Association’s actuary last conducted an experience study in 2004. Pursuant to the experience study, the Retirement Board elected in March 2004 to modify certain of the assumptions used to calculate the UAAL. The changed assumptions included the assumed future pay increases for current employees, the assumed rates of disability, the assumed retirement ages of active employees, the assumed marital status at retirement, and the post-employment life expectancies of retirees and beneficiaries. The changed assumptions were included in the actuarial valuation report as of the year ended June 30, 2003. The next experience study is expected to be available in early 2007. Any changed assumptions resulting from the experience study are expected to be included in the actuarial valuation report as of the year ended June 30, 2007.

At the May 6, 2004 meeting of the Retirement Board, the Association's actuary recommended and the Retirement Board approved an asset smoothing methodology pursuant to which the expected investment return on the market value of assets (instead of the expected return on the valuation value of assets) will be compared to the actual investment return on the market value of assets, and the difference will be "smoothed" over a five-year period. This smoothing methodology became effective with return deviations beginning with the fiscal year ended June 30, 2005 and may accelerate the rate at which investment losses and gains are realized. For a discussion on actions of the Retirement Board with respect to the disposition of Excess Earnings (as defined herein), subsequent to consultation with the Actuary, see "County Financial Information – San Diego County Employees Retirement Association – Transfers of Investment Earnings by the Association" herein. For a discussion on recommended changes to the assumed investment return, rate of inflation, and individual salary increases currently under consideration by the Retirement Board, see "– Prospective Funding Status of the Association" herein.

On an annual basis, the Retirement Board receives the Actuary's recommendations on and considers the assumptions to be used by the Actuary to project the assets and liabilities of the pension fund, including the actuarial assumed rate of earnings. The County cannot predict at this time the further recommendations to be made by the Actuary, the Retirement Board's determinations with respect thereto and their potential effects on the Association's assets and liabilities.

*Investment Policy; Historical Investment Return.* The Retirement Law grants the Retirement Board exclusive control over the investment of the Association's assets. The Retirement Law provides general guidelines which generally require the Retirement Board to manage the investments for the purpose of providing benefits to members, minimizing Employer Contributions, and defraying the reasonable expenses of administering the Association. The Retirement Law further requires the Retirement Board to manage the Association's investments prudently and to diversify investments.

The Retirement Board has adopted an investment policy statement and related policies to ensure that the Association is managed prudently and in compliance with the Retirement Law. These policies set investment return and risk objectives and provide for extensive guidelines with respect to diversification of assets, securities, lending, commission recapture, value-added strategies, proxy voting, and corporate governance issues. Based on the investment policies of the Retirement Board, the Retirement Board has adopted, upon the recommendation of the Actuary, an actuarial assumed rate of return of 8.25%.

The historical annual net investment return on the market value of the Association's assets was 13.91% for the year ended June 30, 2005, 12.8% for the three years then ended, 4.71% for the five years then ended and 10.21% for the ten years then ended. This compares to the 8.25% actuarial assumed rate of return that the Association's actuary uses to calculate the normal Employer and employee contribution rates and the UAAL on a year-to-year basis (which is done by projecting into the future a variety of estimates, including how much will be earned on the assets of the Association in future years). In December 2005, the Retirement Board adopted the June 30, 2005 valuation. It reaffirmed and approved the continued use of an assumption of an 8.25% return on plan assets of the Association for purposes of calculating normal Employer and employee annual contributions and UAAL.

*Employee Contributions Paid by the Employers.* In addition to making annual contributions to the Association in accordance with the applicable actuarial valuation, the Employers also have agreed pursuant to the collective bargaining arrangements with their employee unions to pay a portion of the employees' required contribution to the Association (these payments by the Employers are referred to herein as the "Employer Offsets"), which, for non-safety employees of the Employers range from 3% to 9.5% of their salary, and for safety employees range from 2.75% to 16.42% of their salary. In most instances, the amount of Employer Offsets will be less than the total required employee annual contribution. Some of these collective bargaining agreements expire in 2006 and some expire in 2007,

but since 1982, the Employers' agreement to pay Employer Offsets has been a consistent feature of these collective bargaining arrangements. See "County Financial Information – San Diego County Employees Retirement Association – Historical Funding Status" herein for information regarding payments by the Employer of Employer Offsets for each of the ten years ending June 30, 2005.

### ***Pension Obligation Bonds***

*Introduction.* The County has issued taxable pension obligation bonds ("POBs") and transferred the proceeds to the Association to reduce the UAAL. Under California law, the obligation to fund the UAAL by making actuarially required contributions is an obligation imposed by law. The effect of issuance of POBs is to refinance that obligation and convert it from an obligation to make actuarially required contributions to an obligation to make interest and principal payments on bonds which are sold to the public.

*County Pension Obligation Bonds.* In February 1994, the County issued \$430,430,000 in principal amount of POBs (the "1994 POBs") and in October 2002 the County issued an additional \$737,340,000 in principal amount of POBs (the "2002 POBs"), in part to refund a portion of the 1994 POBs. On June 29, 2004, the County issued its 2004 POBs in the aggregate principal amount of \$454,112,915.70, including the Series 2004B Bonds that will convert from auction rate securities to bonds bearing interest at fixed interest rates on August 15, 2006. The County has contributed to the Association an aggregate amount of \$1,428,500,000 from the issuance of the 1994 POBs, the 2002 POBs and the 2004 POBs to reduce the UAAL. As of May 1, 2006, the County has POBs outstanding in the aggregate principal amount of \$1.191 billion (which amount does not include the 1994 POBs subject to the escrow and pledge of funds described under the caption "County Financial Information – San Diego County Employees Retirement Association – Pension Obligation Bonds – Escrow and Pledge of Funds for 1994 POBs" herein). The County may, from time to time, finance all or a portion of the UAAL through the additional issuances of POBs.

*Swaps.* The County has entered into swap agreements in connection with the 2002 POBs with Citibank, N.A. New York ("Citibank") and Morgan Stanley Capital Services Inc. ("Morgan") (collectively, the "Swap Providers"). The County entered into interest rate swaps to attain a "synthetic" fixed interest rate on a portion of the underlying POBs, which provided for variable interest rates, at a cost expected by the County to be less than rates associated with fixed-rate obligations at the time the related POBs were issued. See Appendix B – "County of San Diego Audited Financial Statements for the Fiscal Year Ended June 30, 2005" Note 4(J) attached to the Official Statement. Except in the event of an early swap termination, the notional amounts set forth in the table below are amortized in accordance with the scheduled reductions for the related POBs.



Table 8 below sets forth information regarding the County's interest rate swaps with respect to a portion of its 2002 POBs as of the date hereof.

**TABLE 8**  
**INTEREST RATE SWAPS**

<u>Initial and Current Notional Amount Covered by Swaps</u>	<u>Effective Date</u>	<u>Fixed Rate Paid by County</u>	<u>Variable Rate Received by County</u>	<u>Current Ratings of Swap Providers</u>	<u>Termination Date</u>
\$263 million <sup>(1)</sup>	9/17/02	5.30%	4.05% <sup>(2)</sup>	Aa1/AA/AA+ <sup>(1)(3)</sup>	2/15/31
\$142 million <sup>(4)</sup>	9/17/02	5.30%	4.05% <sup>(2)</sup>	Aa3/A+/AA- <sup>(2)(4)</sup>	2/15/31

<sup>(1)</sup> The counterparty is Citibank, N.A.

<sup>(2)</sup> Variable rate received by the County is a variable rate based on the One-Month London Interbank Offered Rate ("LIBOR"), which as of April 19, 2006 was 4.922%. The actual rate received is the One-Month LIBOR average rate for the six months preceding the payment dates of February 15 and August 15 over the life of the swap. As of February 15, 2006, the average One-Month LIBOR rate for the preceding six months was 4.05%.

<sup>(3)</sup> Ratings of Moody's Investors Service, Standard & Poor's Ratings Service and Fitch Ratings, respectively.

<sup>(4)</sup> The counterparty is Morgan Stanley Capital Services Inc.

Scheduled payments made to the County by the Swap Providers are on a parity with the respective series of POBs to which they relate. The County's rights and obligations under the swaps do not alter the County's obligation to pay the principal of, premium, if any, and interest on the respective POBs. If a Swap Provider defaults on its payment obligations under its respective swap agreement, the swap may terminate and, depending on market conditions, a termination payment (which could be substantial) may be due from the County. The County would then potentially have to pay any prospective increases in the variable interest rates payable on that portion of its POBs related to the swap.

*Escrow and Pledge of Funds for 1994 POBs.* On September 27, 2004, the County deposited with BNY Western Trust Company approximately \$63.5 million (the "Deposit"), which was invested in an Investment Agreement (the "Investment Agreement") entered into by the Trustee and an obligor. The obligations of the obligor under the Investment Agreement are guaranteed by American International Group, Inc. ("AIG"), which has been assigned long-term credit ratings from Moody's Investors Service and Standard & Poor's Ratings Services of "Aa2" and "AA," respectively. Under the Investment Agreement, the obligor will make payments to the BNY Western Trust Company in July of each of 2005, 2006 and 2007 in amounts which will be sufficient to meet the County's remaining annual payment obligations to a counterparty under a Debt Service Forward Sale Agreement (the "Forward Agreement") currently in effect for the 1994 POBs until the final maturity of the 1994 POBs on August 15, 2007. In exchange for the County's annual payments, the Forward Agreement requires the counterparty thereto to deposit securities (which must be non-callable obligations issued or guaranteed by the United States of America or certain instrumentalities or agencies of the United States of America) into the Bond Fund relating to the 1994 POBs, the cash flows of which are sufficient to pay each scheduled payment of principal of and interest on the 1994 POBs during the applicable fiscal year. The 1994 POBs will remain outstanding until their regularly scheduled maturities. If the obligor under the Investment Agreement and AIG under its related guaranty, or the counterparty to the Forward Agreement defaults in its respective obligations for any reason, the County remains obligated to make any affected payment of principal of and interest on the 1994 POBs. The 1994 POBs will remain a liability of the County until they are no longer outstanding.

### ***Funding Status of the Association***

*Current Status.* As of June 30, 2005, the date of the most recent actuarial valuation report, the valuation value of assets of the Association was approximately \$5.61 billion, the actuarial accrued liability was approximately \$6.99 billion and the funded ratio was approximately 80.3%. The actuarial value of assets may increase or decrease as a result of investment results of the Association increasing or decreasing below the actuarially assumed rate of 8.25% per annum as a consequence of increases or decreases in the securities market. No assurance can be given that the actuarial value of assets of the Association will not materially decrease.

As of June 30, 2005, the UAAL was approximately \$1.378 billion. The Association's funded ratio and the UAAL as of June 30, 2005 reflect the contribution by the County of the proceeds of the 1994 POBs, the 2002 POBs and the 2004 POBs and the contribution by the County during Fiscal Year 2004-05 of \$25 million above the County's annual required contribution, all as described above. In the valuation as of June 30, 2005, the combined contribution rate for the County for 2005-06 was calculated at 24.69%. The UAAL as of June 30, 2005 was approximately \$176 million greater than the UAAL as of June 30, 2004. This increase was primarily attributable to an actuarial loss of \$91.23 million due to return on valuation assets of 6.50% compared to the actuarially assumed rate of 8.25%, an actuarial loss of approximately \$34 million due to higher than expected salary increases in Fiscal Year 2004-05 that also carried forward into compensation assumptions used in future fiscal years, an actuarial loss of approximately \$44.5 million due to assumption changes and an actuarial loss of approximately \$54.4 million due to differences in actual versus expected experience, including losses from new service retirements. The various losses were offset in part by Employer Contributions and employee contributions during Fiscal Year 2004-05, which exceeded the normal cost and interest expense accrued during such period. The UAAL as of June 30, 2005 excludes a total net unsmoothed gain of \$411.2 million as of June 30, 2005, which amount will be spread over the four years ending June 30, 2009. See "-- UAAL and its Calculation" herein.

*Historical Funding Status.* Table 9 below sets forth for each of the ten years ended June 30, 2005 the amount of the total Employer Contributions made by the County and the other Employers, the UAAL as of the end of each of such fiscal year and the funded ratio of the Association as of the end of each of such fiscal years.

**TABLE 9**  
**HISTORICAL FUNDING STATUS**  
**Fiscal Years Ended June 30, 1996 through 2005**  
**(In Millions)**

<u>Fiscal Year</u>	<u>Employer Contribution</u> <sup>(1)</sup>	<u>Employer Offsets</u> <sup>(1)</sup>	<u>UAAL</u> <sup>(2)</sup>	<u>Funded Ratio</u> <sup>(2)</sup>
1996	37.6	37.3	(29.9)	101.3
1997	23.3	38.3	(200.2)	108.1
1998	24.3	37.2	(157.0)	105.9
1999	0.0	36.4	(221.8)	107.4
2000	0.0	38.2	(319.8)	109.9
2001	2.0	39.1	(238.8)	106.8
2002	5.3	45.2	905.1 <sup>(3)</sup>	82.5 <sup>(3)</sup>
2003	12.2 <sup>(4)</sup>	53.9	1,435.4 <sup>(4)</sup>	75.5 <sup>(4)</sup>
2004	195.0 <sup>(3)(4)</sup>	55.2	1,202.7 <sup>(4)</sup>	81.1 <sup>(4)</sup>
2005	260.0 <sup>(5)</sup>	56.1	1,378.4 <sup>(6)</sup>	80.3

Source: County of San Diego.

- (1) These contribution amounts reflect the aggregate contribution amount of all Employers and not only that of the County. The County General Fund share of Employer Contributions and Employer Offsets are estimated to be 92% based on the estimated relative percentage of payroll of the County General Fund for Fiscal Years 2003-04 and 2004-05. See "County Financial Information – San Diego County Employees' Retirement Association – General" herein.
- (2) In each year the amounts indicated under the columns Employer Contribution and the Employer Offsets were based on the valuations as reported in the actuarial valuation dated as of the end of the second preceding year ended June 30. Negative numbers represent an actuarially accrued surplus.
- (3) The UAAL and Funded Ratio indicated for the fiscal year ending June 30, 2002 are those calculated in an October 2002 actuarial valuation. The October 2002 actuarial valuation report reflected the contribution by the County of \$550 million of proceeds of the 2002 POBs to the Association on October 3, 2002. The use by the Retirement Board of the October 2002 actuarial valuation to establish the Employer required contributions is currently the subject of litigation pending against the Retirement Board and the County; see "County Financial Information – San Diego County Employees' Retirement Association – Litigation Relating to the Association – 2003-04 Contribution Litigation" for a description of this litigation. If the Retirement Board had established the Employer required contribution based on the June 30, 2002 actuarial valuation report, then the Employer required contributions in the year ended June 30, 2004 would have been approximately \$308 million, and the Employer Offsets with respect to the same year would have been the same as indicated above.
- (4) These contributions do not include any of the amounts contributed by the County from the proceeds of the issuance of the POBs in the indicated Fiscal Years. However, such amounts are reflected in the UAAL and Funded Ratios of the Association as of the end of such Fiscal Years.
- (5) Includes \$235.1 million of required contributions plus an additional discretionary contribution of \$24.9 million.
- (6) Excludes a total net unsmoothed gain of \$411.2 million as of June 30, 2005, which amount will be spread over the four years ending June 30, 2009. See "– UAAL and its Calculation" herein.

*Impacts to UAAL.* As shown in the foregoing table, from June 30, 2001 to June 30, 2003, the UAAL increased from (\$238.8) million (an "overfunded" situation) to slightly above \$1.435 billion, and the funded ratio as of the same dates declined from 106.8% to 75.5%. A number of events occurred during this period which adversely affected the UAAL and the funded ratio, including, but not limited to, (1) effective March 8, 2002, the Board of Supervisors increased retirement benefits for active employees which in turn increased actuarially determined liabilities, (2) effective March 8, 2002, the County and a

number of other counties in California agreed to increase benefits, which in turn required transfers from valuation assets; (3) investment results of the Association were below the actuarially assumed rate of 8.25% per annum as a consequence of declines in the securities market; (4) the Association adjusted several demographic assumptions based on a regular experience study conducted by its actuary that evaluates the reasonableness of the Association's assumptions and implemented those in the actuarial valuation report as of June 30, 2003; (5) the Association ceased including amounts in the Undistributed Reserve (as defined herein) as valuation assets when calculating the Association's UAAL; and (6) deviations between actual experience and those assumptions used in calculating the UAAL. In October 2002, the County contributed \$550 million from the proceeds of the 2002 POBs, thus refunding an equal amount of UAAL. From June 30, 2003 to June 30, 2004, the UAAL decreased primarily because of the issuance of the 2004 POBs. From June 30, 2004 to June 30, 2005, the UAAL increased by approximately \$176 million due to the actuarial losses described under "County Financial Information – San Diego County Employees Retirement Association – Funding Status of the Association" herein. See also "County Financial Information – San Diego County Employees Retirement Association – Prospective Funding Status of the Association" herein.

*Contribution by the County from Proceeds of VLF Receivable.* On March 17, 2005, the County transferred approximately \$24.9 million to the Association from the proceeds of the County's VLF-related obligations, which amount was in addition to the County's actuarially determined contribution for Fiscal Year 2004-05. See "– Vehicle License Fee" above.

#### ***Transfers of Investment Earnings by the Association***

*Introduction.* Pursuant to statutory authority under the Retirement Law, the Retirement Board annually directs the crediting of the Association's investment earnings to reserves, some of which are part of valuation assets, and some of which are not. Valuation assets are those assets used in calculating the UAAL and the funded ratio. For the purpose of such crediting, the Retirement Board has defined investment earnings as current income (*i.e.*, the interest, dividends, and rents) plus net realized capital gains on the book value of the Association's valuation and non-valuation assets. All of the Association's investment earnings on the Association's assets are transferred to and kept in a reserve entitled the "Undistributed Reserve," and from there such earnings are transferred in accordance with Retirement Board policy. The Undistributed Reserve is currently not part of valuation assets and, except in certain limited circumstances described herein, amounts in the Undistributed Reserve are not included as assets for purposes of calculating the Association's UAAL.

Pursuant to the statutory authority of the Retirement Law, the Retirement Board has adopted certain "Interest Crediting Goals" which direct that investment earnings be transferred from the Undistributed Reserve to the following Association reserves, effectively, in the following order. First, such earnings are credited to the Association's valuation assets up to an amount determined by the Retirement Board's policies, currently in an amount equal to 8.25% of the value of the Association's valuation assets as of the end of the prior fiscal year. Second, an amount of such earnings is transferred to a contingency reserve (the "Contingency Reserve") that is necessary to maintain the amount on deposit in the Contingency Reserve, which is not part of valuation assets, equal to one percent of the total valuation assets of the Association. The Association may transfer amounts from the Contingency Reserve to valuation assets when current investment earnings are insufficient to credit the valuation asset reserves with the 8.25% interest target. Earnings in excess of the amounts transferred to the Contingency Reserve are referred to herein as "Excess Earnings."

Although the Retirement Law permits the Association to use any Excess Earnings to pay certain supplemental benefits to retirees as well as crediting Excess Earnings to the Association's valuation assets, the Retirement Board on September 1, 2005 voted unanimously to allocate Excess Earnings to the

Health Reserve (herein defined) and the STAR COLA reserve (herein defined) to maintain amounts in each reserve at levels at least equal to that necessary to cover the costs of the respective benefits for current eligible retirees for five years, as estimated by the Association's actuary. The Retirement Board also voted unanimously to apply any remaining Excess Earnings to valuation assets to fund a portion of the pension benefits. The Health Reserve is a reserve from which the Association reimburses the Employers for amounts that the Employers contribute for the payment of post-retirement health care benefits, and the STAR COLA reserve is a reserve established for a supplemental targeted adjustment for a cost of living adjustment.

Allocation of Excess Earnings may impact the UAAL and thus the amount of Employer Contributions required to fund pension benefits in the future in part because both the Health Reserve and the STAR COLA reserve are outside of valuation assets and are not included as assets when calculating the Association's UAAL. When earnings are held outside of valuation assets, those amounts are not available to decrease an unfunded actuarial accrued liability because they are not available to pay benefits under the County's pension plan. For a discussion of the STAR COLA benefits paid by the Association and certain other related issues, see "County Financial Information – STAR COLA Benefits" herein. For a discussion of post-retirement health care benefits paid by the Association and certain other related issues, see "County Financial Information – Post-Retirement Health Care Benefits" herein.

On May 4, 2006, the Retirement Board approved a change to the methodology for calculating excess earnings of the retirement fund. Beginning with the measurement of earnings for Fiscal Year 2005-06, the Actuary will use the change in actuarial value to calculate excess earnings. Previously, the change in book value was used to measure excess earnings. No impact on the UAAL is anticipated as a result of the change in methodology.

*Historical Transfers of Investment Earnings.* Table 10 below sets forth the amount of the Association’s investment earnings that the Retirement Board has transferred from the Undistributed Reserve into reserves that are separate from valuation assets during the ten fiscal years ending June 30, 2005:

**TABLE 10**  
**TRANSFERS OF INVESTMENT EARNINGS**  
**TO NON-VALUATION RESERVES**  
**Years Ended June 30, 1996 through 2005**  
**(In Millions)**

<u>Fiscal Year</u> <u>Ended June 30,</u>	<u>Post-Retirement</u> <u>Health Care<sup>(1)</sup></u>	<u>STAR COLA<sup>(2)</sup></u>	<u>Contingency</u> <u>Reserve<sup>(3)</sup></u>	<u>Total</u>
1996	\$ 7.4	--	--	\$ 7.4
1997	23.3	--	--	6.5
1998	112.3	\$50.5	--	162.8
1999	7.3	0.0	--	7.3
2000	32.0	9.8	--	41.8
2001	45.5	8.2	--	53.7
2002	117.0	24.2	\$35.3	176.5
2003	0.0	0.0	0.0	0.0
2004	0.0	19.6	19.8	39.4
2005 <sup>(4)</sup>	<u>0.0</u>	<u>9.3</u>	<u>8.5</u>	<u>17.8</u>
Total	<u>\$344.80</u>	<u>\$121.60</u>	<u>\$63.6</u>	<u>\$513.2</u>

Source: The Association.

- (1) Reflects amounts that the Association has transferred to the Health Reserve from Excess Earnings.
- (2) Reflects amounts that the Association has transferred from Excess Earnings to a reserve established for the payment of STAR COLA. The Association began providing STAR COLA benefits in the year ended June 30, 1999, and transfers to the STAR COLA reserve began in the year ended June 30, 1998.
- (3) Reflects amounts that the Association has transferred from the Association’s investment earnings to the Contingency Reserve. The Contingency Reserve was created in the fiscal year ended June 30, 2002. Before the creation of the Contingency Reserve, the 1% contingency amounts required by the Retirement Law were maintained in the Undistributed Reserve and were not separated from valuation assets.
- (4) The Retirement Board determined that no amounts would be transferred from Excess Earnings to the Health Reserve for the year ended June 30, 2005 based on a determination that the amounts on deposit in the Health Reserve at the time was sufficient to pay post retirement health care benefits for at least 5 years from the date of determination.

In certain of the years indicated in the foregoing table, the amounts credited to the STAR COLA reserve and the Health Reserve were actually transferred after the end of the fiscal year with retroactive effect. The Association does not track either the Employer or the departments or funds of any Employer from which retired personnel receiving STAR COLA or health benefits, when in active service, were paid.

*Reserve Levels.* As of June 30, 2005, there were no funds on deposit in the Undistributed Reserve, approximately \$63.6 million was on deposit in the Contingency Reserve, approximately \$55.2 million was on deposit in the STAR COLA reserve (see “County Financial Information – STAR COLA Benefits” herein), and approximately \$216.2 million was on deposit in the Health Reserve. For a discussion on actions of the Retirement Board with respect to the transfer of certain Excess Earnings to the Health Reserve and the STAR COLA reserve, see “County Financial Information – San Diego County Employees Retirement Association – Transfers of Investment Earnings by the Association” herein. See

also “County Financial Information – STAR COLA Benefits” and “County Financial Information – Post-Retirement Healthcare Benefits – Health Reserve” herein.

***Prospective Funding Status of the Association***

Table 11 below sets forth projections by the Association’s actuary relating to future Employer Contribution amounts, Employer Offsets, UAAL, and funded ratio. The information contained in this table, and the related assumptions, are “forward-looking” in nature and are not to be construed as representations of fact or representations that in fact the various tabular information shown will be the correct amounts for the years indicated. Rather, these reflect good faith estimates by the Association’s actuary and the County taking into account a variety of assumptions, a number of which are discussed herein. Accordingly, prospective investors are cautioned to review these estimates as general indications of orders of magnitude and not as precise amounts.

On June 1, 2006, the Association’s Actuary presented to the Retirement Board for discussion purposes a report entitled “Review of Economic Actuarial Assumptions for the June 30, 2006 Actuarial Valuation,” pursuant to which the Actuary recommended certain changes to the assumed investment return, rate of inflation, and individual salary increases. The Actuary indicated in discussions with the Association that its recommended changes could result in an estimated \$200 million increase in the Association’s UAAL and an approximate 200 basis point increase in the Employer Contribution rate for Fiscal Year 2007-08, which is approximately \$20 million higher than the projected Employer Contribution amount for Fiscal Year 2007-08 calculated using the actuarial assumptions currently in effect. Consistent with the Retirement Board’s practice regarding discussion items, the Retirement Board took no immediate action on the Actuary’s recommendations. The Retirement Board is expected to take action on the Actuary’s recommendations at its July 6, 2006 meeting. The County cannot predict the Retirement Board’s upcoming actions and their potential effects on the Association’s assets and liabilities. The amounts shown in Tables 11, 12, and 13 below reflect the currently adopted assumptions, as noted in the footnotes to these tables.

**TABLE 11**

**PROSPECTIVE FUNDING STATUS OF THE ASSOCIATION  
Years Ended June 30, 2006 through 2012  
(In Millions)**

<u>Fiscal Year</u>	<u>Employer Contributions</u> <sup>(1)(3)(4)</sup>	<u>Employer Offsets</u> <sup>(2)(3)(4)</sup>	<u>UAAL</u> <sup>(1)(3)(4)(5)</sup>	<u>Funded Ratio</u> <sup>(1)(4)</sup>
2006	\$212	\$58	\$1,326	82.4%
2007	237	60	1,131	86.0
2008	243	63	900	89.6
2009	238	66	793	91.5
2010	231	69	766	92.3
2011	234	72	745	93.1
2012	243	75	719	93.8

Source: The Segal Company.

- (1) The following assumptions have been applied in preparing the foregoing estimates:
- (a) The annual investment return on the market value of assets will be 8.25% after June 30, 2005. Under the Retirement Board's asset smoothing method, if actual return on market value of assets is above/below the expected return on market value of assets, the difference between the actual and the expected return will be recognized over a five-year period. There was a total of \$411.2 million in unrecognized investment gain as of June 30, 2005.
  - (b) All of the actuarial assumptions used in developing the contribution rates in the June 30, 2005 valuation will be met in the future.
  - (c) In projecting the payroll, the Actuary assumed that the estimated Fiscal Year 2005-2006 payroll of \$921.8 million used in the June 30, 2005 actuarial valuation will increase by 4.25% per annum.
  - (d) The Retirement Board's current valuation methodologies, such as the 20-year fixed layered amortization period for the UAAL and the five-year smoothing asset valuation method (described in (a)), will remain unchanged.
  - (e) The Employee Offsets (*i.e.*, the County's pickup of member contributions) of about \$56 million (reported by the Association for the 2004-2005 Fiscal Year) will increase by the 4.00% inflation plus the 0.25% across-the-board salary increase assumptions used in the June 30, 2005 valuation to \$58 million for Fiscal Year 2005-06. The Employee Offsets for Fiscal Year 2007-2008 and thereafter have been approximated by increasing the prior year's offsets by 4.25%. See "County Financial Information – San Diego County Employees Retirement Association – General" herein. This is a simplifying assumption as the actual Employee Offsets amount is governed by bargaining agreements with employee groups and actual membership demographics.
- (2) Employer Offsets for each year will increase over the prior year by approximately 4.25%. Employer Offsets are governed by collective bargaining agreements with the Employers' employee groups and reflect in part actual membership demographics, since the actual amount of contributions depend upon length of service with the County.
- (3) The County is obligated to make 91.5% of the annual Employer Contributions to the Association, the County's General Fund is obligated to make 84.7% of the annual Employer Contributions to the Association and the other participating employers are obligated to make 8.5% of the annual Employer Contributions to the Association, based on the estimated relative percentage of payroll of the County, the County General Fund and the other participating employers for Fiscal Year 2006-07.
- (4) In each year the Employer-Required Contribution and the Employer Offsets will be based on the UAAL as reported in the actuarial valuation dated as of the end of the second preceding year ended June 30. Indicated projected amounts under the columns entitled "UAAL" and "Funded Ratio" are as of June 30 of the years indicated.

The amounts shown in the foregoing table do not give effect to any transfers of Excess Earnings to non-valuation assets (such as to the Health Reserve or to the STAR COLA reserve); however, a transfer of earnings sufficient to maintain the amount on deposit in the Contingency Reserve equal to 1% of the market value of all of the Association's assets is reflected in the indicated amounts. Historically, the Association has transferred from Excess Earnings to the Health Reserve and the STAR COLA reserve, collectively, approximately \$223.8 million for the five years ended June 30, 2005. See "County Financial Information – San Diego County Employees Retirement Association – Transfers of Investment Earnings by the Association" for a description of how transfers from excess earnings remove assets from valuation assets which, over time, may increase the UAAL and the required contributions of the County



and the other Employers. If such transfers occur in one or more of the years shown, which will most likely occur but the amounts to be transferred or when any transfers will in fact occur is not known, the effect of such transfers will be to increase Employer Contributions and UAAL.

### **Pension Related Payments and Obligations**

*Payments.* Table 12 below sets forth the historical and estimated Employer Contributions, Employer Offsets and POB debt service for Fiscal Years 2001 through 2012. The estimates contained in this table, and the related assumptions, are “forward-looking” in nature and are not to be construed as representations of fact or representations that in fact the various estimates shown will be the correct amounts for the years indicated. Rather, these reflect good faith estimates by the County taking into account a variety of assumptions, a number of which are discussed herein. Accordingly, prospective investors are cautioned to review these estimates as general indications of orders of magnitude and not as precise amounts.

The County anticipates converting the portion of the 2004 POBs bearing interest at auction rates to bonds bearing fixed rates of interest on August 15, 2006. The fixed rates applicable to such 2004 POBs have not been determined. The POB debt service set forth below reflects debt service on such 2004 POBs while bearing interest at variable rates, as described below.

**TABLE 12**

**PENSION RELATED PAYMENTS**  
**Fiscal Years Ended June 30, 2001 through 2014**  
(In Millions)

<u>Fiscal Year</u>	<u>Employer Contributions<sup>(3)</sup></u>	<u>Employer Offsets</u>	<u>County Pension Obligation Bonds Debt Service<sup>(4)</sup></u>	<u>Total Pension Related Payments</u>	<u>Percent Change Year to Year</u>
2001 <sup>(1)</sup>	\$ 2.0	\$39.1	\$51.3	\$ 92.4	6.2%
2002 <sup>(1)</sup>	5.3	45.2	53.8	104.3	12.9
2003 <sup>(1)</sup>	12.2	53.9	55.8	121.9	16.9
2004 <sup>(1)</sup>	195.0 <sup>(5)</sup>	55.2	56.8	307.0	151.8
2005 <sup>(1)</sup>	260.0	56.1	62.9	379.0	23.5
2006 <sup>(2)(7)</sup>	212.0	58.0	78.0	348.0	(8.2)
2007 <sup>(2)(7)</sup>	237.0	60.0	71.6	368.6	5.9
2008 <sup>(2)(7)</sup>	243.0	63.0	70.3	376.3	2.1
2009 <sup>(2)(7)</sup>	238.0	66.0	85.9	389.9	3.6
2010 <sup>(2)(7)</sup>	231.0	69.0	87.2	387.2	(0.7)
2011 <sup>(2)(7)</sup>	234.0	72.0	88.5	394.5	1.9
2012 <sup>(2)(7)</sup>	243.0	75.0	89.9	407.9	3.4
2013 <sup>(2)(7)</sup>	253.0	78.0	92.2	423.2	3.8
2014 <sup>(2)(7)</sup>	264.0	81.0	92.8	437.8	3.4

Source: The Segal Company; County of San Diego.

<sup>(1)</sup> Actual.

<sup>(2)</sup> Estimated. The amounts indicated are subject to the same assumptions as set forth in footnotes (1) through (4) to the “Prospective Funding Status of the Association” table herein.

<sup>(3)</sup> Contribution amounts reflect the aggregate contribution amount of all Employers and not only that of the County. The County General Fund share of Employer Contributions and Employer Offsets are estimated to be 92% based on the estimated relative percentage of payroll of the County General Fund for Fiscal Years 2003-04 and 2004-05. See “County Financial Information – San Diego County Employees Retirement Association – General” herein.

<sup>(4)</sup> A portion of the 2002 POBs in the principal amount of \$100,000,000 (the “Variable 2002 POBs”) and a portion of the 2004 POBs in the principal amount of \$147,825,000 (the “Variable 2004 POBs”) currently bear interest at variable rates. In projecting debt service for fiscal years 2005 to 2014, the County has made the following assumptions with respect to the variable interest rate for the Variable 2002 POBs and the Variable 2004 POBs. \$405,125,000 principal amount of the Variable 2002 POBs has been synthetically fixed pursuant to a swap agreement between the County and the Swap Providers, and the balance of the Variable 2002 POBs are not subject to such agreement. The County has assumed that those Variable 2002 POBs subject to the swap agreement will bear interest at 5.30% during the indicated fiscal years, and that Swap Providers will perform their obligations under the swap agreement in all material respects. For a description of the swap agreement with respect to the Variable 2002 POBs, see “County Financial Information – San Diego County Employees Retirement Association – Pension Obligation Bonds – Swaps” herein. The balance of the Variable 2002 POBs are assumed to bear interest at a variable rate of 6.18%, which consists of the historical average rate from March 2005 through March 2006 of 3.87%, plus an additional 2.00% contingency amount and an additional 0.31% to account for ongoing broker-dealer fees. All of the Variable 2004 POBs are assumed to bear interest at a variable rate of 6.16%, which consists of the historical average rate from March 2005 through March 2006 of 3.85%, plus an additional 2.00% contingency amount and an additional 0.31% to account for ongoing broker-dealer fees. The County anticipates converting the Variable 2004 POBs to bonds bearing fixed rates of interest on August 15, 2006. There are no swaps with respect to the 2004 POBs. On September 27, 2004, the County established an Escrow and Pledge Fund with respect to the 1994 POBs. See “County Financial Information – San Diego County Employees Retirement Association – Pension Obligation Bonds – Escrow and Pledge of Funds for 1994 POBs” herein. Accordingly, debt service with respect to the 1994 POBs for Fiscal Years ending after June 30, 2004 is not reflected in this table.

<sup>(5)</sup> See footnote (3) to the “Historical Funding Status” table herein.

<sup>(6)</sup> Increased total pension payments in 2004 are primarily a result of the implementation of enhanced benefit levels and investment results that were below the actuarially assumed rate of 8.25%. See “County Financial Information – San Diego County Employees Retirement Association – Funding Status of the Association – Impacts to UAAL” herein. Increased total pension payments in 2005 are primarily a result of changes in actuarial assumptions for the valuation as of June 30, 2003 based on an experience study and recognition of smoothed losses.

<sup>(7)</sup> Estimated; based on data, results and assumptions used in preparation the actuarial valuation as of June 30, 2005.

*Obligations.* Table 13 below sets forth the historical and estimated UAAL and expected outstanding principal amounts of POBs for the years indicated, assuming no additional POBs are issued and the outstanding POBs mature on their respective amortization schedules. The estimates contained in this table, and the related assumptions, are “forward-looking” in nature and are not to be construed as representations of fact or representations that in fact the various estimates shown will be the correct amounts for the years indicated. Rather, these reflect good faith estimates by the County taking into account a variety of assumptions, a number of which are discussed herein. Accordingly, prospective investors are cautioned to review these estimates as general indications of orders of magnitude and not as precise amounts.

**TABLE 13**  
**COUNTY PENSION RELATED OBLIGATIONS**  
**Fiscal Years Ended June 30, 2001 through 2012**  
**(In Millions)**

<u>Fiscal Year</u> <sup>(1)</sup>	<u>UAAL</u> <sup>(1)</sup>	<u>Outstanding Pension Obligation Bonds</u> <sup>(1)(4)</sup>	<u>Total Outstanding Obligations</u> <sup>(1)</sup>
2001	(\$ 238.8) <sup>(2)</sup>	\$ 317.3 <sup>(2)</sup>	\$ 78.5
2002	905.1 <sup>(2)(3)</sup>	282.9 <sup>(2)</sup>	1,188.0
2003	1,435.4 <sup>(2)</sup>	980.8 <sup>(2)</sup>	2,416.2
2004	1,202.7 <sup>(2)</sup>	1,269.8 <sup>(2)</sup>	2,472.5
2005	1,378.0 <sup>(5)</sup>	1,193.6 <sup>(2)</sup>	2,571.6
2006	1,326.0 <sup>(5)</sup>	1,197.2 <sup>(6)</sup>	2,523.2
2007	1,131.0 <sup>(5)</sup>	1,191.3 <sup>(6)</sup>	2,322.3
2008	900.0 <sup>(5)</sup>	1,186.7 <sup>(6)</sup>	2,086.7
2009	793.0 <sup>(5)</sup>	1,165.9 <sup>(6)</sup>	1,958.9
2010	766.0 <sup>(5)</sup>	1,143.0 <sup>(6)</sup>	1,909.0
2011	745.0 <sup>(5)</sup>	1,117.7 <sup>(6)</sup>	1,862.7
2012	719.0 <sup>(5)</sup>	1,089.9 <sup>(6)</sup>	1,808.9

Source: The Segal Company; County of San Diego.

<sup>(1)</sup> As of June 30 of each fiscal year.

<sup>(2)</sup> Actual.

<sup>(3)</sup> See footnote (3) to the “Historical Funding Status” table herein.

<sup>(4)</sup> On September 27, 2004, the County established an Escrow and Pledge Fund with respect to the 1994 POBs. See “County Financial Information – San Diego County Employees Retirement Association – Pension Obligation Bonds – Escrow and Pledge of Funds for 1994 POBs” herein. Accordingly, outstanding principal balances with respect to the 1994 POBs for Fiscal Years ending after June 30, 2004 are not reflected in this table.

<sup>(5)</sup> Estimated; based on data, results and assumptions used in preparation of the actuarial valuation as of June 30, 2005.

<sup>(6)</sup> Includes a portion of the 2004 POBs issued as capital appreciation bonds (the “CABs”), for which interest accretes semiannually on February 15 and August 15, but is not payable until the final maturity of each respective capital appreciation bond. The initial total issuance amount of the CABs was \$64,927,915.70, which will accrete to a total maturity value of \$100,170,000 over the respective maturity dates commencing August 15, 2009 and ending August 15, 2015.

## **STAR COLA Benefits**

*STAR COLA Benefits.* The STAR COLA benefits provide retirees with additional cost-of-living adjustments. The Retirement Board’s STAR COLA policy preserves 80% of a retiree’s purchasing power calculated against when that retiree retired. The Retirement Law does not require the Association to provide any STAR COLA payments. In addition, in the opinion of County Counsel, the County has not entered into any collective bargaining agreements or other arrangements that require the County or the

Association to maintain STAR COLA benefits. Therefore, in the view of County Counsel, the Association’s payments of STAR COLA benefits is an unvested benefit which can be cancelled at any time and for any reason by the Association.

*STAR COLA Reserve; Historical Payments.* Since it authorized the payment of STAR COLA benefits in 1998, the Retirement Board’s historical practice has maintained an amount in the STAR COLA reserve that the Association’s actuary estimates will be necessary to cover the costs of the STAR COLA benefits for current eligible retirees for five years. Each year, the Association’s actuary prepares an estimate of the amounts necessary to be contributed to the STAR COLA reserve to meet this targeted level. For a discussion on actions of the Retirement Board with respect to the transfer of certain Excess Earnings to the Health Reserve and the STAR COLA reserve, see “County Financial Information – San Diego County Employees Retirement Association – Transfers of Investment Earnings by the Association” herein. As of June 30, 2005, approximately \$55.2 million was on deposit in the STAR COLA reserve.

Table 14 below sets forth the amounts paid by the Association to retirees out of the STAR COLA reserve since 1999. The Association does not track either the Employer or the departments or funds of any Employer from which retired personnel receiving STAR COLA benefits, when in active service, were paid.

**TABLE 14**

**PAYMENTS FROM STAR COLA RESERVE  
Years Ended June 30, 1998 through 2005**

<u>Fiscal Year</u> <u>Ending June 30</u>	<u>Payments from</u> <u>STAR COLA Reserve</u> <u>(in millions)</u>
1999	\$ 11.5
2000	9.2
2001	8.2
2002	8.1
2003	7.2
2004	11.3
2005	11.0

**Post-Retirement Healthcare Benefits**

*General.* The Association offers to its retirees a health benefit to offset or reimburse the cost of medical insurance premiums. A variety of health care and dental plans with varying providers and levels of premiums are sponsored by the Association. Once a retiree elects a particular health care or dental plan, the amount of the premium is deducted from the retiree’s monthly retirement check. Alternatively, retirees may be reimbursed for health insurance premiums of non-Association sponsored plans. With respect to those retirees who have 10 or more years of service credit before retirement, the Association currently offers a monthly medical allowance that ranges from \$200 to \$400 depending on the years of service credit and Medicare eligibility. With respect to those retirees who are Medicare eligible, the maximum monthly medical allowance is reduced to \$300, but the Association reimburses such retirees for their Medicare Part B premium, which for 2006 is \$88.50.

*Nature of the Post-Retirement Health Care Payments.* The Retirement Law does not require the Association to provide any post-retirement health care payments. In addition, in the opinion of County Counsel, the County has not entered into any collective bargaining agreements or other arrangements that require the County or the Association to maintain post-retirement health care benefits (although some members of the Association have stated that the County did promise retirees such benefits, which the County disputes). Therefore, in the view of County Counsel, the Association's payment of post-retirement health care benefits is an unvested benefit which can be cancelled at any time and for any reason by the Association. Nonetheless, the Association has continuously provided post-retirement health care benefits for many years.

*Accounting Considerations.* Currently, governmental agencies that are on a pay-as-you-go basis, such as the County, are not required to accrue for post-employment healthcare benefits in the same manner as they accrue for pension benefits. In 2004, the Governmental Accounting Standards Board ("GASB") issued two statements that address other post-employment benefits ("OPEB"), which are defined to include post retirement health care benefits. GASB Statement No. 43, Financial Reporting for Post-employment Benefits Plans Other Than Pension Plans ("GASB 43"), establishes financial reporting standards for OPEB in a manner similar to those currently in effect for pension benefits. The provisions of GASB 43, which focuses on the entity that administers such benefits (currently the Association) and requires an actuarial valuation to determine the funded status of benefits accrued, must be implemented by the Association no later than the Fiscal Year ending June 30, 2007. The Association has taken steps to inform itself, its members, the County and the general public about funding healthcare and cost-of-living benefits. In connection therewith, the Association held three retiree healthcare workshops between December 2005 and March 2006. One of the workshops was led by the Actuary; another specifically focused on benefits that could be available through a voluntary employee benefits association and other trust options.

The Actuarial Valuation and Review of Postretirement Welfare Benefits as of June 30, 2005, dated November 18, 2005 (the "2005 Postretirement Benefits Valuation"), delivered to the Association with respect to its post-retirement healthcare benefits does not provide disclosure information that may be required under GASB 43. In particular, the appropriate interest rate for liabilities will need to be determined. It may be determined that the interest rate used to calculate GASB 43 liabilities is lower than the rate used in the 2005 Postretirement Benefits Valuation, in which case the actuarial accrued liabilities would be higher than reported.

The 2005 Postretirement Benefits Valuation indicated that the actuarial accrued liability for post retirement health care benefits, whether vested or not vested, was approximately \$639.5 million, approximately 16.6% above the actuarial accrued liability of \$548.4 million as of June 30, 2003, the date of the last actuarial valuation for post-retirement benefits. Approximately \$216.2 million was on deposit in the Health Reserve as of June 30, 2005. See " – Health Reserve" herein.

GASB Statement No. 45, Accounting and Financial Reporting by Employers for Post-employment Benefits Other Than Pensions ("GASB 45"), establishes financial reporting standards designed to measure, recognize and disclose OPEB costs. GASB 45 requires substantially different financial accounting of OPEB, or any post-employment benefits that are provided separately from a pension plan, such as post-employment healthcare. For the County, the affected benefits include the post-employment health care benefits paid by the Association. GASB 45 seeks to associate the costs of the OPEB with the periods in which the employee services are rendered in exchange for the OPEB. Currently, however, OPEB is accounted for by the County on a pay-as-you-go basis, which does not require the accrual of costs associated with OPEB that are attributable to current and past fiscal years.

The core requirement of GASB 45 is that at least biennially an actuarial analysis must be prepared with respect to projected benefits (“Plan Liabilities”); against this would be measured the actuarially determined value of the related assets (the “Plan Assets”). To the extent that Plan Liabilities exceeded Plan Assets, then similar to the actuarial and accounting practices for pension plan liabilities, the difference would be amortized over a period which could be up to 30 years. The method of financial reporting for OPEB costs would be similar to financial reporting for pension plan normal costs and UAAL.

The requirements that GASB 45 imposes on the County only affect the County’s financial statements and would not impose any requirements regarding the funding of any OPEB plans. The County is required to include the disclosure required by the Statement beginning with the fiscal year ending June 30, 2008. The UAAL of OPEB has not been determined, nor have actuarial contribution rates been established to fund the UAAL. The County’s ability to fund OPEB on an accrual basis in the future is unknown, but the liability is expected to be substantial. At this time, the County does not intend to implement GASB 45 prior to the issuance of financing statements for the fiscal year ending June 30, 2008.

*Source of Payment.* The Retirement Law authorizes a mechanism for the payment of post-retirement health care benefit costs pursuant to which a portion of the Employers’ contributions are applied to the payment of these post-retirement health care benefits and the amounts of those contributions are credited to the Employers as part of their current-year contributions. The Employers currently designate up to 25% of their respective normal cost and employer offset annual contributions to the payment of the monthly medical allowance and Medicare Part B premium reimbursement. Upon receiving the Employers’ contributions, the Association transfers from the Health Reserve an amount equal to that contributed by the Employers to the Association’s valuation assets as a credit for the Employers’ current-year contributions.

*Health Reserve.* The Association has transferred varying annual amounts to the Health Reserve from Excess Earnings, as described above under “County Financial Information – San Diego County Employees Retirement Association – Transfers of Investment Earnings by the Association.” For a discussion on actions of the Retirement Board with respect to the transfer of certain Excess Earnings to the Health Reserve and the STAR COLA reserve, see “County Financial Information – San Diego County Employees Retirement Association – Transfers of Investment Earnings by the Association” herein. As of June 30, 2005, approximately \$216.2 million was on deposit in the Health Reserve.

*Payments.* Table 15 below sets forth the amounts for each of the ten years ended June 30, 2005 that the Association has paid to its members from the Health Reserve:

**TABLE 15**  
**PAYMENTS FROM HEALTH RESERVE**  
**Years Ended June 30, 1996 through 2005**

<u>Fiscal Year</u> <u>Ending June 30</u>	<u>Payments from</u> <u>Health Reserve</u> <u>(in millions)</u>
1996	\$ 7.4
1997	6.5
1998	6.6
1999	8.0
2000	9.0
2001	10.8
2002	14.3 <sup>(1)</sup>
2003	20.0 <sup>(1)</sup>
2004	26.4 <sup>(1)</sup>
2005	32.6

<sup>(1)</sup> A portion of the indicated amounts are allocated to the administrative expenses related to the provision of the post-retirement health care benefits.

According to cash flow projections conducted by the Actuary, reimbursements to Association members from the Health Reserve are projected to increase by almost 90% over the next 10 years, reaching approximately \$61.5 million in 2015. The Association does not track either the Employer or the departments or funds of any Employer from which retired personnel receiving post-retirement health care benefits, when in active service, were paid.

**Litigation Relating to the Association**

*2003-04 Contribution Litigation.* Two retired employees of the County who are members in the Association brought an action against the County and the Retirement Board claiming that the Retirement Board did not require an adequate contribution to the Association with respect to Fiscal Year 2003-04. The amount of the County’s annual contribution varies depending on the results of an annual actuarial valuation of the assets in and obligations of the pension fund. The Association prepared an actuarial valuation as of June 30, 2002, and the Retirement Board authorized a contribution by the County of approximately \$260 million (the “First Valuation”). As a result of a number of factors, the Association undertook a revised actuarial valuation as of October 3, 2002 that reflected a lower amount necessary to contribute to the Association, which equaled approximately \$184 million (the “Second Valuation”), which the Retirement Board has now authorized. The major factors that reduced the amount of the County’s contribution between the First Valuation and the Second Valuation were (1) the County’s contribution to the Association of amounts received from the County’s Taxable Pension Obligation Bonds and (2) the change by the Retirement Board of the amortization period over which the County funds the unfunded liability of the Association from five and ten years rolling (depending on the type of unfunded liability) to a rolling 15 years (with respect to all unfunded liabilities). The essence of the plaintiffs’ complaint was that the Retirement Board by authorizing the second valuation, which resulted in lowering

the County's annual contribution, acted against the best interest of the members of the Retirement Association and therefore violated the State Constitution.

On May 18, 2004, the trial court ruled in favor of the Association and the County. Plaintiffs appealed the trial court ruling and on January 30, 2006 the Court of Appeal issued a decision that affirmed the judgment of the trial court. The California Supreme Court has denied plaintiff's petition for review.

*Amortization Litigation.* Three residents of the County, two of whom are retired members of the Association, brought an amended complaint against the County and the Association seeking, among other things, a judicial determination that the Retirement Law does not permit the negative amortization alleged included in the first three years of the Retirement Board's 20-year layered fixed amortization policy, monetary damages against the County, without borrowing, payable to the Association, for the amount of unfunded liability of the retirement system that existed on June 30, 1975, with interest, that was not "fully paid" as of June 30, 2005, an injunction prohibiting the Association from adopting any actuarial method or practice that includes negative amortization of the retirement system's unfunded liability, and a judicial determination that the Retirement Board violated Section 17(b) of Article XVI of the State Constitution by allegedly giving precedence to minimizing the County's annual Employer Contribution rather than assuring the sufficiency of the assets of the retirement system to deliver the retirement and other statutorily-authorized benefits that may be provided to the Association's members under the Retirement Law. The trial court sustained the Association's demurrer in connection with the initial complaint.

The amortization policy approved by the Retirement Board is within the 30 year amortization limit set forth under the Retirement Law. In addition, Section 17 of Article XVI of the State Constitution provides retirement boards with "sole and exclusive power to provide for actuarial service". The County has transferred to the Association over the last two Fiscal Years an aggregate \$66 million above the County's annual required contribution that has offset any effect of negative amortization. See "County Financial Information – San Diego County Employees Retirement Association – General Funding Practices of the Association" herein. Although the County believes that it will be successful in defending against the complaint, the financial consequences to the County could be material if the court grants one or more of the remedies sought by the plaintiffs. In addition, the County does not control the litigation position or strategy of the Association. Actions of the Association in response to the litigation could have material financial consequences to the County.

## **Risk Management**

The County is required to obtain and maintain public liability insurance and workers' compensation insurance under various types of its financing lease obligations. These financing leases generally require public liability insurance to be issued by a responsible carrier or be in the form of self-insurance or self-funding to cover claims for damages including death, personal injury, bodily injury, or property damage arising from operations involving the facilities covered by such leases, affording protection with a combined single limit loss of not less than \$5,000,000 per occurrence with respect to bodily injury, death or property damage liability. In addition, these financing leases generally require the County to obtain and maintain workers' compensation insurance issued by a responsible carrier or in the form of self-insurance or self-funding to cover all persons employed by the County in connection with the facilities covered by such leases and to cover full liability for compensation under the act requiring workers' compensation. Any self-insurance or self-funding for these risks is subject to certain conditions, including, but not limited to, providing evidence of self-insurance and annual certification to the trustee with respect to such financing leases by an authorized representative of the County's risk management division or an independent insurance consultant of the sufficiency of coverage. Appropriation of such funds as may be necessary for self-funding, are made by the County.



The County operates a Risk Management Program, whereby it is self-insured for premises liability, medical malpractice, errors and omissions, false arrest, forgery, general liability and workers' compensation. The County purchases insurance for property damage, certain casualty claims, public officials bond, employee dishonesty, faithful performance, volunteers, airport comprehensive, and loss of money and securities based upon site locations. Settlements in the areas covered have not exceeded insurance coverage for each of the past three fiscal years. The County allocated the cost of providing claims service to all its operating funds as a "premium" charge expressed as a percentage of payroll. In accordance with Government Accounting Standards Board Statement 10, "Accounting and Financial Reporting for Risk Financing and Relating Insurance Items," the County established two Internal Service Funds, the Public Service Liability Fund and the Worker's Compensation Fund (collectively, the "ISF") to report all of its uninsured risk management activities. Risk management liabilities are reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. Actuarial evaluations were obtained which determine estimates of known and projected public liability and workers compensation claim liabilities. At June 30, 2005, the amount of these liabilities, including an estimate for claims incurred but not reported and allocated and unallocated loss adjustment expenses was estimated at \$103.6 million, including \$17.5 million in public liability and \$86.1 million in workers' compensation. As of June 30, 2005, the ISF had reserves of \$53.5 million. The estimate of claims liabilities were recorded in the ISF. In Fiscal Year 2004-05, the County deposited \$2 million into the Worker's Compensation Fund Reserve and appropriated sufficient funds to pay anticipated claims. For Fiscal Year 2005-06, the County is scheduled to deposit \$3.4 million into the Workers' Compensation Fund Reserve in addition to appropriating sufficient funds to pay anticipated claims. The County's Fiscal Year 2006-07 Proposed Budget provides for a deposit of \$4.0 million into the Workers' Compensation Fund Reserve in addition to appropriating sufficient funds to pay anticipated claims.

## **Litigation**

*CMS Litigation.* Section 17000 of the California Welfare & Institutions Code requires the County to provide relief and support to all incompetent, poor and indigent persons, and those incapacitated by age, disease, or accident, who are lawful residents in the County, if those person are not supported or relieved by some other means. The County satisfies its Section 17000 obligation to provide medical care through its County Medical Services (the "CMS") program. Persons who are eligible to receive medical care services under the CMS program are those who have net income below a certain level designated by the CMS program (the "Eligibility Level") and are not otherwise eligible for medical care services from the State or Federal Government. The County pays for medically necessary care received by individuals who are eligible and have qualified for the CMS program.

The County was sued by five individuals who were denied eligibility under the CMS program because their respective net incomes exceeded the Eligibility Level. Plaintiffs sought to invalidate the income eligibility requirements of the CMS program and to compel the County to implement new eligibility requirements. Class action status was requested by the plaintiffs and granted by the court. The class includes all individuals whose applications for CMS were denied on or after January 24, 2004 because their net income exceeded the Eligibility Level.

As a result of the litigation, the County Board of Supervisors, on December 6, 2005, adopted new income standards for determining eligibility for the CMS program. Pursuant to the court's order, the new standards are retroactive to January 24, 2004. On April 7, 2006, the court approved the new income eligibility standards adopted by the County and approved the County's plan of implementation for notifying class members who were denied eligibility on or after January 24, 2004, of the procedure for filing claims to obtain reimbursement of amounts paid for medical services. The plaintiffs' right to file an appeal of the court's determination expires on July 31, 2006; no such appeal has been filed to date.

The new standards became effective November 30, 2005, and will result in an increased number of applicants who will be eligible for benefits from the CMS program and an increase in the overall cost to the County in administering the CMS program. The County budgeted \$66.3 million for the provision of these benefits (without regard to any new eligibility requirements) in the 2005-06 Adopted Budget and provided for \$72.3 million for the provision of these benefits (accounting for new eligibility requirements) in the 2006-07 Proposed Budget. Additional costs incurred in Fiscal Year 2005-06 will be paid from existing appropriations.

Because the number of additional persons who may be eligible for benefits under the new standards will not be fully known until after the new standards have been fully implemented and in effect for at least one fiscal year, the County cannot, at this time, reasonably predict the extent of the increased costs that it may incur in the fiscal years after Fiscal Year 2005-06. However, since the CMS program is not fully funded on an on-going basis by the State or Federal Government, the County's general purpose revenues may be used to pay for any cost increases in providing these benefits. See "County Financial Information – County's 2006-07 Proposed Budget and the Operational Plan" for a description of the County's general purpose revenues.

*Cedar Fire Litigation.* The County and the California Department of Forestry (the "CDF") are named defendants in a law suit the claims of which arise out of the loss of the plaintiffs' home in the October 2003 Cedar Fire. In their original complaint, the plaintiffs alleged that the County and CFD failed to coordinate an effective response or to promptly dispatch sufficient resources to control the fire. With respect to the plaintiffs' original complaint, the trial court sustained the defendants' demurrer with leave to amend only as to narrow aspects of their suit. The plaintiffs submitted an amended complaint, which also alleged that the defendants failed to prevent an overgrowth of vegetation on "public lands that were subject to defendants' [regulatory] control" and that 911 emergency dispatchers misled callers with respect to the severity of the fire, thereby breaching a special relationship duty. The County demurred again to plaintiffs' amended complaint. The court invited supplemental briefing on certain issues, and then sustained the demurrer without leave to amend. Judgment was entered in favor of the defendants in late November 2005. Plaintiffs did not appeal. For that reason, the plaintiffs' request to have their lawsuit certified as a class action on behalf of all "similarly situated" property owners was rendered moot. Further, the statute of limitation has now expired without any new claim or lawsuit having been filed by any potential plaintiff.

*Wrongful Conviction Litigation.* Ken Marsh filed a claim against the County of San Diego seeking damages in excess of \$50,000,000. He alleged that the County and some of its employees conspired with employees of Children's Hospital to wrongfully convict him of the murder of 2 ½ year old Phillip Buell. The claim was rejected and on August 9, 2005, Marsh filed a complaint for damages in the United States District Court, Southern District of California, Case No. 05cv1568 WQH(NLS). In the County's opinion, to prevail in the civil action Marsh must prove that a County pathologist and deputy coroner lied about Phillip's cause of death in concert with physicians at Children's Hospital, and then committed perjury during the criminal trial to secure the conviction of Marsh. While the outcome of any litigation is uncertain, the County does not expect any facts will be uncovered during the civil case to establish liability and anticipates that the matter will be resolved favorably by the trial judge on motion. The County anticipates that any impact of this litigation will not adversely affect the ability of the County to pay its obligations as and when due.

## **Short-Term Borrowing**

On July 1, 2005, the County issued its 2005-06 Tax and Revenue Anticipation Notes (the “2005 TRANs”) on behalf of the County and certain school districts within the County in an aggregate principal amount of \$317,100,000, of which \$250,000,000 represent notes issued by the County. The 2005 TRANs mature on July 14, 2006. The 2005 TRANs were issued for the purpose of financing seasonal cash flow requirements for general fund expenditures.

In addition, in June 2005 the County authorized and issued its Series B-1 Teeter Notes and its Series B-2 Teeter Notes as taxable and tax-exempt obligations, secured by (1) a pledge of all amounts received by the County as payments for delinquent property taxes associated with the Teeter Plan levied in all Fiscal Years ended before June 30, 2004 and (2) all amounts received by the County upon the sale of property to recover such property taxes, assessments and other levies, or upon redemption of properties previously sold to recover such property taxes, assessments or other levies. The Teeter Obligation Commercial Paper Notes may also be payable from the General Fund of the County. The County expects to pay in full such notes by June 20, 2006 and does not intend to issue Series B Teeter Notes for Fiscal Year 2005-06, but may issue such notes in the future. See “County Financial Information – Teeter Plan.”

During the 1990s, the County has utilized Temporary Transfers from time to time for various purposes, including the finance of County library programs and other County programs. Should the County find it necessary to use a Temporary Transfer, then such borrowing, pursuant to the California Constitution, must be repaid from the first County revenues received thereafter before any other obligation, including the Notes, is paid from such revenues.

## **General Obligation Debt, Pension Obligation Bonds, Lease Obligations and Long-Term Loans**

The County has no outstanding general obligation bonds. As of January 1, 2006, the County has POBs outstanding in the aggregate principal amount of \$1.191 billion (which amount does not include the 1994 POBs subject to the escrow and pledge of funds described under the caption “County Financial Information – San Diego County Employees Retirement Association – Pension Obligation Bonds – Escrow and Pledge of Funds for 1994 POBs” herein). Starting with the financing of the El Cajon Administrative Building in 1955, the County has made use of various lease arrangements with joint powers authorities, a nonprofit corporation, a redevelopment agency and private parties to finance capital project needs. Under these arrangements, the financing entity usually constructs or acquires capital assets with the proceeds of lease revenue bonds or certificates of participation and then leases the asset or assets to the County. The annual long-term lease payments and annual debt service payments on the POBs of the County aggregated to approximately \$57 million for Fiscal Year 2004-05 and will aggregate to approximately \$137.2 million for Fiscal Year 2005-06. As of July 1, 2005, there was approximately \$1.6 billion aggregate principal amount of long-term general fund obligations outstanding. The annual long-term lease payments and annual debt service payments on the POBs of the County for Fiscal Year 2006-07 will aggregate to approximately \$144.8 million. In addition, the County has approximately \$2,771,506 of capital leases outstanding as of January 1, 2006. The debt service on all such capital leases will aggregate to approximately \$1,196,836 for Fiscal Year 2005-06 and will aggregate to approximately \$714,617 for Fiscal Year 2006-07.

Table 16 below sets forth a summary of long-term obligations payable from the General Fund:

**TABLE 16**  
**COUNTY OF SAN DIEGO**  
**SUMMARY OF GENERAL LONG-TERM OBLIGATIONS**  
**PAYABLE FROM THE GENERAL FUND**  
**As of March 1, 2006<sup>(1)</sup>**  
**(In Thousands)**

	<u>Interest Rates</u>	<u>Final Maturity Dates</u>	<u>Original Principal Amounts</u>	<u>Principal Amounts Outstanding</u>
Certificates of Participation:				
San Diego County Capital Asset Leasing Corporation (SANCAL):				
1993 Master Refunding, issued May 1993	2.50-5.625%	2012	\$203,400	\$ 57,600
1997 Central Jail Refunding, issued July 1997	4.00-5.42	2025	80,675	65,415
1998 Downtown Courthouse Refunding, issued December 1998	4.00-4.94	2023	73,115	54,875
1999 East Mesa Refunding, issued September 1999	3.60-4.75	2009	15,010	6,780
2000 Information Technology, issued May 2000	4.50-5.125	2010	51,620	28,970
2002 Motorola, issued March 2002	2.00-5.00	2011	26,060	18,085
2005 Edgemoor Project and 1996 Regional Communications System Refunding, issued February 2005	3.00-5.00	2030	112,395	112,395
2005 North and East County Justice Facilities Refunding, issued September 2005	3.25-5.00	2019	<u>28,210</u>	<u>28,210</u>
Total SANCAL			<u>\$590,485</u>	<u>\$372,330</u>
San Diego Regional Building Authority (SDRBA):				
2001 MTS Tower Refunding, issued September 2001	2.15-5.25%	2019	\$ 36,960	\$ 30,845
Total SDRBA			<u>36,960</u>	<u>30,845</u>
Total Certificates of Participation				
Third-Party Financing Leases:				
Others, various beginning dates from March 1991 to the present	4.24-8.00	2006-08	<u>8,705</u>	<u>2,235</u>
Total Third-Party Financing Leases			<u>\$ 8,705</u>	<u>\$ 2,235</u>
Taxable Pension Bonds:				
County of San Diego Pension Obligation Bonds, Series A, issued February 1994 <sup>(2)</sup>	4.70-6.60%	2007	\$ 430,430	\$ 39,830
County of San Diego Pension Obligation Bonds, issued September 2002				
Series A	3.88-4.95	2015	132,215	132,215
Series B	Variable Rate	2032	505,125	505,125
Series C (PINES)	6.13	2032	100,000	100,000
County of San Diego Pension Obligation Bonds, issued June 2004				
Series A	3.28-5.865	2022	241,360	241,360
Series B	Variable Rate	2024	147,825	147,825
Series C	4.66-5.76	2015	<u>64,928</u>	<u>64,928</u>
Total Pension Bonds			<u>\$1,621,883</u>	<u>\$1,231,283</u>
Unamortized Issuance Premium <sup>(3)</sup>			765	555
Unamortized Issuance Discount <sup>(3)</sup>			(11,244)	(9,565)
Unamortized Deferred Amount on Refunding <sup>(3)</sup>			<u>(21,108)</u>	<u>(14,072)</u>
Total General Long Term Obligations			<u>\$2,235,926</u>	<u>\$1,985,941</u>

<sup>(1)</sup> Unaudited.

<sup>(2)</sup> On September 27, 2004, the County deposited with the trustee for the 1994 POBs amounts which the County calculates will be sufficient, when taken together with the debt service forward agreement currently in force and effect, to make the County's remaining debt service payments with respect to the 1994 POBs. For a description of this deposit, see "-- San Diego County Employees Retirement Association -- Pension Obligation Bonds -- Escrow and Pledge of Funds for 1994 POBs."

<sup>(3)</sup> As of June 30, 2005; audited.

## **SAN DIEGO COUNTY INVESTMENT POOL**

### **General**

Pursuant to a resolution adopted July 8, 1958, the Board of Supervisors delegated to the Treasurer the authority to invest and reinvest funds of the County. Applicable law limits this delegation of authority to a one-year period and must be renewed annually by action of the Board of Supervisors. In addition to funds of the County (and the various departments in the County, such as Public Works and Public Administration), funds of certain local agencies within the County, including school districts in the County, are required under state law to be deposited into County treasury (“Involuntary Depositors”). In addition, certain agencies, including community college districts, invest certain of their funds in the County treasury on a voluntary basis (“Voluntary Depositors” and together with the Involuntary Depositors, the “Depositors”). Deposits made by the County and the various local agencies are commingled in a pooled investment fund (the “Treasury Pool” or the “Pool”). No particular deposits are segregated for separate investment.

Under State law, Depositors in the Pool are permitted to withdraw funds which they have deposited on 30 days notice. The County does not expect that the Pool will encounter liquidity shortfalls based on its current portfolio and investment guidelines or realize any losses that may be required to be allocated among all Depositors in the Pool.

The County has established an Oversight Committee pursuant to State law. The Oversight Committee consists of members appointed from the County Treasurer-Tax Collector, the County Auditor and Controller, a representative appointed by the Board, the County superintendent of schools or his or her designee, a representative selected by a majority of the presiding officers of the governing bodies of the school districts and community college districts in the county, a representative selected by a majority of the presiding officers of the legislative bodies of the special districts in the county that are required or authorized to deposit funds in the County Treasury and up to five other members of the public. The Oversight Committee directs the preparation of an annual audit, which audit may include issues relating to the structure of the investment portfolio and its related risk, to determine the County Treasury’s compliance with law.

### **The Treasury Pool’s Portfolio**

As of March 31, 2006, the securities in the Treasury Pool had a market value of \$4,319,402,770 and a book value of \$4,343,610,927, for a net unrealized loss of \$24,208,158 of the book value of the Treasury Pool. As of March 31, 2006, the weighted average maturity of the Pool portfolio was approximately 170 days. As of March 31, 2006, 25.9% of the Pool was invested in securities with maturities ranging from 1-30 days, 22.6% of the Pool was invested in securities with maturities ranging from 31-90 days, 25.1% of the Pool was invested in securities with maturities ranging from 91-180 days, 12.6% of the Pool was invested in securities with maturities ranging from 181-365 days, 9.4% of the Pool was invested in securities with maturities ranging from 366 days to 2 years, and 0.8% of the Pool was invested in securities with maturities between 2 and 5 years.

The effective duration for the Treasury Pool was 0.419 years as of March 31, 2006. “Duration” is a measure of the price volatility of the portfolio and reflects an estimate of the projected increase or decrease in the value of the portfolio based upon a decrease or increase in interest rates. A duration of 0.419 means that for every one percent increase in interest rates the market value of the portfolio would decrease by 0.419%

As of March 31, 2006, approximately 1.87% of the total funds in the Pool were deposited by Voluntary Depositors, such as cities and fire districts, 10.36% by community colleges, 44.64% by the County, and 43.13% by K-12 school districts.

Standard & Poor's, a Division of the McGraw-Hills Companies, Inc. maintains ratings on the Pool's ability to meet its financial commitments of "AAAF" (long-term) and "S1" (short-term volatility). The rating reflects only the view of the rating agency and any explanation of the significance of such rating may be obtained from such rating agency as follows: Standard & Poor's, 55 Water Street, New York, New York 10041.

## **Investments of the Treasury Pool**

### ***Authorized Investments.***

Investments of the Pool are placed in those securities authorized by various sections of the California Government Code, which include obligations of the United States Treasury, Agencies of the United States Government, local and State bond issues, bankers acceptances, commercial paper of prime quality, certificates of deposit (both collateralized and negotiable), repurchase and reverse repurchase agreements, medium term corporate notes, shares of beneficial interest in diversified management companies (mutual funds), and asset backed (including mortgage related) and pass-through securities. Generally, investments in repurchase agreements cannot exceed a term of one year and the security underlying the agreement shall be valued at 102% or greater of the funds borrowed against the security and the value of the repurchase agreement shall be adjusted no less than quarterly. In addition, reverse repurchase agreement generally may not exceed 20% of the base value of the portfolio and the term of the agreement may not exceed 92 days. Securities lending transactions are considered reverse repurchase agreements for purposes of this limitation. Base Value is defined as the total cash balance excluding any amounts borrowed (*i.e.*, amounts obtained through selling securities by way of reverse repurchase agreements or other similar borrowing methods).

Legislation which would modify the currently authorized investments and place restrictions on the ability of municipalities to invest in various securities is considered from time to time by the California State Legislature. Therefore, there can be no assurances that the current investments in the Treasury Pool will not vary significantly from the investments described herein.

### ***The Investment Policy.***

The County's Investment Policy (the "Investment Policy") (which may be modified, amended, or otherwise changed at any time at the sole discretion of the Treasurer) currently states that the objectives of the Treasurer when investing, reinvesting, purchasing, acquiring, exchanging, selling and managing public funds are as follows: the primary objective is to safeguard the principal of the funds under the Treasurer's control, the secondary objective is to meet the liquidity needs of the Pool Participants, and the third objective is to achieve an investment return on the funds under the control of the Treasurer within the parameters of prudent risk management. The Investment Policy contains a goal that 50% of the Pool should be invested in securities maturing one year or less with the remainder spread over 1-5 years on the yield curve depending on opportunities in the marketplace. With respect to reverse repurchase agreements, the Investment Policy provides for a maximum maturity of 92 days (unless the reverse repurchase agreement includes a written guarantee of a minimum earning or spread for the entire period of such agreement) and a limitation on the total amount of reverse repurchase agreements to 20% of the total investments in the Pool. The Investment Policy states that the purpose of reverse repurchase agreements is to invest the proceeds from the agreement into permissible securities that have the highest short-term credit rating, to supplement the yield on securities owned by the Pool or to provide funds for

the immediate payment of an obligation, and that the maturity of the reverse repurchase agreement and the maturity of the security purchased be the same.

The Investment Policy also authorizes investments in covered call options or put options, which are options on the part of a third party to buy from the Pool a specified security within a finite time at a specified price. Under the Investment Policy, securities subject to covered calls are not to be used for reverse repurchase agreements, cash sufficient to pay for outstanding puts are to be invested in securities maturing on or before the expiration date of the option, the maximum maturity of a covered call option/put option is to be 90 days and not more than 10% of the total investments in the Pool could have options (in contrast to “derivatives”) written against them at any one time.

The County from time to time has engaged in securities lending transactions. Generally, these transactions involve the transfer by the governmental entity, through an agent, of securities to certain broker-dealers and financial institutions or other entities in exchange for collateral, and this collateral may be cash or securities. Most commonly, these transactions provide for the return of the collateral to the securities borrower upon receipt of the same securities at a later date. Presently, the County has suspended its securities lending transactions program, but may decide to enter into a securities lending agreement with another custodian in the future. Any such securities lending transactions are considered reverse repurchase agreements under the Investment Policy and, accordingly, the total principal amount of reverse repurchase agreements and securities lending agreements may not exceed 20% of the Pool. Since the inception of the County’s securities lending program in 1987, there has not been any loss of principal to the Pool resulting from these securities lending transactions or the investment of the related collateral.

#### **Certain Information Relating to Pool**

Table 17 below sets forth information with respect to the Pool as of the close of business March 31, 2006. As described above, a wide range of investments is authorized by state law. Therefore, there can be no assurances that the investments in the Pool will not vary significantly from the investments described herein. In addition, the value of the various investments in the Pool will fluctuate on a daily basis as a result of a multitude of factors, including generally prevailing interest rates and other economic conditions. Therefore, there can be no assurance that the values of the various investments in the Pool will not vary significantly from the values described herein. In addition, the values specified in the following tables were based upon estimates of market values provided to the County by a third party. Accordingly, there can be no assurance that if these securities had been sold on March 31, 2006, the Pool necessarily would have received the values specified. The County has no Pool investments in any corporation that has filed for bankruptcy.

TABLE 17

TREASURER-TAX COLLECTOR  
 SAN DIEGO COUNTY PORTFOLIO STATISTICS  
 (AS OF MARCH 31, 2006)

	Percent of Portfolio	Book Value	Market Price	Accrued Interest	Market Value	Unrealized Gain/(Loss)	Yield to Maturity
Federal Farm Credit Bank Notes	7.32%	\$322,621,082	97.99%	\$1,574,948	\$316,145,030	(\$6,476,052)	2.48%
Federal Home Loan Bank Notes	14.57	636,163,166	98.90	4,831,586	629,322,087	(6,841,079)	2.75
Federal National Mortgage Association Notes	10.84	472,891,000	99.05	3,120,165	468,404,200	(4,486,800)	2.71
Federal Home Loan Mortgage Corporation Notes	9.75	424,315,813	99.13	3,995,104	421,284,593	(3,031,220)	4.36
Corporate Medium Term Notes	3.06	133,508,262	97.97	868,951	132,258,687	(1,249,575)	3.30
Asset Backed Notes	1.77	76,842,717	98.39	503,667	76,253,933	(588,785)	3.39
Money Market Funds	5.63	243,300,000	100.00	231,507	243,300,000	0	4.52
Repurchase Agreements	4.63	200,000,000	100.00	27,417	200,000,000	0	4.93
Negotiable Certificates of Deposit	7.86	339,997,457	99.82	6,950,426	339,396,965	(600,492)	4.30
Commercial Paper	34.54	1,492,880,431	99.20	0	1,491,946,277	(934,154)	4.67
Collateralized Certificates of Deposit	0.03	1,091,000	100.00	1,945	1,091,000	0	4.19
Totals for March 2006	100.00%	\$4,343,610,927	99.12%	\$22,105,717	\$4,319,402,770	(\$24,208,158)	3.89%
Totals for February 2006	100.00%	\$4,240,219,444	99.05%	\$22,615,164	\$4,213,800,196	(\$26,419,248)	3.68%
Change From Prior Month		\$ 103,391,483	0.07%		\$105,602,574	\$2,211,091	0.21%
Portfolio Effective Duration	0.419 years						
March 2006 Return				Annualized	Calendar Year to Date Return		Annualized
Book Value	.318%	2,452%		3.267%	.910%		3.690%
Market Value	.426	2,790		3.717	1.180		4.785



## **CONSTITUTIONAL AND STATUTORY LIMITATIONS ON TAXES, REVENUES AND APPROPRIATIONS**

### **Article XIII A**

On June 6, 1978, California voters approved Proposition 13, adding Article XIII A to the California Constitution. Article XIII A, among other things, affects the valuation of real property for the purpose of taxation in that it defines the full cash property value to mean “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 newly constructed, or when a change in ownership has occurred after the 1975 assessment.” The full cash value may be adjusted annually to reflect inflation at a rate not to exceed 2% per year, or a reduction in the consumer price index or comparable local data at a rate not to exceed 2% per year, or reduced in the event of declining property value caused by damage, destruction or other factors including a general economic downturn. The amendment further limits the amount of any ad valorem tax on real property to 1% of the full cash value except that additional taxes may be levied to pay debt service on indebtedness approved by the voters prior to July 1, 1978, and bonded indebtedness for the acquisition or improvement of real property approved on or after July 1, 1978 by two-thirds of the votes cast by the voters voting on the proposition.

Legislation enacted by the California Legislature to implement Article XIII A provides that all taxable property is shown at full assessed value as described above. In conformity with this procedure, all taxable property value included in this Official Statement (except as noted) is shown at 100% of assessed value and all general tax rates reflect the \$1 per \$100 of taxable value. Tax rates for voter approved bonded indebtedness are also applied to 100% of assessed value.

Future assessed valuation growth allowed under Article XIII A (new construction, change of ownership, 2% annual value growth) will be allocated on the basis of “situs” among the jurisdictions that serve the tax rate area within which the growth occurs. Local agencies and school districts will share the growth of “base” revenue from the tax rate area. Each year’s growth allocation becomes part of each agency’s allocation the following year. The County is unable to predict the nature or magnitude of future revenue sources which may be provided by the State to replace lost property tax revenues. Article XIII A effectively prohibits the levying of any other ad valorem property tax above the 1% limit except for taxes to support indebtedness approved by the voters as described above.

### **Article XIII B**

On November 6, 1979, California voters approved Proposition 4, which added Article XIII B to the California Constitution. In May 1990, the voters through their approval of Proposition 111 amended Article XIII B. Article XIII B of the California Constitution limits the annual appropriations of the State and any city, county, school district, authority or other political subdivision of the State to the level of appropriations for the prior fiscal year, as adjusted annually for changes in the cost of living, population and services rendered by the governmental entity. The “base year” for establishing such appropriation limit is the 1978-79 fiscal year. Increases in appropriations by a governmental entity are also permitted (i) if financial responsibility for providing services is transferred to a governmental entity, or (ii) for emergencies so long as the appropriations limits for the three years following the emergency are reduced to prevent any aggregate increase above the Constitutional limit. Decreases are required where responsibility for providing services is transferred from the government entity.

Appropriations subject to Article XIII B include generally any authorization to expend during the fiscal year the proceeds of taxes levied by the State or other entity of local government, exclusive of certain State subventions, refunds of taxes, benefit payments from retirement, unemployment insurance

and disability insurance funds. Appropriations subject to limitation pursuant to Article XIII B do not include debt service on indebtedness existing or legally authorized as of January 1, 1979, on bonded indebtedness thereafter approved according to law by a vote of the electors of the issuing entity voting in an election for such purpose, appropriations required to comply with mandates of courts or the Federal government, appropriations for qualified outlay projects, and appropriations by the State of revenues derived from any increase in gasoline taxes and motor vehicle weight fees above January 1, 1990 levels. "Proceeds of taxes" include, but are not limited to, all tax revenues and the proceeds to any entity of government from (i) regulatory licenses, user charges, and user fees to the extent such proceeds exceed the cost of providing the service or regulation, (ii) the investment of tax revenues and (iii) certain State subventions received by local governments. Article XIII B includes a requirement that 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 fiscal years.

As amended in May 1990, the appropriations limit for the County in each year is based on the limit for the prior year, adjusted annually for changes in the costs of living and changes in population, and adjusted, where applicable, for transfer of financial responsibility of providing services to or from another unit of government. The change in the cost of living is, at the County's option, either (i) the percentage change in California per capita personal income, or (ii) the percentage change in the local assessment roll for the jurisdiction due to the addition of nonresidential new construction. The measurement of change in population is a blended average of statewide overall population growth, and change in attendance at local school and community college ("K-14") districts.

As amended by Proposition 111, the appropriations limit is tested over consecutive two-year periods. Any excess of the aggregate "proceeds of taxes" received by the County over such two-year period above the combined appropriations limits for those two years is to be returned to taxpayers by reductions in tax rates or fee schedules over the subsequent two years.

Article XIII B permits any government entity to change the appropriations limit by vote of the electorate in conformity with statutory and Constitutional voting requirements, but any such voter-approved change can only be effective for a maximum of four years.

The Board adopted the annual appropriation limit for the Fiscal Year 2005-06 of approximately \$3.3 billion. The limitation applies only to proceeds of taxes and therefore does not apply to service fees and charges, investment earnings on non-proceeds of taxes, fines, and revenue from the sale of property and taxes received from the State and federal governments that are tied to special programs. Based on the 2005-06 Adopted Budget, the funds subject to limitation total approximately \$877 million (total General Operating Budget minus non-proceeds of taxes and debt service) and are approximately \$2.4 billion below the Article XIII B limit

### **Proposition 46**

On June 3, 1986, California voters approved Proposition 46, which added an additional exemption to the 1% tax limitation imposed by Article XIII A. Under this amendment to Article XIII A, local governments and school districts may increase the property tax rate above 1% for the period necessary to retire new general obligation bonds, if two-thirds of those voting in a local election approve the issuance of such bonds and the money raised through the sale of the bonds is used exclusively to purchase or improve real property.

## **Proposition 62**

Proposition 62 was adopted by the voters at the November 4, 1986, general election which (a) requires that any new or higher taxes for general governmental purposes imposed by local governmental entities such as the County be approved by a two-thirds vote of the governmental entity's legislative body and by a majority vote of the voters of the governmental entity voting in an election on the tax, (b) requires that any special tax (defined as taxes levied for other than general governmental purposes) imposed by a local government entity be approved by a two-thirds vote of the voters of the governmental entity voting in an election on the tax, (c) restricts the use of revenues from a special tax to the purposes or for the service for which the special tax was imposed, (d) prohibits the imposition of ad valorem taxes on real property by local governmental entities except as permitted by Article XIII A of the California Constitution, (e) prohibits the imposition of transaction taxes and sales taxes on the sale of real property by local governmental entities, and (f) requires that any tax imposed by a local governmental entity on or after August 1, 1985, be ratified by a majority vote of the voters voting in an election on the tax within two years of the adoption of the initiative or be terminated by November 15, 1988.

On September 28, 1995, the California Supreme Court, in the case of *Santa Clara County Local Transportation Authority v. Guardino*, upheld the constitutionality of Proposition 62. In this case, the court held that a county-wide sales tax of one-half of one percent was a special tax that, under Section 53722 of the Government Code, required a two-thirds voter approval. Because the tax received an affirmative vote of only 54.1%, this special tax was found to be invalid.

Following the California Supreme Court's decision upholding Proposition 62, several actions were filed challenging taxes imposed by public agencies since the adoption of Proposition 62. On June 4, 2001, the California Supreme Court released its decision in one of these cases, *Howard Jarvis Taxpayers Association v. City of La Habra, et al.* ("La Habra"). In this case, the court held that public agency's continued imposition and collection of a tax is an ongoing violation, upon which the statute of limitations period begins anew with each collection. The court also held that, unless another statute or constitutional rule provided differently, the statute of limitations for challenges to taxes subject to Proposition 62 is three years. Accordingly, a challenge to a tax subject to Proposition 62 may only be made for those taxes received within three years of the date the action is brought. The portion of the County's taxes subject to Proposition 62, including the County's transient occupancy tax, is in compliance with Proposition 62 requirements.

## **Proposition 218**

On November 5, 1996, the voters of the State approved Proposition 218, a constitutional initiative, entitled the "Right to Vote on Taxes Act" ("Proposition 218"). Proposition 218 added Articles XIII C and XIII D to the California Constitution and contained a number of interrelated provisions affecting the ability of local governments, including the County, to levy and collect both existing and future taxes, assessments, fees and charges. The County is unable to predict whether and to what extent Proposition 218 may be held to be constitutional or how its terms will be interpreted and applied by the courts. Proposition 218 could substantially restrict the County's ability to raise future revenues and could subject certain existing sources of revenue to reduction or repeal, and increase the County's costs to hold elections, calculate fees and assessments, notify the public and defend its fees and assessments in court. However, the County does not presently believe that the potential financial impact on the County as a result of the provisions of Proposition 218 will adversely affect the County's ability to pay its debt obligations and perform its other obligations payable from the General Fund as and when due.

Article XIII C requires that all new local taxes be submitted to the electorate before they become effective. Taxes for general governmental purposes of the County require a majority vote and taxes for

specific purposes, even if deposited in the County's General Fund, require a two-thirds vote. Further, any general purpose tax that the County imposed, extended or increased without voter approval after December 31, 1994 may continue to be imposed only if approved by a majority vote in an election held within two years of November 5, 1996. The County has not enacted, imposed, extended or increased any tax without voter approval since January 1, 1995. These voter approval requirements of Proposition 218 reduce the flexibility of the County to raise revenues through General Fund taxes, and no assurance can be given that the County will be able to impose, extend or increase such taxes in the future to meet increased expenditure requirements.

Article XIII C also expressly extends to voters the power to reduce or repeal local taxes, assessments, fees and charges through the initiative process, regardless of the date such taxes, assessments, fees or charges were imposed. This extension of the initiative power is not limited by the terms of Proposition 218 to fees imposed after November 6, 1996 and absent other legal authority could result in retroactive reduction in any existing taxes, assessments or fees and charges.

SB 919 provides that the initiative powers extended to voters under Article XIII C likely excludes actions construed as impairment of contracts under the contract clause of the United States Constitution. SB 919 provides that the initiative power provided for in Proposition 218 "shall not be construed to mean that any owner or beneficial owner of a municipal security, purchased before or after November 6, 1998, assumes the risk of, or in any way consents to, any action by initiative measure that constitutes an impairment of contractual rights" protected by the United States Constitution. However, no assurance can be given that the voters of the County will not, in the future, approve an initiative which reduces or repeals local taxes, assessments, fees or charges that currently are deposited into the County's General Fund. Further, "fees" and "charges" are not defined in Article XIII C or SB 919, and it is unclear whether these terms are intended to have the same meanings for purposes of Article XIII C as they do in Article XIII D. Accordingly, the scope of the initiative power under Article XIII C could include all sources of General Fund moneys not received from or imposed by the federal or State government or derived from investment income.

The initiative power granted under Article XIII C of Proposition 218, by its terms, applies to all local taxes, assessments, fees and charges. The County is unable to predict whether the courts will ultimately interpret the initiative provision to be limited to property related local taxes, assessments, fees and charges. No assurance can be given that the voters of the County will not, in the future, approve an initiative which reduces or repeals local taxes, assessments, fees or charges which are deposited into the County's General Fund. The County believes that in the event that the initiative power was exercised so that all local taxes, assessments, fees and charges which may be subject to the provisions of Proposition 218 are reduced or substantially reduced, the financial condition of the County, including its General Fund, would be materially adversely affected. As a result, there can be no assurances that the County would be able to pay the Note Participations as and when due or any of its other obligations payable from the General Fund.

Article XIII D of Proposition 218 adds several new requirements to make it more difficult for local agencies to levy and maintain "assessments" for municipal services and programs. "Assessment" is defined in Proposition 218 and SB 919 as any levy or charge upon real property for a special benefit conferred upon the real property. This includes maintenance assessments imposed in County service areas and in special districts. In most instances, in the event that the County is unable to collect assessment revenues relating to specific programs as a consequence of Proposition 218, the County will curtail such services rather than use amounts in the General Fund to finance such programs. Accordingly, the County anticipates that any impact Proposition 218 may have on existing or future taxes, fees, and assessments will not adversely affect the ability of the County to pay the Note Participations as and when

due. However, no assurance can be given that the County may or will be able to reduce or eliminate such services in the event the assessments that presently finance them are reduced or repealed.

Article XIII D also adds several provisions, including notice requirements and restrictions on use, affecting “fees” and “charges” which are defined as “any levy other than an ad valorem tax, a special tax, or an assessment, imposed by a local government upon a parcel or upon a person as an incident of property ownership, including a user fee or charge for a property related service.” The annual amount of revenues that are received by the County and deposited into its General Fund which may be considered to be property related fees and charges under Article XIII D of Proposition 218 is not substantial. Accordingly, presently the County does not anticipate that any impact Proposition 218 may have on future fees and charges will not adversely affect the ability of the County to pay the principal and interest on the Note Participations as and when due. However, no assurance can be given that the County may or will be able to reduce or eliminate such services in the event the fees and charges that presently finance them are reduced or repealed.

The County has a clean water enterprise fund which is self-supporting from fees and charges that may ultimately be determined to be property related for purposes of Article XIII D of Proposition 218. Further, the fees and charges of the County’s enterprise funds, including those which are not property related for purposes of Article XIII D of Proposition 218, may be determined to be fees and charges subject to the initiative power as provided in Article XIII C of Proposition 218, as described above. In the event that fees and charges cannot be appropriately increased or are reduced pursuant to the exercise of the initiative power, the County may have to choose whether to reduce or eliminate the service financed by such fees or charges or finance such service from its General Fund. Further, no assurance can be given that the County may or will be able to reduce or eliminate such services in the event the fees and charges that presently finance them are reduced or repealed.

Additional implementing legislation respecting Proposition 218 may be introduced in the State legislature from time to time that would supplement and add provisions to California statutory law. No assurance may be given as to the terms of such legislation or its potential impact on the County.

### **Proposition 1A**

Proposition 1A (SCA 4) (“Proposition 1A”), proposed by the Legislature in connection with the 2004-05 Budget Act and approved by the voters in November 2004, provides that the State may not reduce any local sales tax rate, limit existing local government authority to levy a sales tax rate or change the allocation of local sales tax revenues, subject to certain exceptions. Proposition 1A generally prohibits the State from shifting to schools or community colleges any share of property tax revenues allocated to local governments for any fiscal year, as set forth under the laws in effect as of November 3, 2004. Any change in the allocation of property tax revenues among local governments within a county must be approved by two-thirds of both houses of the Legislature. Proposition 1A provides, however, that beginning in fiscal year 2008-09, the State may shift to schools and community colleges up to 8% of local government property tax revenues, which amount must be repaid, with interest, within three years, if the Governor proclaims that the shift is needed due to a severe state financial hardship, the shift is approved by two-thirds of both houses and certain other conditions are met. The State may also approve voluntary exchanges of local sales tax and property tax revenues among local governments within a county. Proposition 1A also provides that if the State reduces the VLF rate currently in effect, 0.65 percent of vehicle value, the State must provide local governments with equal replacement revenues. Further, Proposition 1A requires the State, beginning July 1, 2005, to suspend State mandates affecting cities, counties and special districts, excepting mandates relating to employee rights, schools or community colleges, in any year that the State does not fully reimburse local governments for their costs to comply with such mandates.

## **Future Initiatives**

Article XIII A, Article XIII B, Article XIII C, Article XIII D and Propositions 62 and 1A were each adopted as measures that qualified for the ballot pursuant to the State's initiative process. From time to time, other initiative measures could be adopted, further affecting revenues of the County or the County's ability to expend revenues. The nature and impact of these measures cannot be predicted by the County.

## **STATE OF CALIFORNIA BUDGET INFORMATION**

*The following information concerning the State's budgets has been obtained from publicly available information which the County believes to be reliable; however, the County takes no responsibility as to the accuracy or completeness thereof and has not independently verified such information. Information about the State Budget is regularly available at various State-maintained websites. Text of the budget may be found at the Department of Finance website, [www.dof.ca.gov](http://www.dof.ca.gov), under the heading "California Budget." An impartial analysis of the budget is posted by the Office of the Legislative Analyst at [www.lao.ca.gov](http://www.lao.ca.gov). In addition, various State official statements, many of which contain a summary of the current and past State budgets, may be found at the website of the State Treasurer, [www.treasurer.ca.gov](http://www.treasurer.ca.gov). The information referred to is prepared by the respective State agency maintaining each website and not by the County or the Underwriters, and the County and the Underwriters take no responsibility for the continued accuracy of the internet addresses or for the accuracy or timeliness of information posted there, and such information is not incorporated herein by these references.*

### **State Budget for Fiscal Year 2004-05**

On July 31, 2004, Governor Schwarzenegger signed the 2004-05 Budget Act (the "2004-05 Budget Act") into law. The 2004-05 Budget Act assumed the State General Fund revenues would increase from \$76.6 billion in Fiscal Year 2003-04 to \$77.3 billion in Fiscal Year 2004-05. The State General Fund expenditures were expected to increase from \$77.6 billion in Fiscal Year 2003-04 to \$78.8 billion in Fiscal Year 2004-05. The 2004-05 Budget Act projected a year-end reserve of \$678 million as of June 30, 2005. Approximately \$268 million of the reserve was designated for Proposition 98 and the remaining \$410 million was designated for non-Proposition 98 purposes.

Certain of the features of 2004-05 Budget Act affecting local governments included the following:

1. The Vehicle License Fee ("VLF") rate was lowered from 2.0 percent to 0.65 percent and the VLF backfill was eliminated. The State would provide increased property tax revenues to compensate for the reduction in revenues local governments previously received from VLF.

2. A diversion of \$1.3 billion from local governments in Fiscal Years 2004-05 and 2005-06, including \$350 million from counties, \$350 million from cities, \$350 million from special districts and \$250 from redevelopment agencies. Each county's reduction reflected its proportionate share of statewide county VLF revenues, property taxes and sales taxes.

3. The 2004-05 Budget Act proposed a constitutional amendment to protect certain local government revenues ("Proposition 1A"), which was approved by the voters in November 2004. For a discussion of Proposition 1A, see "Constitutional and Statutory Limitations on Taxes, Revenues and Appropriations – Proposition 1A" herein.

## **State Budget for Fiscal Year 2005-06**

The 2005-06 Budget Act (the “2005-06 Budget Act”) was passed by the State Legislature on July 7, 2005 and signed by the Governor on July 11, 2005. The 2005-06 Budget Act authorized \$113 billion in spending, of which \$90 billion was from the General Fund and \$23 billion was from special funds, and reflected an improving State fiscal outlook resulting from better-than-expected growth in General Fund revenues.

Fiscal Year 2004-05 began with a prior-year balance of \$7.3 billion, which amount included approximately \$4 billion in amnesty-related payments. General Fund Revenues, including transfers, were estimated to total \$79.9 billion in Fiscal Year 2004-05 and \$84.5 billion in Fiscal Year 2005-06, which amounts assumed the approximately \$1 billion reduction in tax collections for each of Fiscal Year 2004-05 and Fiscal Year 2005-06. The 2005-06 Budget Act includes \$525 million in one-time revenues from the refinancing of a previous tobacco-settlement backed bond, a \$428 million loan to fund a settlement relating to flood-related damage that occurred in 1986 and the retention of \$380 million in transportation-related sales tax proceeds in the General Fund. The 2005-06 Budget Act also included approximately \$6 billion in savings and related budget solutions, about one-half of which related to holding 2004-05 Proposition 98 funding at the level set forth in the 2004-05 Budget Act and \$450 million of which related to reductions in social services programs.

The 2005-06 Budget Act included projected expenditures of approximately \$81.7 billion in Fiscal Year 2004-05 and approximately \$90 billion in Fiscal Year 2005-06. The increase in projected expenditures partly reflected (1) the Proposition 42 transfers, which were deferred in Fiscal Year 2004-05 but fully funded in Fiscal Year 2005-06, (2) the prepayment of the \$1.2 billion local government loan in Fiscal Year 2005-06 and (3) increases in both kindergarten through twelfth grade and higher education. The excess of expenditures over revenues in both Fiscal Year 2004-05 and 2005-06 was expected to decrease the General Fund reserve to approximately \$1.3 billion by the end of Fiscal Year 2005-06.

According to the Legislative Analyst, the savings included in the 2005-06 Budget Act would address part of the State’s ongoing structural budget shortfalls, but the legally-required expenditures would exceed projected revenues by approximately \$6.9 billion in Fiscal Year 2006-07, including an \$880 million transfer to the Budget Stabilization Account required by Proposition 58. Absent corrective actions, the remaining year-end shortfall projected for Fiscal Year 2006-07 would be approximately \$4.8 billion, which amount assumed the availability of the \$1.3 billion reserve projected for the end of Fiscal Year 2005-06.

## **State Budget for Fiscal Year 2006-07**

***Governor’s 2006-07 Proposed Budget.*** On January 10, 2006, Governor Schwarzenegger released the Governor’s 2006-07 Proposed Budget. The Governor’s 2006-07 Proposed Budget projects State General Fund revenues and transfers for Fiscal Year 2006-07 of \$92 billion, an increase of approximately 5 percent above the anticipated revenues for Fiscal Year 2005-06, and State General Fund expenditures of \$97.9 billion, an increase of approximately 8 percent above the anticipated expenditures for Fiscal Year 2005-06. The budget imbalance between the anticipated revenues and transfers and the proposed expenditures is expected to be addressed by Fiscal Year 2005-06’s ending fund balance of \$7 billion. The Governor’s 2006-07 Proposed Budget projects a year-end reserve of \$613 million, comprised of \$521 million in a reserve for the liquidation of encumbrances and \$153 million in a special fund for economic uncertainties. In addition, \$920 million is expected to be deposited in the Budget Stabilization Account of the State General Fund in accordance with Proposition 58, of which \$460 million will be allocated to a subaccount that is dedicated to the repayment of economic recovery bonds authorized by Proposition 57.

Three primary revenue sources constitute 95 percent of State General Fund revenues: personal income tax (53.2 percent); sales tax (30.9 percent); and bank and corporation tax (10.9 percent). Personal income tax revenues are projected to be \$45.5 billion in Fiscal Year 2005-06 and \$48.7 billion in Fiscal Year 2006-07. Sales and use tax revenue is forecast at \$27.2 billion in Fiscal Year 2005-06 and \$28.3 billion in Fiscal Year 2006-07. Taxable sales grew by 8.5 percent in Fiscal Year 2004-05, and are expected to increase by 5.3 percent in Fiscal Year 2005-06 and 4.9 percent in Fiscal Year 2006-07.

Revenues to local governments are expected to increase in Fiscal Year 2006-07. Certain of the features of the Governor's 2006-07 Proposed Budget affecting counties include the following:

1. The Governor's 2006-07 Proposed Budget does not include the shift of additional property taxes by local governments to the Educational Revenue Augmentation Fund (the "ERAF"). Chapter 211, Statutes of 2004, required local governments to shift \$1.3 billion in property tax revenues to the ERAF in each of Fiscal Years 2004-05 and 2005-06. The elimination of these shifts in Fiscal Year 2006-07 pursuant to Proposition 1A is expected to lead to additional property tax revenues of \$350 million for both cities and counties, \$350 million for special districts and \$250 million for redevelopment agencies. Local governments are also expected to receive revenues from additional property tax revenues to local governments to offset a reduced VLF rate and to compensate for a loss of sales tax revenues that were dedicated to the repayment of economic recovery bonds.
2. The Governor's 2006-07 Proposed Budget includes \$255 million for local streets and roads maintenance. The funds are part of the proposed \$920 million partial repayment to local governments of the Proposition 42 suspension effected in Fiscal Year 2004-05.
3. The Governor's 2006-07 Proposed Budget proposes to fund, on a one-time basis, Proposition 36 programs in Fiscal Year 2006-07 in the amount of \$120 million. Proposition 36 is a measure approved by the voters in November 2000 to divert certain drug offenders from jail and prison to community drug treatment centers. The 2005-06 Budget Act provided \$120 million for Proposition 36, of which \$96 million was allocated to local governments. While the funding provided by Proposition 36 expires on June 30, 2006, the associated requirements are ongoing, but are not a state mandate. In connection therewith, the Governor's 2006-07 Proposed Budget includes a one-time grant to continue the State's allocation.
4. The Governor's 2006-07 Proposed Budget includes \$40 million in booking fee subventions to offset the counties' costs to book suspects into county jails.
5. The Governor's 2006-07 Proposed Budget increases funding for the Juvenile Justice Crime Prevention Act by \$73.9 million in Fiscal Year 2006-07. Funding for the Juvenile Justice Crime Prevention Act was reduced by \$73.9 million in Fiscal Year 2005-06 due to the availability to local governments of a like amount in carryover monies.
6. The Governor's 2006-07 Proposed Budget includes \$98.1 million for the first of 15 annual repayments to local governments for reimbursable state-mandated programs, payments for which were deferred in some of the years prior to Fiscal Year 2004-05.
7. The Governor's 2006-07 Proposed Budget includes the following adjustments: an additional \$34.2 million to promote and maximize enrollment in Medi-Cal and the Healthy Families Program, improve the retention of children already enrolled, and support county-based efforts to enroll eligible children in existing public programs and CalWORKs reductions of \$198.9 million to maintain expenditures at the federally required level of state funding. These reductions include



\$114.6 million from recovering child care funding associated with welfare reform and \$30 million from delaying payment of the Pay for Performance incentives.

***LAO Analysis of the Governor's 2006-07 Proposed Budget.*** On January 12, 2006, the Legislative Analyst's Office ("LAO") released a report entitled "Overview of the Governor's Budget" (the "LAO Budget Overview"), which provides an analysis by the LAO of the Governor's 2006-07 Proposed Budget. The LAO Budget Overview is available on the LAO website at [www.lao.ca.gov](http://www.lao.ca.gov). Information on the website is not incorporated herein by reference.

In the LAO Budget Overview, the LAO states that the positive revenue assumptions included in the Governor's 2006-07 Proposed Budget were reasonable in light of recent positive cash revenue trends. However, the LAO concludes that the Governor's 2006-07 Proposed Budget should focus more on reducing existing debt before making what the LAO characterized as expansive new commitments, given the State's current structural budgetary shortfall. The LAO notes that over \$4 billion in increased spending is proposed in the Governor's 2006-07 Proposed Budget, including over \$2 billion for new or expanded programs and \$920 million for the prepayment of a transportation loan due in Fiscal Year 2007-08. The LAO states that, even assuming the higher revenue trend underlying the Governor's 2006-07 Proposed Budget, the added ongoing spending would result in larger future fiscal imbalances. The LAO estimates that the implementation of the Governor's 2006-07 Proposed Budget would leave the State with an annual operating shortfall of over \$5 billion in Fiscal Year 2007-08.

On May 12, 2006, the Governor released the May Revision (the "May Revision") to the Governor's 2006-07 Proposed Budget (the "Governor's 2006-07 Proposed Budget"). The May Revision includes approximately \$4.8 billion and \$2.76 billion in additional State General Fund revenues for Fiscal Years 2005-06 and 2006-07, respectively, over what was assumed in the Governor's 2006-07 Proposed Budget. Much of this additional revenue is attributable to the May Revision's assumptions of an increase in personal income tax revenue and an increase in corporate taxes in Fiscal Year 2005-06. Certain of the principal features of the May Revision affecting counties include: (i) proposed increase in funding for the Citizens Option for Public Safety and Juvenile Justice Prevent Act programs in the amount \$42.6 million, which is expected to be divided equally between the programs, and (ii) creation of a new trust in each county for local detention facilities, which are expected to be funded from State grants of \$40 million per year for the operation, renovation, remodel, reconstruction and construction for local detention facility operations.

***LAO May Revision Overview.*** On May 15, 2006, the State's Legislative Analyst's Office (the "LAO") released an analysis of the May Revision entitled "Overview of the 2006-07 May Revision" (the "LAO Overview"). According to the LAO Overview, the May Revision has a number of positive features, including its reliance on cautious revenue assumptions and its emphasis on debt prepayments, one-time spending and the build up of the year end reserve. The LAO Overview states that even though the revenue outlook has improved by \$7.5 billion from the estimates set forth in the Governor's 2006-07 Proposed Budget, the State will continue to face operating budgetary shortfalls of approximately \$3.5 billion in each of Fiscal Years 2007-08 and 2008-09 and \$1 billion in Fiscal Year 2009-10 (assuming continued economic and revenue growth and excluding potential added costs associated with lawsuits and other factors). To place greater priority on regaining long-term fiscal balance, the LAO recommends that the State Legislature weigh the benefits associated with fully funding the Proposition 98 funding targets proposed in the May Revision against the economic shortfalls that such Proposition 98 funding is projected to create in Fiscal Years 2007-08 and 2008-09. The LAO further recommends that State legislatures not adopt the proposal to accelerate \$1 billion of deficit-financing bond prepayments, based on the assumption that the added payment will not produce any benefits to the State General Fund until Fiscal Year 2009-10. Instead, the LAO states that more emphasis should be placed on debt prepayments

and reserve build-up that provide benefits to the State General Fund in the next couple of years, when the projected shortfalls are the largest.

The Fiscal Year 2006-07 State Budget (“Fiscal Year 2006-07 State Budget”) is expected to be subject to significant negotiation and revision prior to its ultimate adoption. There can be no assurances that the final Fiscal Year 2006-07 State Budget will not place additional burdens on local governments, including the County, or will not significantly reduce revenues to such local governments. The Fiscal Year 2006-07 State Budget is subject to approval by the State Legislature, and the County cannot predict the ultimate impact of the final approved Fiscal Year 2006-07 State Budget on the County’s financial situation. In the event the final Fiscal Year 2006-07 State Budget includes decreases in County revenues or increases in required County expenditures from the levels assumed by the County, the County will be required to generate additional revenues or curtail programs and/or services to ensure a balanced budget.

### **Future State Budgets**

No prediction can be made by the County as to whether the State will continue to encounter budgetary problems in this or in any future Fiscal Years, and if it were to do so, it is not clear what measures would be taken by the State to balance its budget, as required by law. In addition, the County cannot predict the final outcome of future State budget negotiations, the impact that such budgets will have on its finances and operations or what actions will be taken in the future by the State Legislature and Governor to deal with changing State revenues and expenditures. Current and future State budgets will be affected by national and State economic conditions and other factors, including the current economic downturn, over which the County has no control.

## **ECONOMIC AND DEMOGRAPHIC INFORMATION**

### **General**

The County is the southernmost major metropolitan area in the State of California. The County covers 4,255 square miles, extending 70 miles along the Pacific Coast from the Mexican border to Orange County, and inland 75 miles to Imperial County. Riverside and Orange counties form the northern boundary. The County is approximately the size of the State of Connecticut.

Topography of the County varies from broad coastal plains and fertile inland valleys to mountain ranges in the east which rise to an elevation of 6,500 feet. Eastern slopes of these mountains form the rim of the Anza-Borrego Desert and the Imperial Valley. The Cleveland National Forest occupies much of the interior portion of the County. The climate is equable in the coastal and valley regions where most of the population and resources are located. The average annual rainfall in the coastal areas is approximately 10 inches.

The County possesses a diverse economic base consisting of a significant manufacturing presence in the fields of electronics and shipbuilding, a large tourist industry attracted by the favorable climate of the region, and a considerable defense-related presence.

In April 2004, PETCO Park opened in the City of San Diego, providing a 42,000 fixed seat baseball stadium for the San Diego Padres. PETCO Park is located in a 26-block neighborhood that contains existing and proposed hotels, office space, retail and housing units within walking distance from the San Diego Convention Center and the Gaslamp Quarter. The baseball stadium is also within walking distance of a Trolley station and nearby parking facilities.

In September 2001, the expansion of the San Diego Convention Center was completed, doubling the size of the existing facility to 2.6 million total gross square feet. The Convention Center generated approximately \$1.2 billion in Fiscal Year 2004 in total economic impact (direct and indirect spending).

The County is also growing as a major center for culture and education. Over 30 recognized art organizations, including the San Diego Opera, the Old Globe Theatre productions, the La Jolla Chamber Orchestra, as well as museums and art galleries, are located in the County. Higher education is provided through five two-year colleges and six four-year colleges and universities.

In addition to the City of San Diego, other principal cities in the County include Carlsbad, Chula Vista, Oceanside, El Cajon, Escondido, La Mesa and National City. Most County residents live within 20 miles of the coast. Farther inland are agricultural areas, principally planted in avocados and tomatoes, while the easternmost portion of the County has a dry, desert-like topography.

The County is the delivery system for federal, state and local programs. The County provides a wide range of services to its residents including: (1) regional services such as courts, probation, medical examiner, jails, elections and public health; (2) health, welfare and human services such as mental health, senior citizen and child welfare services; (3) basic local services such as planning, parks, libraries and Sheriff's patrol to the unincorporated area, and law enforcement and libraries by contract to incorporated cities; and (4) infrastructure such as roads, waste disposal and flood control to the unincorporated area of the County.

### **County Government**

The County was incorporated on February 18, 1850, and functions under a charter adopted in 1933, as subsequently amended from time to time. The County is governed by a five-member Board of Supervisors elected to four-year terms in district nonpartisan elections. The Board of Supervisors appoints the Chief Administrative Officer and the County Counsel. The Chief Administrative Officer appoints the Chief Financial Officer and the Auditor and Controller. Elected officials include Assessor/Recorder/County Clerk, District Attorney, Sheriff and Treasurer-Tax Collector.

## Population

There are 18 incorporated cities in the County, and several unincorporated communities. For many years the population of the County has grown at a greater rate than that of the State and the nation. As of January 2006, the County population was estimated to be approximately 3,066,820, the third largest County by population in California. The 2006 population increased approximately 0.92% from the County population as of January 2005.

Table 18 below sets forth the population in the County, the State and the United States for the years 1997 to 2006.

**TABLE 18**  
**POPULATION ESTIMATES<sup>(1)</sup>**  
**(In Thousands)**

<u>Year</u>	<u>San Diego County</u>	<u>Percent Change</u>	<u>State of California</u>	<u>Percent Change</u>	<u>United States<sup>(2)</sup></u>	<u>Percent Change</u>
1997	2,653	1.23%	32,207	1.16%	267,784	0.92%
1998	2,703	1.88	32,657	1.40	270,248	0.90
1999	2,751	1.78	33,140	1.48	272,691	0.90
2000	2,813	2.25	33,873	2.22	282,192	3.48
2001	2,863	1.77	34,441	1.91	285,102	1.03
2002	2,920	1.99	35,088	1.87	287,941	0.99
2003	2,971	1.74	35,691	1.71	290,789	1.04
2004	3,013	1.41	36,271	1.62	293,657	0.99
2005	3,039	0.86	36,728	1.26	296,410	0.94
2006	3,067	0.92	37,172	1.21	N/A <sup>(3)</sup>	N/A <sup>(3)</sup>

Sources: State of California Department of Finance; U.S. Bureau of the Census

<sup>(1)</sup> As of January 1 of the year shown, except as noted.

<sup>(2)</sup> As of July 1 of the year shown.

<sup>(3)</sup> Information not available.

## Employment

The County's total labor force, consisting of the number of persons who work or are available for work, averaged approximately 1,504,800. The number of employed workers in the labor force averaged approximately 1,440,100. Table 19 below sets forth information regarding the size of the civilian labor force, employment and unemployment rates for the County, the State and the United States for the years 2001 through 2005.

**TABLE 19**  
**CIVILIAN LABOR FORCE, EMPLOYMENT AND UNEMPLOYMENT**  
**ANNUAL AVERAGES 2001-2005**  
**By Place of Residence**  
**(In Thousands)**

	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005<sup>(3)</sup></u>
County of San Diego					
Labor Force	1,417.7	1,458.0	1,482.2	1,493.2	1,504.8
Employment	1,371.8	1,395.6	1,419.1	1,422.5	1,440.1
Unemployment Rate	3.2%	4.3%	4.3%	4.7%	4.3%
State of California <sup>(1)</sup>					
Labor Force	17,152.0	17,331.0	17,404.0	17,500.0	17,695.6
Employment	16,220.0	16,168.0	16,213.0	16,408.0	16,746.9
Unemployment Rate	5.4%	6.7%	6.8%	6.2%	5.4%
United States <sup>(2)</sup>					
Labor Force	143,734.0	144,863.0	146,510.0 <sup>(4)</sup>	147,401.0 <sup>(4)</sup>	149,320.0 <sup>(4)</sup>
Employment	136,933.0	136,485.0	137,736 <sup>(4)</sup>	139,252.0 <sup>(4)</sup>	141,730.0 <sup>(4)</sup>
Unemployment Rate	4.7%	5.8%	6.0% <sup>(4)</sup>	5.5% <sup>(4)</sup>	5.1% <sup>(4)</sup>

Sources: County and State Data - California Employment Development Department; National Data - U.S. Department of Labor, Bureau of Labor Statistics.

(1) January 2005 Benchmark.

(2) As of September 2005.

(3) As of March 2006.

(4) Data are not strictly comparable with data for prior years because of the revisions in the population controls used in the household survey.

Table 20 below sets forth the annual average employment within the County by employment sector, other than farm industries, for 2001 through 2005. The service sector constitutes the largest non-farm employment sector in the County, representing approximately 51% of all non-farm employment.

**TABLE 20**  
**SAN DIEGO COUNTY**  
**NON-AGRICULTURAL LABOR FORCE AND INDUSTRY EMPLOYMENT**  
**ANNUAL AVERAGES<sup>(1)</sup>**  
**2001-2005**  
**(In Thousands)**

<u>Employment Sector</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>
Natural Resources and Mining	0.3	0.3	0.3	0.4	0.4
Construction	75.1	76.4	80.2	87.7	91.4
Manufacturing	119.0	112.3	105.3	104.3	104.2
Trade, Transportation and Utilities	209.0	208.6	209.7	215.3	219.1
Information	38.8	37.7	36.9	36.6	37.3
Financial Activities	72.0	75.0	79.9	81.9	83.2
Professional and Business Services	198.2	201.7	201.2	204.5	209.8
Educational and Health Services	116.0	119.7	121.8	121.7	122.8
Leisure and Hospitality	131.4	133.8	140.7	145.7	150.2
Other Services	44.9	45.6	46.8	47.9	48.7
Government	213.8	219.7	217.3	214.3	214.8
Total	1,218.5	1,230.8	1,240.1	1,260.3	1,281.9

Source: California Employment Development Department.

<sup>(1)</sup> Total may not equal the sum of the line items due to rounding.

### **Regional Economy**

In recent years the County has enjoyed economic stability, out-pacing the State economy despite a general recession in the State. Much of this strength was evidenced by and due to outstanding employment gains, population growth, personal income increases, and high levels of commercial and industrial development.

The Gross Regional Product (“GRP”) for 2004 is estimated to be \$141.7 billion. This is an increase from the County’s estimated GRP of \$133.5 billion in 2003. The County’s GRP is forecasted to rise to \$151.1 billion and \$161.1 billion in 2005 and 2006, respectively. The GRP is an estimate of the value for all goods and services produced in the region.

Table 21 below sets forth the County's GRP from 1997 through 2006.

**TABLE 21**  
**COUNTY OF SAN DIEGO**  
**GROSS REGIONAL PRODUCT**  
**1997-2006**

<u>Year</u>	<u>Gross Regional Product (In Billions)</u>	<u>Annual Percent Change</u>	
		<u>Current Dollars San Diego</u>	<u>Real Change* San Diego</u>
1997	\$85.7	8.3%	6.6%
1998	93.7	9.4	8.2
1999	102.4	9.3	8.2
2000	111.6	9.0	7.0
2001	116.3	4.2	2.1
2002	124.9	7.4	4.9
2003 <sup>(1)</sup>	133.1	6.5	4.5
2004 <sup>(1)</sup>	141.7	6.5	4.4
2005 <sup>(2)</sup>	151.1	6.6	4.5
2006 <sup>(2)</sup>	161.1	6.6	4.9

Sources: Economic Research Bureau of the San Diego Chamber of Commerce.

\* Adjusted using the GDP/GSP Implicit Price Deflator.

(1) Estimate.

(2) Forecast.

Economic activity and population growth in the local economy are closely related. Helping to sustain the County's economy is the performance of three basic industries of the region, which consist of manufacturing, the military, and tourism. The U.S. Department of Defense contributes about \$10 billion annually to the local economy, through wages paid to the uniformed military and civilian personnel, and for equipment and services purchased from local businesses. San Diego's military presence is anticipated to remain relatively stable and may even increase due to the consolidation of military operations and facilities from elsewhere in California, the West, and throughout the United States. The Department of Defense closed and vacated the Naval Training Center in 1997. However, three procurement agencies have recently relocated to San Diego, including the Naval Space and Warfare Systems Command, the Naval Aviation Engineering Servicing Unit, which hires private contractors to service jets, and the Naval Aviation Technical Service Facility, which stores approximately 10 million jet blueprints.

### **Building Activity**

Building permit valuation for both residential and non-residential construction in the County in 2005 decreased over 2004 levels by approximately 4%. Measures limiting new housing remain in effect in areas throughout the County, resulting in a 8% decrease in residential valuations. Non-residential valuations increased 7%.

Table 22 below sets forth the annual total building permit valuation and the annual unit total of new residential permits from 2001 through 2005:

**TABLE 22**

**COUNTY OF SAN DIEGO  
BUILDING PERMIT ACTIVITY  
2001-2005  
(In Thousands)**

	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>
Valuation:					
Residential	\$3,167,920	\$3,475,108	\$3,683,807	\$3,875,359	\$3,562,702
Non-Residential	<u>1,193,866</u>	<u>1,168,866</u>	<u>1,169,397</u>	<u>1,288,130</u>	<u>1,381,794</u>
Total	<u>\$4,361,786</u>	<u>\$4,643,974</u>	<u>\$4,853,204</u>	<u>\$5,163,489</u>	<u>\$4,944,496</u>
New Housing Units:					
Single Family	\$ 9,312	\$ 9,749	\$ 9,455	\$ 9,555	\$ 7,886
Multiple Family	<u>6,326</u>	<u>5,989</u>	<u>8,859</u>	<u>7,751</u>	<u>7,372</u>
Total	\$ <u>15,638</u>	\$ <u>15,738</u>	\$ <u>18,314</u>	\$ <u>17,306</u>	\$ <u>15,258</u>

Source: Construction Industry Research Board.

**Commercial Activity**

Table 23 below sets forth information regarding taxable sales in the County for the years 2000-2004.

**TABLE 23**

**COUNTY OF SAN DIEGO  
TAXABLE SALES  
2000-2004  
(In Thousands)**

Type of Business	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>
Apparel Stores	\$ 1,274,552	\$ 1,374,858	\$ 1,466,233	\$ 1,644,428
General Merchandise	4,445,352	4,557,457	4,832,2826	5,204,962
Specialty Stores	3,718,292	3,803,803	4,144,293	4,541,225
Food Stores	1,595,933	1,650,104	1,685,203	1,736,610
Home Furnishings/Appliances	1,314,860	1,353,158	1,458,403	1,549,482
Eating and Drinking Establishments	3,366,463	3,505,859	3,757,136	4,047,726
Building Materials	2,343,008	2,510,931	2,757,706	3,341,105
Automotive	7,426,582	7,862,366	8,563,690	9,318,277
All Other Retail Stores	778,296	803,063	855,601	961,645
Business and Personal Services	1,957,109	1,977,606	2,040,077	2,146,781
All Other Outlets	<u>9,478,886</u>	<u>9,196,342</u>	<u>9,303,350</u>	<u>9,978,097</u>
<b>TOTAL ALL OUTLETS</b>	<u>\$37,699,333</u>	<u>\$38,595,547</u>	<u>\$40,863,978</u>	<u>\$44,470,338</u>

Source: California State Board of Equalization, Taxable Sales in California.



## Personal Income

Table 24 below sets forth the total effective buying income and the median household effective buying income for the County, the State, and the United States between 2001 and 2005.

**TABLE 24**  
**PERSONAL INCOME**  
**2001 through 2005**

<u>Year and Area</u>	<u>Total Effective Buying Income (In Thousands)</u>	<u>Median Household Effective Buying Income</u>
<u>2001</u>		
San Diego County	54,337,662	44,292
California	652,190,282	44,464
United States	5,230,824,904	39,129
<u>2002</u>		
San Diego County	55,210,119	44,146
California	650,521,407	43,532
United States	5,303,481,498	38,365
<u>2003</u>		
San Diego County	54,831,958	42,315
California	647,879,427	42,484
United States	5,340,682,818	38,035
<u>2004</u>		
San Diego County	57,680,880	43,346
California	674,721,020	42,924
United States	5,466,880,008	38,201
<u>2005</u>		
San Diego County	60,578,879	44,506
California	705,108,410	43,915
United States	5,692,909,567	39,324

Source: Sales and Marketing Management – Survey of Buying Power.

## Transportation

Surface, sea and air transportation facilities serve County residents and businesses. Interstate 5 parallels the coast from Mexico to the Los Angeles area and points north. Interstate 15 runs inland, leading to Riverside-San Bernardino, Las Vegas, and Salt Lake City. Interstate 8 runs eastward through the southern United States.

San Diego's International Airport (Lindbergh Field) is located approximately three miles northwest of the downtown area and sits on 614 acres. The facilities are owned and maintained by the San Diego County Regional Airport Authority and are leased to commercial airlines and other tenants.

The airport is California's third most active commercial airport, served by 18 passenger carriers and six cargo carriers. In addition to San Diego International Airport there are two naval air stations and seven general aviation airports located in the County.

Public transit in the metropolitan area is provided by the Metropolitan Transit Development Board. The San Diego Trolley, developed by the Metropolitan Transit Development Board beginning in 1979, has been expanded. A total of 17.6 miles were added to the original 108 miles; construction was completed in 1990.

San Diego is the terminus of the Santa Fe Railway's main line from Los Angeles. Amtrak passenger service is available at San Diego, with stops at Solana Beach and Oceanside in the North County.

San Diego's harbor is one of the world's largest natural harbors. The Port of San Diego is administered by the San Diego Unified Port District, which includes the cities of San Diego, National City, Chula Vista, Imperial Beach, and Coronado.

### **Visitor and Convention Activity**

An excellent climate, proximity to Mexico, extensive maritime facilities, and such attractions as the San Diego Zoo and Wild Animal Park, Sea World, Cabrillo National Monument, and Palomar Observatory allow San Diego to attract a high level of visitor and convention business each year. Contributing to the growth of visitor business has been the development of the 4,600-acre Mission Bay Park at San Diego and the construction of meeting and convention facilities at the San Diego Community Concourse.

San Diego's visitor industry is a major sector of the region's economy. Visitor revenues in San Diego County reached approximately \$5.8 billion in 2005, according to an estimate by the San Diego Convention and Visitors Bureau, an increase of approximately \$300 million from the prior year. The County hosted 54 conventions and trade shows in 2005, attended by approximately 470,950 delegates, who spent approximately \$462,117,578.

### **Education**

Forty-two independent school districts provide educational programs for the elementary and secondary public school children in the County. Each school system is governed by a locally elected board of education and administered by a superintendent or other chief administrative officer appointed by the board. In the County there are three types of school districts: elementary, union high and unified. Elementary districts educate elementary students, union high districts educate for the most part secondary students, and unified districts educate both elementary and secondary students. There are currently 12 unified, 24 elementary and 6 union high school districts in the County.

Community colleges in California are locally operated and administered two-year institutions of higher education. They offer Associates in Arts and Associates in Science degrees and have extensive vocational curricula. There are five community college districts in the County with students at eleven campuses and numerous adult and community centers.

Among the institutions of higher education offering bachelors and graduate programs in metropolitan San Diego are San Diego State University, the University of California, San Diego, National University, the University of San Diego, Point Loma College, California State University - San Marcos, Alliance International University and the University of Phoenix.

**APPENDIX B**

**SELECTED PORTIONS OF THE SAN DIEGO COUNTY GENERAL PURPOSE  
FINANCIAL STATEMENTS FOR THE FISCAL YEAR ENDED JUNE 30, 2005**

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**INDEPENDENT AUDITOR’S REPORT**

Board of Supervisors  
County of San Diego, California

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the discretely presented component unit, each major fund, and the aggregate remaining fund information of the County of San Diego, California (County), as of and for the year ended June 30, 2005, which collectively comprise the County’s basic financial statements as listed in the table of contents. These financial statements are the responsibility of the County’s management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of the First 5 Commission of San Diego (Commission), the discretely presented component unit, and the San Diego County Employees Retirement Association (SDCERA), which represents 63%, 65%, and 6% of the assets, net assets/fund balances and revenues, respectively, of the aggregate remaining fund information as of and for the year ended June 30, 2005. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinion, insofar as it relates to the amounts included for the Commission and SDCERA, is based on the reports of the other auditors.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. The financial statements of SDCERA were not audited in accordance with *Government Auditing Standards*. 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 County’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 the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the reports of other auditors provide a reasonable basis for our opinions.

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



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As discussed in Note V. of the basic financial statements, effective July 1, 2004, the County adopted the provisions of Governmental Accounting Standards Board (GASB) Statement No. 40 – *Deposit and Investment Risk Disclosures – an amendment of GASB Statement No. 3.*

In accordance with *Government Auditing Standards*, we have also issued our report dated December 19, 2005 on our consideration of the County’s internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management’s discussion and analysis, budgetary comparison information, and schedule of funding progress on pages 23 through 39, 112 through 114, and 116, respectively, 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 and the other auditors 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 and the other auditors did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the County’s basic financial statements. The introductory section, combining and individual nonmajor fund financial statements and schedules, and statistical tables are presented for purposes of additional analysis and are not a required part of the basic financial statements. The combining and individual nonmajor fund financial statements and schedules have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole. The introductory section and statistical tables have not been subjected to the auditing procedures applied by us and the other auditors in the audit of the basic financial statements and, accordingly, we express no opinion on them.

*Mauar, Jini & Company LLP*

Certified Public Accountants

Los Angeles, California  
December 19, 2005

# Management's Discussion and Analysis



**Don Steuer**  
Chief Financial Officer



**Tracy M. Sandoval**  
Auditor and Controller

This section of the County of San Diego's (County) Comprehensive Annual Financial Report provides a narrative overview and analysis of the basic financial activities of the County as of and for the year ended June 30, 2005. The intent of the information presented here, in conjunction with the Letter of Transmittal is to provide the reader with a clearer picture of the County's overall financial status. Unless otherwise indicated, all amounts in this section are expressed in thousands of dollars.

## Financial Highlights

- The assets of the County exceeded liabilities at the close of the fiscal year 2004-2005 by \$2.18 billion (net assets). Of this amount, \$224 million is restricted for specific purposes (restricted net assets), and \$2.43 billion is invested in capital assets, net of related debt. The remaining portion of the net assets represents a deficit balance in unrestricted net assets of \$465 million.
- Total net assets increased by \$201 million. For governmental activities, revenues exceeded expenses by \$198 million. For business type activities, revenues exceeded expenses by \$3 million.
- General revenues for governmental activities were \$970 million. Of this amount, property taxes and property taxes in lieu of vehicle license fees accounted for \$646 million or 67 percent; other taxes, interest and other general revenues accounted for \$324 million or 33 percent.
- Program revenues for governmental activities were \$2.2 billion. Of this amount, \$1.8 billion or 81 percent was attributable to

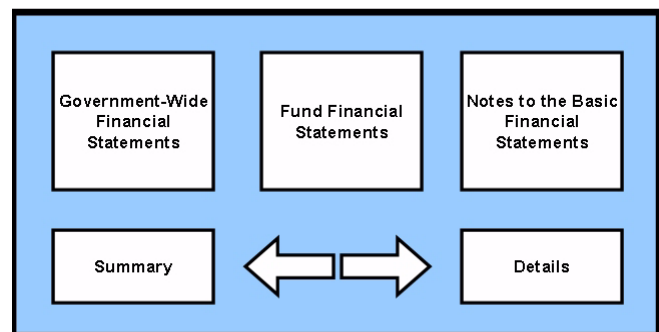
operating grants and contributions while charges for services accounted for \$414 million or 19 percent.

- The total expenses for governmental activities were \$2.99 billion. Public assistance accounted for \$973 million or 33 percent of this amount, while public protection accounted for \$960 million or 32 percent. Additionally, health and sanitation accounted for \$546 million or 18 percent.

## Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the County's basic financial statements. The County's basic financial statements comprise three components: 1) *Government-wide* financial statements 2) *Fund* financial statements, and 3) *Notes* to the basic financial statements. Required Supplementary Information is included in addition to the basic financial statements.

The illustration below depicts the required components of the basic financial statements.





*Government-wide Financial Statements* are designed to provide readers with a broad overview of County finances, in a manner similar to a private-sector business.

The *statement of net assets* presents information on all County 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 County is improving or deteriorating.

The *statement of activities* presents information showing how the County'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, revenue and expenses are reported in this statement for some items that will result in cash flows in future fiscal periods (e.g., uncollected taxes and earned but unused vacation leave).

Both of the aforementioned government-wide financial statements distinguish functions of the County 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 County include general government, public protection, public ways and facilities, public assistance, health and sanitation, recreational and cultural, and education. The business-type activities of the County include airport operations, wastewater management and sanitation districts.

*Fund Financial Statements* are groupings of related accounts that are used to maintain control over resources that have been segregated for specific activities or objectives. The County, 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 County can be divided into three categories: governmental funds, proprietary funds and fiduciary 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 funds 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 county'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 County maintains twenty-eight individual governmental funds. Information is presented separately in the governmental funds balance sheet and in the governmental funds statement of revenues, expenditures and changes in fund balances for the General Fund and the Tobacco Securitization Special Revenue Fund, both of which are considered to be major funds. Data from the other twenty-six governmental funds are combined into a single, aggregated presentation. Individual fund data for each of these nonmajor governmental funds is provided in the Combining Financial Statements and Supplementary Information section in this report.





*Proprietary funds* are generally used to account for services for which the County charges customers - either outside customers, or internal departments of the County. Proprietary funds provide the same type of information as the government-wide financial statements, only in more detail. The County maintains the following 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 County uses enterprise funds to account for sanitation services, wastewater management and airport operations. These nonmajor enterprise funds are combined and aggregated. Individual fund data for each nonmajor enterprise fund is provided in the Combining Financial Statements and Supplementary Information section in this report.

*Internal service funds* are an accounting device used to accumulate and allocate costs internally among the County's various functions. Internal service funds are used to account for the financing of public works and communications equipment; the financing of materials and supplies (purchasing); for start up services for new and existing county service districts; for the County's uninsured risk management activities; the financing of fleet services; for facilities management activities; for the financing of information technology services; and for the financing of clothing and personal sundry items for persons institutionalized at various County facilities. Additionally, mail services are included within the facilities function, and printing and record storage services are included in the purchasing function. Because all of these services predominantly benefit governmental rather than business-type functions, they have been included within governmental activities in the government-wide financial statements.

The County's *eight internal service funds* are combined into a single, aggregated presentation in the proprietary funds financial statements. Individual fund data for the internal service funds is provided in the form of combining statements in the Combining Financial Statements/Schedules and Supplementary Information section in this report.

*Fiduciary funds* are used to account for resources held for the benefit of parties outside the government. Fiduciary funds are not reflected in the government-wide financial statements because the resources of these funds are not available to support the County's own programs. The accounting used for fiduciary funds is much like that used for proprietary funds.

*Notes to the Basic Financial Statements* provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements.

*Required Supplementary Information* is presented concerning the County's General Fund budgetary schedule, and San Diego County Employees Retirement Association (SDCERA) pension schedules. The County 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. In addition, a budgetary comparison schedule has been provided for the Tobacco Securitization Special Revenue Fund for it was determined to be a major governmental fund. The SDCERA pension schedules have been provided to present SDCERA's progress in funding its obligation to provide pension benefits to County employees.



Combining Financial Statements/Schedules and Supplementary Information section of this report presents combining and individual fund statements and schedules referred to earlier that provide information for nonmajor governmental funds, enterprise funds and internal service funds and are presented immediately following the Required Supplementary Information section of this report.

## Government-wide Financial Analysis

### Net Assets June 30, 2005 (In Thousands)

	Governmental Activities		Primary Government Business-Type Activities		Total	
	2005	2004	2005	2004	2005	2004
<b>ASSETS</b>						
Current and other assets	\$ 2,456,419	1,678,164	79,091	81,031	2,535,510	1,759,195
Capital assets	2,674,393	2,680,570	87,581	81,938	2,761,974	2,762,508
Total assets	5,130,812	4,358,734	166,672	162,969	5,297,484	4,521,703
<b>LIABILITIES</b>						
Long-term liabilities	2,335,192	2,301,177	3,250	3,538	2,338,442	2,304,715
Other liabilities	771,977	231,636	2,696	1,588	774,673	233,224
Total liabilities	3,107,169	2,532,813	5,946	5,126	3,113,115	2,537,939
<b>NET ASSETS</b>						
Invested in capital assets, net of related debt	2,341,126	2,324,806	84,416	78,485	2,425,542	2,403,291
Restricted	223,565	169,983			223,565	169,983
Unrestricted	(541,048)	(668,868)	76,310	79,358	(464,738)	(589,510)
Total net assets	\$ 2,023,643	1,825,921	160,726	157,843	2,184,369	1,983,764

### Analysis of Net Assets

Net assets may serve over time as a useful indicator of a government's financial position. In the case of the County, assets exceeded liabilities by \$2.18 billion at the close of fiscal year 2004-2005. The County also had positive balances in two of its categories of net assets, (Invested in capital assets net of related debt and Restricted net assets). Unrestricted net assets had a deficit balance of \$465 million.

The largest portion of the County's net assets (111 percent) reflects its investment of \$2.43 billion in capital assets (e.g. land, infrastructure, buildings, and equipment); less any related outstanding debt used to acquire those assets. The County uses these capital assets to provide services to citizens; consequently, these assets are not available for future spending.

Although the County's investment in capital assets is reported net of related debt, it should be noted that the resources needed to repay

this debt must be provided from other sources, since the capital assets themselves cannot be liquidated for these liabilities.

An additional portion of the County's net assets, \$224 million (10 percent), represents resources that are subject to external restrictions on how they may be used. External restrictions include those imposed by grantors, contributors, laws/regulations of other governments, or restrictions imposed by law through constitutional provisions or legislation.

The remaining portion of the County's net assets represents a deficit unrestricted net assets balance of \$465 million (an increase of \$125 million). This increase was in large part due to increased Property taxes collected in lieu of vehicle license fee (VLF) revenue (\$204 million), decrease in the State allocation of sales tax and VLF (\$121 million) and an increase in other taxes (\$44 million). A more detailed discussion of these revenue sources can be found below in the Analysis of Changes in Net Assets Revenues section.



**Changes in Net Assets  
For the Year Ended June 30, 2005 (In Thousands)**

	Governmental Activities		Business-type Activities		Total	
	2005	2004	2005	2004	2005	2004
<b>Revenues:</b>						
Program revenues						
Charges for services	\$ 414,384	351,928	30,651	27,404	445,035	379,332
Operating grants and contributions	1,769,805	1,747,368	3,700	4,671	1,773,505	1,752,039
Capital grants and contributions	32,303	67,357	1,036	1,539	33,339	68,896
General revenues						
Property taxes	441,716	412,587			441,716	412,587
Property taxes in lieu of vehicle license fees	203,788				203,788	
Other taxes	96,927	52,489			96,927	52,489
State allocation of sales tax and vehicle license fees	106,548	227,688			106,548	227,688
Interest	38,066	21,992	1,730	417	39,796	22,409
Other	83,079	92,138	287	24	83,366	92,162
<b>Total revenues</b>	<b>3,186,616</b>	<b>2,973,547</b>	<b>37,404</b>	<b>34,055</b>	<b>3,224,020</b>	<b>3,007,602</b>
<b>Expenses:</b>						
Governmental Activities						
General government	232,826	286,997			232,826	286,997
Public protection	960,227	1,124,382			960,227	1,124,382
Public ways and facilities	122,797	164,551			122,797	164,551
Health and sanitation	545,805	592,426			545,805	592,426
Public assistance	972,592	1,017,705			972,592	1,017,705
Education	27,394	31,722			27,394	31,722
Recreation and cultural	21,405	26,774			21,405	26,774
Interest expense	106,612	91,897			106,612	91,897
Business-type Activities						
Airport			8,117	7,373	8,117	7,373
Wastewater Management			5,076	4,005	5,076	4,005
Sanitation Districts			20,564	15,828	20,564	15,828
<b>Total expenses</b>	<b>2,989,658</b>	<b>3,336,454</b>	<b>33,757</b>	<b>27,206</b>	<b>3,023,415</b>	<b>3,363,660</b>
Excess (deficiency) before transfers	196,958	(362,907)	3,647	6,849	200,605	(356,058)
Transfers	764	673	(764)	(673)		
<b>Increase (decrease) in net assets</b>	<b>197,722</b>	<b>(362,234)</b>	<b>2,883</b>	<b>6,176</b>	<b>200,605</b>	<b>(356,058)</b>
Net assets at beginning of year	1,825,921	2,188,155	157,843	151,667	1,983,764	2,339,822
<b>Net assets at end of year</b>	<b>\$ 2,023,643</b>	<b>1,825,921</b>	<b>160,726</b>	<b>157,843</b>	<b>2,184,369</b>	<b>1,983,764</b>

**Analysis of Changes in Net Assets**

The County's net assets increased by \$201 million during the fiscal year 2004-2005. (Certain fiscal year 2003 - 2004 balances were reclassified to conform with the current year presentation.)

*Governmental activities:*

Governmental activities increased the County's net assets by \$197.7 million for the year ended June 30, 2005, accounting for 99% of the total increase in net assets. Governmental activities operating revenues exceeded operating expenses by \$196.9 million. Transfers provided a total increase in net assets of \$.8 million.



## *Revenues:*

Total revenues for governmental activities were \$3.19 billion, an increase of 7 percent or \$213 million from the previous year. Total program revenues increased \$50 million, due in part to increases in realignment revenues which fund health, mental health and social services programs.

The \$163 million increase in general revenues is primarily due to the following:

\$29 million of the increase was due to property taxes, which increased 7% over the previous year. The increase was due to significant growth in assessed property values as real estate activity remained strong.

\$204 million of the increase is due to property taxes in lieu of vehicle license fee(VLF) revenue. Beginning in Fiscal Year 2004-2005, the County's share of general purpose VLF was eliminated and replaced with property tax revenue previously distributed in the County for education funding via the Educational Revenue Augmentation Fund(ERAF). The ERAF fund was established by state law in Fiscal Year 1992-93 to capture prescribed amounts of property tax to be shifted from local governmental agencies to local schools. The swap of property tax for VLF general purpose

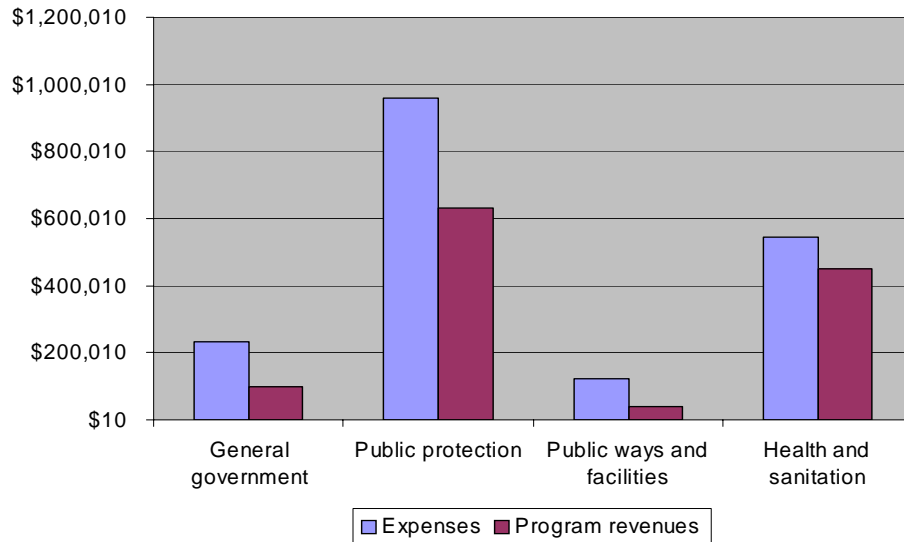
revenues resulted from the State's Fiscal Year 2004-05 budget actions and the signing of SB1099. The mechanism used to shift property tax revenues from ERAF to cities and counties was the establishment of a new VLF Property Tax Compensation Fund which holds initial allocations of property tax before distributions to cities and counties in January and May of the fiscal year. The County's share of this "swapped" revenue was \$204 million.

\$121 million represents a decrease in the State allocation of sales tax and VLF. Decreases in VLF are a result of the "swap" explained above while decreased sales taxes were caused by the State's exchange of sales tax revenue for property tax revenue. Effective July 1, 2004, provisions of AB7X1, one of the 2003-04 State budget bills referred to as the "triple flip" took effect. It redirected one-quarter cent of sales tax to the State to repay up to \$15 billion in bonds authorized by Proposition 57 (March 2004) to help the State finance its past debt. In turn, the State replaced the County's loss of sales tax revenue with a like amount of property tax revenue.

Interest earnings increased \$16 million or 73%, as the annual pool investment earnings rate increased to 2.24% from the prior year of 1.59%.



Expenses and Program Revenues - Governmental Activities ( In Thousands)



(Continued on Next Page)

Expenses:

Total expenses for governmental activities were \$2.99 billion, a decrease of 10% or \$347 million from the prior year. Public assistance is the largest function in expense (33 percent), followed by public protection (32 percent) and health and sanitation (18 percent).

The total decrease in program expenses is attributed generally to the following:

\$450 million represented savings as a result of the prior year's contributions paid to SDCERA to reduce the County's unfunded accrued actuarial liability (UAAL). This was offset by Board action to pay down \$25 million of the UAAL in the current fiscal year, for a net overall decrease in this category of expense of \$425 million. The reduced expense was applicable across all functions.

Offsetting the above decrease are the following increases in expenses:

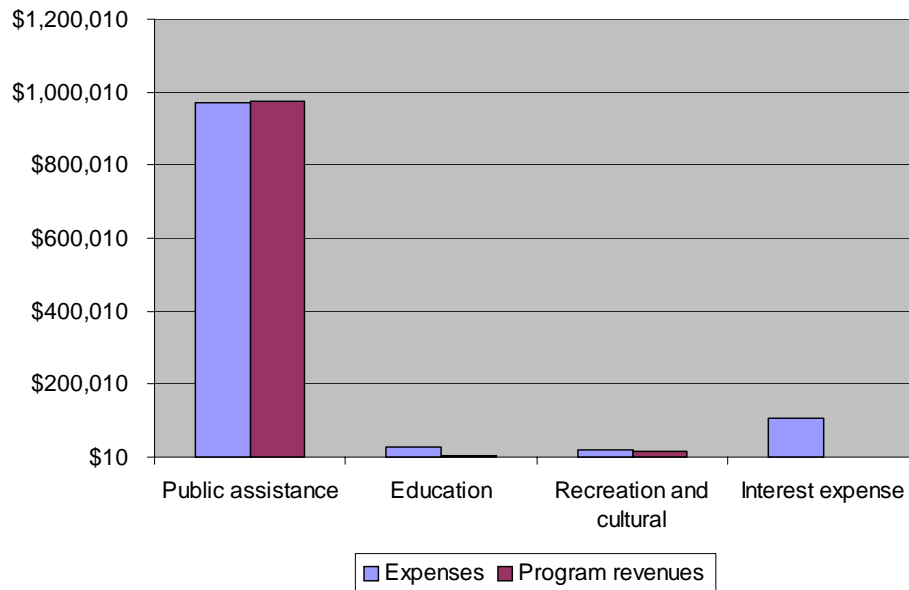
\$30 million is attributable to increases in salaries and benefit costs, an increase of 2.4% over the previous year. As a service delivery entity, the County's major cost component is salaries and benefits, amounting to approximately 43% of the total County expenditures. The County's overall strategy whereby some positions are deleted, some are frozen and others are temporarily funded has minimized the impact of negotiated salary increases and increased benefit costs.

\$15 million is attributable to increased interest expense on borrowings to meet cash flow needs of operations.

\$3 million represents basic increases in the costs of services and supplies across all functions.



**(Continued) Expenses and Program Revenues -  
Governmental Activities ( In Thousands)**



*Revenues By Sources:*

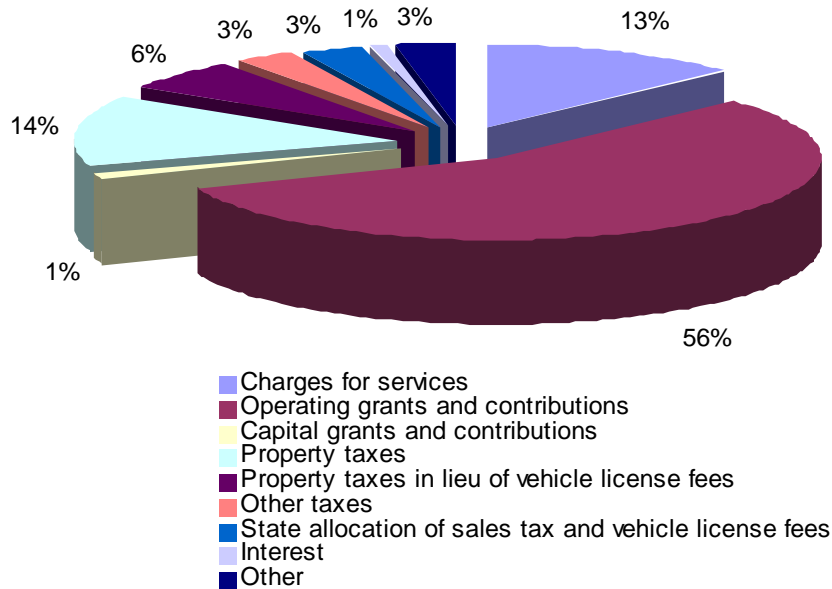
The County's governmental activities rely on several sources of revenue to finance ongoing operations. As shown, for governmental activities overall, without regard to program, operating grants and contributions are the largest single source of funds (56 percent). Operating grants and contributions are monies received from parties outside the County and are generally restricted to one or more specific programs. Examples of operating grants and contributions include State and Federal revenue for public assistance programs and for health and sanitation programs. General revenues such as property taxes and property taxes in lieu of vehicle license fees are not shown by program, but are effectively used to

support program activities County-wide. Combined, these revenues account for 20% of governmental activities.

At the end of fiscal year 2004-2005, total revenues for the governmental activities were \$3.19 billion, while total expenses for governmental activities were \$2.99 billion.



Revenues By Source - Governmental Activities  
(In Thousands)



Other factors concerning the finances of the County's major governmental funds are discussed in the Governmental Funds section of the "Financial Analysis of the County's Funds."

*Business-type Activities:*

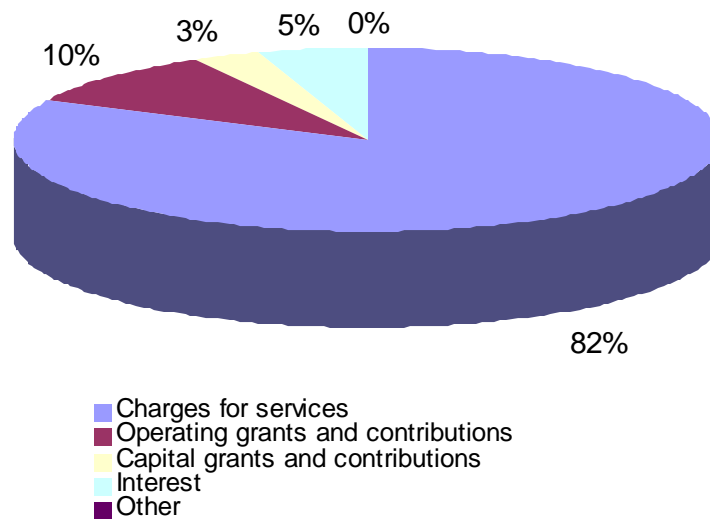
The net assets of business-type activities increased by \$2.9 million or 1.8%, indicating that these activities generated revenues sufficient to cover the costs of operations. Revenues

increased 9% to \$37.4 million due to an increase in charges for services and expenses of 20% to \$33.7 million, primarily due to increased costs of sewage processing and costs of repairs and maintenance.





**Revenues By Source - Business Type Activities  
(In Thousands)**



**Financial Analysis of the County Funds**

The County uses fund accounting to demonstrate and ensure compliance with finance-related legal requirements.

*Governmental Funds:*

The focus of the County's governmental funds is to provide information on near-term inflows, outflows, and balances of resources that are available for spending. Such information is useful in assessing the County'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. Types of Major Governmental Funds reported by the County include the General Fund and the Tobacco Securitization Special Revenue Fund. Nonmajor Governmental Funds include Special Revenue Funds, Debt Service Funds, and Capital Project Funds.

As of the end of fiscal year 2004-2005, the County's governmental funds reported combined ending fund balances of \$1.52 billion, an increase of \$224 million in comparison with the prior year fund balance. Of the total June 30, 2005 amount, \$942 million constitutes unreserved fund balance, which is available for spending at the County's discretion. The remainder of fund balance is reserved to indicate that it is not available for new spending because it has already been committed, (1) to liquidate existing contracts and purchase orders (\$177 million), (2) for landfill closure costs (\$26 million), (3) to pay debt service (\$148 million), and (4) for a variety of other purposes (\$225 million).

Revenues for governmental functions overall totaled \$3.12 billion representing a 6 percent increase. Expenditures for governmental functions, totaled \$3.0 billion, a 13 percent decrease from the fiscal year ended June 30, 2004.





### *General Fund:*

The General Fund is the chief operating fund of the County. At the end of fiscal year 2004-2005, the unreserved fund balance of the General Fund was \$376 million, while total fund balance was \$667 million, an increase of \$116 million from fiscal year 2003-2004. This was primarily attributed to increases in property tax revenues of \$215 million, federal aid of \$31 million and charges for current services of \$8 million offset by a decrease in State aid of \$138 million. As a measure of the General Fund's liquidity, it may be useful to compare both unreserved fund balance and total fund balance to total fund expenditures. Unreserved fund balance represents 15 percent of total General Fund expenditures of \$2.5 billion, while total fund balance represents 26 percent of that same amount.

### *Tobacco Securitization Special Revenue Fund:*

This Special Revenue Fund is used to account for the \$411 million (net of closing costs and reserve requirements) the County received from the Tobacco Asset Securitization Corporation related to the sale of 25 years of tobacco settlement revenue in fiscal year 2001-2002. The County will continue to invest these funds in investment products to maximize the sustained long-term use of these dollars. At the end of fiscal year 2004-2005, fund balance was \$332 million, a decrease of \$14 million from fiscal year 2003-2004. This represents the net of transfers out of the fund of \$23 million to support health related program expenditures and interest earnings of \$9 million.

### *Other Governmental Funds:*

Other Governmental funds consist of twenty-six nonmajor funds, which include Special Revenue Funds, Debt Service Funds, and Capital Project Funds. Individual fund data for each of these nonmajor governmental funds is provided in the Combining Financial Statements and Supplementary Information Section of this report. As of the end of fiscal year 2004-2005, the Fund Balance of the Other Governmental Funds totaled \$518 million, an

increase of \$122 million over the prior year. The change is primarily due to the following: an increase in the fund balance of the SANCAL Capital Projects Fund of \$63 million due to proceeds from a bond issuance; an increase of \$52 million in the fund balance of the Pension Obligation Bonds Fund due to transfers in of \$106 million and principal and interest payments of \$16 million and \$41 million, respectively; an increase of \$16 million in the fund balance of the Edgemoor Development Fund due to proceeds from the sale of capital assets.

### *Proprietary Funds:*

The County's proprietary funds provide the same type of information found in the government-wide financial statements, but in more detail. The nonmajor Enterprise Funds and the Internal Service Funds are combined into single, aggregated presentations in the proprietary fund financial statements with the individual fund data provided in combining statements, which can be found in the Combining Financial Statements/Schedules and Supplemental Information section of this report. Due to the quantitative nature of the Sanitation Districts, the County has elected not to report them as a major fund beginning fiscal year 2004-05.

As of the end of fiscal year 2004-2005, the Net Assets of the Enterprise Funds totaled \$160 million, an increase of \$3 million over the prior year, primarily due to an increase in the net assets of the Airport Fund as a result of an increase in charges for services of \$2 million and a decrease in non-operating expenses of \$1.7 million.

Net Assets of the Internal Service Funds totaled \$103 million, a decrease of \$10 million from the prior year. The net change in the Internal Service Funds is primarily due to a decrease of \$6 million in the Risk Financing Fund due to an excess of claims (\$43 million) over revenue (\$37 million); a decrease in the Facilities Management Fund of \$3 million due to increase utilities (\$2 million) and repairs and



maintenance costs (\$1 million); and a decrease of \$1 million in the Fleet Services Fund due to increased fuel expense.

#### *Fiduciary Funds:*

The County maintains fiduciary funds for the assets of the Pension Trust Fund, the Investment Trust Fund, and the Agency Funds.

#### *Pension Trust Fund:*

This fund is under the control of the Board of Retirement. The fund accumulates employer and employee contributions and earnings from the fund's investments. Disbursements are made from the fund for retirement, disability and death benefits and refunds. This fund includes all assets of the retirement system. As of the end of fiscal year 2004-2005, the net assets of the Pension Trust Fund totaled \$6.4 billion, an increase of \$850 million over the prior year. The change is primarily due to the following: (a) County and member contributions of \$356 million, (b) appreciation in the fair value of pension trust investments and investment income of \$795 million; less (c) member benefits paid and pension costs of \$302 million.

#### *Investment Trust Fund:*

This fund was established to account for the external portion of the County Treasurer's investment pool. This fund consists of school districts, special districts, and funds held for other governments. The Investment Trust Fund's net assets totaled \$2.6 billion, an increase in net assets of \$164 million, primarily resulting from undistributed school bond proceeds, undistributed property tax collections and prepaid unsecured taxes.

#### *Agency Funds:*

The Agency Funds maintain assets held in an agent capacity for other governments, organizations and individuals. These assets do not support the County's programs or services. Any portion of the Agency Funds' assets held at

fiscal year end for other County funds, are reported in those funds rather than in the Agency Funds.

## **General Fund Budgetary Highlights**

The County's final budget differs from the original budget in that it contains supplemental appropriations approved during the fiscal year for various programs and projects, as well as transfers of appropriations, budget corrections, re-budgets, and account reclassifications. At June 30, 2005, the variances between the original and final budgets for the excess of revenues over expenditures, \$49.5 million, and for other financing sources, \$35.5 million, resulted in a total change of \$85 million in budgeted fund balance between the original and final budgets.

Increased appropriations caused significant variances between the original and the final budgets as follows:

- \$33.2 million for the Integrated Property Tax System funded from securitizing the repayment of the Vehicle License Fee Gap loan.
- \$25 million to reduce the unfunded actuarial accrued liability to SDCERA also funded from securitizing the repayment of the Vehicle License Fee Gap loan.
- \$7.5 million increase based on increased State revenues. The Governor's Proposed Budget cut funding in the Probation Department Temporary Assistance for Needy Families (TANF). The shortfall would have resulted in the closure of a juvenile camp and ranch treatment beds and other reductions in juvenile and adult probation services, therefore, General Purpose Revenues replaced the TANF funding for these programs in the County's Adopted Operational Plan. In the final State budget, however, State General Revenues were allocated to continue State categorical funding for these programs. This allowed the County to reallocate the General Purpose



Revenues to fund a variety of one-time and on-going services including capital projects, major maintenance and increased costs in the Defense Attorney/Contract Administration department.

- \$7.4 million for salaries and benefits for incentives earned through the County's Fiscal Year 2003-2004 Quality First program, funded by fund balance.
- \$16.2 million net change in appropriated management reserves for future one-time projects.
- \$8.4 million for costs associated with closing the San Marcos landfill, funded from the Environmental Trust Fund (\$3 million), Land Acquisition-Divestiture Holding Fund (\$4 million) and the Solid Waste Landfill Closure Reserve (\$1.4 million), bringing the total project cost to \$23.2 million.
- \$7.7 million to fund unbudgeted expenditures related to revenue sharing requirements of the Memorandum of Understanding with the State Courts and for payments for undesignated fees pursuant to Assembly Bill 1759 based on traffic court fines, fees and forfeitures (\$6.5 million) and fund balance (\$1.2 million).
- \$8.8 million to fund increased costs in the In-Home Supportive Services Program in Aging and Independence Services based on increased funding from the State Department of Social Services.
- \$60.5 million reduction in appropriations for carryover adjustments for year-end encumbrances.

Actual revenues fell short of the final budgeted amounts by \$80 million, while expenditures fell short of the budgeted amount by \$275.7 million. The combination of revenue and expenditure shortfalls resulted in a net favorable operating variance of \$195.7 million. Other financing sources and uses of funds resulted in a favorable variance from budget of \$50.9 million and there was no variance in the increase to

the reserve for inventories of materials and supplies. These combined variances result in a variance in the net change in fund balance of \$246.6 million. Some highlights of the actual results compared to budgeted results are:

*Property Tax in Lieu of Vehicle License Fee (VLF):* In Fiscal Year 2004-05, the State established initial allocations from the VLF Property Tax Compensation Fund to cities and counties. This replaced the previous distribution of vehicle license fees to local governments. The County budgeted \$196.9 million for this revenue source and received \$204 million, resulting in a favorable variance of \$7.1 million. In addition, during Fiscal Year 2005-06 the County will be receiving a \$17.7 million positive true-up adjustment for Fiscal Year 2004-05. (For further VLF discussion see the section below entitled "Economic Factors and Next Year's Budget and Rates.")

*Salaries and Benefits:* In the continuing environment of uncertainty over State and Federal funding, many County functions have deferred hiring staff for ongoing programs in anticipation of future budget constraints. The total favorable variance in this category is \$36.3 million across all functions.

*Health and Human Services Agency:* Funded by a combination of State, Federal, and County revenues, most Agency programs are carried out in the functional areas of health and sanitation and public assistance, with favorable expenditure variances of \$31.8 million and \$75.9 million respectively. The expenditure variances result from demand for services being less than the budgeted level. These lowered expenditures are offset by corresponding reductions in Federal and State revenue.

*Strong real estate markets:* The real estate markets in San Diego County have been robust for several years due to low interest rates and high demand for residential and commercial real estate. This segment of the economy contributed to a positive variance of \$24.6 million in property taxes.



*Delayed expenditures:* Many County projects such as maintenance and information technology take place over more than one fiscal year; however, at inception they are budgeted at full expected cost, resulting in favorable expenditure variances that are re-budgeted into the new fiscal year. For example, \$17.0 million has been re-budgeted in the Department of Public Works for the Hazardous Fuels Reduction Program and \$2.4 million has been re-budgeted in the Department of Parks and Recreation for parks repair and other fire-related projects. In public protection, \$5.0 million in unexpended appropriations for the Regional Communications System, the Jail Information Management System, the North County Regional Gang Task Force, the Cal-ID mugshot replacement system and U.S. Department of Justice Grants involving DNA analysis were re-budgeted the next fiscal year. Additionally, \$1.3 million was re-budgeted in the Multi-Species Conservation and Watershed programs and another \$.5 million was re-budgeted for document management technology costs.

*Reserves:* The County annually appropriates management and contingency reserves based on both ongoing general purpose revenues and prior years' fund balance for a variety of one-time capital and operating expenditures as well as potential emergencies. Unexpended reserves resulted in a positive variance of \$43.5 million. In addition, in FY 2004-05, the County set aside \$17.4 million for economic uncertainty with the intent that it not be spent unless unusual needs arose; of that amount, \$14.8 million was unexpended at year end.

## Capital Assets and Debt Administration

### Capital Assets

At June 30, 2005, the County's capital assets for both the governmental and business-type activities was \$2.76 billion net of accumulated depreciation. Investment in capital assets includes land, construction in progress, structures and improvements, equipment, and

infrastructure (including roads, bridges, flood channels, and traffic signals). The significant capital asset activity in fiscal year 2004-2005 was as follows:

#### *Governmental Activities:*

- \$23 million towards the construction and improvement of County maintained roads, bridges, and other road related infrastructure. An additional \$23 million was donated by developers.
- \$8.21 million towards the construction of the Edgemoor Skilled Nursing Facility in Santee. Total project costs are estimated at \$83.79 million.
- \$4.37 million towards the construction of the North County Animal Shelter. Total project costs are estimated at \$6.69 million.
- \$3.09 million for the acquisition of real property in the Otay River Valley area for open space habitat restoration and passive recreation.
- \$2.34 million towards the construction of the Bonita Library. Total project costs are estimated at \$4.49 million.
- \$1.53 million towards the construction of a control panel system at the Vista Detention Facility. Total project costs are estimated at \$2.65 million.
- \$1.34 million towards the construction of a nursery at Polinsky Children's Center. Total project costs are estimated at \$2.42 million.
- \$1.25 million towards the construction of the East Mesa Juvenile Detention Facility. Total project costs are estimated at \$52.95 million.
- \$12.96 million towards the construction of numerous other capital outlay projects.

During fiscal year 2004-2005, capital assets valued at \$18.81 million, representing the four transit centers, was removed from inventory as a result of the divestiture of the County Transit System to the Metropolitan Transit Development Board.





## *Business-Type Activities:*

- \$2.21 million towards the replacement of the Galloway Pump Station Force Main in Alpine Sanitation District. Total project costs are estimated at \$4.28 million.
- \$1.88 million towards runway rehabilitation at Gillespie Field Airport in El Cajon. Total project costs are estimated at \$4.97 million.
- \$1.01 million was donated by developers for sewer lines in the East Otay Mesa area.

For government-wide financial statement presentation, governmental fund depreciable capital assets were depreciated from the acquisition date to the end of the current fiscal year. Governmental fund financial statements record capital asset purchases as expenditures.

More detailed capital assets information, including depreciation as of June 30, 2005, can be found in Note IV-D of the notes to the basic financial statements.

## **Capital Commitments**

As of June 30, 2005, capital commitments included the following:

- \$72 million for the Integrated Voting System, Integrated Property Tax System, RCS Equipment, SMART system, Revenue Plus Collection System, Medics Health Information System, and the Automated Records Management and Field Reporting Software Installation.
- \$80 million for the construction of the Edgemoor Skilled Nursing Facility, the Air Pollution Control Facility in Scripps Ranch, Valley Center Road, Spring Valley Gym/Teen Center, Mission Road, and Forester Creek Drainage system.
- \$4.4 million for the Jamacha Boulevard Sewer and the Gillespie Field Runway.

More detailed capital commitments information, including depreciation as of June 30, 2005, can be found in Note IV-D.2 of the notes to the basic financial statements.

## **Long-Term Obligations**

At June 30, 2005, the County had outstanding governmental activity long-term obligations of \$2.3 billion. Of this amount, \$393 million pertains to outstanding certificates of participation, \$35 million pertains to capital leases, and \$1.9 billion pertains to other long-term obligations that include \$1.25 billion of taxable pension obligation bonds, \$430 million of San Diego County Tobacco Asset Securitization Corporation Bonds, \$104 million for claims and judgments, \$48 million for landfill closure and postclosure costs, \$77 million for compensated absences, \$7.3 million for other loans, \$4 million for the 1995 Redevelopment Agency revenue bonds.

Long-term obligations for business-type activities totaled \$3.2 million and consisted of \$2.9 million for capital loans and \$324 thousand for compensated absences.

During fiscal year 2004-2005, the County's total principal amount of bonds and notes payable for governmental activities increased by \$24 million, before giving affect to the unamortized issuance premiums, discounts and unamortized deferred amount on refunding. The increase is due primarily to the County of San Diego's issuance of \$112 million in certificates of participation for the Edgemoor/Regional Communication System refunding. Offsets were \$60 million in principal debt service payments and \$30 million reduction of principal due to the refunding of the 1996 Regional Communication System. The long-term obligations for the business-type activities decreased by \$93 thousand due to a debt service payments on capital loans.

More detailed long-term obligation activity, including interest rates and maturity dates, can be found in Note IV-I through IV-I-6 of the notes to the basic financial statements.

The County's credit ratings on its bonded program are as follows:



Credit Ratings	Moody's	Standard & Poor's	Fitch Ratings
Certificates of Participation	A1	AA-	AA-
Pension Obligation Bonds:			
1994 Series A	Aa3	AA-	Not Rated
2002 Series A, B & C	Aa3	AA-	AA-
2004 Series A, B & C	Aa3	AA-	AA-

In addition, the County has an Issuer Credit Rating of Aa2 from Moody's and AA from Standard & Poor's. These ratings reflect the County's favorable general credit characteristics, which include a strong local economy, a sound financial position and a moderate debt profile. There were no changes in the credit ratings from the previous year.

**Economic Factors and Next Year's Budget and Rates**

The budget for FY 2005-06 resources to support County services contains an increase of \$98.7 million, 2.4% over FY 2004-2005.

The San Diego economy continues to show positive growth (i.e., gross regional product at 4.9% for 2002, 4.5% for 2003, 4.4% for 2004, and forecasted at 4.5% for 2005).

The 2005-06 Budget Act is consistent with the two-year budget agreement reached between the State and local governments in July 2004 and the passage of Proposition 1A on the November 2004 ballot with respect to general purpose revenues. For the second year in a row the County will transfer \$27.5 million of its property taxes to the Educational Revenue Augmentation Fund (ERAF) to assist the State to meet its funding obligations to local schools. This revenue loss was anticipated and factored into the County's 2005-06 Adopted Budget.

Since 1995-96 the State Property Tax Administration Grant program has assisted counties maintain timely property assessments. The 2005-06 Budget Act suspends for two years the entire \$60 million that has historically been budgeted for the program. For the County, the revenue loss is \$5.4 million and was not anticipated in the County's 2005-06 Adopted Budget. The County will be reviewing its options including identifying where costs can be

reduced and whether any other funding source is available to cover all or a portion of this revenue loss.

*Salaries and benefits* are increasing by a net \$63.8 million or 4.5%. This reflects negotiated increases in base pay and health insurance along with required payments to the retirement fund offset by the reduction of 65 staff years.

The County's *general purpose revenues* continue to perform well. Specifically:

- The largest source of general purpose revenues is property taxes (\$400.5 million), representing 55% of the total. The demand for housing, boosted by low interest rates, has remained strong as attested to by significant increases in property values. For the last five years, local secured growth has been high (8.2% average annual growth excluding the State's 2004-05 property tax shift to schools) due to the County's strong overall economy and healthy real estate market. At present, real estate activity is still strong due to stable, historically low mortgage rates, the limited supply of housing for sale, and the area's population growth. As noted above, per the two-year agreement with the State, the County will relinquish \$27.5 million in property tax revenues to ERAF. Current secured property tax revenues budgeted in the Fiscal Year 2005-06 Adopted Budget were based on the assumption that assessed value growth through June 30, 2005 would be 10%. Actual assessed value growth exceeded



13%, which is projected to raise current secured property tax revenue collections by \$12.9 million.

- *Property Taxes in Lieu of Vehicle License Fees (VLF)* comprises 27.8% (an estimated \$200.5 million) of General Purpose Revenues in Fiscal Year 2005-06. This revenue source replaces the previous distribution of vehicle license fees to local governments. In Fiscal Year 2004-05, the State established initial allocations from the VLF Property Tax Compensation Fund to cities and counties. The allocations for Fiscal Year 2005-06 are to be calculated based on a formula that takes into account adjusted actual allocations for Fiscal Year 2004-05 and growth in gross taxable assessed value in each county. Information on the adjusted actuals was released on October 14, 2005 and the County will be receiving a \$17.7 million true-up adjustment for Fiscal Year 2004-05. In addition, the published assessed value growth factor for 2005-06 is 13.3% which establishes the County's 2005-06 property tax in lieu of vehicle license fee base at \$247.3 million.

At June 30, 2005, *unreserved General Fund balance* was \$376 million. Of this amount, the County appropriated to the General Fund \$56.5 million of unreserved, undesignated fund balance and \$3.7 million in reserved fund balance for Fiscal Year 2005-2006 expenditures of one-time items. The County's *Adopted Operational Plan* for Fiscal Years 2005-2006 (the Adopted Budget) and for Fiscal Year 2006-2007 (for planning purposes) and the County's *Capital Program* can be found on the internet at <http://www.sdcounty.ca.gov/auditor/budinfo.html>

### Requests for Information

This financial report is designed to provide our citizens, taxpayers, customers, and investors and creditors with a general overview of the County's finances and to demonstrate the County's *accountability* for the money it receives. If you have questions about this report or need additional financial information, please contact the Auditor and Controller's Office, County of San Diego, located at 1600 Pacific Highway, San Diego, California 92101.







# Basic Financial Statements

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## Basic Financial Statements

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



**STATEMENT OF NET ASSETS**  
**June 30, 2005**  
**(In Thousands)**

	Primary Government			Component Unit
	Governmental Activities	Business-type Activities	Total	First 5 Commission Fund
<b>ASSETS</b>				
Current assets:				
Equity in pooled cash and investments	\$ 925,568	68,937	994,505	172,983
Cash with fiscal agent	118,139		118,139	
Collections in transit	6,716	9	6,725	
Imprest cash	313	2	315	
Investments	69,894		69,894	
Receivables, net	366,567	880	367,447	8,774
Taxes receivable, net	105,784		105,784	
Internal balances	(9,263)	9,263		
Inventory of materials and supplies	11,170		11,170	
Deposits with others	2,370		2,370	
Deferred charges	2,552		2,552	
Prepaid items	1,009		1,009	2
Restricted assets:				
Cash with fiscal agent	97,877		97,877	
Investments	395,773		395,773	
<b>Total current assets</b>	<b>2,094,469</b>	<b>79,091</b>	<b>2,173,560</b>	<b>181,759</b>
Noncurrent assets:				
Restricted assets:				
Investments	335,905		335,905	
Deferred charges	26,045		26,045	
Capital assets:				
Land and construction in progress	407,581	27,489	435,070	
Other capital assets, net of depreciation	2,266,812	60,092	2,326,904	
<b>Total noncurrent assets</b>	<b>3,036,343</b>	<b>87,581</b>	<b>3,123,924</b>	
<b>Total assets</b>	<b>5,130,812</b>	<b>166,672</b>	<b>5,297,484</b>	<b>181,759</b>
<b>LIABILITIES</b>				
Current liabilities:				
Accounts payable	142,965	2,161	145,126	5,813
Accrued payroll	60,374	271	60,645	
Amount due for tax and revenue anticipation notes	369,280		369,280	
Accrued interest	28,743		28,743	
Amount due for commercial paper notes	74,990		74,990	
Unearned revenue	95,625	264	95,889	
Current portion of long-term obligations	117,125	213	117,338	
<b>Total current liabilities</b>	<b>889,102</b>	<b>2,909</b>	<b>892,011</b>	<b>5,813</b>
Noncurrent liabilities:				
Noncurrent portion of long-term obligations	2,218,067	3,037	2,221,104	
<b>Total noncurrent liabilities</b>	<b>2,218,067</b>	<b>3,037</b>	<b>2,221,104</b>	
<b>Total liabilities</b>	<b>3,107,169</b>	<b>5,946</b>	<b>3,113,115</b>	<b>5,813</b>
<b>NET ASSETS</b>				
Invested in capital assets, net of related debt	2,341,126	84,416	2,425,542	
Restricted for:				
Capital projects	20,949		20,949	
Debt service	128,046		128,046	
Inactive landfill maintenance	25,720		25,720	
Other purposes	48,850		48,850	175,946
Unrestricted	(541,048)	76,310	(464,738)	
<b>Total net assets</b>	<b>\$ 2,023,643</b>	<b>160,726</b>	<b>2,184,369</b>	<b>175,946</b>

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



**STATEMENT OF ACTIVITIES**  
**For the Year Ended June 30, 2005**  
**(In Thousands)**

	Program Revenues				Net (Expenses) Revenue and Changes in Net Assets			Component Unit First 5 Commission Fund
	Expenses	Charges for Services	Operating Grants and Contri- butions	Capital Grants and Contri- butions	Primary Government		Total	
					Governmental Activities	Business- type Activities		
<b>Functions/Programs:</b>								
<b>Governmental Activities</b>								
General government	\$ 232,826	84,769	14,812	453	(132,792)		(132,792)	
Public protection	960,227	229,150	403,613		(327,464)		(327,464)	
Public ways and facilities	122,797	13,874	3,645	23,236	(82,042)		(82,042)	
Health and sanitation	545,805	75,034	376,623	8	(94,140)		(94,140)	
Public assistance	972,592	3,296	969,887		591		591	
Education	27,394	1,359	993	558	(24,484)		(24,484)	
Recreation and cultural	21,405	6,902	232	8,048	(6,223)		(6,223)	
Interest expense	106,612				(106,612)		(106,612)	
<b>Total governmental activities</b>	<b>2,989,658</b>	<b>414,384</b>	<b>1,769,805</b>	<b>32,303</b>	<b>(773,166)</b>		<b>(773,166)</b>	
<b>Business-type Activities</b>								
Airport	8,117	8,345	3,653			3,881	3,881	
Wastewater Management	5,076	5,357	21			302	302	
Sanitation Districts	20,564	16,949	26	1,036		(2,553)	(2,553)	
<b>Total business-type activities</b>	<b>33,757</b>	<b>30,651</b>	<b>3,700</b>	<b>1,036</b>		<b>1,630</b>	<b>1,630</b>	
<b>Total primary government</b>	<b>3,023,415</b>	<b>445,035</b>	<b>1,773,505</b>	<b>33,339</b>	<b>(773,166)</b>	<b>1,630</b>	<b>(771,536)</b>	
<b>Component Unit</b>								
First 5 Commission	40,137		42,652					2,515
<b>Total component unit</b>	<b>\$ 40,137</b>		<b>42,652</b>					<b>2,515</b>

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



**STATEMENT OF ACTIVITIES**  
**For the Year Ended June 30, 2005**  
**(In Thousands)**

	Net (Expenses) Revenue and Changes in Net Assets			
	Primary Government			Component Unit First 5 Commission Fund
	Governmental Activities	Business-type Activities	Total	
Revenues:				
General revenues:				
Taxes:				
Property taxes	\$ 441,716		441,716	
Other taxes	96,927		96,927	
Property taxes in lieu of vehicle license fees	203,788		203,788	
Unrestricted contributions from State				
State allocation of sales tax	106,548		106,548	
Total general tax revenues	848,979		848,979	
Interest	38,066	1,730	39,796	2,576
Other	83,079	287	83,366	
Total general revenues	970,124	2,017	972,141	2,576
Transfers	764	(764)		
Total general revenues and transfers	970,888	1,253	972,141	2,576
Change in net assets	197,722	2,883	200,605	5,091
Net assets at beginning of year (Component Unit restated)	1,825,921	157,843	1,983,764	170,855
Net assets at end of year	\$ 2,023,643	160,726	2,184,369	175,946

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



**BALANCE SHEET**  
**GOVERNMENTAL FUNDS**  
**June 30, 2005**  
**(In Thousands)**

	General Fund	Tobacco Securitization Special Revenue Fund	Other Governmental Funds	Total Governmental Funds
<b>ASSETS</b>				
Equity in pooled cash and investments	\$ 496,759	9,878	255,658	762,295
Cash with fiscal agent	43,902		74,237	118,139
Collections in transit	5,362		351	5,713
Imprest cash	298		13	311
Investments	2		69,892	69,894
Receivables, net	224,527	1,229	135,767	361,523
Taxes receivable, net	105,009		775	105,784
Due from other funds	172,209		7,491	179,700
Advances to other funds	928		102	1,030
Inventory of materials and supplies	8,795		1,777	10,572
Deposits with others			2,370	2,370
Prepaid items	5		1,004	1,009
Restricted assets:				
Cash with fiscal agent		3	97,874	97,877
Investments	360,000	323,928	47,750	731,678
<b>Total assets</b>	<b>1,417,796</b>	<b>335,038</b>	<b>695,061</b>	<b>2,447,895</b>
<b>LIABILITIES AND FUND BALANCES</b>				
<b>Liabilities:</b>				
Accounts payable	101,766		25,158	126,924
Accrued payroll	55,366		3,443	58,809
Amount due for tax and revenue anticipation notes	369,280			369,280
Due to other funds	21,342	2,779	119,614	143,735
Advances from other funds			10,699	10,699
Deferred credits and other liabilities	44,624		5,254	49,878
Amount due for commercial paper notes	74,990			74,990
Unearned revenue	82,970		12,655	95,625
<b>Total liabilities</b>	<b>750,338</b>	<b>2,779</b>	<b>176,823</b>	<b>929,940</b>
<b>Fund balances:</b>				
<b>Reserved Fund Balance</b>				
Reserved for encumbrances	131,356		46,003	177,359
Reserved for notes receivable and advances	7,295		35,875	43,170
Reserved for deposits with others			58	58
Reserved for inactive landfill maintenance	16,170		9,550	25,720
Reserved for inventory of materials and supplies	8,795		1,777	10,572
Reserved for debt service			147,996	147,996
Reserved for other purposes	128,216		43,057	171,273
<b>Unreserved:</b>				
Designated for subsequent years' expenditures	111,448			111,448
Undesignated	264,178	332,259		596,437
<b>Unreserved, reported in nonmajor:</b>				
<b>Special Revenue Funds</b>				
Designated for landfill postclosure and inactive landfill maintenance			66,902	66,902
Undesignated			82,631	82,631
<b>Capital Projects Funds</b>				
Undesignated			84,389	84,389
<b>Total fund balances</b>	<b>667,458</b>	<b>332,259</b>	<b>518,238</b>	<b>1,517,955</b>
<b>Total liabilities and fund balances</b>	<b>\$ 1,417,796</b>	<b>335,038</b>	<b>695,061</b>	<b>2,447,895</b>

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



**RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET TO THE GOVERNMENT-WIDE STATEMENT OF NET ASSETS**  
**June 30, 2005**  
**(In Thousands)**

Total fund balances-governmental funds	\$ 1,517,955
Costs of issuances are reported as expenditures in governmental funds and thus have the effect of reducing fund balance because current financial resources have been used. In the government-wide statements however, bond issuance costs are reported as a deferred charge and amortized over the life of the bond issue.	28,597
When capital assets (land, buildings, equipment, infrastructure) that are to be used in governmental activities are purchased or constructed, the costs of those assets are reported as expenditures in governmental funds. However, the statement of net assets includes those capital assets among the assets of the County as a whole.	2,578,776
Interest on long-term debt is not accrued in governmental funds, but rather is recognized as an expenditure when due.	(28,743)
Because the focus of governmental funds is on short-term financing, some assets will not be available to pay for current-period expenditures. Those assets (for example, receivables) are offset by deferred revenues in the governmental funds and thus are not included in fund balance.	49,878
Long-term liabilities applicable to the County's governmental activities are not due and payable in the current period and accordingly are not reported as fund liabilities. All liabilities, current and long-term, are recorded in the statement of net assets.	(2,225,724)
Internal service funds are used by management to charge the costs of certain activities, such as insurance and telecommunications, to individual funds. The assets and liabilities of the internal service funds are included in governmental activities in the statement of net assets.	102,904
Net assets of governmental activities	\$ 2,023,643

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



**STATEMENT OF REVENUES, EXPENDITURES,  
AND CHANGES IN FUND BALANCES-GOVERNMENTAL FUNDS  
For the Year Ended June 30, 2005  
(In Thousands)**

	General Fund	Tobacco Securitization Special Revenue Fund	Other Governmental Funds	Total Governmental Funds
<b>Revenues:</b>				
Taxes	\$ 671,850		45,324	717,174
Licenses, permits and franchise fees	32,015		10,939	42,954
Fines, forfeitures and penalties	51,000		4,538	55,538
Revenue from use of money and property	29,308	8,810	12,693	50,811
Aid from other governmental agencies:				
State	511,830		568,833	1,080,663
Federal	620,477		109,248	729,725
Other	60,415		13,857	74,272
Charges for current services	254,585		32,046	286,631
Other revenue	38,057		46,353	84,410
<b>Total revenues</b>	<b>2,269,537</b>	<b>8,810</b>	<b>843,831</b>	<b>3,122,178</b>
<b>Expenditures:</b>				
<b>Current:</b>				
General	204,566		6,955	211,521
Public protection	928,375		10,695	939,070
Public ways and facilities	4,348		80,212	84,560
Health and sanitation	499,471		42,450	541,921
Public assistance	858,487		111,721	970,208
Education	597		26,522	27,119
Recreation and cultural	18,300		1,314	19,614
Capital outlay	17,928		36,229	54,157
Debt service:				
Principal			60,849	60,849
Interest and other fiscal charges	12,310		82,246	94,556
Bond issuance costs			1,915	1,915
<b>Total expenditures</b>	<b>2,544,382</b>		<b>461,108</b>	<b>3,005,490</b>
Excess (deficiency) of revenues over (under) expenditures	(274,845)	8,810	382,723	116,688
<b>Other financing sources (uses):</b>				
Sale of capital assets			18,400	18,400
Issuance of bonds and loans				
Face value of bonds issued			83,510	83,510
Face value of loans issued			160	160
Bond premiums			5,960	5,960
Refunding bonds issued			28,885	28,885
Payment to refunded bond escrow agent			(31,633)	(31,633)
Transfers in	568,677		250,813	819,490
Transfers out	(179,228)	(23,278)	(617,121)	(819,627)
<b>Total other financing sources (uses)</b>	<b>389,449</b>	<b>(23,278)</b>	<b>(261,026)</b>	<b>105,145</b>
<b>Net change in fund balances</b>	<b>114,604</b>	<b>(14,468)</b>	<b>121,697</b>	<b>221,833</b>
Fund balances at beginning of year	551,000	346,727	396,436	1,294,163
Increase in:				
Reserve for inventory of materials and supplies	1,854		105	1,959
<b>Fund balances at end of year</b>	<b>\$ 667,458</b>	<b>332,259</b>	<b>518,238</b>	<b>1,517,955</b>

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



<b>RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES OF GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES</b> <b>For the Year Ended June 30, 2005</b> <b>(In Thousands)</b>	
Net change in fund balances-total governmental funds	\$ 221,833
Governmental funds accrue property tax revenue, which is deemed collectible within sixty days. However, in the statement of activities the total amount estimated to ultimately be collected is accrued.	25,257
Adjustment for reserve for inventory of materials and supplies.	1,959
Long-term receivables are not available as current resources, and therefore are not reported as revenue in the governmental funds.	(4,274)
The proceeds from the sale of capital assets are reported as other financing sources in the governmental funds.	(18,400)
The book value of the sale of such assets is removed from the capital assets account in the statement of net assets and offset against the sales proceeds resulting in a "loss on sale of capital assets" recorded as an expense in the statement of activities. Governmental funds report capital outlays as expenditures. However, in the statement of activities the cost of those assets is allocated over the estimated useful lives and reported as depreciation expense. This is the amount by which asset acquisition and donations exceeded depreciation in the current period.	15,178
Internal service funds are used by management to charge the costs of certain activities, such as insurance and telecommunications, to individual funds. The adjustments for internal service funds "close" those funds by charging additional amounts to participating governmental activities to completely cover the internal service fund's costs for the year.	(9,357)
Repayment of bond principal and other long term obligations are reported as expenditures in governmental funds and thus has the effect of reducing fund balance because current financial resources have been used. For the County as a whole however, the principal and other payments for liabilities reduce the liabilities in the statement of net assets and do not result in an expense in the statement of activities. The County's long term obligations include bonds, loans and notes payable, capital leases, accumulated unpaid employee leave balances, arbitrage rebate, and closure and postclosure costs for the San Marcos landfill. The County's long term debt was reduced by these payments, principal payments to bondholders, and the adjustment to the San Marcos landfill closure and postclosure liability.	96,168
Bond issuance costs are expended in the governmental funds when paid, and are capitalized and amortized in the statement of activities. This is the amount by which current year amortization expense exceeded bond issuance costs.	(194)
Interest expense in the statement of activities differs from the amount reported in governmental funds because additional interest was calculated for bonds and notes payable and amortization of capitalized bond premiums, discounts and deferred amount of refunded debt that are expended in the governmental funds in the year paid.	(17,893)
Bond proceeds are reported as financing sources in governmental funds and thus contribute to the change in fund balance. In the government-wide statements however, issuing debt increases long-term liabilities in the statement of net assets and does not effect the statement of activities.	(112,555)
Change in net assets of governmental activities	\$ 197,722

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





**STATEMENT OF NET ASSETS  
 PROPRIETARY FUNDS  
 June 30, 2005  
 (In thousands)**

	Business-Type Activities Enterprise Funds	Governmental Activities - Internal Service Funds
<b>ASSETS</b>		
Current assets:		
Equity in pooled cash and investments	\$ 68,937	163,273
Collections in transit	9	1,003
Imprest cash	2	2
Receivables, net	880	5,044
Due from other funds	936	16,315
Advances to other funds	9,312	596
Inventory of materials and supplies		598
<b>Total current assets</b>	<b>80,076</b>	<b>186,831</b>
Noncurrent assets:		
Capital assets:		
Land	10,677	
Construction and contracts in progress	16,812	
Buildings and equipment	43,938	149,528
Infrastructure	64,921	
Accumulated depreciation	(48,767)	(53,911)
<b>Total noncurrent assets</b>	<b>87,581</b>	<b>95,617</b>
<b>Total assets</b>	<b>167,657</b>	<b>282,448</b>
<b>LIABILITIES</b>		
Current liabilities:		
Accounts payable	2,161	16,041
Accrued payroll	271	1,565
Due to other funds	1,247	51,969
Advances from other funds	239	
Unearned revenue	264	
Bonds, loans and notes payable	181	176
Compensated absences	32	224
Claims and judgments		43,251
<b>Total current liabilities</b>	<b>4,395</b>	<b>113,226</b>
Noncurrent liabilities:		
Bonds, loans and notes payable	2,745	3,483
Compensated absences	292	2,016
Claims and judgments		60,318
<b>Total noncurrent liabilities</b>	<b>3,037</b>	<b>65,817</b>
<b>Total liabilities</b>	<b>7,432</b>	<b>179,043</b>
<b>NET ASSETS</b>		
Invested in capital assets, net of related debt	84,416	95,606
Unrestricted net assets	75,809	7,799
<b>Total net assets</b>	<b>\$ 160,225</b>	<b>103,405</b>
Adjustment to reflect the consolidation of internal service fund activities related to enterprise funds.	501	
<b>Net assets of business-type activities</b>	<b>\$ 160,726</b>	

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



**STATEMENT OF REVENUES, EXPENSES, AND  
CHANGES IN FUND NET ASSETS  
PROPRIETARY FUNDS  
For the Year Ended June 30, 2005  
(In Thousands)**

	Business-Type Activities Enterprise Funds	Governmental Activities - Internal Service Funds
<b>OPERATING REVENUES</b>		
Charges for services	\$ 30,948	255,435
Miscellaneous	22	1,017
Total operating revenues	30,970	256,452
<b>OPERATING EXPENSES</b>		
Salaries	5,746	29,587
Repairs and maintenance	5,405	24,532
Equipment rental	538	1,227
Sewage processing	13,617	
Contracted services	2,992	117,293
Depreciation	2,269	10,316
Utilities	142	22,237
Cost of material		4,272
Claims and judgments		42,968
Fuel		7,441
Other operating expenses	2,362	7,629
Total operating expenses	33,071	267,502
Operating (loss)	(2,101)	(11,050)
<b>NONOPERATING REVENUES (EXPENSES)</b>		
Interest and dividends	1,729	726
Grants	3,668	243
Interest expense	(184)	(125)
Loss on disposal of capital assets		(590)
Other nonoperating revenues		55
Other nonoperating expenses	(1)	(17)
Total nonoperating revenues (expenses)	5,212	292
Income (loss) before contributions and transfers	3,111	(10,758)
Capital contributions	1,036	
Transfers in		4,448
Transfers out	(764)	(3,547)
Change in net assets	3,383	(9,857)
Net assets at beginning of year		113,262
Net assets at end of year	\$	103,405
Adjustment to reflect the consolidation of internal service fund activities related to enterprise funds.	(500)	
Change in net assets of business-type activities	\$ 2,883	

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



**STATEMENT OF CASH FLOWS**  
**PROPRIETARY FUNDS**  
**For the Year Ended June 30, 2005**  
**(In Thousands)**

	Business-Type Activities Enterprise Funds	Governmental Activities - Internal Service Funds
Cash flows from operating activities:		
Cash received from customers	\$ 32,100	117,660
Cash received from other funds	459	139,847
Cash payments to suppliers	(19,646)	(200,687)
Cash payments to employees	(5,766)	(29,500)
Cash payments to other funds	(7,775)	(23,503)
Net cash provided (used) by operating activities	(628)	3,817
Cash flows from non-capital financing activities:		
Operating grants	3,666	243
Transfers from other funds		4,448
Transfers to other funds	(764)	(3,547)
Advances from other funds	(20)	161
Advances to other funds	235	
Net cash provided by non-capital financing activities	3,117	885
Cash flows from capital and related financing activities:		
Capital grants revenue	1,035	
Acquisition of capital assets	(6,197)	(7,529)
Proceeds from sale of assets		1,065
Retirement of capital leases, bonds and loans	(368)	(159)
Bond sale proceeds and loans received	100	1,785
Interest paid on long-term debt	(184)	(139)
Net cash used for capital and related financing activities	(5,614)	(4,977)
Cash flows from investing activities:		
Interest	1,535	615
Net increase (decrease) in cash and cash equivalents	(1,590)	760
Cash and cash equivalents at beginning of year	70,538	163,518
Cash and cash equivalents at end of year	68,948	164,278
Reconciliation of operating loss:		
Operating loss	(2,101)	(11,050)
Adjustments to reconcile:		
Increase (decrease) in compensated absences	(20)	87
Increase (decrease) in accrued payroll	1	41
Increase (decrease) in due to other funds	(1,747)	(1,747)
Increase (decrease) in accounts payable	(617)	(2,426)
Increase (decrease) in claims and judgments		7,259
Increase (decrease) in deferred credits and other liabilities	(15)	(43)
Decrease (increase) in accounts and notes receivable	696	(1,853)
Decrease (increase) in due from other funds	906	2,969
Decrease (increase) in Inventory of materials and supplies		264
Depreciation	2,269	10,316
Net cash provided (used) by operating activities	(628)	3,817
Non-cash investing and capital financing activities:		
Accrued interest	200	220
Adjustment to capital leases		11
Capital acquisitions included in accounts payable	1,715	956
Total non-cash investing and capital financing activities	1,915	1,187

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



**STATEMENT OF FIDUCIARY NET ASSETS**  
**FIDUCIARY FUNDS**  
**June 30, 2005**  
**(In Thousands)**

	Pension Trust Fund	Investment Trust Fund	Agency Funds
<b>ASSETS</b>			
Equity in pooled cash and investments	\$ 418	2,557,644	405,835
Cash with fiscal agent	175,335		11,409
Collections in transit		216	9,860
Imprest cash		31	4
Investments:			
Domestic equity securities	882,662		
Cash, cash equivalents, and securities domestic equity swaps and futures	1,368,556		
International equity securities	1,489,825		
Securities lending collateral	503,102		
United States government obligations	628,206		
Domestic corporate bonds	557,566		
International bonds	794,671		
Cash and securities for overlay futures	58,557		
Alternative equity and real estate	548,694		
Receivables:			
Accounts receivable		23,390	29,039
Trade receivable	47,146		
Interest receivable	23,509		
Due from other governments	8,738		
Capital assets, net	2,894		
<b>Total assets</b>	<b>7,089,879</b>	<b>2,581,281</b>	<b>456,147</b>
<b>LIABILITIES</b>			
Accounts payable	228,303	9,709	45,678
Due to other governments			410,469
Obligations under securities lending	503,102		
<b>Total liabilities</b>	<b>731,405</b>	<b>9,709</b>	<b>456,147</b>
<b>NET ASSETS</b>			
Held in trust for pension benefits and other purposes	\$ 6,358,474	2,571,572	

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



**STATEMENT OF CHANGES IN FIDUCIARY NET ASSETS  
FIDUCIARY FUNDS  
For the Year Ended June 30, 2005  
(In Thousands)**

	Pension Trust Fund	Investment Trust Fund
<b>ADDITIONS</b>		
Contributions:		
Employer	\$ 316,075	
Plan members	40,766	
Contributions on pooled investments		15,396,428
Total contributions	356,841	15,396,428
Investment earnings:		
Net increase (decrease) in fair value of investments	658,060	(16,996)
Interest income	99,175	53,333
Securities lending income	11,196	
Other income	84,675	
Total investment earnings	853,106	36,337
Expenses deducted from investment earnings:		
Investment expenses	(48,451)	
Securities lending expenses	(9,896)	
Total additions	1,151,600	15,432,765
<b>DEDUCTIONS</b>		
Benefits	292,089	
Refunds of contributions	2,185	
Administrative expenses	7,491	
Distribution from pooled investments		15,268,436
Total deductions	301,765	15,268,436
Changes in net assets	849,835	164,329
Net assets at beginning of year	5,508,639	2,407,243
Net assets at end of year	\$ 6,358,474	2,571,572

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





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# Notes to the Financial Statements

## (Amounts Expressed in Thousands Unless Otherwise Noted)

### I. Summary of Significant Accounting Policies

#### A. The Reporting Entity

The County of San Diego (the "County"), is a political subdivision of the State of California (the "State") charged with general governmental powers and governed by an elected five-member Board of Supervisors (the "Board"). The County provides a full range of general government services including police protection, detention and correction, public assistance, health and sanitation, recreation, library, flood control, public ways and facilities, inactive waste management, airport management and general financial and administrative support.

As required by generally accepted accounting principles in the United States of America (GAAP), these financial statements present the County (the primary government) and its component units, entities for which the County is considered to be financially accountable. The component units discussed below are included in the County's reporting entity because of the significance of their operational or financial relationships with the County. Management applied the criteria of Governmental Accounting Standards Board (GASB) Statement No. 14, "The Financial Reporting Entity," and Statement No. 39, "Determining Whether Certain Organizations are Component Units - an amendment of GASB Statement No. 14," to determine whether the following component units should be reported as blended or discretely presented component units. Blended component units, although legally separate entities are, in substance, part of the County's operations. Data from these component units are combined with the data from the primary government. The discretely presented component unit is reported in a

separate column in the government-wide financial statements to emphasize that it is legally separate from the County.

#### I. Blended Component Units

Blended component units governed by the Board of Supervisors include the County of San Diego In-Home Support Services Public Authority (IHSS), the San Diego County Housing Authority, the San Diego County Redevelopment Agency, as well as various service areas and districts which provide specific services County-wide or to distinct geographic areas within the County. While each of these component units is legally separate from the County, the County is financially accountable for these entities. Financial accountability is demonstrated by the County Board of Supervisors acting as the governing board for each of these component units. Descriptions of these component units are as follows:

*County of San Diego In-Home Supportive Services Public Authority (IHSS)* - This authority was established to serve as the employer of record for the IHSS program which provides in-home assistance to low-income aged, blind, and disabled individuals enabling them to remain safely in their own homes and avoid institutionalization. The IHSS program is a state-mandated. This fund is included as a *special revenue fund*.

*San Diego County Housing Authority* - This authority accounts for revenues and expenditures related to providing decent housing in a suitable environment for individuals who cannot afford standard private housing. Contracts with the U.S. Department of Housing and Urban Development provide the major funding sources. This fund is included as a *special revenue fund*.

*San Diego County Redevelopment Agency* - This agency was established to provide a method of eliminating slums and blighted areas, improving housing, expanding employment

# Notes to the Financial Statements

## (Amounts Expressed in Thousands Unless Otherwise Noted)



opportunities, and providing an environment for the social, economic and psychological growth, and well-being of all citizens of the County. This agency is included in the *debt service and capital projects funds*.

*Air Pollution Control District* - This district was established to provide for control of air pollution from motor vehicles and other sources in order to attain health-based air quality standards. Revenue sources include license and permit fees, fines, state and federal funds, charges to property owners and vehicle registration fees. This fund is included as a *special revenue fund*.

*County Service Districts* - These special districts were established to provide authorized services such as road, park, lighting maintenance, fire protection or ambulance service to specific areas in the county. They are financed by ad valorem property taxes in the area benefited or by special assessments levied on specific properties. These funds are included as *special revenue funds*.

*Flood Control District* - This district was established to account for revenues and expenditures related to providing flood control in the County. It is financed primarily by ad valorem property taxes and federal grants. This fund is included as a *special revenue fund*.

*Lighting Maintenance District* - This district was established to provide street and road lighting services to specified areas of the County. Revenue sources include ad valorem taxes, benefit fees, state funding and charges to property owners. This fund is included as a *special revenue fund*.

*Sanitation Districts* - These districts are used to account for the activities of all individual sanitation districts governed by the County Board of Supervisors. They are included as *enterprise funds*.

Blended component units governed by Boards other than the Board of Supervisors include the San Diego County Capital Asset Leasing Corporation, the San Diego County Tobacco

Asset Securitization Corporation, the Tobacco Securitization Joint Powers Authority of Southern California and the San Diego County Employee Retirement Association (SDCERA). Because of their relationship with the County and the nature of their operations, the first three of these component units are, in substance, part of the County's operations and, accordingly, the activities of these component units are combined (blended) with the activities of the County for purposes of reporting in the accompanying basic financial statements. The basis for blending these component units is that the governing bodies are substantially the same as the County Board of Supervisors. Although SDCERA is legally separate from the County, it is reported as if it were part of the primary government because it benefits the County almost exclusively by providing services to the County's employees.

Descriptions of these component units are as follows:

*San Diego County Capital Asset Leasing Corporation (SANCAL)* - This corporation was established to finance the acquisition of County buildings and equipment. It is a nonprofit corporation governed by a five-member Board of Directors, which is appointed by the County Board of Supervisors. This corporation is included in the *special revenue, debt service and capital projects funds*.

*The San Diego County Tobacco Asset Securitization Corporation (Corporation)* - This is a separate legal nonprofit public benefit corporation created under the California Nonprofit Public Benefit Corporation Law. It was established to purchase tobacco settlement payments allocated to the County from the State of California, pursuant to the Master Settlement Agreement concluded on November 23, 1998 between the major tobacco companies and 46 states (including California), the District of Columbia and four U.S. Territories. The Corporation is governed by the Board of Directors consisting of three members, two of which are employees of the County of



## Notes to the Financial Statements (Amounts Expressed in Thousands Unless Otherwise Noted)

San Diego and one independent director who is not an employee of the County. This fund is included as a *special revenue fund*.

*The Tobacco Securitization Joint Powers Authority of Southern California (TSJPA)* - This is a separate legal public entity created by a Joint Exercise of Powers Agreement by and between the County of San Diego and the County of Sacramento pursuant to the Government Code of the State of California. The authority's purpose is to finance a loan via the sale of bonds to the San Diego County Tobacco Asset Securitization Corporation which in turn uses the loan proceeds to purchase the County's future tobacco settlement revenues under the Purchase and Sale Agreement. The Authority is administered by the Board of Directors consisting of three members, two members who are appointed by the County of San Diego Board of Supervisors and the third member is appointed by the Sacramento County Board of Supervisors. This fund is included as a *special revenue fund*.

*The San Diego County Employee Retirement Association* - SDCERA is a multiple-employer public retirement system organized under the 1937 Retirement Act and provides retirement, disability and death benefits for plan members and beneficiaries. The County is the major participant and contributes 93.4 percent of total employer contributions. SDCERA is governed by a nine-member board which includes the County Treasurer-Tax Collector, four members appointed by the Board of Supervisors and four members elected by the SDCERA membership. The activity of SDCERA is reported within the *pension trust fund* and included in the *fiduciary funds*.

### 2. Discretely Presented Component Unit

The following component unit is discretely presented because its Board is not substantively the same as the County's Board and it does not provide services entirely or almost entirely to the County.

*First 5 Commission of San Diego (Commission)* - The Commission was established by the County as a separate legal entity to administer the County's share of tobacco taxes levied by the State pursuant to Proposition 10. Its purpose is to develop, adopt, promote and implement early childhood development programs in the County. The Commission is a separate legal entity, and the County appoints a voting majority of the Commission's board. The County is able to impose its will on the Commission, due to its ability to change the appointees. The two boards (County and Commission) are not substantively the same and the Commission does not provide services entirely or almost entirely to the County, but to the citizens instead.

### 3. Additional Detailed Financial Information and/or Financial Reports

Additional detailed information and/or separately issued financial reports of the County's component units may be obtained from the County Auditor and Controller's Office located at 1600 Pacific Highway, Room 166, San Diego, California 92101. Also, complete financial statements for SDCERA may be obtained from the San Diego County Employees Retirement Association, 401 West A Street, San Diego, California 92101.

## B. Government-Wide and Fund Financial Statements

### 1. Government-Wide Financial Statements

The government-wide financial statements consist of the statement of net assets and the statement of activities and report information on all of the nonfiduciary activities of the primary government and its component units. As a general rule, the effect of interfund activity has been eliminated from the government-wide financial statements. All internal balances in the statement of net assets have been eliminated, with the exception of those



representing balances between the governmental activities and the business-type activities, which are presented as internal balances and eliminated in the total government column. The statement of activities presents function revenue and expenses of governmental activities and business-type activities. 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 and charges for support. In the statement of activities, internal service funds' revenue and expenses related to interfund services have been eliminated. Revenue and expenses related to services provided to external customers have not been eliminated and are presented within governmental activities.

The government-wide financial statements distinguish functions of the County 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 County include general government and support services, public protection, public ways and facilities, public assistance, health and sanitation, recreational and cultural, and education activities. The business type activities of the County include sanitation, wastewater and airport.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment is offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function or segment. Program revenues include (1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment and (2) grants and contributions that are restricted to meeting the operational or capital requirements of a

particular function or segment. Taxes and other items not properly included among program revenues are reported instead as general revenues.

## **2. Fund Financial Statements**

Separate fund financial statements are provided for governmental funds, proprietary funds and fiduciary funds, even though the latter are excluded from the government-wide financial statements. Major individual governmental funds and major individual enterprise funds are reported as separate columns in the fund financial statements. The focus of governmental and proprietary fund financial statements is on major funds. The financial information of each major fund is shown in a separate column in the fund financial statements, with the data for all nonmajor governmental funds aggregated into one single column on the Governmental Funds Balance Sheet, and with data for all nonmajor enterprise funds aggregated into one single column on the Statement of Net Assets Proprietary Funds.

The County reports the following major governmental funds:

The *General Fund* is the County's primary operating fund. It accounts for all financial resources of the County except those required to be accounted for in another fund. Revenues are primarily derived from taxes; licenses, permits and franchises; fines, forfeitures and penalties; use of money and property; intergovernmental revenues; charges for services; and other revenues. Expenditures are expended for functions of general government, public protection, public ways and facilities, health and sanitation, public assistance, education, and recreational and cultural. They also include capital outlay, and debt service.

The *Tobacco Securitization Special Revenue Fund* accounts for tobacco settlement payments allocated to the County from the State of California, pursuant to the Master Settlement





## Notes to the Financial Statements (Amounts Expressed in Thousands Unless Otherwise Noted)

Agreement concluded on November 23, 1998 between the major tobacco companies and 46 states (including California), the District of Columbia and four U.S. Territories.

The County reports the following additional funds and fund types:

*Enterprise Funds* account for airport, sanitation district and wastewater management activities, including operations and maintenance, sewage collection and treatment services.

*Internal Service Funds* account for the financing of public works and communications equipment; the financing of materials and supplies (purchasing); for start up services for new and existing county service districts; for the County's uninsured risk management activities; the financing of fleet services; for facilities management activities; for the financing of information technology services; and for the financing of clothing and personal sundry items for persons institutionalized at various county facilities. Additionally, mail services are included within the facilities function, and printing and record storage services are included in the purchasing function. The goods or services provided by one County department to other County departments are on a cost reimbursement basis.

The following *fiduciary funds* account for resources that are held by the County as a trustee or agent for outside parties and cannot be used to support the County's programs.

The *Pension Trust Fund* accounts for the activities of SDCERA. This fund is under the control of the Board of Retirement and is governed by the rules and regulations of the 1937 Retirement Act. The fund accumulates employer and employee contributions and earnings from the fund's investments. Disbursements are made from the fund for retirements, disability and death benefits and refunds and administrative costs. This fund includes all assets of the retirement system.

The *Investment Trust Fund* accounts for the external portion of the County Treasurer's investment pool. This fund consists of school districts, special districts and funds held for other governments.

*Agency Funds* are custodial in nature and do not involve measurement of results of operations and account for assets held by the County as an agent for various local governments, organizations and individuals. Included are funds for child support payments; payroll taxes; public administrator and public guardian accounts; and apportioned taxes for other local governments.

### C. Measurement Focus, Basis of Accounting, and Financial Statement Presentation

The government-wide, proprietary, pension and investment trust fund financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Agency Funds are reported using the accrual basis of accounting.

Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Nonexchange transactions, in which the County gives (or receives) value without directly receiving (or giving) equal value in exchange, include property taxes and sales taxes, grants, entitlements, and donations. On the accrual basis, revenue from property taxes is recognized in the fiscal year for which the taxes are levied. Revenue from sales taxes is recognized when the underlying transactions take place. Revenue from grants, entitlements and donations is recognized in the fiscal year in which all eligible requirements have been satisfied.

*Governmental Funds* are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Under this method, revenues are recognized when measurable and available. Sales taxes, interest, state and federal grants, and charges



for services are accrued when their receipt occurs within 180 days following the end of the fiscal year. Property taxes are accrued if they are collectible within 60 days after the end of the accounting period. Expenditures are generally recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures, as well as expenditures related to compensated absences, claims, and judgments, are recorded only when payment is due. General capital assets acquisitions and general principal payments are reported as expenditures in governmental funds. Proceeds of general long-term debt and capital leases are reported as other financing sources.

*Proprietary Funds* distinguish operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of the County's enterprise funds and internal service funds are charges to customers for services. Operating expenses for enterprise funds and internal service funds include the cost of services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

For *business-type activities*, the County has elected to apply all applicable Governmental Accounting Standards Board (GASB) pronouncements as well as any applicable pronouncements of the Financial Accounting Standards Board (FASB), 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 County has elected to not apply the FASB standards issued subsequent to November 30, 1989. The GASB periodically updates its codification of the existing Governmental Accounting and

Financial Reporting Standards, which, along with subsequent GASB pronouncements (Statements and Interpretations), constitutes GAAP for governmental users.

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

*Fiduciary Funds* include all *Trust and Agency Funds*, which account for assets held by the County as a trustee or as an agent for individuals or other government units.

## **D. Assets, Liabilities, and Net assets or Fund Balance**

### **1. Deposits and Investments**

The County follows the practice of pooling cash and investments of all funds with the County Treasurer-Tax Collector's *Investment Pool (Pool)*, except for certain restricted funds which are generally held by outside custodians and classified as "cash with fiscal agent" or investments on the accompanying financial statements. The individual funds' portions of the Pool's fair value are presented as "equity in pooled cash and investments." For purposes of reporting cash flows, equity in pooled cash and investments, (which includes cash in banks and investments with original maturities of 90 days or less), collections in transit and imprest cash are considered cash equivalents. Pooled cash and investment carrying amounts are similar to demand deposits i.e. funds may be deposited and withdrawn any time without prior notice or penalty. Earnings on pooled funds are apportioned and paid or credited to the funds quarterly based on the average daily balance of each participating fund. A separately issued comprehensive annual financial report of the San Diego County Investment Pool can be accessed at [http://www.sdtreastax.com/mcf\\_afreports.html](http://www.sdtreastax.com/mcf_afreports.html).





## Notes to the Financial Statements (Amounts Expressed in Thousands Unless Otherwise Noted)

The *Pool's* investments are reported at fair value at June 30, 2005 based on market prices. Securities that are traded on a national or international exchange are valued at the last reported sales price at current exchange rates.

The County Employees Retirement Law of 1937 (Law) grants exclusive control to the Board of Retirement over the investment of SDCERA's investment portfolio. The Law allows for the Board to invest, or delegate the authority to invest, the investment portfolio through the purchase, holding, or sale of any form or type of investment, financial instrument or financial transaction when prudent in the informed opinion of the Board.

The *Pension Trust Fund's* cash and short-term investments consist of cash and securities with fiscal agents and deposits held in a pooled account with the County of San Diego. All participants in the pool proportionately share earnings and losses. Short-term investments consist of cash held in money market accounts and securities readily convertible to cash. Cash equivalents and securities for swaps and futures consist of money market securities and collective short-term investments with original maturities of three months or less.

Investments are reported at fair value at June 30, 2005 in the Pension Trust Fund based upon closing sale prices reported on recognized securities exchanges on the last business day of the period. For listed securities having no sales reported and for unlisted securities, fair value is based upon last reported bid prices. All purchases and sales of investments are accounted for on a trade-date basis, and dividends declared but not received are accrued on the ex-dividend date. Realized and unrealized gains or losses of securities are determined on the basis of average cost. Real estate investments are reported at estimated fair value, which has been determined by appraisals performed by independent real estate advisors approximately every three years.

### 2. Receivables and Payables

Activity between funds that are representative of lending and borrowing arrangements outstanding at the end of the fiscal year are referred to as either "due to/from other funds" (i.e., the current portion of interfund loans) or "advances to/from other funds" (i.e., the non-current portion of interfund loans). All other outstanding balances between funds are reported as "due to/from other funds." Any residual balances outstanding between the governmental activities and business-type activities are reported in the government-wide financial statements as "internal balances."

All property taxes and accounts receivable are shown net of an allowance for uncollectibles. Property taxes are levied on July 1 each fiscal year on taxable real and personal property, which is situated in the County as of the preceding January 1 lien date. However, upon a change in ownership of property or completion of new construction, State law requires an accelerated recognition and taxation of changes in real property assessed valuation. For assessment and collection purposes, property is classified either as "secured" or "unsecured" and is listed accordingly on separate parts of the assessment roll. The "secured roll" is that part of the assessment roll containing locally assessed and State assessed property secured by a lien, which is sufficient, in the opinion of the assessor, to secure payment of the taxes. Other property is assessed on the "unsecured roll."

Property taxes on the secured roll are payable in two installments, due November 1 and February 1. If unpaid, such taxes become delinquent after 5:00 p.m. on December 10 and April 10, respectively, and a ten percent penalty attaches. Property on the secured roll with unpaid delinquent taxes is declared tax-defaulted after 5:00 p.m. on June 30th. Such property may thereafter be redeemed by payment of the delinquent taxes, the ten percent delinquency penalty, a ten dollar cost,



a fifteen dollar per parcel redemption fee (from which the State receives five dollars), and a redemption penalty of one and one-half percent per month starting July 1 and continuing until the end of redemption collectively, the "Redemption Amount". If taxes remain unpaid after five years on the default roll, the property becomes subject to tax sale by the County Treasurer-Tax Collector.

Property taxes on the unsecured roll are due as of the January 1 lien date and become delinquent, if unpaid, on August 31. A ten percent penalty attaches to delinquent taxes on property on the unsecured roll and an additional penalty of one and one-half percent per month begins to accrue on November 1.

As established by the *Teeter Plan*, the Auditor and Controller allocates to the County and other agencies 100% of the secured property taxes billed but not yet collected by the County; in return, as the delinquent property taxes and associated penalties and interest are collected, the County retains such amounts in a separate fund. To the extent that fund's tax loss reserves are higher than required, transfers may be made to benefit the County's General Fund. The tax loss reserve requirement for fiscal year 2004-2005 was \$7.5 million. The fund balance of the tax loss reserve fund as of June 30, 2005 was \$8.2 million, which is included in the General Fund for reporting purposes.

### **3. County Leased Property**

The County leases real property to the private sector and other governmental agencies. In the government-wide and proprietary funds financial statements, non-cancelable and cancelable leases are reported in the applicable governmental activities or proprietary funds statement of net assets.

### **4. Inventories and Prepaid Items**

Inventories, which consist of expendable supplies, are stated at average cost. They are accounted for as expenditures at the time of

purchase and reported in the balance sheet of the General Fund and the Other Governmental Funds as an asset with an offsetting reserve. Proprietary fund types are carried at average cost and are expended when consumed. Certain payments to vendors reflect costs applicable to future accounting periods and are recorded as prepaid items in both the government-wide and fund financial statements. The inventories and prepaid items recorded in the governmental funds do not reflect current appropriable resources and thus, an equivalent portion of fund balance is reserved.

### **5. Deferred Charges**

Bond issuance costs are deferred and amortized over the life of the bonds using the straight-line method. In the government-wide financial statements, deferred charges are reported as assets in the governmental activities.

### **6. Restricted Cash and Investments**

*Debt covenants* require resources to be set aside to repay principal and interest thereon for tax and revenue anticipation notes, pension obligation bonds and SANCAL certificates of participation as restricted assets. Additionally, Tobacco Securitization Special Revenue Fund resources have been restricted and set aside to fund new and existing programs.

### **7. Capital Assets**

Capital assets are defined as assets of a long-term character that are intended to be held or used in operations, such as land, buildings and improvements, equipment, and infrastructure. Infrastructure assets include roads, bridges, flood channels, street lights, signals, and sewers.

Capital assets are recorded at *historical cost* if purchase or constructed. Donated capital assets are recorded at *estimated fair market value* at the date of donation. Capital assets with an original unit cost equal to or greater



# Notes to the Financial Statements

## (Amounts Expressed in Thousands Unless Otherwise Noted)

than the County's *capitalization threshold* shown in **Table 1** below are reported in the applicable *governmental* or *business-type activities* columns in the government-wide financial statements.

**Table 1 (Note I - D-7)**

Structures and improvements	\$	50
Infrastructure (permanent road divisions, county service areas, sanitation and special districts)	\$	25
Infrastructure (all others)	\$	50
Equipment	\$	5

*Depreciation* is charged over the capital assets' estimated useful lives using the *straight-line method* for proprietary and governmental fund types. Governmental fund type depreciation is only shown in the statement of activities. Proprietary fund type depreciation is shown both in the fund statements and the statement of activities. The estimated useful lives are shown in **Table 2** below:

**Table 2 (Note I - D -7)**

Structures and improvements	50 years
Infrastructure	10-50 years
Equipment	5-20 years

### 8. Deferred and Unearned Revenue

Under both the accrual and modified accrual basis of accounting revenue may be recognized only when earned. Therefore, the government-wide statement of net assets as well as governmental and enterprise funds defer revenue recognition in connection with resources that have been received as of year-end, but not yet earned. In the government-wide statement of net assets deferred revenue represents unearned revenue. Assets recognized in connection with a transaction before the earnings process is complete are offset by a corresponding liability for both deferred and unearned revenue. Under the modified accrual basis it is not enough that revenue has been earned if it is to be recognized in the current period. Revenue must

also be susceptible to accrual (i.e. measurable and available to finance expenditures of the current period). Governmental funds report deferred revenues in connection with receivables for revenues not considered available to liquidate liabilities of the current period.

### 9. Lease Obligations

The County leases various assets under both *operating* and *capital* lease agreements. In the government-wide and proprietary funds financial statements, capital lease and operating lease obligations are reported as liabilities in the applicable governmental activities or proprietary funds statement of net assets.

### 10. Long-term Obligations

In the government-wide financial statements, and proprietary fund types in the fund financial statements, long-term debt and other long-term obligations are reported as liabilities in the applicable governmental activities, business-type activities, or proprietary fund type statement of net assets. Bond premiums and discounts, as well as issuance costs discussed above, 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, discount, or deferred amount on refunding. In the fund financial statements, governmental fund types recognize bond premiums and discounts, as well as bond issuance costs, during the current period. The face amount of debt issued is reported as other financing sources. Premiums received on debt issuances are reported as other financing sources while discounts on debt issuances are reported as other financing uses. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures.



## **11. Employee Compensated Absences**

The County's policy is to permit employees to accumulate *earned* but *unused* vacation, compensatory time, holiday and sick pay benefits. All vacation pay and a certain portion of compensatory and sick pay for specified employee classes is accrued when incurred in the government-wide and proprietary funds financial statements. In the governmental funds, only those amounts that are due and payable at year-end are accrued. Except for specified employee classes, there is no liability for *unpaid accumulated* sick leave since the County does not pay any amounts when employees separate from service with the County. However, employees eligible for retirement benefits that meet minimum balance requirements may apply unused sick leave toward determining their length of service for purposes of determining their retirement benefits.

Amounts recorded as accumulated leave benefits include an amount representing salary-related payments such as the employer's share of Social Security and Medicare taxes associated with payments made for such compensated absences. Accumulated leave benefits including vacation, sick leave, and compensatory time worked in the amount of approximately \$76.7 million for the governmental activities as of June 30, 2005, is recorded in the statement of net assets. These amounts would not be expected to be liquidated from expendable available financial resources but would be expected to be liquidated in future years as employees elect to use these benefits as prescribed by Civil Service rules and regulations.

## **12. Fund Balance**

In the fund financial statements, governmental funds report reservations of fund balance for amounts that are not available for appropriation or are legally restricted by outside parties for use for a specific purpose.

Designations of fund balance represent tentative management plans that are subject to change.

## **13. Net Assets Invested in Capital Assets, Net of Related Debt**

This amount is derived by subtracting the outstanding debts incurred by the County to buy or construct capital assets shown in the statement of net assets. Capital assets cannot readily be sold and converted to cash.

## **14. Restricted Net Assets**

Restricted net assets arise when restrictions on the use of net assets are externally imposed by a creditor, (such as through debt covenants), grantors, contributors, or laws or regulations of other governments; or imposed by law through constitutional provisions or enabling legislation.

## **15. Unrestricted Net Assets**

These assets are resources of the County that can be used for any purpose, though they may not necessarily be liquid. In addition, assets in a restricted fund that exceed the amounts required to be restricted by external parties or enabling legislation are reported as unrestricted net assets.

## **16. Indirect Costs**

Expenditures and expenses for functional activities include County indirect costs that are allocated to benefiting departments under the County's Fiscal Year 2004-2005 *Countywide Cost Allocation Plan* which was prepared in accordance with the Federal Office of Management and Budget Circular A-87.

## **17. Use of Estimates**

The preparation of the basic financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the basic financial statements and



## Notes to the Financial Statements (Amounts Expressed in Thousands Unless Otherwise Noted)

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accompanying notes. Actual results could differ from those estimates. Where significant estimates have been made in preparing these financial statements, they are described in the applicable footnotes.







## II. Reconciliation of Government-Wide and Fund Financial Statements

### A. Funds Balance Sheets/Statement of Net Assets

Explanations of certain differences between the governmental funds balance sheet and the government-wide statement of net assets are detailed in **Table 3** below:

Total fund balance of the County governmental funds, \$1,517,955, differs from net assets of governmental activities, \$2,023,643 reported in the statement of net assets. The difference primarily results from the *long-term economic resources measurement focus* and the accrual basis of accounting in the statement of net assets versus the *current financial resources measurement focus* and modified accrual basis of accounting in the governmental fund balance sheets.

**Table 3 (Note II-A)**  
**Balance Sheet/Statement of Net Assets- Reconciliation**  
 PRIMARY GOVERNMENT

	Total Governmental Funds	Long-term Assets and Liabilities (1)	Internal Service Funds (2)	Reclassifications and Eliminations (3)	Statement of Net Assets Totals
<b>ASSETS</b>					
Cash and cash equivalents	\$ 768,319		164,278		932,597
Cash with fiscal agent	216,016				216,016
Investments	801,572				801,572
Taxes receivables, net	105,784				105,784
Internal balances				(9,263)	(9,263)
Accounts and notes receivables, net	361,523		5,044		366,567
Due from other funds	179,700		16,315	(196,015)	
Advances to other funds	1,030		596	(1,626)	
Inventory of materials and supplies	10,572		598		11,170
Deferred charges and other assets	3,379	28,597			31,976
Capital assets		2,578,776	95,617		2,674,393
<b>Total assets</b>	<b>2,447,895</b>	<b>2,607,373</b>	<b>282,448</b>	<b>(206,904)</b>	<b>5,130,812</b>
<b>LIABILITIES</b>					
Accounts payable	126,924		16,041		142,965
Accrued payroll	58,809		1,565		60,374
Amount due for tax and revenue anticipation notes	369,280				369,280
Accrued interest		28,743			28,743
Due to other funds	143,735		52,470	(196,205)	
Advances from other funds	10,699			(10,699)	
Deferred credits and other liabilities	124,868	(49,878)			74,990
Unearned revenue	95,625				95,625
Long-term liabilities		2,225,724	109,468		2,335,192
<b>Total liabilities</b>	<b>929,940</b>	<b>2,204,589</b>	<b>179,544</b>	<b>(206,904)</b>	<b>3,107,169</b>
<b>FUND BALANCE/NET ASSETS</b>					
Total fund balances/net assets	1,517,955	402,784	102,904		2,023,643
<b>Total liabilities and fund net assets</b>	<b>\$ 2,447,895</b>	<b>2,607,373</b>	<b>282,448</b>	<b>(206,904)</b>	<b>5,130,812</b>

(1) Costs of issuances are reported as expenditures in governmental funds and thus have the effect of reducing fund balance because current financial resources have been

used. In the government-wide statements however, bond issuance costs are reported as a deferred charge and amortized over the life of the bond issue.



## Notes to the Financial Statements

### (Amounts Expressed in Thousands Unless Otherwise Noted)

Net cost of issuance	\$	28,597
Total deferred charges and other assets	\$	28,597

When capital assets (land, buildings, equipment, and infrastructure) that are to be used in governmental activities are purchased or constructed, the costs of those assets are reported as expenditures in governmental funds. However, the statement of net assets includes those capital assets among the assets of the County as a whole.

Cost of capital assets	\$	3,611,933
Accumulated depreciation		(1,033,157)
Net capital assets	\$	2,578,776

Interest on long-term debt is not accrued in governmental funds, but rather is recognized as an expenditure when due.

Total accrued interest	\$	(28,743)
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Because the focus of governmental funds is on short-term financing, some assets will not be available to pay for current-period expenditures. Those assets (for example, receivables) are offset by deferred revenues in the governmental funds and thus are not included in fund balance.

Adjustment of deferred revenue	\$	49,878
Total deferred credits and other liabilities	\$	49,878

Long-term liabilities applicable to the County's governmental activities are not due and payable in the current period and accordingly are not reported as fund liabilities; including bond premiums, discounts, and the cost of refunded debt that are recognized as revenue (premiums) and expenditures in governmental funds in the year of sale. However, all liabilities, current and long-term, are reported in the statement of net assets. Bond premiums,

discounts and deferred costs on refunded debt are recorded as additions (premiums) and reductions of a liability respectively and amortized over the life of the corresponding bonds. Balances at June 30, 2005 were:

Bonds, notes and loans payable	\$	(2,083,916)
Unamortized issuance Premium		(6,031)
Unamortized issuance Discount		9,054
Unamortized deferred amount on refunding		12,103
Capital leases		(34,614)
Compensated absences		(74,429)
Landfill closure and postclosure - San Marcos Landfill		(47,891)
Total long-term liabilities	\$	(2,225,724)

(2) Internal service funds are used by management to charge the costs of certain activities, such as insurance and telecommunications, to individual funds. The assets and liabilities of the internal service funds are included in governmental activities in the statement of net assets.

Costs	\$	102,904
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(3) The government-wide financial statements are designed to minimize the duplicative effects of transactions between funds for internal activities. Therefore, due to/from and advances to/from balances have been eliminated on the government-wide financial statements. The net amount due between governmental and business-type activities after eliminations, are reported as internal balances in the government-wide statement of net assets. Due to/from and advances to/from transactions between governmental funds and fiduciary funds are reclassified as receivables and payables in the government-wide statement of net assets.

**Notes to the Financial Statements**  
**(Amounts Expressed in Thousands Unless Otherwise Noted)**



**B. Funds Statement of Revenues, Expenditures, and Changes in Fund Balances/Statement of Activities**

The net change in fund balances for governmental funds \$221,833 differs from the change in net assets for governmental activities \$197,722 reported in the statement of activities. The differences arise primarily from the long-

term economic resources measurement focus and the accrual basis of accounting in the statement of activities versus the current financial resources measurement focus and modified accrual basis of accounting in the governmental funds. The effect of the differences is illustrated in **Table 4** below.

**Table 4 (Note II-B)**  
**Statement of Revenues, Expenditures, and Changes in Fund Balances/Statement of Activities-Reconciliation**  
 PRIMARY GOVERNMENT

	Total Governmental Funds	Long-term Revenues/ Expenses (4)	Capital Related Items (5)	Internal Service Funds (6)	Long-term Debt Transactions (7)	Statement of Activities Totals
<b>Revenues:</b>						
Taxes	\$ 717,174	25,257				742,431
Licenses, permits and franchise fees	42,954					42,954
Fines, forfeitures and penalties	55,538					55,538
Revenue from use of money and property	50,811			726		51,537
Aid from other governmental agencies:						
State	1,080,663					1,080,663
Federal	729,725					729,725
Other	74,272					74,272
Charges for current services	286,631			19,493		306,124
Other revenue	84,410	(4,274)	23,236			103,372
<b>Total revenues</b>	<b>3,122,178</b>	<b>20,983</b>	<b>23,236</b>	<b>20,219</b>		<b>3,186,616</b>
<b>Expenditures:</b>						
<b>Current:</b>						
General	211,521	(1,855)	3,756	21,312	(1,908)	232,826
Public protection	939,070	(16)	15,469	5,373	331	960,227
Public ways and facilities	84,560	(67)	37,974	330		122,797
Health and sanitation	541,921	(26)	2,643	1,267		545,805
Public assistance	970,208		693	1,691		972,592
Education	27,119	5	78	192		27,394
Recreation and cultural	19,614		1,602	189		21,405
Capital outlay	54,157		(54,157)			
<b>Debt service:</b>						
Principal	60,849				(60,849)	
Interest and other fiscal charges	94,556			123	11,933	106,612
Bond issuance costs	1,915				(1,915)	
<b>Total expenditures</b>	<b>\$ 3,005,490</b>	<b>(1,959)</b>	<b>8,058</b>	<b>30,477</b>	<b>(52,408)</b>	<b>2,989,658</b>





## Notes to the Financial Statements (Amounts Expressed in Thousands Unless Otherwise Noted)

**Table 4 (Note II-B)(Continued)**

**Statement of Revenues, Expenditures, and Changes in Fund Balances/Statement of Activities-Reconciliation**

**PRIMARY GOVERNMENT**

	Total Governmental Funds	Long-term Revenues/ Expenses (4)	Capital Related Items (5)	Internal Service Funds (6)	Long-term Debt Transactions (7)	Statement of Activities Totals
Other financing sources (uses):						
Sale of capital assets	\$ 18,400		(18,400)			
Issuance of bonds and loans						
Face value of bonds issued	83,510				(83,510)	
Face value of loans issued	160				(160)	
Bond premiums	5,960				(5,960)	
Refunding bonds issued	28,885				(28,885)	
Payment to refunded bond escrow agent	(31,633)				31,633	
Transfers (net)	(137)			901		764
Total other financing sources (uses)	105,145		(18,400)	901	(86,882)	764
Net change for the year	\$ 221,833	22,942	(3,222)	(9,357)	(34,474)	197,722

Explanations of certain differences between the governmental funds statement of revenues, expenditures, and changes in fund balances and the government-wide statement of activities are detailed below.

(4) Governmental funds accrue property tax revenue, which is deemed collectible within sixty days. However, in the statement of activities the total amount estimated to ultimately be collected is accrued.

Property taxes	\$ 25,257
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Adjustment for reserve for inventory of materials and supplies.

Adjustment	\$ 1,959
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Long-term receivables are not available as current resources, and therefore are not reported as revenue in the governmental funds.

Adjustment of deferred revenue	\$ (4,274)
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(5) The proceeds from the sale of capital assets are reported as other financing sources in the governmental funds.

Proceeds from sale of capital assets	\$ (18,400)
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The book value of the sale of capital assets is removed from the capital assets account in the statement of net assets and offset against the sales proceeds resulting in a "loss on sale of capital assets" recorded as an expense in the statement of activities. Governmental funds report capital outlays as expenditures. However, in the statement of activities the cost of those assets is allocated over the estimated useful lives and reported as depreciation expense. This is the amount by which asset acquisition and donations exceeded depreciation in the current period.

Loss on disposal of assets	\$ (1,100)
Capital outlay	77,182
Depreciation expense	(84,140)
Subtotal	(8,058)
Donated infrastructure - roads	23,236
Difference	\$ 15,178

(6) Internal service funds are used by management to charge the costs of certain activities, such as insurance and telecommunications, to individual funds. The adjustments for internal service funds "close" those funds by charging additional amounts to

# Notes to the Financial Statements

## (Amounts Expressed in Thousands Unless Otherwise Noted)



participating governmental activities to completely cover the internal service fund's costs for the year.

Adjustments	\$ (9,357)
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(7) Repayment of bond principal as well as refunding of bonds which are considered a repayment of principal and other costs of refunding, and other long-term obligations are reported as expenditures in governmental funds and thus has the effect of reducing fund balance because current financial resources have been used. For the County as a whole however, the principal and other payments for liabilities reduce the liabilities in the statement of net assets and do not result in an expense in the statement of activities. The County's long-term obligations include bonds, loans and notes payable, capital leases, accumulated unpaid employee leave balances, arbitrage rebate, and closure and postclosure costs for the San Marcos landfill. The County's long-term debt was reduced by these payments, principal payments to bondholders, and the adjustment to the San Marcos Landfill closure and postclosure liability.

Other miscellaneous debt reductions - general function	\$ 4,017
Other miscellaneous debt reductions - public protection function	650
Change in accounting estimate for closure and postclosure costs public Protection function - San Marcos Landfill	(981)
Principal payments made	60,849
Payment to refunded bond escrow agent - SANCAL	31,633
Total repayment of long-term obligations	\$ 96,168

Bond issuance costs are expensed in governmental funds when paid, and are capitalized and amortized over the life of the corresponding bonds for purposes of the statement of activities.

Bond issuance costs	\$ 1,915
Amortization of bond issuance costs - general function	(2,109)
Difference	\$ (194)

Interest expense in the statement of activities differs from the amount reported in governmental funds because additional interest was calculated for bonds and notes payable and amortization of capitalized bond premiums, discounts and deferred amount of refunded debt that are expended in the governmental funds in the year paid.

Accrued interest	\$ (7,814)
Premium	(5,960)
Amortization of bond premium	484
Amortization of bond discounts	(511)
Amortization of deferred amount on refunding	(4,092)
Total reduction in interest	\$ (17,893)

Bond proceeds are reported as financing sources in governmental funds and thus contribute to the change in fund balance. In the government-wide statements however, issuing debt increases long-term liabilities in the statement of net assets and does not affect the statement of activities. Bond proceeds were received from:

Proceeds of refunding bonds	\$ (28,885)
Face Value of bonds issued	(83,510)
Face Value of loans issued	(160)
Total long-term debt proceeds	\$ (112,555)





### III. Stewardship, Compliance and Accountability

#### A. Fund Deficits

The following funds in **Table 5** below have an accumulated deficit at June 30, 2005. The deficit within the Redevelopment Agency Capital Projects fund is due to the construction of various capital projects including streets, utilities, sidewalks, traffic signals and other improvements. This deficit will be reduced in future years upon the receipt of the incremental tax revenues. The deficit in the Risk Financing Internal Service fund resulted from accrual of known and projected Workers' Compensation claim liabilities based on actuarial studies. The deficit has increased from the previous fiscal year due to mandated indemnity benefits and a trend of rising medical costs. The County intends to reduce the deficit by focusing resources on injury prevention and safety training programs, and by increasing charges to County departments to provide sufficient cash flow to the Risk Financing fund. The deficit within the Facilities Management Internal Service fund is due to the use of loan proceeds for expenses incurred for maintenance cost for energy conservation equipment. This deficit will be reduced as fees are collected in future years.



**Table 5 (Note III-A)**

Fund Deficits - Various Funds	
Capital Projects Fund:	
San Diego County Redevelopment Agency (SDCRA)	\$ 4,964
Internal Service Funds:	
Risk Financing	\$ 23,079
Facilities Management	\$ 4,561



## **IV. Detailed Notes on all Funds**

### **A. Deposits and Investments**

#### **1. San Diego County Investment Pool**

The *San Diego County Investment Pool (the pool)* is a local government investment pool with approximately \$4.1 billion in assets as of June 30, 2005, (consisting of the primary government, pension trust and other fiduciary funds and the First 5 Commission Component Unit). It is headed by the Treasurer-Tax Collector, an elective office that is responsible for tax collection, banking, investment, disbursement and accountability of public funds. The San Diego County Investment Pool is managed by the County Treasurer's Office on behalf of the Pool participants, which include the County, local school districts, local community colleges and other districts and agencies. The local school districts are required by State statutes to deposit their funds with the County of San Diego. "Mandatory" participants in the Pool comprise the majority of the Pool's assets, approximately 98%. All participants comply with the same requirements per the Pool Investment Policy.

The San Diego County Investment Pool operates under the prudent person standard. Specifically, California Government Code Sections 27000.1-27000.5, 27130-27137, and 53600-53686, authorize the Treasurer to invest funds in permissible types of investment or financial instruments. These include government obligation securities, commercial paper, medium-term notes, asset-backed securities, negotiable certificates of deposit, repurchase and reverse repurchase agreements, money market mutual funds, and collateralized certificates of deposit. The Pool's *investment objectives* are to safeguard principal, meet the liquidity needs of the participants, and achieve an investment return on the funds within the parameters of prudent risk management.

Pursuant to Sections 27130-27137 of the California Government Code, the Board of Supervisors has established the Treasurer's Oversight Committee (TOC) that monitors and reviews the Pool's investment policy. The TOC consists of members appointed from the districts or offices that they represent, and up to five members of the public, having expertise in, or an academic background in public finance. This Committee requires a financial audit to be conducted annually on a fiscal year basis, which includes limited tests of compliance with laws and regulations. The San Diego County Investment Pool is not registered with the Securities and Exchange Commission (SEC) as an investment company. The Pool does not have any legally binding guarantees of share values.

Each fund type's portion of the pool is displayed on the balance sheet as "Equity in pooled cash and investments." Interest earned on the pooled deposits is accrued in a pooled interest apportionment agency fund and is allocated based on the average daily cash balances of the participating funds. All participating funds share *earnings and losses proportionately*. State law permits interest income related to certain funds to be considered as income of the General Fund of the County. Such interest has been recorded as revenue in the General Fund.

#### **2. Investments Outside of the Pool**

##### **a. Cash and Investments with Fiscal Agents**

*Cash with Fiscal Agents* totaled \$402.8 million on deposit with trustees for the General Fund, Tobacco Securitization Joint Special Revenue Fund, Air Pollution Special Revenue Fund, SANCAL Special Revenue Fund, Housing Authority Special Revenue Fund, Pension Obligation Bond Debt Service Fund, SANCAL Debt Service Fund, Redevelopment Agency Debt Service Fund, SANCAL Capital Projects Fund, and Other Agency Funds.



# Notes to the Financial Statements

## (Amounts Expressed in Thousands Unless Otherwise Noted)

*Investments with Fiscal Agents* totaled approximately \$801.6 million with Trustees. These amounts are accounted for in the General Fund, Tobacco Securitization Special Revenue Fund, Inactive Wastesites Fund, Pension Obligation Bonds Debt Service Fund and SANCAL Debt Service Fund.

### b. Pension Trust Fund

SDCERA had *investments* of approximately \$6.8 billion as of June 30, 2005. Investments are reported at fair value upon closing sale prices reported on recognized securities exchanges on the last business day of the period. For listed securities having no sales reported or for unlisted securities, fair value is based upon last reported bid prices. All purchases and sales of investments are accounted for on a trade-date basis, and dividends declared but not received are accrued on the ex-dividend date. Realized and unrealized gains or losses of securities are determined on the basis of average costs. Real estate investments consist of real estate equities primarily in office, industrial, retail and residential properties with 98% in the United States and 2% International.

In addition to the above, SDCERA utilizes derivative financial instruments, such as equity swap agreements and stock and bond futures contracts that allow SDCERA to build portfolios with performance characteristics very similar to benchmarks and to manage allocation of risk. As of June 30, 2005 SDCERA had two types of derivative financial instruments; equity swaps and financial futures.

Equity swaps allow SDCERA to exchange a money market return for the rights to the return on a specific index of equity securities. As of June 30, 2005 SDCERA entered into S&P 500 Swap contracts with a notional value of \$1.185 billion and a fair value of \$1.173 billion. Futures represent commitments to purchase or sell securities at a future date and at a specified price. Future contracts are traded on organized exchanges (exchange traded) thereby minimizing credit risk. The net change

in the futures contracts value is settled daily in cash with the exchanges. As shown in **Table 6** below, as of June 30, 2005 SDCERA had the following futures balances:

**Table 6 (Note IV-A-2-b)**

Notional Amount	Long/(Short)
International Equity	\$ 253,720
Domestic Equity	(169,527)
International Fixed Income	36,550
Domestic Fixed Income	249,907
Commodities	225,000
<b>Total</b>	<b>\$ 532,650</b>

These financial instruments are intended to be equivalent to the asset they are designed to emulate. SDCERA's use of swaps and futures is structured such that market exposure is fundamentally equivalent to the direct cash investments. SDCERA will only execute a swap agreement with counterparties rated A or higher. The use of swap agreements exposes SDCERA to the risk of dealing with financial counterparties and their ability to meet the terms of the contracts. However, all swaps are fully collateralized by cash at least equal to the notional value of the most recent cash reset. Allowing insufficient collateral is strictly prohibited as a trading strategy by SDCERA's investment policies.

### 3. Deposits

(For Notes IV-A-3., Deposits through IV-A-11., Securities Lending Transactions, please refer to **Tables 7 through 18** on **pages 81 through 86**).

*County Investment Pool* - At year-end the carrying amount of the County's demand deposits was \$48.698 million. Of this balance \$494 thousand was covered by federal deposit insurance and \$48.204 million was considered a collateralized custodial credit risk.

*Cash and Investments with Fiscal Agents* - At year-end the carrying amount of the County's demand deposits was \$227.425 million. Of this balance \$1.666 million was covered by federal deposit insurance; \$61.991 million was collateralized with securities held by the





pledging agent but not in the County's name and the remaining \$163.768 million was uncollateralized.

*SDCERA Investment Portfolio* - At year-end the carrying amount of SDCERA's demand deposits was \$175.335 million. A deposits and investments reconciliation as reported in the basic financial statements is summarized on **Table 7** on page **81**.

#### **4. Investments**

As of June 30, 2005, investments in *the County Pool*, with *Fiscal Agents* and in the *Pension Trust Fund*, (SDCERA) are shown on **Tables 8 through 10** on pages **82** and **83**.

#### **5. Deposit and Investment Risk**

In accordance with GASB Statement 40, Deposit and Investment Risk Disclosures, investment risk disclosure is required for; interest rate risk, credit risk (including custodial credit risk and concentrations of credit risk) and foreign currency risk.

As of June 30, 2005, the Pool had the following investments and maturities shown on **Table 8** on page **82**.

#### **6. Interest Rate Risk**

*County's Investment Pool* - The Pool does not have a general policy to manage interest rate risk, however it is banned from purchasing Inverse Floaters, Range Notes, Interest only strips derived from a pool of mortgages, and any security that could result in zero interest accrual. It is limited on maturity levels, which in turn, allows the Pool to manage its exposure to fair value losses arising from increased rates.

*Investments with Fiscal Agents* - No general policies have been established to manage interest rate risk, however, moneys held by trustees on behalf of the County may generally only be invested in permitted investments specified in trustee or indenture agreements. As

of June 30, 2005, the following investments and maturities with fiscal agents were as shown on **Table 11** on page **83**.

*SDCERA Investment Portfolio* - SDCERA does not have a general policy to manage interest rate risk, but requires investment managers to diversify by issue, maturity, sector, coupon and geography. As of June 30, 2005, SDCERA had the following investments and maturities as shown on **Table 12** on page **83**.

#### **7. Credit Risk**

*County's Investment Pool* - As of June 30, 2005, the Investment Pool's Security Ratings are shown on **Table 8** on page **82**.

*Investments with Fiscal Agents* - No general policies have been established for credit risk, however, moneys held by trustees on behalf of the County may generally only be invested in permitted investments specified in trustee or indenture agreements. The security ratings for these investments are shown on **Table 13** on page **84**.

*SDCERA Investment Portfolio* - SDCERA's Investment guidelines address fixed income quality requirements by investment category. The minimum investment grade held in domestic fixed income portfolios shall be no lower than "BBB" (as rated by Moody, Standard & Poor's, or Fitch's equivalent). Domestic high yield fixed income portfolios must have a weighted average quality of B/B+ or higher (Moody or Standard & Poor's equivalent). Not rated issues must be evaluated by the manager and determined that if rated they would not lower the weighted average below B/B+. SDCERA has no policy for Global and Emerging Market Fixed Income.

**Tables 14 and 15** on pages **84** and **85** illustrate SDCERA's Fixed Income securities ratings as of June 30, 2005, shown as a percentage of the total portfolio.



#### Domestic Fixed Income Portfolio

SDCERA's Domestic Fixed Income portfolio of government securities, collateralized mortgage obligations, corporate bonds, private placements, and other bonds include \$456.296 million or 99.5% that are rated BBB or higher and \$2.283 million or 0.5% currently rated BB.

#### Global Fixed Income Portfolio

SDCERA's Global Fixed Income portfolio includes corporate bonds and sovereign debt. The weighted average rating for Global Fixed Income portfolio was AA/AAA, excluding \$652 thousand or 0.1% of unrated securities.

#### High Yield Fixed Income Portfolio

The weighted average quality of the High Yield Fixed Income Portfolio as of June 30, 2005 was B/BB, excluding \$40.107 million or 10.3% of unrated securities in the portfolio.

#### Emerging Market Debt

SDCERA's Emerging Market Debt portfolio invests in sovereign debt of emerging countries. As of June 30, 2005, the weighted average rating for Emerging Market Debt portfolio was rated BB, excluding \$74 million or 23.3% of unrated securities in the portfolio.

### **8. Concentration of Credit Risk**

*County's Investment Pool* - The Pool Investment Policy limits the amount of exposure to any one single issuer. The Investment Policy is limited to 5% per issuer and cannot exceed this limit. An exclusion to this limit is dependent upon the weighted average days to maturity for commercial paper. If the weighted average days is 5 days or less the issuer limit can increase to 10% of total portfolio. The County of San Diego adheres to both State law and the County's Investment Policy for limits on investments.

*Cash and Investments with Fiscal Agents* - No general policies have been established to limit the amount of exposure to any one single issuer, however, moneys held by trustees on behalf of

the County may generally only be invested in permitted investments specified in trustee or indenture agreements.

*SDCERA Investment Portfolio* - Fixed income managers are expected to adhere to the following guidelines as a means of limiting credit risk. Domestic Fixed Income managers are limited within their portfolios to no more than 5% exposure in any single security, with the exception of United States Treasury and government agencies. High Yield and International Fixed Income managers limit is 10% exposure in any single security, with the exception of United States Treasury and government agencies. As of June 30, 2005, SDCERA has no single issuer that exceeds 5% of total fixed income investments.

### **9. Custodial Credit Risk**

*County's Investment Pool* - The County of San Diego does not invest in Category 3 type investments. The Investment policy does not permit investments in uninsured and unregistered securities not held by the County. However, the Policy does permit for securities lending transactions. The portfolio has not been exposed to these types of investments during the fiscal year.

*Cash and Investments with Fiscal Agents* - There are no general policies addressing custodial credit risk, however, moneys held by trustees on behalf of the County may generally only be invested in permitted investments specified in trustee or indenture agreements.

*SDCERA Investment Portfolio* - SDCERA does not have a general policy addressing custodial credit risk, but it is the practice of the Fund that all investments are insured, registered, or held by the plan or its agent in the Plan's name. Deposits are to be insured, registered or collateralized with securities held at fiscal agents in the Plan's name. SDCERA also retains investment managers that specialize in the use of a particular asset class. Investment managers are subject to the guidelines and



controls established in the SDCERA Investment Policy and contracts executed with the Board. SDCERA utilizes a third party as custodian over the plan assets.

In March 2005 the Board of Retirement completed a comprehensive asset/liability study that resulted in a new asset allocation strategy. This strategy specified an asset allocation target of 24% Domestic Equity, 25% International Equity, 31% Fixed Income, 10% Real Estate, 5% Commodities and 5% Alternative Equity.

## **10. Foreign Currency Risk**

*County's Investment Pool* - There are no general policies addressing foreign currency based securities, however the County does not invest in foreign currency based securities.

*Cash and Investments with Fiscal Agents* - There are no general policies addressing foreign currency based securities, however, moneys held by trustees on behalf of the County may generally only be invested in permitted investments specified in trustee or indenture agreements.

*SDCERA Investment Portfolio* - SDCERA's investment policy allows international managers to enter into foreign exchange contracts provided that the contracts have a maturity of one year or less and are limited to hedging currency exposure existing in the portfolio. SDCERA's exposure to foreign currency risk derives from its positions in foreign currency denominated international equity and fixed income investments.

SDCERA's net exposure to foreign currency risk is shown on **Table 16** on **page 85**.

## **11. Securities Lending Transactions**

*County's Investment Pool* - Although the Pool's Policy permits securities lending transactions, the portfolio has not been exposed to these types of investments during the fiscal year.

*Cash and Investments with Fiscal Agents* - There are no general policies addressing securities lending transactions, however, moneys held by trustees on behalf of the County may generally only be invested in permitted investments specified in trustee or indenture agreements.

*SDCERA Investment Portfolio* - SDCERA lends U.S. government obligations, domestic and international bonds, and equities to various brokers with a simultaneous agreement to return collateral for the same securities plus a fee in the future. The securities lending agent manages the securities lending program and receives securities and cash as collateral. Collateral cash is pledged at 102% and 105% of the fair value of domestic securities and non-domestic securities lent, respectively. There are no restrictions on the amount of securities that can be lent at one time. The term to maturity of the loaned securities is generally not matched with the term to maturity of the investment of the cash collateral.

SDCERA's securities lending transactions as of June 30, 2005, are summarized on **Table 17** on **page 86**. The Fund lent \$612.033 million in securities and received collateral of \$123.832 million and \$503.190 million in securities and cash, respectively from borrowers.

SDCERA receives a premium on all securities it holds as collateral. As of June 30, 2005, the cash collateral that was received from the borrowers was then invested in the investment types as shown on **Table 18** on **page 86**.

SDCERA's investment guidelines require that certificates of deposit, commercial paper, notes, bonds, and other debt obligations that are maturing within one year shall be no lower than A-1 as rated by Standard & Poor's, or P-1 by Moody's. Obligations may have fixed, floating, or variable rate interest payment provisions. Obligations maturing beyond one year shall be rated at least A/A2 (as rated by Standard & Poor's or Moody's equivalent). As of June 30, 2005, all of SDCERA's securities lending investment's maturing in less than one year





## Notes to the Financial Statements (Amounts Expressed in Thousands Unless Otherwise Noted)

were rated A-1/P-1 for US corporate and certificate of deposit floating rate, and AAA/Aaa for asset backed securities and bank notes as rated by Standard & Poor's and Moody's. For obligations maturing beyond one year, eleven percent of the investment in asset backed securities was rated AAA/Aaa by Standard & Poor's and Moody's. The remaining 89 percent of US corporate floating rate, bank notes, and certificates of deposit floating rate were rated AA/Aa3.

SDCERA does not have the ability to pledge or sell collateral securities without a borrower default. At the end of the fiscal year, SDCERA has no credit risk exposure to borrowers because the amounts the system owes them exceed the amounts they owe the system. As with other extensions of credit, SDCERA may bear the risk of delay in recovery or of rights in the collateral should the borrower of the securities fail financially. In addition, the Bank of New York indemnifies SDCERA against all borrower default.

**Table 7 (Note IV-A-3)**

Deposits and Investments Reconciliation					
	Primary Government	Fiduciary Funds	Sub-Total	Component Unit	Total
Equity in pooled cash and investments	\$ 994,505	2,963,897	3,958,402	172,983	4,131,385
Cash with fiscal agent	118,139	186,744	304,883		304,883
Restricted cash with fiscal agent	97,877		97,877		97,877
Collections in transit	6,725	10,076	16,801		16,801
Imprest cash	315	35	350		350
Investments	69,894	6,831,839	6,901,733		6,901,733
Restricted investments	731,678		731,678		731,678
<b>Total</b>	<b>2,019,133</b>	<b>9,992,591</b>	<b>12,011,724</b>	<b>172,983</b>	<b>12,184,707</b>
Less:					
Cash with fiscal agent					(304,883)
Restricted cash with fiscal agent					(97,877)
Collections in transit					(16,801)
Imprest cash					(350)
Deposits					(48,698)
<b>Total investments</b>	<b>\$</b>				<b>11,716,098</b>
Investments in County Pool	\$		4,082,687		
Deposits			48,698		
Equity in pooled cash and investments	\$		4,131,385		
Investments in County Pool	\$		4,082,687		
Investments with Fiscal Agent			801,572		
Investments in SDCERA			6,831,839		
<b>Total Investment</b>	<b>\$</b>		<b>11,716,098</b>		

# Notes to the Financial Statements

## (Amounts Expressed in Thousands Unless Otherwise Noted)



Table 8 (Note IV-A-4)

Investments - County Pool										
Investment Type	Moody's Rating	S&P Rating	Rate Range%	Maturity Date Range	Par value	Amortized Cost	Fair Value	Yield To Maturity	Weighted Average Maturity	Percent of Total
U.S. Government Agencies:										
Federal Home Mortgage Corporation	Aaa	AAA	2.25 - 4.00	06/06 - 08/07	\$ 100,000	100,000	98,646	2.89%	541	2%
Federal Home Loan Bank	Aaa	AAA	1.8 - 4.15	10/05 - 07/07	721,295	720,305	711,538	2.73%	412	17%
Federal National Mortgage Association	Aaa	AAA	2.00 - 4.00	12/05 - 09/07	500,691	500,604	494,429	2.55%	439	12%
Federal Farm Credit Bank	Aaa	AAA	1.85 - 3.50	10/05 - 05/08	496,040	495,719	488,681	2.41%	414	12%
U.S Treasury Notes	Aaa	AAA	1.50	3/06	100,000	99,588	98,555	2.06%	274	2%
Short Term Notes:										
Commercial Paper	P-1	A-1+	2.67 - 3.40	7/05 - 10/05	1,138,714	1,135,359	1,135,940	3.14%	34	28%
Medium - Term Notes	Aa2	AA+	2.00 - 5.35	12/05 - 11/06	293,987	296,807	294,883	2.92%	298	7%
Repurchase Agreements	P-1	A-1	3.51	07/05	50,000	50,000	50,000	3.51%	1	1%
Negotiable Certificates of Deposit	Aaa	AAA	2.15 - 3.75	07/05 - 04/06	625,000	624,937	623,287	2.80%	146	17%
Open - End Institutional Money Market Funds	Aaa	AAA	2.97 - 3.00	07/05	27,600	27,600	27,600	2.99%	1	1%
Asset-Backed Notes	Aaa	AAA	2.50 - 2.55	04/06 - 01/07	60,000	59,699	59,128	2.90%	449	1%
<b>Total Investments</b>					<b>\$ 4,113,327</b>	<b>4,110,618</b>	<b>4,082,687</b>	<b>2.81%</b>	<b>259</b>	<b>100%</b>

Table 9 (Note IV-A-4)

Investments - With Fiscal Agents									
Investment Type	Moody's Rating	S&P Rating	Maturity Under 1 Month	Maturity 1 to 6 months	Maturity 6 to 12 Months	Maturity Greater than 12 Months	Market Value	Coupon Rate	Maturity Date
Tax and Revenue Anticipation Notes-Investment Agreement	Unrated	Unrated	\$ 360,000				360,000	NA	7/22/2005
Fixed Income Tax Exempt Bonds	Various	Various		25,557		298,371	323,928	1.79%-5.625%	11/15/2006-02/01/2042
Commercial Paper	P-1	A-1	44,995				44,995	NA	7/7/2005
Federal Farm Credit Bank Notes	NA	AAA	24,897				24,897	NA	10/28/2005
AIG Investment Agreement	Unrated	Unrated		39,277			39,277	NA	7/3/2007
Bayerische Investment Agreements	Unrated	Unrated			8,473		8,473	NA	4/26/2006
Common Stock	Aa2	AA-				2	2	NA	NA
<b>Total Investments</b>			<b>\$ 429,892</b>	<b>64,834</b>	<b>8,473</b>	<b>298,373</b>	<b>801,572</b>		



## Notes to the Financial Statements (Amounts Expressed in Thousands Unless Otherwise Noted)

**Table 10 (Note IV-A-4)**

Investments - Pension Trust Fund (SDCERA)	Fair Value
Domestic equity securities	\$ 882,662
Cash, cash equivalents, and securities domestic equity swaps and futures	1,368,556
International equity securities	1,489,825
Securities lending collateral	503,102
United States government obligations	628,206
Domestic corporate bonds	557,566
International bonds	794,671
Cash and securities for overlay futures	58,557
Alternative equity and real estate	548,694
<b>Total investments</b>	<b>\$ 6,831,839</b>

**Table 11 (Note IV-A-6)**

Investments and Maturities - With Fiscal Agents					
Investment Type	Market Value	Maturity Under 1 month	Maturity 1 to 6 Months	Maturity 6 to 12 Months	Maturity Greater than 12 Months
Tax and Revenue Anticipation Notes- Investment Agreement	\$ 360,000	360,000			
Fixed Income Tax Exempt Bonds	323,928		25,557		298,371
Commercial Paper	44,995	44,995			
Federal Farm Credit Bank Notes	24,897	24,897			
AIG Investment Agreement	39,277		39,277		
Bayerische Investment Agreements	8,473			8,473	
Common Stock	2				2
<b>Total Investments</b>	<b>\$ 801,572</b>	<b>429,892</b>	<b>64,834</b>	<b>8,473</b>	<b>298,373</b>

**Table 12 (Note IV-A-6)**

Investments and Maturities - SDCERA Investment Portfolio					
Investment Type	Fair Value	Maturity Less than 1 year	Maturity 1 to 5 years	Maturity 6 to 10 years	Maturity More than 10 years
Asset and mortgage backed securities	\$ 169,055	4,182	6,005	2,065	156,803
Collateralized mortgage obligations	99,016		525		98,491
Convertible Bonds	191,442	7,133	101,021	5,530	77,758
Corporate bonds	281,555	9,300	89,217	126,633	56,405
Emerging market debt securities	317,911	1,975	33,993	39,256	242,687
International bonds	2,189			2,189	
International Governments	491,457	12,510	240,857	138,470	99,620
Managed Futures *	53,994	NA	NA	NA	NA
Municipals	7,922		219	3,533	4,170
Private placements	43,927		2,303	33,561	8,063
Treasury inflation protected securities	210,304		42,761	98,217	69,326
US Treasuries	111,671	28,438	33,496	21,753	27,984
<b>Total Investments</b>	<b>\$ 1,980,443</b>	<b>63,538</b>	<b>550,397</b>	<b>471,207</b>	<b>841,307</b>

\* Investment maturities for Managed Futures are not available and are therefore not included in the subtotals by maturity.

# Notes to the Financial Statements (Amounts Expressed in Thousands Unless Otherwise Noted)



**Table 13 (Note IV-A-7)**

Securities Ratings - Investments With Fiscal Agents				
Fixed Income Tax Exempt Bonds:	S&P Rating	Market Value	Percent of Total	
ALASKA ST HSG FIN CORP	AAA/A-1+	\$ 18,596	6%	
ATLANTA GA ARPT PASSENGER FAC	AAA	15,225	5%	
BARTON CNTY GA DEV AUTH POLLU	A	10,000	3%	
BAY AREA TOLL AUTH CA TOLL BRG	AAA	9,975	3%	
CALIFORNIA ST DEPT WTR RES PWR	AAA	5,628	2%	
CALIFORNIA ST DEPT WTR RES PWR	AAA	1,124	0%	
CALIFORNIA STATEWIDE CMNTYS	AAA	25,464	8%	
CALIFORNIA STATEWIDE CMNTYS	A+/A-1	6,396	2%	
CALIFORNIA STATEWIDE CMNTYS	A+/A-1	4,950	2%	
DELAWARE VALLEY PA REGL FIN	AAA	10,000	3%	
GRAND TRAVERSE CNTY MI HOSP	NR	19,700	6%	
INDIANA HLTH FAC HOSP REV	AAA	8,500	3%	
JEA FL ELEC SYS REV	AAA	15,000	5%	
JEFFERSON CNTY AL SWR REV	AAA	20,000	6%	
MEDFORD OR HOSP FACS AUTH REV	AAA	20,000	6%	
METROPOLITAN TRANSN AUTH NY	AAA	20,000	6%	
NEW YORK N Y	AAA	11,320	3%	
PUTNAM CNTY GA DEV AUTH POLLUT	A/A-1	19,025	6%	
SEATTLE WA NUM LT + PWR REV	AA+/A-1+	16,900	5%	
SOUTH CAROLINA ST	AA+	9,849	3%	
UNIVERSITY AL UNIV REVS	AAA	7,650	2%	
WAKE CNTY NC INDL FACS + PLLTN	AAA	5,000	2%	
WAKE CNTY NC INDL FACS + PLLTN	AAA	10,000	3%	
WAKE CNTY NC INDL FACS + PLLTN	AAA	12,000	4%	
WAYNE CNTY ARPT AUTH REV	AAA	16,000	5%	
DAPHNE AL SPL CARE FACS	AAA	5,626	1%	
<b>Total</b>		<b>\$ 323,928</b>	<b>100%</b>	

**Table 14 (Note IV-A-7)**

Fixed Income Securities Ratings - SDCERA Investment Portfolio					
Credit Risk	Domestic Fixed Income	Global Fixed Income	High Yield Fixed Income	Emerging Market Debt Fixed Income	Total
AAA	\$ 29,329	448,692	1,669		479,690
AA	222	28,944	1,691		30,857
A	304	70,323	11,679	7,248	89,554
BBB	2,997	77,920	34,731	87,076	202,724
BB	2,283	11,657	92,538	24,797	131,275
B		67	159,207	120,170	279,444
CCC			42,947	4,610	47,557
CC			3,184		3,184
D			2,984		2,984
NR		652	40,107	74,010	114,769
Govt	423,445	174,960			598,405
<b>Total</b>	<b>\$ 458,580</b>	<b>813,215</b>	<b>390,737</b>	<b>317,911</b>	<b>1,980,443</b>



## Notes to the Financial Statements (Amounts Expressed in Thousands Unless Otherwise Noted)

**Table 15 (Note IV-A-7)**

Credit Risk	SDCERA Investment Portfolio			
	Domestic Fixed Income	Global Fixed Income	High Yield Fixed Income	Emerging Market Debt Fixed Income
AAA	6.4%	55.2%	0.4%	0.0%
AA	0.1%	3.6%	0.4%	0.0%
A	0.1%	8.6%	3.0%	2.3%
BBB	0.6%	9.6%	8.9%	27.4%
BB	0.5%	1.4%	23.7%	7.8%
B	0.0%	0.0%	40.7%	37.8%
CCC	0.0%	0.0%	11.0%	1.4%
CC	0.0%	0.0%	0.8%	0.0%
D	0.0%	0.0%	0.8%	0.0%
NR	0.0%	0.1%	10.3%	23.3%
Govt	92.3%	21.5%	0.0%	0.0%
	100%	100%	100%	100%

**Table 16 (Note IV-A-10)**

Foreign Currency Exposure - SDCERA Investment Portfolio	
Currency	Fair Value
JAPANESE YEN	\$ 410,945
EURO CURRENCY	249,013
BRITISH PND STERLING	218,812
AUSTRALIAN DOLLAR	195,174
SOUTH KOREAN WON	112,655
SWISS FRANC	110,169
SINGAPORE DOLLAR	67,378
MEXICAN NUEVO PESO	56,228
HONG KONG DOLLAR	53,570
SOUTH AFRICAN RAND	47,802
SWEDISH KRONA	41,642
BRAZILIAN REAL	34,878
TAIWAN DOLLAR	31,161
THAI BAHT	21,718
INDIAN RUPEE	21,648
INDONESIAN RUPIAH	17,724
MALAYSIAN RINGGIT	14,567
TURKISH LIRA	14,444
EGYPTIAN POUND	12,741
NORWEGIAN KRONE	11,468
RUSSIAN NEW RUBLE	8,983
CHILEAN PESO	8,905
NEW ZEALAND DOLLAR	8,188
DANISH KRONE	8,082
HUNGARIAN FORINT	8,044
RENMINBI YUAN	7,986
POLISH ZLOTY	5,386
CANADIAN DOLLAR	(41,928)
Other (Less than \$2 million holdings)	9,292
<b>Total</b>	<b>\$ 1,766,675</b>

**Notes to the Financial Statements**  
**(Amounts Expressed in Thousands Unless Otherwise Noted)**



**Table 17 (Note IV-A-11)**

<b>Securities Lending Transactions - SDCERA Investment Portfolio</b>				
Investment Type	Fair Value	Maturity Less than 1 year	Maturity 1 to 5 years	
U.S. Corporate Floating Rate	\$ 194,015	25,014	169,001	
Asset Back Securities	52,918	8,506	44,412	
Bank Notes	108,536	8,502	100,034	
Certificates of Deposit Floating Rate	85,985	9,996	75,989	
Repurchase Agreements	61,722	61,722		
Other (cash)	114	114		
<b>Total</b>	<b>\$ 503,291</b>	<b>113,854</b>	<b>389,437</b>	

**Table 18 (Note IV-A-11)**

<b>Securities Lent - SDCERA Investment Portfolio</b>			
Investment Type	SDCERA Securities Lent	Securities Received Value	Cash Received Value
<b>Lent for cash collateral:</b>			
U.S. government and agency securities	\$ 123,384		124,251
International governments securities	21,980		22,989
Domestic corporate fixed income securities	125,762		128,479
Domestic equities	178,859		184,285
International equities	41,314		43,187
<b>Lent for securities collateral:</b>			
Domestic Equity	2,808	2,905	
Domestic Government Securities	104,150	106,186	
International equities	6,311	6,874	
International governments securities	7,465	7,866	
<b>Total</b>	<b>\$ 612,033</b>	<b>123,832</b>	<b>503,190</b>

**B. Receivables**

Receivable balances not expected to be collected within the next fiscal year are as follows:

1. Community Development Block Grant - \$14.176 million, Home Investment Partnership Program - \$13.294 million, Mobile Home Opportunity Assistance Program - \$5.178 million and various REHAB programs - \$7.406 million. These are included in the General and Housing Special Revenue Funds and represent loans for the provision low-income housing development activities under these programs.
2. Metropolitan Transit Development Board (MTDB) - General Fund. The County leases the Metropolitan Transit System (MTS) Towers

building from the San Diego Regional Building Authority. The County subleases a 27.61% share of the building to the Metropolitan Transit Development Board (MTDB). At June 30, 2005 the MTDB receivable balance was \$12.684 million. Of this amount, \$11.838 million will not be received in the next fiscal year.

3. Sale and Use of Surplus Land - Road Fund, Airport Enterprise Fund \$842 thousand.

**Table 19** below presents receivables at June 30, 2005 for the County's individual major funds, nonmajor internal service, governmental and business type activities' funds and the discrete component unit including the applicable allowances for uncollectible accounts.



## Notes to the Financial Statements (Amounts Expressed in Thousands Unless Otherwise Noted)

**Table 19 (Note IV-B)**

Primary Government and Discretely Presented Component Unit									
Receivables									
	Accounts	Interest	Due From Other Gov't Agencies	Notes	Loans	Other	Total Receiv- ables	Allowance For Doubtful Accounts	Receivables Net
<b>Governmental activities:</b>									
General Fund	\$ 1,033	4,819	197,314		19,052	13,008	235,226	(10,699)	224,527
Tobacco Securitization Special Revenue Fund	1,187	42					1,229		1,229
Other governmental funds	7,451	1,979	91,061	1,590	33,686		135,767		135,767
Internal service funds	257	219	4,568				5,044		5,044
<b>Total governmental activities</b>	<b>9,928</b>	<b>7,059</b>	<b>292,943</b>	<b>1,590</b>	<b>52,738</b>	<b>13,008</b>	<b>377,266</b>	<b>(10,699)</b>	<b>366,567</b>
<b>Business-type activities:</b>									
Enterprise Funds	253	464	163				880		880
<b>Total business-type activities</b>	<b>253</b>	<b>464</b>	<b>163</b>				<b>880</b>		<b>880</b>
<b>Component Unit:</b>									
First 5 Commission		544	8,230				8,774		8,774
<b>Total component unit</b>	<b>\$</b>	<b>544</b>	<b>8,230</b>				<b>8,774</b>		<b>8,774</b>

### C. County Property on Lease to Others

The County has *noncancelable* operating leases for certain properties which are not material to the County's governmental operations, except for the aforementioned sublease of a share of the Metropolitan Transit System (MTS) Towers. In this regard, the share of the County's property under this lease is an estimated \$12.74 million in land and structures and improvements with accumulated depreciation of \$4.3 million at June 30, 2005.

Additionally, the Airport Enterprise Fund derives a substantial portion of its revenues from noncancelable operating leases with air carriers and concessionaires. The Airport Enterprise Fund's property under operating leases includes an estimated \$2.4 million in land at June 30, 2005,

Lease revenues for both non-cancelable and cancelable leases for the year ended June 30, 2005 were approximately \$22.81 million.

Future minimum *revenue* to be received under these noncancelable operating leases as of June 30, 2005 are noted below in **Table 20**. (One lease extends through 2091 for a two acre parcel leased to a non-profit public benefit corporation.)

**Table 20 (Note IV-C)**

Lease Revenue County Property Leased To Others	
Fiscal Year	Minimum Lease Revenue
2006	\$ 12,252
2007	11,608
2008	11,070
2009	10,818
2010	10,363
2011-2091	161,764
<b>Total</b>	<b>\$ 217,875</b>

### D. Capital Assets

#### 1. Primary Government

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

# Notes to the Financial Statements (Amounts Expressed in Thousands Unless Otherwise Noted)



## Governmental Activities:

On **Table 21** below, building and infrastructure projects are recorded as construction in progress until completion. Intangible projects such as software acquisition and implementation are recorded as contracts in progress until implementation is completed.

**Table 21 (Note IV-D)**

Capital Assets Governmental Activities				
	Beginning Balance at July 1, 2004	Increases	Decreases	Ending Balance at June 30, 2005
Capital assets, not being depreciated:				
Land	\$ 262,110	5,323	(473)	266,960
Construction in progress	175,086	30,330	(64,795)	140,621
Total capital assets, not being depreciated	437,196	35,653	(65,268)	407,581
Capital assets, being depreciated:				
Buildings and improvements	969,977	17,751	(25,098)	962,630
Equipment	167,976	74,590	(11,117)	231,449
Road network	2,074,421	45,427		2,119,848
Bridge network	39,193	760		39,953
Total capital assets, being depreciated	3,251,567	138,528	(36,215)	3,353,880
Less accumulated depreciation for:				
Buildings and improvements	(280,611)	(18,625)	6,286	(292,950)
Equipment	(88,800)	(15,882)	9,295	(95,387)
Road network	(627,137)	(59,202)		(686,339)
Bridge network	(11,645)	(747)		(12,392)
Total accumulated depreciation	(1,008,193)	(94,456)	15,581	(1,087,068)
Total capital assets, being depreciated, net	2,243,374	44,072	(20,634)	2,266,812
Governmental activities capital assets, net	\$ 2,680,570	79,725	(85,902)	2,674,393

Depreciation expense was charged to functions of the primary government as shown in **Table 22** below:

**Table 22 (Note IV-D)**

Depreciation Expense - Governmental Activities	
General Government	\$ 3,708
Public Protection	15,269
Public Ways and Facilities	60,212
Health and Sanitation	2,609
Public Assistance	684
Education	77
Recreational and Cultural	1,581
Internal Service Funds	10,316
Total Depreciation Expense - Governmental Activities	\$ 94,456





## Notes to the Financial Statements (Amounts Expressed in Thousands Unless Otherwise Noted)

### *Business Type Activities:*

On **Table 23** below, building and infrastructure projects are recorded as construction in progress until completion.

**Table 23 (Note IV-D)**

<b>Capital Assets - Business Type Activities</b>				
	Beginning Balance at July 1, 2004	Increases	Decreases	Ending Balance at June30, 2005
<b>Capital assets, not being depreciated:</b>				
Land	\$ 10,677			10,677
Construction in progress	15,516	4,480	(3,184)	16,812
<b>Total capital assets, not being depreciated</b>	<b>26,193</b>	<b>4,480</b>	<b>(3,184)</b>	<b>27,489</b>
<b>Capital assets, being depreciated:</b>				
Buildings and improvements	37,291	5,441		42,732
Equipment	1,214		(8)	1,206
Infrastructure		139		139
Sewer network	63,746	1,036		64,782
<b>Total capital assets, being depreciated</b>	<b>102,251</b>	<b>6,616</b>	<b>(8)</b>	<b>108,859</b>
<b>Less accumulated depreciation for:</b>				
Buildings and improvements	(19,627)	(907)		(20,534)
Equipment	(848)	(55)	8	(895)
Sewer network	(26,031)	(1,307)		(27,338)
<b>Total accumulated depreciation</b>	<b>(46,506)</b>	<b>(2,269)</b>	<b>8</b>	<b>(48,767)</b>
<b>Total capital assets, being depreciated, net</b>	<b>55,745</b>	<b>4,347</b>		<b>60,092</b>
<b>Enterprise fund capital assets, net</b>	<b>\$ 81,938</b>	<b>8,827</b>	<b>(3,184)</b>	<b>87,581</b>

*Depreciation expense* was charged to *business type activities* as shown on **Table 24** below:

**Table 24 (Note IV-D)**

<b>Depreciation Expense - Business Type Activities</b>	
Airport	\$ 911
Wastewater	23
Sanitation	1,335
<b>Total Depreciation Expense</b>	<b>\$ 2,269</b>

# Notes to the Financial Statements (Amounts Expressed in Thousands Unless Otherwise Noted)



## 2. Capital Commitments

At June 30, 2005, major contracts entered into for software development, construction in progress, buildings, equipment and infrastructure were as follow, listed by fund within *governmental and business-type activities* are shown below in **Table 25**:

**Table 25 (Note IV-D)**

Capital Commitments		Remaining Commitments
	Project Title	
<b>Governmental Activities:</b>		
General Fund	Registrar of Voters-Integrated Voting System and Optional Items	\$ 29,779
	Integrated Property Tax System (PTS)	31,287
	Revenue Plus Collection System	1,379
	Automated Records MGMT & Field Reporting Cots Software Installation	1,705
	Regional Communications System Motorola Services and Equipment	3,739
	Service MGMT Access and Resource System (Smart)	2,416
	Creative Socio-Medics Corpublic Health Information System Acquisition	1,743
	Sub Total	72,048
Other Governmental Funds	Construction of Forester Creek Drainage	3,000
	Construction of Mission Road	3,008
	Construction of Valley Center Road South, Phase I	2,800
	Spring Valley Gym and Teen Center	1,744
	Construction of Edgemoor Skill Nursing Facility	61,891
	Construction of APCD Bldg in Scripps Ranch	7,508
	Sub Total	79,951
<b>Business-type Activities:</b>		
Enterprise Funds	Jamacha Blvd Sewer	2,000
	Construction of Gillespie Field Runway	2,424
	Sub Total	4,424
	<b>Total</b>	<b>\$ 156,423</b>

## E. Payables

The County's payables at June 30, 2005 are shown on **Table 26** for the General Fund, nonmajor internal service funds, governmental funds, business type activities' funds and the discrete component unit:

**Table 26 (Note IV-E)**

Payables				
	Vendors	Due to Other Gov't Agencies	Other	Total Payables
<b>Governmental Activities:</b>				
General Fund	\$ 46,862	48,431	6,473	101,766
Other governmental funds	15,917	9,166	75	25,158
Internal service funds	15,797	244		16,041
Total governmental activities	78,576	57,841	6,548	142,965
<b>Business-type activities:</b>				
Enterprise Funds	2,122	39		2,161
Total business-type activities	2,122	39		2,161
<b>Component Unit:</b>				
First 5 Commission	5,813			5,813
Total component unit	\$ 5,813			5,813



# Notes to the Financial Statements

## (Amounts Expressed in Thousands Unless Otherwise Noted)

### F. Interfund Transactions

The composition of interfund balances as of June 30, 2005, is as follows:

#### 1. Due To/Due From Other Funds

Due to/due from other funds shown in **Table 27** below arise due to the exchange of goods or services between funds that were pending the transfer of cash as of June 30, 2005. These due to/from other funds have been eliminated in the government-wide financial statements, except for "internal balances" that are reflected between the governmental and business-type statements as of June 30, 2005.

**Table 27 (Note IV-F-1)**

Due To/From Other Funds		
Receivable Fund	Payable Fund	Amount
General Fund	Tobacco Securitization Special Revenue Fund	\$ 2,779
	Nonmajor Governmental Funds	117,745
	Nonmajor Enterprise Funds	75
	Internal Service Funds	51,610
<b>Total General Fund</b>		<b>172,209</b>
Nonmajor Governmental Funds	General Fund	6,496
	Nonmajor Governmental Funds	745
	Nonmajor Enterprise Funds	171
	Internal Service Funds	79
<b>Total Nonmajor Governmental Funds</b>		<b>7,491</b>
Nonmajor Enterprise Funds	General Fund	28
	Nonmajor Governmental Funds	1
	Nonmajor Enterprise Funds	906
	Internal Service Funds	1
<b>Total Nonmajor Enterprise Funds</b>		<b>936</b>
Internal Service Funds	General Fund	14,818
	Nonmajor Governmental Funds	1,123
	Nonmajor Enterprise Funds	95
	Internal Service Funds	279
<b>Total Internal Service Funds</b>		<b>16,315</b>
<b>Total</b>		<b>\$ 196,951</b>

#### 2. Advances

Advances to/from at June 30, 2005 are noted on **Table 28** below. The purpose of these advances was primarily for the establishment of loans that are not due within one year. These loans are for the planning, undertaking, construction or operation of redevelopment projects within the County. These advances to/from other funds have been eliminated in the government-wide financial statements, except for "internal balances" that are reflected between the governmental and business-type statements as of June 30, 2005.

**Table 28 (Note IV-F-2)**

Advances		
Funds	Advances To Other Funds	Advances From Other Funds
General Fund	\$ 928	
Nonmajor Governmental Funds	102	10,699
Nonmajor Enterprise Funds	9,312	239
Internal Service Funds	596	
<b>Total</b>	<b>\$ 10,938</b>	<b>10,938</b>

#### 3. Prior-Year Advance

Prior to the issuance of Revenue Bonds in 1995 by the San Diego County Redevelopment Agency, the County Airport Enterprise Fund funded the initial expenditures of the Agency's two airport projects. The Redevelopment Agency is required to reimburse the Airport Enterprise Fund, which spent approximately \$9.6 million on the projects consisting of \$3.7 million for initial expenditures and \$5.9 million for 2001. The Agency pays interest on advances, but is not responsible for payment until funds are available for this purpose. As of June 30, 2005, interest of approximately \$4.3 million has accrued on these advances; however such amounts have not been recorded because the ultimate collection has not been determined.



#### 4. Transfers In/Transfers Out

The purposes of these transfers were primarily for reimbursement of project costs, lease payments, initiation fees and replacement costs. Transfers in/transfers out at June 30, 2005 were as follows on **Table 29** below:

**Table 29 (Note IV-F-4)**

Transfers In/Transfers Out		
From	To	Amount
General Fund	Nonmajor Governmental Funds	\$ 175,599
	Internal Service Funds	3,629
Total General Fund		179,228
Tobacco Securitization Special Revenue Fund	General Fund	23,278
Nonmajor Governmental Funds	General Fund	544,668
	Nonmajor Governmental Funds	71,963
	Internal Service Funds	490
Total Nonmajor Governmental Funds		617,121
Nonmajor Enterprise Funds	Nonmajor Governmental Funds	588
	Internal Service Funds	176
Total Nonmajor Enterprise Funds		764
Internal Service Funds	General Fund	731
	Nonmajor Governmental Funds	2,663
	Internal Service Funds	153
Total Internal Service Funds		3,547
Total		\$ 823,938

#### G. Short-Term Obligations

The County's short-term borrowing program consists of its annual Tax and Revenue Anticipation Notes (Notes), which fund the County's annual operating cash flow needs, and the issuance of Teeter Commercial Paper, which fund payments to public agencies their full share of property taxes levied. The County bears the risk of loss on delinquent property taxes that go unpaid; however, it also benefits from the penalties associated with these delinquent property taxes when they are paid.

On July 1, 2004, the County of San Diego issued \$360 million of Notes with an interest and principal maturity date of July 25, 2005. The Notes carry an interest rate of 3.25% and a yield of 1.59%. The amount outstanding at June 30, 2005 is \$369.28 million, including accrued interest payable of \$9.28 million.

In 1995 the County of San Diego Board of Supervisors approved the Master Teeter Resolution providing the terms and conditions of its teeter plan obligations. Pursuant to this resolution, the County is able to issue additional Series B Teeter Commercial Paper each fiscal year. On May 17, 2005, the Board of Supervisors adopted a resolution for the issuance of additional Series B borrowings to finance the uncollected property taxes and assessments attributable to the fiscal year ended June 30, 2005. The Teeter commercial paper shall mature not more than 270 days after date of issuance and is not subject to redemption prior to maturity. The payment of principal and interest on each series is supported by an irrevocable direct pay letter of credit that will expire on December 31, 2015.



# Notes to the Financial Statements

## (Amounts Expressed in Thousands Unless Otherwise Noted)

Short-term obligation activity (Table 30 below) for the year ended June 30, 2005 was as follow

**Table 30 (Note IV-G)**

Short-Term Obligations				
	Beginning Balance at July 1, 2004	Issued	Redeemed	Ending Balance at June 30, 2005
Tax and Revenue Anticipation Notes	\$	369,280		369,280
Teeter B-1 Tax - Exempt Principal	49,100	46,000	32,110	62,990
Teeter B-2 Taxable Principal	12,001	12,000	12,001	12,000
Total Teeter	\$ 61,101	427,280	44,111	444,270

## H. Lease Obligations

### I. Lease Commitments- Real Property

The County has commitments under long-term property operating lease agreements for facilities used for operations through fiscal year 2012 (Table 31 below). These leases do not meet the criteria for capitalization under FASB Statement 13. The County is the lessee under the terms of several non-cancelable operating leases for real property used to house certain County facilities. Total rental expense for all real property operating leases, including short-term cancelable leases for the year ended June 30, 2005, was approximately \$26 million.

The combined rental cost for which the County is obligated under these leases is as follows:

**Table 31 (Note IV-H-1)**

Lease Commitments - Real Property	
Fiscal Year	Minimum Lease Payments
2006	\$ 7,645
2007	7,172
2008	3,666
2009	3,094
2010	2,499
2011-2012	3,311
Total	\$ 27,387

## 2. Lease Commitments- Personal Property

The County has also entered into long-term operating leases for personal property, a large portion of which represents data processing and duplicating equipment. Many of these leases are subject to annual adjustment based upon negotiations. Management expects that in the normal course of business, leases that expire will be renewed or replaced by other leases. Total rental expense for these operating leases for the year ended June 30, 2005, was \$7.7million.

## 3. Capital Leases

### a. Minimum Lease Payments

Certain buildings and equipment are being leased under capital leases as defined in FASB Statement 13. The present value of the minimum lease obligation has been capitalized in the statement of net assets and is reflected as a liability in that statement. The County assumes responsibility for all maintenance, repair, and structural modifications under the terms of the lease agreements. Future minimum lease payments (Table 32 below) under capital leases at June 30, 2005 were as follows:

**Table 32 (Note IV-H-3-a)**

Capital Leases-Future Payments	Minimum Lease Amount
Fiscal Year	
2006	\$ 4,359
2007	3,785
2008	3,454
2009	3,068
2010	3,053
2011-2015	13,535
2016-2020	15,290
2021-2023	3,057
Total minimum lease payments	49,601
Less: amount representing interest	(14,976)
Net lease payments	\$ 34,625



**b. Book Value**

The book value of capital lease property (**Table 33**) at June 30, 2005 consisted of the following:

**Table 33 (Note IV-H-3-b)**

<b>Capital Leases - Book Value</b>			
Capital Lease Property	Original Cost	Accumulated Depreciation	Net Book Value June 30, 2005
Land	\$ 2,221		2,221
Buildings and Improvements	52,314	16,195	36,119
<b>Total</b>	<b>\$ 54,535</b>	<b>16,195</b>	<b>38,340</b>

**I. General Long-Term Obligations**

Outstanding general long-term obligations at June 30, 2005 consist of certificates of participation, capital lease obligations, third party financing leases, and other long-term obligations. All obligations listed, carry a fixed interest rate with the exception of \$505.125 million of the 2002 taxable pension obligation bonds and \$147.8 million of the 2004 taxable pension obligation bonds which are variable rate and are subject to market fluctuations. The range listed in **Table 34** below represents the range of interest rates on the serial, term bonds or in the case of third party financing leases; it is the range of rates for the various leases. The variable interest rate used for the 2002 taxable pension obligation bonds Series B1 and for the 2004 taxable pension obligation bonds Series B1 - B2 is 3.34%, which represents the one-month London Interbank Offered Rate (LIBOR) at June

30, 2005. The variable rate used for the 2002 taxable pension obligation bonds Series B2 - B4 is 3.153%, which represents the average auction rate bond coupon for June 2005. The maximum interest rate on these bonds shall not exceed 17% per annum.

**I. Outstanding long-term obligations**

Outstanding long-term obligations at June 30, 2005 were as follows:

*Governmental Activities:*

The certificates of participation (COPs) of the SANCAL, a non-profit corporation, are secured by annual base rental lease payments payable primarily by the County General Fund for use of the facilities constructed or equipment purchased from the proceeds. There are also encumbrances on the facilities constructed or purchased with the proceeds of the SANCAL. The capital leases between the County and SANCAL have been eliminated for financial reporting purposes and the related assets and long-term obligation (e.g. certificates of participation of SANCAL) are reported as San Diego County's assets and debt, respectively.

Also, the County, in compliance with the Tax Reform Act of 1986 and subsequent U.S. Treasury Regulations, has performed arbitrage rebate calculations to determine probable amounts due to the Federal government. At June 30, 2005, the probable arbitrage rebate is zero.



## Notes to the Financial Statements (Amounts Expressed in Thousands Unless Otherwise Noted)

Long-term obligations (Table 34) for *governmental activities* at June 30, 2005 were as follows:

**Table 34 (Note IV-I-1)**

Long-Term Obligations - Governmental Activities				
	Interest Rate	Final Maturity Date	Original Amount	Amount Outstanding
<b>San Diego County Capital Asset Leasing Corporation (SANCAL):</b>				
1993 Master Refunding issued May, 1993	2.50 - 5.625%	2012	\$ 203,400	72,545
1996 North & East County Courthouse issued December, 1996	4.00 - 6.00%	2019	37,690	30,595
1997 Central Jail Refunding issued July, 1997	4.00 - 5.42%	2025	80,675	67,635
1998 Downtown Courthouse Refunding issued January, 1999	4.00 - 4.94%	2023	73,115	54,875
1999 East Mesa Refunding issued September, 1999	3.60 - 4.75%	2009	15,010	8,295
2000 Information Technology issued May, 2000	4.50 - 5.125%	2010	51,620	28,970
2002 Motorola issued March 2002	2.00 - 5.00%	2011	26,060	18,085
2005 Edgemoor & RCS Refunding issued February, 2005	3.00 - 5.00%	2030	112,395	112,395
Total certificates of participation			599,965	393,395
<b>Capitalized Leases:</b>				
<b>San Diego Regional Building Authority</b>				
Lease beginning September 2001	2.15 - 5.25%	2019	36,960	32,380
Third party financing leases with various beginning dates from August, 1997 to the present	4.24 - 8.00%	2007-2008	8,705	2,245
Total capitalized leases			45,665	34,625
<b>Other long-term obligations:</b>				
<b>Capital loans:</b>				
1997 United States Department of Agriculture	1.00%	2028	4,486	3,351
2002-2004 California Bank & Trust	7.75 - 8.75%	2007-2009	663	317
2003-2004 California Energy Commission	3.95 - 4%	2014-2015	3,648	3,648
Total Capital Loans			8,797	7,316
<b>Taxable Pension Obligation Bonds:</b>				
1994 Series A	4.7 - 6.6%	2007	430,430	60,790
2002 Series A, B & C	3.88 - 6.125%	2032	737,340	737,340
2004 Series A, B & C	3.28 - 5.86%	2024	454,113	454,113
Total Taxable Pension Obligation Bonds			1,621,883	1,252,243
1995 Redevelopment Agency Revenue Bonds	4.75 - 6.75%	2020	5,100	4,260
2001 San Diego County Tobacco Asset Securitization Corporation	4.00 - 6.00%	2043	466,840	430,350
Unamortized issuance premium			6,725	6,031
Unamortized issuance discount			(11,244)	(9,054)
Unamortized deferred amount on refunding			(23,231)	(12,103)
Compensated absences				76,669
Claims and judgments				103,569
Landfill closure and postclosure				47,891
Total other long-term obligations			2,074,870	1,907,172
Total governmental activities			\$ 2,720,500	2,335,192



# Notes to the Financial Statements

## (Amounts Expressed in Thousands Unless Otherwise Noted)



### Business-Type Activities:

Long-term obligations (Table 35) for business-type activities at June 30, 2005 were as follows:

**Table 35 (Note IV-I-1)**

Long-Term Obligations - Business-Type Activities				
	Interest Rate	Final Maturity Date	Original Amount	Amount Outstanding
Enterprise funds				
Capital loans:				
Department of Transportation				
Beginning March 2001	5.63%	2019	\$ 3,584	2,832
US Department of Agriculture				
Beginning December 2003	4.63%	2040	100	94
Compensated absences				324
Total business-type activities			\$ 3,684	3,250

## 2. Debt Service Requirements to Maturity

### Governmental Activities:

The following (Table 36) is a schedule of debt service requirements to maturity for *governmental activities'* long-term bond and note obligations outstanding at June 30, 2005. (The above table does not reflect the County's exposure to the interest rate swap on the 2002 Taxable Pension Obligation Bonds. See Interest Rate Swap disclosure below for further information.)

**Table 36 (Note IV-I-2)**

Governmental Activities - Debt Service Requirements To Maturity			
Fiscal year Ending June 30	Principal	Interest	Total
2006	\$ 59,342	100,892	160,234
2007	72,543	89,134	161,677
2008	59,654	85,821	145,475
2009	57,926	83,085	141,011
2010	58,492	83,166	141,658
2011-2015	244,716	396,629	641,345
2016-2020	319,344	327,191	646,535
2021-2025	460,473	230,100	690,573
2026-2030	278,232	160,239	438,471
2031-2035	227,415	97,220	324,635
2036-2040	101,505	60,642	162,147
2041-2043	147,922	21,461	169,383
Subtotal	2,087,564	1,735,580	3,823,144
Add:			
Unamortized issuance premium	6,031		
Less:			
Unamortized issuance discount	(9,054)		
Unamortized deferred amount on refunding	(12,103)		
Total	\$ 2,072,438		





*Business-Type Activities:*

Debt service requirements to maturity for *business-type activities'* capital loans obligations outstanding at June 30, 2005 (**Table 37**) were the following:

**Table 37 (Note IV-I-2)**

<b>Business-Type Activities -</b>			
<b>Debt Service Requirements to Maturity</b>			
<b>Fiscal Year Ending</b>	<b>Principal</b>	<b>Interest</b>	<b>Total</b>
<b>June 30</b>			
2006	\$ 181	163	344
2007	193	153	346
2008	206	142	348
2009	218	131	349
2010	231	119	350
2011-2015	1,342	385	1,727
2016-2020	487	53	540
2021-2025	13	14	27
2026-2030	17	11	28
2031-2035	21	7	28
2036-2040	17	2	19
<b>Total</b>	<b>\$ 2,926</b>	<b>1,180</b>	<b>4,106</b>

**3. Special Assessment Debt**

In July of 1991, the County issued \$28.804 million of bonds to finance the acquisition and construction of various public improvements required for the development of land located in north San Diego County west of Interstate 15 and the community of Rancho Bernardo. In July of 1997 the bonds were refunded. The County Treasurer-Tax Collector acts as an agent for property owners and bondholders in collecting and forwarding special assessment monies. The County is not obligated to pay for any special assessment bonds. Special assessment debt is solely the obligation of various separate governmental agencies. The amount of the 4-S Ranch special assessment debt outstanding for which the County is a fiduciary is \$16.9 million at June 30, 2005.

**4. Prior Year Defeasance of Long-Term Debt**

In prior years, the County defeased certain certificates of participation (COPs) and taxable pension obligation bonds by placing the proceeds of the original issue plus additional

County contributions in an irrevocable trust to provide for all future debt service payments on the old obligations. Accordingly, the trust account assets and the liability for the defeased obligations are not included in the County's financial statements. At June 30, 2005, \$86.4 million of bonds and COPs were legally defeased and remain outstanding.

**5. Advance Refunding of Long-Term Debt Including New Long-Term Debt**

In February 2005, the San Diego County Capital Asset Leasing Corporation issued \$112.395 million of fixed rate serial Certificates of Participation titled, 2005 Edgemoor Project and 1996 Regional Communications System Refunding (the "Certificates"). These certificates have maturity dates beginning in February 2006 with a final maturity of February 2030. Each maturity date carries a different fixed interest rate beginning in February 2006 at a fixed rate of 3 percent with fixed rates ranging to 5 percent. The face value of the new certificates attributed to refunding debt is \$28.885 million.

These certificates were issued with a premium of \$5.960 million. The \$118.355 million in proceeds of the Certificates along with approximately \$5.36 million of funds held by the 1996 Regional Communication System trustee were distributed as follows: 1) approximately \$77.486 million will be used to finance the construction of a skilled nursing facility to replace the existing County of San Diego skilled nursing facility located in the City of Santee; 2) approximately \$31.633 million was transferred to the refunded bond escrow agent to advance refund the entire \$29.51 million outstanding 1996 Regional Communications System Financing Certificates of Participation; 3) to fund a Reserve Fund in the amount of approximately \$3.181 million; 4) to fund capitalized interest in the amount of approximately \$9.5 million to fund a portion of the Certificates through July 1, 2007; and, 5) and to pay for certain costs of issuance of \$1.915 million incurred in connection with the

# Notes to the Financial Statements

## (Amounts Expressed in Thousands Unless Otherwise Noted)



Series 2005 Certificates. The \$31.633 million was used to purchase Treasuries and have been placed in an irrevocable trust with an escrow agent to provide for all future remaining debt service payments on the 1996 Regional Communications System Financing. As a result, the 1996 COPs are considered to be defeased and the liability for those bonds has been removed from the Government-wide Statement of Net Assets Governmental Activities Current and Non-Current. The advance refunding will result in reducing the County's debt service payments by \$2.4 million over the next 14 years to obtain an economic

gain (difference between the present values of the debt service payments on the refunded debt and refunding debt) of \$1.2 million.

### 6. Changes in Long-Term Obligations

Long-term obligation activity (Governmental Activities) for the year ended June 30, 2005 was as follows in **Table 38** below:

**Table 38 (Note IV-I-6)**

Long-Term Obligations - Governmental Activities					
	Beginning Balance at July 1, 2004	Additions	Reductions	Ending Balance at June 30, 2005	Amounts Due within One Year
<b>Bonds and notes payable:</b>					
Certificates of participation	\$ 344,365	112,395	(63,365)	393,395	35,710
Redevelopment Agency	4,400		(140)	4,260	150
San Diego County Tobacco					
Securitization Corporation	440,305		(9,955)	430,350	2,015
Taxable pension obligation bonds	1,268,878		(16,635)	1,252,243	20,960
Capital and retrofit loans	5,750	1,945 *	(379)	7,316	428
<b>Total Bonds and notes payable, before issuance discount and premiums and deferred amount on refunding</b>	<b>2,063,698</b>	<b>114,340</b>	<b>(90,474)</b>	<b>2,087,564</b>	<b>59,263</b>
<b>Unamortized issuance premium, discount and deferred amount on refunding:</b>					
Unamortized issuance premium	555	5,960	(484)	6,031	1,052
Unamortized issuance discount	(9,565)		511	(9,054)	666
Unamortized deferred amount on refunding	(14,072)	(2,123)	4,092	(12,103)	(4,895)
<b>Total bonds and notes payable</b>	<b>2,040,616</b>	<b>118,177</b>	<b>(86,355)</b>	<b>2,072,438</b>	<b>56,086</b>
<b>Other liabilities:</b>					
Capitalized leases	37,346	11 *	(2,732)	34,625	2,732
Arbitrage rebate	979	17	(996)		
Claims and judgments	97,789	48,748	(42,968)	103,569	43,251
Compensated absences	77,537	58,036	(58,904)	76,669	7,666
Landfill closure and postclosure	46,910	2,550	(1,569)	47,891	7,390
<b>Total other liabilities</b>	<b>260,561</b>	<b>109,362</b>	<b>(107,169)</b>	<b>262,754</b>	<b>61,039</b>
<b>Total governmental activities</b>	<b>\$ 2,301,177</b>	<b>227,539</b>	<b>(193,524)</b>	<b>2,335,192</b>	<b>117,125</b>

\* This includes loan additions recorded in Internal Service Funds.



## Notes to the Financial Statements (Amounts Expressed in Thousands Unless Otherwise Noted)

The following funds presented in **Table 39** below have typically been used to liquidate other long-term liabilities in prior years:

**Table 39 (Note IV-I-6)**

<b>Liquidated Liabilities</b>	
Liability	Fund(s) Used to Liquidate in Prior Years
Arbitrage Rebate	Debt Service Fund- SANCAL
Claims and Judgments	Internal Service Fund - Risk Financing
Compensated Absences	General Fund; Special Revenue Funds - County Library, Road, Cable TV and Air Pollution; Internal Service Funds - Facilities Management, Fleet Services and Purchasing
Landfill Closure and Postclosure	General Fund and Inactive Wastesites Fund

Long-term obligation activity (Business Activities) for the year ended June 30, 2005 was as follows in **Table 40** below:

**Table 40 (Note IV-I-6)**

<b>Long-Term Obligations - Business-Type Activities</b>					
	Beginning Balance at July 1, 2004	Additions	Reductions	Ending Balance at June 30, 2005	Amounts Due within One Year
<b>Enterprise Funds</b>					
Capital loans	\$ 2,998	100	(172)	2,926	181
Compensated absences	345	258	(279)	324	32
<b>Total business-type activities</b>	<b>\$ 3,343</b>	<b>358</b>	<b>(451)</b>	<b>3,250</b>	<b>213</b>

### J. Interest Rate Swap

To manage interest rate risk and lower the County's borrowing cost in its 2002 Taxable Pension Obligation Bonds, the County entered into an interest rate swap on September 17, 2002 with two counterparties. The swap converts the variable interest rates on several subseries of the 2002 Taxable Pension Obligation Bonds to a single long-term fixed rate that was lower than the "natural" fixed rate available at the time of the swap. The interest rate swap with Citibank N.A. (Citibank) and Morgan Stanley Capital Services (Morgan Stanley), (together the "counterparties") is governed by the International Swaps and Derivatives Association, Inc. Master Agreement (the Agreement) and a Confirmation. In fiscal year 2002-2003, the County issued \$737.340 million of Pension Obligation Bonds of which \$505.125 million of the Series B Bonds are Auction Rate Securities. Within the Series B Auction Rate Securities there are the following subseries: \$100 million of Series B-1, \$135.025 million of Series B-2, \$135.05 million Series of B-3

and \$135.05 million of Series B-4 bonds. The County swapped Series B-2, B-3 and B-4 totaling \$405.125 million of the Auction Rate Securities for a contractually agreed fixed interest rate of 5.30%. Of the \$405.125 million our exposure with Citibank is \$263.325 million and our exposure with Morgan Stanley is \$141.8 million notional.

Further details concerning this interest rate swap are the discussed below:

#### I. Terms

County payments are due to bondholders semi-annually on August 15 and February 15, beginning February 15, 2003. The effective date of the swap was September 17, 2002 and the initial six-month calculation period began February 15, 2003. The Agreement and the Confirmation terminate on February 15, 2031 and the series B-2, B-3 and B-4 bonds mature on August 15, 2030. The County did not receive any upfront payments but pursuant to the terms of the Agreement, each August 15 and February 15 the County will receive an amount from each of the counterparties based on the



notional amount of principal outstanding for the past six months at an interest rate of one month London Interbank Offered Rate (LIBOR) and each February 15 the County will pay the counterparties the scheduled 5.30% of the notional amount outstanding. The February 15 payment due from the counterparties will be netted against the 5.30% County payment. The notional amount of the swap will begin to decline in fiscal year 2016-2017 in direct proportion to the repayment of the bonds.

The obligations of the County to make payments to the counterparties under this Agreement constitute general obligations of the County, payable from taxes, income, revenue cash receipts and other moneys of the County legally available therefore in the General Fund. The payments due to the counterparties and the obligations of the County under this Agreement do not constitute any kind of indebtedness of the County as defined under and/or proscribed by any constitution, charter, law, rule, regulation, government code, constituent or governing instrument, resolution, guideline, ordinance, order, writ, judgment decree, or ruling.

As of June 30, 2005, the swap created a synthetic fixed rate for the bonds as noted in **Table 41** below:

**Table 41 (Note IV-J-1)**

Interest Rate Swap - Synthetic Fixed Rate		
	Terms	Rates
Fixed Rate to Counterparty	Fixed	5.30%
Variable Rate from Counterparty	1 month LIBOR	(3.340)%
Net Interest Rate Swap Payments		1.960%
Average Auction Rate Bond Coupon Payments		3.153%
Synthetic Interest Rate on Bonds		5.113%

**2. Fair Value**

As of June 30, 2005 the swaps had a mark to market fair value of \$(39.3) million. The mid-market or indicative unwind valuation was

derived from a proprietary model using the zero coupon method. This model takes into consideration estimates about relevant present and future market consideration as well as the size and liquidity of the position and any related actual or potential hedging transaction.

The primary risks associated with this transaction are: Credit Risk, Termination Risk, and Basis Risk.

**3. Credit Risk**

As of June 30, 2005 the County was not exposed to credit risk because the swap had a negative mark to market fair value of \$39.3 million. However, should interest rates change and the fair value of the swap becomes positive the County would be exposed to credit risk in the amount of the swap's fair value. Citibank is rated Aa1/AA/AA+ by Moody's, Standard & Poors and Fitch, respectively and Morgan Stanley is rated Aa3/A+/AA- by Moody's, Standard & Poor's and Fitch, respectively. Pursuant to the Agreement if the rating issued by Standard & Poors or Moody's of the senior unsecured debt obligations of the counterparties is suspended or withdrawn or falls below "A-" in the case of Standard & Poors or below "A3" in the case of Moody's, collateral is to be delivered to a third party.

**4. Termination Risk**

The Agreement includes standard termination events such as failure to pay, bankruptcy and early termination. For this transaction, the swap and bond maturities match and carries an Interest Rate Swap Insurance Policy by MBIA Insurance Corporation (MBIA). If the Agreement is terminated for any of the conditions in the agreement, and at the time of the termination the swap has a negative fair value, the County would be liable to the counterparties for a payment equal to the swap's fair value. The swap can be terminated by the County for market value at any time. As of June 30, 2005 the fair value of the swap is a



# Notes to the Financial Statements

## (Amounts Expressed in Thousands Unless Otherwise Noted)

\$(39.3) million. Value is predominantly tied to changes in the market for the fixed swap rate for the remaining swap term.

### 5. Basis Risk

The County's exposure to basis risk arises when the one-month LIBOR rate index received from the counterparties may be less than the applicable auction rate that is being paid to the bondholders, that is the cash flow being received by the counterparty is not equal to the cash flow being paid to the variable rate bondholder. By using one month LIBOR, the County's objective is to mitigate the effect of the differential between the swap index and the bondholder variable rate. For fiscal year 2004-2005, the differential was \$(68) thousand.

### 6. Swap Payments and Associated Debt

As of June 30, 2005, debt service requirements of the variable-rate debt and net swap payments, *assuming current interest rates remain the same*, for their term are presented in **Table 42**. As rates vary, variable rate bond interest payments and net swap payments will vary.

**Table 42 (Note IV-J-5)**

Swap Payments Associated with Debt				
Fiscal Year Ending June 30	Principal	Interest (3.153%)	Interest Rates Swaps, Net (1.96%)	Total
2006		12,774	7,940	20,714
2007		12,774	7,940	20,714
2008		12,774	7,940	20,714
2009		12,774	7,940	20,714
2010		12,774	7,940	20,714
2011-2015		63,870	39,700	103,570
2016-2020	\$ 79,625	59,021	36,688	175,334
2021-2025	128,100	41,671	25,904	195,675
2026-2030	169,500	18,359	11,412	199,271
2031-2033	27,900	440	273	28,613
<b>Total</b>	<b>\$ 405,125</b>	<b>247,231</b>	<b>153,677</b>	<b>806,033</b>

### K. Landfill Site Closure and Postclosure Care Costs

State laws and regulations require the placement of final covers on all landfill sites that stopped accepting solid waste after October 9, 1991 and the performance of certain maintenance and monitoring functions at these sites for a minimum of 30 years after closure. Closure and postclosure care costs are paid near or after the date a landfill stops accepting waste. The San Marcos Landfill is the sole waste disposal site owned by the County that is subject to these regulations. It was operational and accepted solid waste from 1979 until March 11, 1997. The formal closure of this landfill is expected to span from July 2004 through February 2006. Once closure is complete, post closure maintenance will begin.

The County is required by GASB Statement No. 18, "Accounting for Municipal Solid Waste Landfill Closure and Postclosure Care Costs", to report the projected closure and postclosure care costs as of each balance sheet date. The projected landfill closure and postclosure care liability at June 30, 2005 for the San Marcos Landfill was \$47.891 million. This estimated amount is based on what it would cost to perform all closure and postclosure care in calendar year 2005 dollars and is subject to change as a result of such factors including but not limited to: inflation; deflation; advancements in technology; and amendments to laws and regulations.

In addition to the above, state regulations require that landfill closure and postclosure maintenance costs be fully funded at the time of closure, unless a landfill owner/operator can demonstrate financial responsibility towards these activities by using other approved financial assurance alternatives. A pledge of revenue is one of various alternatives allowed to fund estimated postclosure costs. Under this alternative, the Board of Supervisors, on February 3, 1998, approved Minute Order No. 5 "Postclosure Maintenance Funding for the San





Marcos Landfill", wherein the County entered into a pledge of revenue agreement with the California Integrated Waste Management Board (CIWMB). Pursuant to Resolution No. 98-24, adopted under Minute Order No. 5, the Board exacted that the amount of pledged revenue shall be equal to \$790 thousand per year for the 30 year period of postclosure maintenance commencing upon completion of the final closure of the San Marcos Landfill. The pledged amount is a promise of existing funds rather than future revenues and may increase or decrease to match any adjustment to identified cost estimates that are mutually agreed to by the County and the CIWMB.

As of June 30, 2005, \$25.72 million of the Net Assets of the Government-Wide Statement of Net Assets has been restricted for closure costs of the San Marcos Landfill.

Regulations governing solid waste management are promulgated by government agencies on the federal and state levels. These regulations address the design, construction, operation, maintenance, closure and postclosure maintenance of various types of facilities; acceptable and prohibited waste types; and inspection, permitting, environmental monitoring and solid waste recycling requirements. Regulations at both the state and federal levels could impose retroactive liability, particularly with respect to cleanup activities relating to any landfill site ever operated by the County, whether or not owned by the County. Thus, the County has potential liability with respect to every landfill ever owned, operated, contracted to be operated, or into which the County disposed waste. Compliance with these regulations may be costly, and, as more stringent standards are developed to protect the environment, these costs could increase.

## L. Fund Balances Reserved For Other Purposes

At June 30, 2005, the fund balances reserved for other purposes (**Table 43**) were as follows:

**Table 43 (Note IV-L)**

<b>Fund Balances Reserved For Other Purposes</b>	
<b>General Fund</b>	
General Government	\$ 70,259
Public Protection	31,880
Health and Sanitation	19,415
Public Assistance	4,491
Education	1,138
Recreational and Cultural	1,033
<b>Total General Fund</b>	<b>\$ 128,216</b>
<b>Special Revenue Funds</b>	
Road-Future Road Improvements	\$ 22,862
Lighting Maintenance	16
County Library	86
County Service Districts-Advances	1,365
Flood Control-Future Drainage Improvements	17,220
Housing Authority-Escrow payment	25
Tobacco Securitization	231
<b>Total Special Revenue Funds</b>	<b>\$ 41,805</b>
<b>Capital Projects Funds</b>	
Edgemoor capital projects	\$ 250
Redevelopment Agency-Advances	1,002
<b>Total Capital Projects</b>	<b>\$ 1,252</b>





## V. Other Information

### A. Risk Management

The County operates a Risk Management Program, whereby it is self-insured for premises liability at medical facilities, medical malpractice, errors and omissions, false arrest, forgery, general liability and workers' compensation. The County purchases insurance for property damage, certain casualty claims, public officials bond, employee dishonesty, faithful performance, volunteers, airport comprehensive, and loss of money and securities based upon site locations. Settlements in the areas covered have not exceeded insurance coverage for each of the past three fiscal years. The County's Internal Service Fund (ISF) is used to report all of its uninsured risk management activities. Risk management liabilities are reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. Actuarial evaluations were obtained which determine estimates of known and projected public liability and workers compensation claim liabilities. At June 30, 2005, the amount of these liabilities, including an estimate for claims incurred but not reported and allocated and unallocated loss adjustment expenses was estimated at \$103.6 million, including \$17.5 million in public liability and \$86.1 million in workers' compensation. The County began allocating the cost of providing claims service to all its operating funds as a "premium" charge expressed as a percentage of payroll beginning fiscal year 1996-1997. Changes in the balances of claim liabilities for fiscal year 2003-2004 and 2004-2005 are shown in **Table 44** below:

**Table 44 (Note V-A)**

<b>Risk Management - Changes in Claim Liabilities</b>				
Fiscal Year	Beginning Balance at June 30	Current- Year Claims and Changes in Estimates	Claim Payments	Ending Balance at June 30
2003-2004	\$ 100,588	29,096	(31,895)	97,789
2004-2005	97,789	42,968	(37,188)	103,569

### B. Subsequent Events

#### 1. Tax and Revenue Anticipation Notes

In July 2005, the County issued tax and revenue anticipation notes (TRANS) totaling \$250 million due July 14, 2006 at a coupon rate of 4.00% and net interest cost of 2.58%. Proceeds from the notes will be used to meet fiscal year 2005-2006 cash flow requirements. Fiscal year 2005-2006 unrestricted revenues collateralize the notes.

#### 2. San Diego County Capital Asset Leasing Corporation

In August 2005, the San Diego County Capital Asset Leasing Corporation (SANCAL) issued \$28.21 million of fixed rate serial Certificates of Participation titled, "North and East County Justice Facility Refunding (the "Certificates")." These certificates have maturity dates beginning in November 2006 with a final maturity of November 2019. Each maturity date carries a different fixed interest rate beginning in November 2006 at a fixed rate of 3.25 percent with fixed rates ranging to 5 percent. These certificates were issued with a premium of \$1.3 million. The proceeds were applied to 1) advance refund all of the outstanding certificates of participation for the 1996 North County Regional Center Expansion and East County Courthouse Detention Facility Conversion, 2) fund a reserve fund; and, 3) pay certain costs of issuance incurred in connection with the refunding.



## **C. Contingencies**

### **1. Litigation**

In addition to the accrued liability for litigation and workers compensation claims described in Note V-A, the County has a potential liability of \$34.9 million that could result if unfavorable final decisions were rendered in numerous lawsuits to which the County is a named defendant. Appropriations are budgeted annually for those portions of obligations coming due that fiscal year. Estimates of potential liabilities described above include estimates of claims incurred but not reported at June 30, 2005.

### **2. Unrecorded Leave Benefits**

County employees have unrecorded accumulated benefits of approximately \$129.5 million in sick leave and compensatory time. These benefits are not payable to employees upon termination and are normally liquidated in future years as employees elect to use their benefits as prescribed by Civil Service rules and regulations. Accumulated vacation, sick leave, and compensatory time-off for which employees are eligible for payment upon separation have been recorded as current or long-term liabilities in the appropriate proprietary funds and the statement of net assets.

### **3. Federal and State Programs**

Amounts received or receivable from grant agencies are subject to audit and adjustment by grantor agencies, principally the federal government. Any disallowed claims, including amounts already collected, may constitute a liability of the applicable funds. The amount, if any, of expenditures that may be disallowed by the grantor cannot be determined at this time, although the County expects such amounts, if any, to be immaterial.

## **D. Jointly Governed Organizations**

The County Board of Supervisors jointly governs the Service Authority for Freeway Emergencies (S.A.F.E.). San Diego S.A.F.E. is governed by a seven-member board, whose members are appointed by the County Board of Supervisors and the eighteen cities within the county. The purpose of the authority is to provide for freeway emergency call boxes on major freeways within the County. Funding for the authority is provided by a \$1 dollar yearly fee on vehicle registrations in San Diego County, which are collected by the State and deposited into the County Treasury. The County provides minimal administrative staff support for the S.A.F.E. authority.

The County Board of Supervisors and the San Diego City Council jointly govern the San Diego Workforce Partnership (Partnership). The Partnership's Board of Directors consists of two members of the County Board of Supervisors, two members from the San Diego City Council and one member of a charitable organization. The purpose of the Partnership is to provide employment training to area residents. Funding for such training is provided by State and Federal grants.

The County also jointly governs the San Dieguito River Valley Authority, the Serra Cooperative Library System, Southern California Regional Training and Development Center, and the Van Horn Regional Treatment Facility. The governing boards of these entities consist of representatives from the County and/or other regional governments and other counties. The County does not appoint a voting majority to the above boards. Services provided by these entities include park land acquisition, coordination of library services, regional governmental training, and treatment of emotionally disturbed youth.





## **E. Joint Venture**

The County is a participant with eighteen incorporated cities in a joint venture to operate an emergency services organization for the purpose of providing regional planning and mutual assistance in the event of an emergency or disaster in the region including accidents involving hazardous waste. The organization is governed by the Unified Disaster Council composed of one voting member from each represented jurisdiction. A contractual agreement requires that the cities provide one-half of the total required funding each year. The County, by agreement, also provides one-half of the required yearly funding. Any participant may terminate participation in the agreement by giving 120 days notice prior to the beginning of the next fiscal year. Total participant contributions for fiscal year 2004-2005 were \$1.3 million. The organization had a cumulative surplus of \$32 thousand at June 30, 2005. Separate financial statements for the joint venture may be obtained from the office of the Auditor and Controller.

## **F. San Diego County Employees Retirement System**

### **I. Plan Description**

The SDCERA administers a cost-sharing, multi-employer defined benefit plan, with County members representing 93.4% of covered employees, which provides retirement, disability, and death benefits for plan members and beneficiaries pursuant to the County Retirement Law of 1937, as enacted and amended by the State legislature. The plan is integrated with the Federal Social Security System. Cost-of-living adjustments are provided to members and beneficiaries at the discretion of the SDCERA Board of Retirement. SDCERA issues a publicly available financial report that includes financial statements and required supplementary information for the pension plan. The financial report may be obtained by writing

to the San Diego County Employees Retirement Association, 401 West A Street, Suite 1300, San Diego, California 92101 or by calling (619) 515-0130.

## **2. Basis of Accounting, Estimates and Fair Value of Investments**

### **a. Measurement Focus and Basis of Accounting**

SDCERA's operations are accounted for on an economic resources measurement focus and the accrual basis of accounting. Employer and member contributions are recognized when due pursuant to formal commitments, as well as statutory or contractual requirements. Investment income is recognized as revenue when earned. Retirement benefits and refunds are recognized when due and payable in accordance with the terms of the Plan. Other expenses are recognized when the corresponding liabilities are incurred. The net appreciation/(depreciation) in fair value of investments held by SDCERA is recorded as an increase/(decrease) to investment income based on the valuation of investments.

### **b. Estimates**

A number of estimates and assumptions have been made relating to the reporting of assets and liabilities, the disclosure of reserves and designation of plan assets to prepare these financial statements in conformity with accounting principles generally accepted in the United States of America. Actual results could differ from those estimates.

### **c. Fair Value of Investments**

Please refer to details contained in Note IV. A. 2. b. (IV Detailed Notes on all Funds; A. Deposits and Investments; 2. Investments Outside the Pool; b. Pension Trust Fund.)

## **3. Funding Policy**

State statutes require member contributions to be actuarially determined to provide a specific statutory level of benefit. Member contribution



rates, as a percentage of salary, vary according to age at entry, benefit tier level, and certain negotiated contracts which provide for the County to pay a portion of the employees' contribution. Member contribution rates (weighted average), in effect at June 30, 2005, expressed as a percentage of salary are 8.92%-9.49% for general members and 11.31% for safety members. The County is also required by State statutes to contribute at an actuarially determined rate, expressed as a percentage of annual covered payroll. The fiscal year 2004-2005 rates, expressed as a percentage of covered payroll, are 25.59% for general members and 34.99% for safety members. Additionally, in accordance with various agreements with employee bargaining units, the County has contributed \$20.3 million on behalf of employees.

In March 2002, the County implemented a new enhanced retirement package. In October 2002, the County issued taxable Pension Obligation Bonds to fund a portion of its statutory obligations arising from enhanced benefits. In June 2004, the County issued Pension Obligation Bonds and transferred \$450 million of the issuance to the retirement fund. The retirement plan's funding status (the ratio of system assets to system liabilities) was 80.3% at June 30, 2005.

**4. Annual Pension Cost**

For the fiscal year ended June 30, 2005, the County's annual pension cost was \$264.8 million. The County's actual contribution during the fiscal year ended June 30, 2005 totaled \$264.8 million, resulting in a net pension obligation of zero as of June 30, 2005, compared to zero at the end of the prior year. Additionally, in Fiscal Year 2004-05, the County contributed \$24.866 million to SDCERA to pay down the Unfunded Actuarial Accrued Liability, increase the funded ratio and reduce the County's future contributions. The required contribution rates, as adopted by the SDCERA Board, were determined as part of the June 30, 2003 interim

actuarial valuation based on entry-age actuarial cost method. The actuarial assumptions included (a) an 8.25% investment rate-of-return, (b) projected salary increases of 5.0% per year, and (c) cost-of-living increases for retirees of 3%.

**5. Three-Year Trend Information**

The following trend information concerning annual pension costs and the percentage of annual pension costs contributed for the last three fiscal years is included in **Table 45** below:

**Table 45 (Note V-F-5)**

<b>Three-Year Trend Information</b>			
Fiscal Year Ended June 30	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation
2003	\$ 6,538	100.00%	\$ 0
2004	194,580	100.00%	0
2005	264,816	100.00%	0

**6. Retiree Health Benefits**

Retiree health benefits may be available to eligible retirees to the extent that the Board of Retirement annually approves the payment of such benefits. SDCERA recognizes the cost of providing those benefits by expending annual insurance premiums, which approximated \$32.6 million for fiscal year 2004-2005.

The Board of Supervisors and the Board of Retirement adopted a funding mechanism under Section 401(h) of the Internal Revenue Code, which calls for a portion of the County's contributions to be deposited to a separate health benefits 401(h) account each year. Any investment income earned on the account balance increases the balance and any losses reduce it.

The reserve for health benefits, established by the SDCERA Board of Directors, designates funds that may be used for future payments under the retiree health benefits program and related administrative expenses. The reserve for health benefits was approximately \$193.8 million at June 30, 2005, a \$36.7 million decrease from the previous fiscal year.



## G. Restatement of Beginning Net Assets Balance

### I. First 5 Commission

The beginning net asset balance of the First 5 Commission was restated as shown in **Table 46** below in the amount of \$1.333 million resulting from 1.) An adjustment of prior year mark to market unrealized loss of \$1.281 million and 2.) Unrecognized compensated absences of \$52 thousand in the prior year.

**Table 46 (Note V-G)**

Restatement	
Net Asset balance as of June 30, 2004	\$ 169,522
Adjustment for restatement	1,333
Net Asset balance, restated June 30, 2004	\$ 170,855

## H. Commitments

### I. Third Party Debt

The tax code allows for certain types of nongovernmental borrowers to take advantage of tax-exempt financing through a governmental agency. The County of San Diego as a governmental agency, has issued tax-exempt debt on behalf of qualified borrowers. The County of San Diego is not responsible for the repayment of the debt. Accordingly, no liability for these bonds has been recorded in the statement of net assets.

#### a. Mortgage Revenue Bonds

Mortgage Revenue Bonds are issued to provide construction and permanent financing to developers of multi-family residential rental projects located in the County to be partially occupied by persons of low or moderate income. Between 1995 and 2002, the County issued \$14 million of Mortgage Revenue Bonds of which \$12.2 million were still outstanding as of June 30, 2005.

### b. Certificates of Participation

The County has implemented a conduit program whereby the County is the issuer of tax-exempt bonds and loans, where the proceeds are provided to a qualifying for profit or nonprofit organization. The County has no obligation to pay for the bonds and loans. The original amounts of Certificates of Participation issued as well as the amounts outstanding per issue at June 30, 2005 are as follows in **Table 47**:

**Table 47 (Note V-H-5)**

Certificates of Participation - Conduit Program			
	Date Issued	Original Amount Issued	Amount Outstanding at June 30, 2005
Sharp Hospital	April 1998	\$ 112,020	101,575
San Diego Natural History Museum	December 1998	15,000	13,800
Burnham Institute	September 1999	51,500	42,500
San Diego Museum of Art (principal due at maturity)	March 2000	6,000	6,000
Salk Institute	April 2000	15,000	14,305
University of San Diego	May 2001	36,870	34,500
San Diego-Imperial Counties Developmental Services	September 2002	10,750	10,250
Chabad Jewish Academy (principal due at maturity)	January 2003	11,700	11,410
San Diego Jewish Academy (principal due at maturity)	December 2003	13,325	13,325
Bishop School	June 2004	25,000	25,000
Museum of Contemporary Art	December 2004	13,000	13,000
<b>Total</b>		<b>\$ 310,165</b>	<b>285,665</b>

### c. Reassessment District Improvement Bonds

Reassessment District Improvement Bonds were issued to provide refunding an earlier issuance of improvement bonds for the 4-S Ranch assessment district. The District originally issued \$28.8 million of Improvement Bonds in July 1991 to finance the acquisition of certain infrastructure improvements specially benefiting properties within an assessment district. In July 1997, the District issued \$21.8 million of



Reassessment Bonds to refund the original issuance, of which \$16.9 million were still outstanding as of June 30, 2005.

## **2. Deposits for Other Agencies**

The Treasurer is a named paying agent for various bonds issued by other agencies, e.g., school districts, pursuant to the bond covenants. The proceeds from these issues are deposited in the County pool or as specified in the bond resolution. The amounts deposited belong to the specific agency which issued the bonds and are not assets of the County. The County has no liability with respect to these issues, the repayment of these bonds are from ad valorem taxes levied on the properties in the school district.

## **1. New Governmental Accounting Standards**

### **1. Implemented**

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. In Fiscal Year 2004-2005, the County implemented these new reporting requirements.

### **2. Under Analysis**

The County 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 County'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 County's fiscal year ending June 30, 2007.

In May 2004, GASB issued Statement No. 44, *Economic Condition Reporting: The Statistical Section-an amendment of NCGA Statement 1*. This statement amends the portions of NCGA Statement 1, *Governmental Accounting and Financial Reporting Principles* that guide the preparation of the statistical section. The statistical section presents detailed information, typically in ten-year trends, that assists users in utilizing the basic financial statements, notes to basic financial statements, and required supplementary information to assess the economic condition of a government. This statement adds new information that financial statement users have identified as important



## Notes to the Financial Statements (Amounts Expressed in Thousands Unless Otherwise Noted)

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and eliminates certain previous requirements. This statement is effective for the County's fiscal year ending June 30, 2006.

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 County's fiscal year ending June 30, 2008.

In December 2004, GASB issued Statement No. 46, *Net Assets Restricted by Enabling Legislation - an amendment of GASB Statement No. 34*. This Statement requires that limitations on the use of net assets imposed by enabling legislation be reported as restricted net assets. A legally enforceable enabling legislation restriction is one that a party external to the County - such as citizens, public interest groups, or the judiciary - can compel a government to honor. This Statement is effective for the County's fiscal year ending June 30, 2006.

In June 2005, GASB issued Statement 47, *Accounting for Termination Benefits*. This Statement establishes accounting standards for termination benefits. This Statement requires employers to disclose a description of the termination benefit arrangement, the cost of the termination benefits (required in the period in which the employer becomes obligated if that information is not otherwise identifiable from information displayed on the face of the financial statements), and significant methods and assumptions used to determine termination benefit liabilities. The requirements of this Statement are effective in two parts. For termination benefits other than those provided through an existing defined OPEB plan, this Statement is effective for the County's fiscal year ending June 30, 2006. For termination benefits provided through an existing defined benefit OPEB plan, the provisions of this Statement should be implemented simultaneously with the requirements of Statement 45, and are therefore effective for the County's fiscal year ended June 30, 2008.







## Required Supplementary Information

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**Required Supplementary Information**



**SCHEDULE OF REVENUES, EXPENDITURES, AND  
CHANGES IN FUND BALANCE-BUDGET AND ACTUAL  
General Fund  
For the Year Ended June 30, 2005  
(In Thousands)**

	Budgeted Amounts		Actual
	Original Budget	Final Budget	
Revenues:			
Taxes	\$ 617,776	617,776	671,850
Licenses, permits and franchise fees	31,876	31,876	32,015
Fines, forfeitures and penalties	68,608	70,699	51,000
Revenue from use of money and property	20,256	26,528	29,308
Aid from other governmental agencies:			
State	679,480	711,555	511,769
Federal	525,730	526,124	620,477
Other	64,491	72,710	60,415
Charges for current services	244,438	252,339	254,585
Other revenue	42,618	39,915	38,057
<b>Total revenues</b>	<b>2,295,273</b>	<b>2,349,522</b>	<b>2,269,476</b>
Expenditures:			
Current:			
General:			
Board of supervisors district #1	983	1,180	973
Board of supervisors district #2	1,010	1,139	966
Board of supervisors district #3	971	1,102	1,027
Board of supervisors district #4	986	1,151	920
Board of supervisors district #5	1,071	1,404	1,035
Board of supervisors general office	935	935	808
Clerk of the board of supervisors - legislative and administrative	2,423	2,501	1,955
Chief Administrative office - legislative and administrative	4,037	4,068	3,778
Community services	5,596	8,738	2,166
Public safety - legislative and administrative	6,732	16,870	8,987
Land use and environment - legislative and administrative	5,630	4,899	2,697
Financing and general government - Legislative and administrative	17,870	21,346	16,091
Auditor and controller	25,778	27,260	24,636
Countywide general expense	20,455	43,052	27,627
Assessor/recorder/county clerk - finance	31,821	31,834	29,148
Treasurer/tax collector	15,559	14,306	13,625
County counsel	18,278	18,431	17,919
Civil service commission	397	495	457
Human resources - personnel	15,369	14,291	12,993
Registrar of voters	9,483	12,350	12,220
Clerk of the board of supervisors - property management	3,065	2,990	2,827
CAC major maintenance	1,122	904	904
Contributions to capital outlay	4,826	6,989	3,117
Community enhancement	3,013	3,007	3,007
Community projects	11,513	5,207	5,207
Human resources - other general government	3,597	3,497	3,370
County technology office	6,908	6,658	6,120
Contingency reserve	15,600	15,600	
<b>Total general</b>	<b>235,028</b>	<b>272,204</b>	<b>204,580</b>
Public protection:			
Grand jury	509	507	468
Defense attorney/contract administration	8,098	11,022	10,026
Contributions for trial courts	68,266	76,083	75,674
District attorney-judicial	102,562	103,501	99,770
Public defender	42,887	43,615	42,230
Alternate public defender	12,975	13,216	11,915
Judicial - other budgetary entity	22,458	23,353	
Citizens law enforcement review board	513	525	442
Sheriff - police protection	261,147	273,456	263,189
Probation - police protection		2,399	2,399
Sheriff - detention and correction	23	14	1
Probation - detention and correction	98,351	96,350	92,357

See notes to required supplementary information





**SCHEDULE OF REVENUES, EXPENDITURES, AND  
CHANGES IN FUND BALANCE-BUDGET AND ACTUAL  
General Fund  
For the Year Ended June 30, 2005  
(In Thousands)**

(Continued)	Budgeted Amounts		Actual
	Original Budget	Final Budget	
Public works, flood control, soil and water, general	1,965	945	945
Agriculture weights and measures	11,924	13,148	12,295
Land use and environment - other protection	1,071	652	558
LAFCO administration	226	226	226
Office of emergency services	17,891	21,797	5,852
Assessor/recorder/county clerk - other protection	13,290	15,331	15,331
Health and human services agency - other protection	3,035	3,034	2,961
Medical examiner	6,486	6,491	6,277
Department of animal services	10,622	10,699	10,494
Planning and land use	41,586	33,515	25,129
Public works, general - other protection	23,125	4,391	4,391
Child support	53,851	53,850	51,047
Sheriff - adult detention	173,538	168,439	163,410
Probation - adult detention	593	814	814
Probation - juvenile detention	31,508	30,551	30,160
<b>Total public protection</b>	<b>1,008,500</b>	<b>1,007,924</b>	<b>928,361</b>
Public ways and facilities:			
Public works, general - public ways	5,800	4,348	4,348
<b>Total public ways and facilities</b>	<b>5,800</b>	<b>4,348</b>	<b>4,348</b>
Health and sanitation:			
Health and human services agency - mental health	181,112	180,301	166,949
Environmental health	30,120	31,090	27,679
Health and human services agency - health	119,712	120,191	107,530
Public works, general - sanitation	4,417	13,633	13,374
Health and human services agency - medical care	132,187	130,004	126,732
Health and human services agency - California children services	15,368	15,370	14,515
Health and human services agency - health administration	47,897	47,376	42,692
<b>Total health and sanitation</b>	<b>530,813</b>	<b>537,965</b>	<b>499,471</b>
Public assistance:			
Health and human services agency - social administration	670,292	663,632	607,457
Probation - care of court wards	11,493	10,055	7,522
Health and human services agency - other assistance	192,784	200,740	198,919
Housing Authority	11,554	11,441	9,029
Health and human services agency - aid programs	53,496	53,496	35,560
<b>Total public assistance</b>	<b>939,619</b>	<b>939,364</b>	<b>858,487</b>
Education:			
Farm and home advisor	989	1,086	597
<b>Total education</b>	<b>989</b>	<b>1,086</b>	<b>597</b>
Recreation and cultural:			
Parks and recreation	25,203	22,758	18,300
<b>Total recreational and cultural</b>	<b>25,203</b>	<b>22,758</b>	<b>18,300</b>
Capital outlay	62,345	21,087	17,928
Debt service:			
Interest and other fiscal charges	7,085	13,353	12,310
<b>Total expenditures</b>	<b>2,815,382</b>	<b>2,820,089</b>	<b>2,544,382</b>
Excess of revenues over (under) expenditures	(520,109)	(470,567)	(274,906)
Other financing sources (uses):			
Long-term debt proceeds	25	25	
Transfers in	511,493	521,330	568,677
Transfers out	(208,474)	(182,848)	(179,228)
<b>Total other financing sources (uses)</b>	<b>303,044</b>	<b>338,507</b>	<b>389,449</b>
<b>Net change in fund balance</b>	<b>(217,065)</b>	<b>(132,060)</b>	<b>114,543</b>
Fund balances at beginning of year	217,065	551,000	551,000
Increase (decrease) in:			
Reserve for inventory of materials and supplies		1,854	1,854
<b>Fund balances at end of year</b>	<b>\$</b>	<b>420,794</b>	<b>667,397</b>

See notes to required supplementary information



**SCHEDULE OF REVENUES, EXPENDITURES, AND  
CHANGES IN FUND BALANCE-BUDGET AND ACTUAL  
Tobacco Securitization Special Revenue Fund  
For the Year Ended June 30, 2005  
(In Thousands)**

(Continued)	Budgeted Amounts		Actual
	Original Budget	Final Budget	
Revenues:			
Revenue from use of money and property	\$		8,810
Total revenues			8,810
Expenditures:			
Current:			
General:			
Tobacco Settlement	3,634	3,205	
Total general	3,634	3,205	
Total expenditures	3,634	3,205	
Excess of revenues over (under) expenditures	(3,634)	(3,205)	8,810
Other financing sources (uses):			
Transfers out	(23,666)	(24,095)	(23,278)
Total other financing sources (uses)	(23,666)	(24,095)	(23,278)
Net change in fund balance	(27,300)	(27,300)	(14,468)
Fund balances at beginning of year	27,300	346,727	346,727
Fund balances at end of year	\$	319,427	332,259

See notes to required supplementary information



### Budgetary Information

#### General Budget Policies

An operating budget is adopted each fiscal year by the Board of Supervisors for the governmental funds. The annual resolution adopts the budget at the object level of expenditures within departments. Annual budgets are not required to be adopted for: the Tobacco Securitization Joint Special Revenue Fund; SANCAL, a non-profit corporation, and the Debt Service and Capital Projects Funds (other governmental funds). Certain annual appropriations are budgeted on a project or program basis. If such projects or programs are not completed at the end of the fiscal year, unexpended appropriations, including encumbered funds, are carried forward to the following year with the approval of the Board of Supervisors.

Appropriations may also be adjusted during the year with the approval of the Board of Supervisors. Additionally, the Chief Financial Officer is authorized to approve certain transfers and revisions of appropriations within a department. Such adjustments are reflected in the final budgetary data. Accordingly, the legal level of budgetary control by the Board of Supervisors is the department level.

The reduction in appropriations during the year ended June 30, 2005, amounted to \$20.919 million in the General Fund.

The Schedule of Revenues, Expenditures, And Changes In Fund Balance - Budget and Actual for the General Fund and the Tobacco Securitization Special Revenue Fund presented as Required Supplementary Information were prepared using the Generally Accepted Accounting Principles (GAAP) basis.

The Original Budget column consists of the Fiscal Year 2004-05 adopted budget plus the budget carried forward from Fiscal Year 2003-04. As such, the County has included encumbrances that are subject to automatic re-appropriation as part of the original budget. Also, the original budget is adjusted to reflect reserves, transfers, allocations, and supplemental appropriations that occur prior to the start of the fiscal year. The County adopts its budget subsequent to the start of the each new fiscal year (August 17, 2004). Therefore, under the circumstances, the complete budget that is adopted by the County Board of Supervisors constitutes the adopted budget, plus the approved carry forward for purposes of budgetary comparison presentation.

The Final Budget column consists of the Original Budget column plus amended budget changes occurring during Fiscal Year 2004-05 plus technical amendments that occur after the close of the fiscal year less the amount of budget carried forward to Fiscal Year 2005-06.

The Actual column represents the actual amounts of revenue and expenditures reported on a GAAP basis which is the same basis that is used to present the aforementioned Original and Final Budget.



**Schedule of Funding Progress**

San Diego County Employees Retirement Association  
 Schedule of Funding Progress (In millions) (Unaudited)

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) Entry Age (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
6/30/2003	\$ 4,417.7	\$ 5,853.1	\$ 1,435.4	75.5%	\$ 906.1	158.4 %
6/30/2004	5,166.8	6,369.5	1,202.7	81.1	917.1	131.1
6/30/2005	5,612.3	6,990.7	1,378.4	80.3	921.8	149.5

## APPENDIX C

### SUMMARY OF THE TRUST AGREEMENT

The following is a summary of certain provisions contained in the Trust Agreement and is not to be considered a full description thereof. Reference is made to the Trust Agreement for a full description of its terms.

#### DEFINITIONS

“1994 Series A Bonds” means the County of San Diego Taxable Pension Obligation Bonds, Series A issued under the Original Trust Agreement and delivered on February 15, 1994.

“2002 Insurer” means MBIA Insurance Corporation, a stock insurance company incorporated under the laws of the State of New York.

“2004 Debenture” means the Pension Obligation Debenture dated as of the 29th day of June, 2004, issued in favor of the Association in the principal amount of \$450,000,000.

“2004 Insurers” means, collectively, the 2004A Insurer and the 2004B Insurer.

“2004A Insurer” means Financial Guaranty Insurance Company, a New York stock insurance company, or any successor thereto..

“2004A Insurance Policy” means the municipal bond new issue insurance policy issued by the 2004A Insurer that guarantees payment of principal of and interest on the Series 2004 A Bonds and payment of principal of and Accreted Value on the Series 2004 C Bonds.

“2004B Insurer” means XL Capital Assurance Inc. is a monoline financial guaranty insurance company incorporated under the laws of the State of New York.

“2004B Insurance Policy” means the municipal bond new issue insurance policy issued by the 2004B Insurer that guarantees payment of principal of and interest on the Series 2004 B Bonds.

“Act” means Articles 10 and 11 (commencing with Section 53570) of Chapter 3, Division 2, Title 5 of the Government Code of the State of California.

“Additional Bonds” means all bonds other than the Prior Bonds of the County authorized by and at any time Outstanding pursuant to the Trust Agreement and executed, issued and delivered in accordance with the Trust Agreement.

“Authorized Denomination” means, (a) with respect to Series 2002 A Bonds, Series 2004 A Bonds and Series 2004 C Bonds, \$5,000 principal amount or any integral multiple thereof, (b) with respect to Series 2002 B Bonds and the Series 2004 B Bonds that are Auction Rate Securities, \$25,000 principal amount or any integral multiple thereof and with respect to Series 2002 B Bonds and Series 2004 B Bonds that are not Auction Rate Securities, \$5,000 or any integral multiple thereof; and (c) with respect to Series 2002 C Bonds, \$25 principal amount or any integral multiple thereof.

“Bond Year” means the twelve-month period ending on August 15 of each year to which reference is made; provided that the first Bond Year is deemed to have commenced on February 15, 1994 (the date the 1994 Series A Bonds were originally delivered) and ended on August 15, 1994.

“Bonds” means, collectively, the 1994 Series A Bonds, the Series 2002 Bonds, the Series 2004 Bonds, and all Additional Bonds.

“Business Day” means any day other than a Saturday or Sunday or day upon which the Corporate Trust Office is authorized by law to remain closed.

“Certificate of the County” means an instrument in writing signed by the Chairperson or Vice-Chairperson of the Board of Supervisors of the County or the Chief Administrative Officer or Treasurer-Tax Collector of the County, or by any other officer of the County duly authorized by the Board of Supervisors for that purpose.

“Corporate Trust Office” means such corporate trust office of the Trustee as may be designated from time to time by written notice from the Trustee to the County, initially being 700 South Flower Street, Suite 500, Los Angeles, California 90017; provided, however, that the Trustee may designate in writing to the County and the Holders such other office or agency from time to time for purposes of registration, transfer, exchange, payment or redemption of Bonds.

“County Auditor” means the Auditor-Controller of the County.

“County Treasurer” means the Treasurer-Tax Collector of the County.

“County” means the County of San Diego, a legal subdivision and body corporate and politic of the State.

“Comparable Treasury Issue” means, with respect to any redemption date for a particular Series 2004 A Bond or Series 2004B Bond, the United States Treasury security or securities selected by the Designated Investment Banker which has an actual or interpolated maturity comparable to the remaining average life of the applicable Series 2004 A Bonds or Series 2004B Bonds to be redeemed, and that would be utilized in accordance with customary financial practice in pricing new issues of debt securities of comparable maturity to the remaining average life of the Series 2004 A Bonds or Series 2004B Bonds to be redeemed.

“Comparable Treasury Price” means, with respect to any redemption date for a particular Series 2004 A Bond or Series 2004B Bond, (1) if the Designated Investment Banker receives at least four Reference Treasury Dealer Quotations, the average of such quotations for such redemption date, after excluding the highest and lowest Reference Treasury Deal Quotations, or (2) if the Designated Investment Banker obtains fewer than four such Reference Treasury Dealer Quotations, the average of all such quotations.

“Dated Date” means June 29, 2004, being the initial issuance date of the Series 2004 Bonds.

“Defaulted Interest” means interest with respect to any Series 2004 B Bond which is payable but is not punctually paid or duly provided for on any Interest Payment Date.

“Designated Investment Banker” means one of the Reference Treasury Dealers appointed by the County.

“Event of Default” means an event of default under and as defined in the Trust Agreement.

“Federal Securities” means, collectively, the following investments:

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

“Financial Newspaper” means *The Wall Street Journal* or *The Bond Buyer*, or any other newspaper or journal printed in the English language, publishing financial news and selected by the Trustee, who shall be under no liability by reason of such selection.

“First Supplemental Trust Agreement” means the First Supplemental Trust Agreement, dated as of September 1, 2002, between the County and the Trustee.

“Fiscal Year” means the twelve-month period terminating on June 30 of each year, or any other annual accounting period hereafter selected and designated by the County as its Fiscal Year in accordance with applicable law.

“Fixed Rate Conversion Date” means August 15, 2006, the date on which interest with respect to the Series 2004 B-1 Bonds and the Series 2004 B-2 Bonds is converted to a fixed interest rate in accordance with the provisions of Section 2.10(p) of the Second Supplemental Trust Agreement.

“Holder” and “Holders” means any person who shall be a registered owner of any Outstanding Bond; provided that the 2004 Insurers are deemed to be the Holders of the Series 2004 Bonds that they insure. See “2004 INSURER PROVISIONS—2004 Insurers Deemed Holders.”

“Independent Certified Public Accountant” means any certified public accountant or firm of such accountants duly licensed and entitled to practice and practicing as such under the laws of the State or a comparable successor, appointed and paid by the County, and who, or each of whom —

(1) is in fact independent according to Statement of Auditing Standards No. 1 and not under the domination of the County;

(2) does not have a substantial financial interest, direct or indirect, in the operations of the County; and

(3) is not connected with the County as a member, officer or employee of the County, but who may be regularly retained to audit the accounting records of and make reports thereon to the County.

“Information Services” means Financial Information, Inc.’s “Daily Called Bond Service,” 30 Montgomery Street, 10th Floor, Jersey City, New Jersey 17302, Attention: Editor; Kenny Information Services’ “Called Bond Service,” 55 Broad Street, 28th Floor, New York, New York 10004; Moody’s Investors Service’s “Municipal and Government,” 99 Church Street, 8th Floor, New York, New York 10007, Attention: Municipal News Reports; and Standard & Poor’s Corporation’s “Called Bond Service,” 25 Broadway, 3rd Floor, New York, New York 10004; or, in accordance with then current guidelines of the Securities and Exchange Commission, such other addresses and/or such other services providing information with respect to called bonds, or such services as the County may designate in a Certificate of the County delivered to the Trustee.

“Interest Payment Date” means a date on which interest is due on the Bonds (or, in the case of the Series 2004 C Bonds, a date one which interest is compounded), being February 15 and August 15 of each year to which reference is made, (a) commencing August 15, 1994 with respect to the 1994 Series A Bonds, (b) commencing with respect to the Series 2002 B Bonds and the Series 2002 C Bonds, February 15, 2003; and with respect to the Series 2002 A Bonds, August 15, 2003, and (c) commencing with respect to the Series 2004 B Bonds and Series 2004 C Bonds, August 15, 2004, and with respect to the Series 2004 A Bonds, August 15, 2005.

“Moody’s” means Moody’s Investors Service, Inc., and its successors and assigns, or, if it shall no longer perform the functions of a securities rating organization, any other nationally recognized securities Rating Agency designated by the County, by notice to the Trustee.

“Nominee” means Cede & Co. or such other entity as is designated by an authorized representative of the Depository.



“Non-Payment Rate” means 17% per annum; provided, that in no event shall the Non-Payment Rate be more than the maximum rate permitted by the laws of the State.

“Opinion of Counsel” means a written opinion of counsel of recognized national standing in the field of law relating to municipal bonds, appointed and paid by the County.

“Original Trust Agreement” means the Trust Agreement, dated as of February 1, 1993, between the County and the Trustee, as originally executed and delivered.

“Outstanding,” when used as of any particular time with reference to Bonds, means (subject to the provisions of the Trust Agreement) all Bonds except:

- (1) Bonds theretofore cancelled by or surrendered to the Trustee for cancellation;
- (2) Bonds paid or deemed to have been paid within the meaning of the Trust Agreement; and
- (3) Bonds in lieu of or in substitution for which other Bonds shall have been executed, issued and delivered by the County pursuant to the Trust Agreement.

“Permitted Investments” means any of the following to the extent permitted by the laws of the State:

- (1) United States Treasury notes, bonds, bills, or certificates of indebtedness, or obligations for which the faith and credit of the United States of America are pledged for the payment of principal and interest (including obligations issued or held in book-entry form on the books of the Department of the Treasury of the United States of America and securities which represent an undivided interest in such direct obligations), and also any securities now or hereafter authorized, the timely payment of both the principal of and interest on which is guaranteed fully and directly by the full faith and credit of the United States of America;
- (2) Bonds or debentures of the Federal Home Loan Bank Board established under the Federal Home Loan Bank Act, bonds, debentures, participation certificates or other obligations of the Government National Mortgage Association or the Federal National Mortgage Association established under the National Housing Act, as amended;
- (3) Demand deposits, time certificates of deposit or negotiable certificates of deposit issued by a state or nationally chartered bank or trust company, including the Trustee, or a state or national savings and loan association, provided that such certificates of deposit shall be (i) continuously and fully insured by the Federal Deposit Insurance Corporation or (ii) issued by any bank or trust company organized under the laws of any state of the United States, or any national banking association (including the Trustee), having a combined capital and surplus of at least \$500,000,000, whose non-guaranteed senior debt is rated “A” or equivalent or better by the Rating Agencies and such certificates shall have maturities of six months or less;
- (4) Any repurchase agreement approved by the 2004B Insurer with any bank or trust company organized under the laws of any state of the United States (including the Trustee) or any national banking association or government bond dealer reporting to, trading with and recognized as a primary dealer by, the Federal Reserve Bank of New York, which agreement is secured at all times by collateral security described in clause (1) or (2) of this definition and in

which the Trustee has a perfected security interest, and which collateral (a) is held by the Trustee or a third party agent, (b) is not subject to liens or claims of third parties, (c) has a market value determined as frequently and in an amount sufficient to satisfy the collateralization levels required by the Rating Agencies, and (d) failure to maintain the requisite collateral level will require the liquidation of the collateral;

(5) Bankers' acceptances which are issued by a bank or trust company organized under the laws of any state of the United States or any national banking association (including the Trustee) rated "A" or equivalent or better by the Rating Agencies; provided, that such banker's acceptances may not exceed 270 days' maturity;

(6) Commercial paper of "prime" quality of the highest ranking or of the highest letter and numerical rating as provided by the Rating Agencies, which commercial paper is limited to issuing corporations that are organized and operating within the United States of America and that have total assets in excess of \$500,000,000 and that have an "A" or equivalent or higher rating for the issuer's debentures, other than commercial paper, as provided by the Rating Agencies; provided that purchases of eligible commercial paper may not exceed 180 days' maturity nor represent more than 10% of the outstanding commercial paper of an issuer corporation;

(7) Bonds, notes, warrants or other evidence of indebtedness of any of the states of the United States or of any political subdivision or public agency thereof which are rated in the highest short-term or one of the two highest long-term rating categories by the Rating Agencies;

(8) Government money market portfolios or money market funds registered under the Federal Investment Company Act of 1940, whose shares are registered under the Federal Securities Act of 1933, and restricted to obligations issued or guaranteed as to payment of principal and interest by the full faith and credit of the United States, which portfolios shall have an "AAA" or equivalent by the Rating Agencies;

(9) Tax exempt securities issued by any state or municipality rated "AAA" or equivalent by the Rating Agencies, for which the interest and principal has been provided by an escrow deposit which, in the opinion of an Independent Certified Public Accountant, is fully sufficient to pay the principal of and interest and redemption premium, if any, on such tax exempt securities at their stated maturity or redemption date;

(10) Guaranteed investment contracts in a form approved by the Rating Agencies and the 2004B Insurer with entities the unsecured debt securities of which are rated in one of the two highest long-term rating categories by the Rating Agencies or the equivalent of such ratings by virtue of guarantees or insurance arrangements;

(11) The pooled investment fund of the County of San Diego, California, which is administered in accordance with the investment policy of said County as established by the County Treasurer, as permitted by Section 53601 of the Government Code of the State, copies of which policy are available upon written request to the County Treasurer; and

(12) The Local Agency Investment Fund (as that term is defined in Section 16429.1 of the Government Code of the State, as such Section may be amended or recodified from time to time).

“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.

“Principal Office” means the address stated as such for the Trustee and any other fiduciary, agent or service provider as provided in the Trust Agreement.

“Principal Payment Date” means, with respect to each Series and Subseries of Bonds, each date on which principal is scheduled to be due and payable by reason of mandatory sinking fund redemption or maturity dates.

“Rating Agencies” means, collectively, Moody’s and S&P.

“Record Date” means, with respect to an Interest Payment Date, fifteen calendar days immediately preceding such Interest Payment Date, whether or not such day is a Business Day.

“Redemption Date” means any date on which any Bond is redeemed and fully paid pursuant to the Trust Agreement.

“Redemption Price” means the principal, premium (if any) and accrued interest to the applicable redemption date on which all or any portion of the Series 2004 B Bonds are subject to optional or mandatory sinking fund redemption pursuant to the provisions of the Second Supplemental Trust Agreement.

“Reference Treasury Dealer Quotations” means, with respect to each Reference Treasury Dealer and any redemption date for a particular Series 2004 A Bond or Series 2004B Bond, the average, as determined by the Designated Investment Banker, of the bid and asked prices for the Comparable Treasury Issue (expressed in each case as a percentage of its principal amount) quoted in writing to the Designated Investment Banker by such Reference Treasury Dealer at 3:30 p.m., New York City time, on the third business day preceding such redemption date.

“Representation Letter” means the letter of representation dated the date of issuance of the 1994 Series A Bonds, to The Depository Trust Company, New York, New York, from the County and the Trustee relating to the 1994 Series A Bonds.

“Retirement Law” means the County Employees Retirement Law of 1937, consisting of Division 4 of Title 3 of the Government Code of the State.

“S&P” means Standard & Poor’s, a Division of the McGraw Hills Companies, Inc., and its successors and assigns, or, if it shall no longer perform the functions of a securities rating organization, any other nationally recognized securities Rating Agency designated by the County.

“Second Supplemental Trust Agreement” means the Second Supplemental Trust Agreement, dated as of June 1, 2004, between the County and the Trustee.

“Securities Act” means the Securities Act of 1933, as amended.

“Securities Depositories” means The Depository Trust Company, 55 Water Street, New York, New York 10041, facsimile transmission: (212) 855-1000, (212) 855-7320, or, in accordance with then current guidelines of the Securities and Exchange Commission, such other addresses and/or such other securities depositories as may be designated by the County and delivered to the Trustee.

“Serial Bonds” means Bonds for which no sinking fund payments are provided.

“Series 2002 Bonds” means the County of San Diego Taxable Pension Obligation Bonds, Series 2002 A, Series 2002 B and Series 2002 C.

“Series 2004 Bonds” means the County of San Diego Taxable Pension Obligation Bonds, Series 2004 A, Series 2004 B and Series 2004 C.

“Series 2004 B Fixed Rate Bonds” means any Subseries of Series 2004 B Bonds which are no longer Auction Rate Securities following the Fixed Rate Conversion Date.

“Series 2004 B Serial Bonds” means, upon the Fixed Rate Conversion Date, Series 2004 B Fixed Rate Bonds of any single maturity or maturities (*i.e.* “term bonds” prior to the Fixed Rate Conversion Date), with respect to which the County elects to establish a schedule of one or more principal maturity dates, and/or principal amounts and redemption dates and prices for optional redemption or mandatory redemption of Series 2004 B Fixed Rate Bonds if an Opinion of Counsel is provided to the Trustee to the effect that such schedule, dates, principal amounts and/or redemption prices will not adversely affect the validity of the Series 2004 B Bonds under State law.

“Special Record Date” means a special date fixed to determine the names and addresses of Holders of the Bonds for purposes of paying interest on a special interest payment date for the payment of defaulted interest, all as further provided in the Second Supplemental Trust Agreement.

“State” means the State of California.

“Subseries” means, severally, the Series 2004 B Bonds, Subseries B-1 and Subseries B-2.

“Supplemental Trust Agreement” means any trust agreement then in full force and effect which has been duly executed and delivered by the County and the Trustee amendatory or supplemental to the Trust Agreement; but only if and to the extent that such Supplemental Trust Agreement is specifically authorized under the Trust Agreement.

“Term Bonds” means Bonds which are payable on or before their specified maturity dates from sinking fund payments established for that purpose and calculated to retire such Bonds on or before their specified maturity dates.

“Third Supplemental Trust Agreement” means the Third Supplemental Trust Agreement, dated as of June 1, 2006, between the County and the Trustee.

“Treasury Rate” means, with respect to any redemption date for a particular Series 2004 A Bond or Series 2004 B Bond, the rate per annum, expressed as a percentage of the principal amount, equal to the semiannual equivalent yield to maturity or interpolated maturity of the Comparable Treasury Issue, assuming that the Comparable Treasury Issue is purchased on the redemption date for a price equal to the Comparable Treasury Price, as calculated by the Designated Investment Banker.

“Trust Agreement” means the Trust Agreement, dated as of February 1, 1993, between the County and the Trustee, as originally executed and as amended and supplemented by the First Supplemental Trust Agreement, the Second Supplemental Trust Agreement and the Third Supplemental Trust Agreement, and as it may from time to time be amended or supplemented by all Supplemental Trust Agreements executed pursuant to the provisions of the Trust Agreement.

“Trust Indenture Act” means the Trust Indenture Act of 1939, as amended.

“Trustee” means BNY Western Trust Company, any other association or corporation which may at any time be substituted in its place as provided in the Trust Agreement.

“Written Request of the County” means an instrument in writing signed by the Chief Administrative Officer or Treasurer-Tax Collector of the County, or by any other officer of the County duly authorized by the County for that purpose.

## **SERIES 2004 B BONDS**

### **Date; Initial Accrual of Interest of Series 2004 B Bonds**

Each Series 2004 B Bond shall be dated the Dated Date. Interest with respect thereto shall be payable from the Interest Payment Date next preceding the date of execution thereof, unless:

(a) it is executed on an Interest Payment Date, in which event interest with respect thereto shall be payable from such Interest Payment Date; or

(b) it is executed after a Regular Record Date and on or before the following Interest Payment Date, in which event interest with respect thereto shall be payable from such Interest Payment Date; or

(c) it is executed on or before the first Regular Record Date, in which event interest with respect thereto shall be payable from the Dated Date;

provided, however, that if, as of the date of execution of any Series 2004 B Bond, interest is in default with respect to any Outstanding Series 2004 B Bond, interest on such Series 2004 B Bond shall be payable from the Interest Payment Date to which interest has previously been paid or made available for payment with respect to the Outstanding Series 2004 B Bonds.

### **Maturity, Interest Rates and Payment Terms of Series 2004 B Bonds**

The principal of the Series 2004 B Bonds shall be payable in lawful money of the United States of America at the Corporate Trust Office of the Trustee.

The Series 2004 B Bonds shall bear interest at the rates (based on a 360-day year of twelve 30-day months) set forth above, payable semiannually February 15 and August 15 of each year, commencing on February 1, 2007. Payment of interest on the Series 2004 B Bonds due on or before the maturity or prior redemption thereof shall be made to the person whose name appears in the Series 2004 B Bonds registration books kept by the Trustee as the registered owner thereof as of the close of business on the Record Date for an interest payment date, whether or not such day is a Business Day, such interest to be paid by check mailed by first class mail to such registered owner at the address as it appears in such books; provided that upon the written request of a Holder of \$1,000,000 or more in aggregate principal amount of Bonds received by the Trustee prior to the applicable Record Date, interest shall be paid by wire transfer in immediately available funds.

Payment of the principal of the Series 2004 B Bonds shall be made upon the surrender thereof at maturity or on redemption prior to maturity at the Corporate Trust Office of the Trustee.

## **Transfer and Exchange**

(a) Transfer of Series 2004 B Bonds. The registration of any Series 2004 B Bond may, in accordance with its terms, be transferred upon the Registration Books by the Person in whose name it is registered, in Person or by his attorney duly authorized in writing upon surrender of such Series 2004 B Bond for cancellation at the Office of the Trustee, accompanied by delivery of a written instrument of transfer in a form acceptable to the Trustee, duly executed. Whenever any Series 2004 B Bond shall be surrendered for registration of transfer, the Trustee shall execute and deliver a new Series 2004 B Bond or Series 2004 B Bonds for a like aggregate principal amount in authorized denominations. The Trustee shall require the payment by the Series 2004 B Bond Holder requesting such transfer of any tax or other governmental charge required to be paid with respect to such transfer. The cost of printing any Series 2004 B Bonds and any services rendered or any expenses incurred by the Trustee in connection with any transfer shall be paid by the County. The Trustee shall not be required to transfer:

(i) any Series 2004 B Bonds during the period between the date fifteen (15) days prior to the date of selection of Series 2004 B Bonds for redemption and such date of selection, or

(ii) any Series 2004 B Bonds selected for redemption.

(b) Exchange of Series 2004 B Bonds. Series 2004 B Bonds may be exchanged, upon surrender thereof, at the Office of the Trustee for a like aggregate principal amount of Series 2004 B Bonds of other authorized denominations of the same maturity. Whenever any Series 2004 B Bond or Series 2004 B Bonds shall be surrendered for exchange, the Trustee shall execute and deliver a new Series 2004 B Bond or Series 2004 B Bonds for like aggregate principal amount in Authorized Denominations. The Trustee shall require the payment by the Series 2004 B Bond Holder requesting such exchange of any tax or other governmental charge required to be paid with respect to such exchange. The cost of printing any Series 2004 B Bonds and any services rendered or any expenses incurred by the Trustee in connection with any exchange shall be paid by the County. The Trustee shall not be required to exchange:

(i) any Series 2004 B Bonds during the period between the date 15 days prior to the date of selection of Series 2004 B Bonds for redemption and such date of selection, or

(ii) any Series 2004 B Bonds selected for redemption.

## **CUSIP Numbers**

The Trustee and the County shall not be liable for any defect or inaccuracy in any CUSIP number that appears on any Series 2004 B Bond or in any redemption notice. The Trustee may, in its discretion, include in any redemption notice a statement to the effect that the CUSIP numbers on the Series 2004 B Bonds have been assigned by an independent service and are included in such notice solely for the convenience of the Holders and that neither the Trustee nor the County shall be liable for any inaccuracies in such numbers.

## **Book-Entry Procedures**

(a) Transfers Outside Book-Entry System. The Depository may determine to discontinue providing its services with respect to the Series 2004 B Bonds at any time by giving notice to the County and the Trustee and discharging its responsibilities with respect thereto under applicable law. The Trustee shall notify the Depository in the event any such notice is received from the Depository. The

County, at the request or with the consent of the Depository and without the consent of any other Person, may terminate the services of the Depository with respect to the Series 2004 B Bonds if the County or the Depository determines that:

(i) the Depository is unable to discharge its responsibilities with respect to the Series 2004 B Bonds, or

(ii) a continuation of the requirement that all of the Outstanding Series 2004 B Bonds be registered in the Registration Books kept by the Trustee in the name of the Nominee, or any other nominee of the Depository, is not in the best interest of the Beneficial Owners of the Series 2004 B Bonds.

Upon the termination of the services of the Depository with respect to the Series 2004 B Bonds pursuant to subparagraph (ii) immediately above, or upon any other discontinuance or termination of the services of the Depository with respect to the Series 2004 B Bonds after which no substitute securities depository willing to undertake the functions of the Depository hereunder can be found which, in the opinion of the County, is willing and able to undertake such functions upon reasonable and customary terms, the Trustee is obligated to deliver Series 2004 B Bonds at the expense of the Beneficial Owners of the Series 2004 B Bonds, as described in the Second Supplemental Trust Agreement, and the Series 2004 B Bonds shall no longer be restricted to being registered in the registration books kept by the Trustee in the name of the Nominee of the Depository, but may be registered in whatever name or names Series 2004 B Bond Holders transferring or exchanging Series 2004 B Bonds shall designate, in accordance with the provisions of the Second Supplemental Trust Agreement.

(b) Payments and Notices. Notwithstanding any other provision of the Second Supplemental Trust Agreement to the contrary, so long as any Series 2004 B Bond is registered in the name of the Nominee, all payments with respect to principal, premium, if any, and interest evidenced by such Series 2004 B Bond and all notices with respect to such Series 2004 B Bond shall be made and given, respectively, in the manner prescribed by the Depository from time to time. Series 2004 B Bond Holders shall have no lien or security interest in any rebate or refund paid by the Depository to the Trustee or the County which arises from the payment by the Trustee of principal or interest evidenced by the Series 2004 B Bonds in immediately available funds to the Depository.

(c) Tenders and Deliveries. So long as Cede & Co. is the sole registered Holder of the Series 2004 B Bonds, all deliveries of Series 2004 B Bonds under the provisions of the Second Supplemental Trust Agreement shall be made pursuant to DTC's procedures as in effect from time to time, and none of the County or the Trustee shall have any responsibility for or liability with respect to the implementation of such procedures.

## **FUNDS AND ACCOUNTS**

### **Bond Fund; Deposits to Bond Fund**

The 2004 Debenture provides that the County is obligated to prepay each Fiscal Year's obligations within 30 days of the commencement of such Fiscal Year. To meet the County's obligations under Section 31453.5 of the Retirement Law for each Fiscal Year, the County shall deposit or cause to be deposited with the Trustee the amount of the County's obligations on the Series 2004 Bonds for such Fiscal Year within 30 days of the commencement of each Fiscal Year (the "Prepayment Obligation Date") and on each Prepayment Obligation Date thereafter, it will transfer to the Trustee an amount which, together with the amount then on deposit in the Debt Service Fund, will be not less than the amount of the obligations on the Series 2004 Bonds becoming due in such Fiscal Year.

If on the second Business Day prior to any February 15 Interest Payment Date the amount then on deposit in the Interest Account is less than the amount of the interest to be payable on all Outstanding Series 2004 Bonds on such February 15, the County will transfer to the Trustee an amount which, together with the amount then on deposit in the Interest Account, will be not less than the amount of the interest to be payable on all Outstanding Series 2004 Bonds on such February 15.

Further, to the extent permitted by law, the County covenants to take such action as may be necessary to amend or supplement the budget appropriations for payments of the County's obligations on the Bonds at any time and from time to time during any Fiscal Year in the event that the County's obligations on the Bonds and Swap Payments paid in any Fiscal Year exceeds the *pro rata* portion of the appropriations then contained in the County's budget.

All amounts payable by the County under the Trust Agreement shall be promptly deposited by the Trustee upon receipt thereof in a special fund designated as the "Bond Fund" which fund is created under the Trust Agreement and shall be held in trust by the Trustee.

### **Allocation of Moneys in Bond Fund**

At least two Business Days prior to each Interest Payment Date or date fixed for redemption of Bonds, the Trustee shall transfer from the Bond Fund, in immediately available funds or securities scheduled to timely mature for the purposes so designated, for deposit into the following respective accounts (each of which the Trustee shall maintain in trust separate and distinct from the other funds and accounts established under the Trust Agreement), the following amounts in the following order of priority, the requirements of each such account (including the making up of any deficiencies in any such account resulting from lack of funds sufficient to make any earlier required deposit) at the time of deposit to be satisfied before any deposit is made to any account subsequent in priority:

- (a) Interest Account,
- (b) Principal Account, and
- (c) Administrative Expense Account.

All money in each of such accounts shall be held in trust by the Trustee and shall be applied, used and withdrawn only for the purposes authorized in the Trust Agreement.

**Interest Account.** On each February 15 and August 15, (commencing on August 15, 1994 with respect to the issuance of the 1994 Series A Bonds and February 15, 2003 with respect to the issuance of the Series 2002 Bonds, August 15, 2004 with respect to Series 2004 B Bonds, and August 15, 2005 with respect to Series 2004 A Bonds), the Trustee shall set aside from the Bond Fund and deposit in the Interest Account that amount of money which is equal to the amount of interest becoming due and payable on all Outstanding Bonds on such February 15 or August 15, as the case may be.

No deposit need be made in the Interest Account if the amount contained in the Trust Agreement is at least equal to the aggregate amount of interest becoming due and payable on all Outstanding Bonds on such Interest Payment Date.

All money in the Interest Account shall be used and withdrawn by the Trustee solely for the purpose of paying the interest on the Bonds as it shall become due and payable (including accrued interest on any Bonds purchased or redeemed prior to maturity).



**Principal Account.** On each August 15, the Trustee shall set aside from the Bond Fund and deposit in the Principal Account an amount of money equal to the amount of all sinking fund payments required to be made on such August 15 into the respective sinking fund accounts for all Outstanding Term Bonds and the principal amount and the Accreted Value of all Outstanding Bonds maturing on such August 15.

No deposit need be made in the Principal Account if the amount contained in the Trust Agreement is at least equal to the aggregate amount of the principal and the Accreted Value of all Outstanding Serial Bonds maturing by their terms on such August 15 plus the aggregate amount of all sinking fund payments required to be made on such August 15 for all Outstanding Term Bonds.

The Trustee shall establish and maintain within the Principal Account a separate subaccount for the Term Bonds of each series and maturity, designated as the “\_\_ Sinking Account” (the “Sinking Account”), inserting in the Trust Agreement the series and maturity (if more than one such account is established for such series) designation of such Bonds. With respect to each Sinking Account, on each mandatory sinking account payment date established for such Sinking Account, the Trustee shall apply the mandatory sinking account payment required on that date to the redemption (or payment at maturity, as the case may be) of Term Bonds of the series and maturity for which such Sinking Account was established, upon the notice and in the manner provided in the Trust Agreement; provided that, at any time prior to giving such notice of such redemption, the Trustee may upon the Written Request of the County, apply moneys in such Sinking Account to the purchase for cancellation of Term Bonds of such series and maturity at public or private sale, as and when and at such prices (including brokerage and other charges, but excluding accrued interest, which is payable from the Interest Account), as may be directed by the County, except that the purchase price (excluding accrued interest) shall not exceed the redemption price that would be payable for such Bonds upon redemption by application of such mandatory sinking account payment. If, during the twelve-month period immediately preceding said mandatory sinking account payment date, the Trustee has purchased Term Bonds of such series and maturity with moneys in such Sinking Account, such Bonds so purchased shall be applied, to the extent of the full principal amount thereof to reduce said mandatory sinking account payment.

All money in the Principal Account shall be used and withdrawn by the Trustee solely for the purpose of paying the principal of the Bonds as they shall become due and payable, whether at maturity or redemption, except that any money in any sinking account shall be used and withdrawn by the Trustee only to purchase or to redeem or to pay Term Bonds for which such sinking account was created.

The Trustee shall establish and maintain within the Principal Account separate accounts for each of the four Subseries of the Series 2002 B Bonds, designated as the Series B-\_\_ Term Bonds Sinking Account. The Trustee shall establish and maintain within the Principal Account separate accounts for each of the four Subseries of the Series B Bonds, designated as the Series 2004 B-\_\_ Term Bonds Sinking Account. Subject to the terms and conditions set forth in the Trust Agreement, each of the four Subseries of the Series 2002 B Bonds, and each of the four Subseries of the Series 2004 B Bonds, respectively, shall be redeemed (or paid at maturity, as the case may be) by application of mandatory sinking account payments in the amounts and upon the dates established for the respective Term Bonds Sinking Account, as set forth in the Trust Agreement, the First Supplemental Trust Agreement and the Second Supplemental Trust Agreement.

**Administrative Expense Account.** Following the deposits set forth above having been made on each February 15 Interest Payment Date, any moneys remaining in the Bond Fund (other than those funds representing Swap Payments under any swap agreement paid to the County or the Trustee and deposited in the Bond Fund as of August of the preceding year, which amounts shall be retained in the Bond Fund until February 15 of such year) shall be deposited by the Trustee in the Administrative

Expense Account. Moneys deposited in the Administrative Expense Account shall be transferred by the Trustee to or upon the order of the County, as specified in a Written Request of the County to, among other things and without limitation, (i) make payments due under the ISDA Master Agreements entered into in connection with the Series 2002 Bonds, and (ii) pay rating agency, Broker-Dealer and Auction Agent fees incurred in connection with the Series 2002 Bonds, and rating agency, Broker-Dealer and Auction Agent fees incurred in connection with the Series 2004 Bonds, and other administrative and ongoing costs incident to the Bonds, in each case provided all of the County's obligations under the Trust Agreement are then otherwise satisfied.

### **Deposit and Investments of Money in Accounts and Funds**

All money held by the Trustee in any of the accounts or funds established pursuant hereto shall be invested in Permitted Investments at the Written Request of the County. If no Written Request of the County is received, the Trustee shall invest funds held by it in Permitted Investments described in clause (8) of the definition thereof. Such investments shall as nearly as practicable mature on, but in any event before, the dates on which such money is anticipated to be needed for disbursement under the Trust Agreement. All interest or profits received on any money so invested shall be deposited in the Bond Fund.

## **REDEMPTION OF BONDS**

### **Notice of Redemption**

Notice of any redemption under this section shall be given by the Trustee by first-class mail, not less than 30 nor more than 60 days prior to the redemption date to the respective Holders of the Series 2004 Bonds designated for redemption at their addresses appearing on the registration books of the Trustee. In addition, notice of redemption shall also be sent to the 2004B Insurer, to each Broker-Dealer (if applicable), to the Rating Agencies, to all municipal registered Securities Depositories and to at least two of the NRMSIRs, no later than simultaneously with the mailing of notices required by the first paragraph above; provided, that neither failure to receive such notice nor any defect in any notice so mailed shall affect the sufficiency of the proceedings for the redemption of such Series 2004 Bonds. Each notice of redemption shall state the date of such notice, the redemption price, if any, the name and appropriate address of the Trustee, the CUSIP number (if any) of the maturity or maturities, and, if less than all of any such maturity is to be redeemed, the distinctive certificate numbers of the Bonds of such maturity, to be redeemed and, in the case of Series 2004 Bonds to be redeemed in part only, the respective portions of the principal amount thereof to be redeemed. Each such notice shall also state that on said date there will become due and payable on each of said Series 2004 Bonds the redemption price, if any, thereof and in the case of a Series 2004 Bond to be redeemed in part only, the specified portion of the principal amount thereof to be redeemed, together with interest accrued thereon to the redemption date, and that from and after such redemption date interest thereon shall cease to accrue, and shall require that such Series 2004 Bonds be then surrendered at the address of the Trustee specified in the redemption notice. Failure to receive such notice shall not invalidate any of the proceedings taken in connection with such redemption.

In the event of redemption of Series 2004 Bonds (other than sinking account redemptions), the Trustee shall mail a notice of redemption upon receipt of a Written Request of the County but only after the County shall file a Certificate of the County with the Trustee that on or before the date set for redemption, the County shall have deposited with or otherwise made available to the Trustee for deposit in the Principal Account the money required for payment of the redemption price, including accrued interest, of all Series 2004 Bonds then to be called for redemption (or the Trustee

determines that money will be deposited with or otherwise made available to it in sufficient time for such purpose), together with the estimated expense of giving such notice.

If notice of redemption has been duly given as aforesaid and money for the payment of the redemption price of the Series 2004 Bonds called for redemption is held by the Trustee, then on the redemption date designated in such notice Series 2004 Bonds so called for redemption shall become due and payable, and from and after the redemption date so designated interest on such Series 2004 Bonds shall cease to accrue, and the Holders of such Series 2004 Bonds shall have no rights in respect thereof except to receive payment of the redemption price thereof.

### **Effect of Redemption**

From and after the date fixed for redemption, if funds available for the payment of the principal of and interest (and premium, if any) with respect to the Series 2004 Bonds so called for redemption shall have been duly provided, such Series 2004 Bonds so called shall cease to be entitled to any benefit under the Trust Agreement other than the right to receive payment of the principal, interest accrued to the Redemption Date, and premium, if any, and no interest shall accrue with respect thereto from and after the Redemption Date specified in the notice of such redemption. All Series 2004 Bonds redeemed in whole or in part pursuant to the provisions of the Trust Agreement shall be canceled by the Trustee and destroyed, and the Trustee shall certify in writing as to their destruction. If such funds shall not be so available on the Redemption Date, interest with respect to such Series 2004 Bonds or portions thereof shall continue accrue until paid at the same rate as it would have accrued had they not been called for redemption.

## **ISSUANCE OF ADDITIONAL BONDS**

### **Conditions for the Issuance of Additional Bonds**

The County may at any time issue Additional Bonds on a parity with the Prior Bonds, but only subject to the following specific conditions, which are hereby made conditions precedent to the issuance of any such Additional Bonds:

(a) The County shall be in compliance with all agreements and covenants contained in the Trust Agreement.

(b) The issuance of such Additional Bonds shall have been authorized pursuant to the Act and shall have been provided for by a Supplemental Trust Agreement which shall specify the following:

(1) The purpose for which such Additional Bonds are to be issued; provided that such Additional Bonds shall be applied solely for (i) the purpose of satisfying any obligation to make payments to the Association pursuant to the Act relating to pension benefits accruing to the Association's members, and/or for payment of all costs incidental to or connected with the issuance of Additional Bonds for such purpose, and/or (ii) the purpose of refunding any Bonds then Outstanding, including payment of all costs incidental to or connected with such refunding;

(2) The authorized principal amount and designation of such Additional Bonds;

(3) The denomination or denominations of and method of numbering such Additional Bonds;

(4) The redemption premiums, if any, and the redemption terms, if any, for such Additional Bonds;

(5) The amount, if any, to be deposited from the proceeds of sale of such Additional Bonds in the Interest Account in the Trust Agreement after referred to;

(6) Such other provisions (including the requirements of a book-entry Bond registration system, if any) as are necessary or appropriate and not inconsistent herewith.

### **Procedure for the Issuance of Additional Bonds**

At any time after the sale of any Additional Bonds in accordance with the Act, the County shall execute such Additional Bonds for issuance under the Trust Agreement and shall deliver them to the Trustee, and thereupon such Additional Bonds shall be delivered by the Trustee to the purchaser thereof upon the Written Request of the County, but only upon receipt by the Trustee of the following documents or money or securities, all of such documents dated or certified, as the case may be, as of the date of delivery of such Additional Bonds by the Trustee:

(a) An executed copy of the Supplemental Trust Agreement authorizing the issuance of such Additional Bonds;

(b) A Written Request of the County as to the delivery of such Additional Bonds;

(c) An Opinion of Counsel to the effect that (1) the County has executed and delivered the Supplemental Trust Agreement, and the Supplemental Trust Agreement is valid and binding upon the County and (2) such Additional Bonds are valid and binding obligations of the County entitled to the benefits of the Act and of the Trust Agreement, and such Additional Bonds have been duly and validly issued in accordance with the Act and with the Trust Agreement;

(d) A Certificate of the County containing such statements as may be reasonably necessary to show compliance with the conditions for the issuance of such Additional Bonds contained in the Trust Agreement;

(e) Such further documents, money or securities as are required by the provisions of the Supplemental Trust Agreement providing for the issuance of such Additional Bonds.

### **Additional Bonds**

The County shall not issue Additional Bonds if immediately following issuance of such Additional Bonds the aggregate principal amount of Bonds insured by a financial guaranty insurance policy issued by the 2002 Insurer shall be less than 51% of the aggregate principal amount of all Outstanding Bonds.

## **COVENANTS OF THE COUNTY**

### **Punctual Payment and Performance**

The County will punctually pay the interest on and the principal and Accreted Value of and redemption premiums, if any, to become due on every Bond issued hereunder in strict conformity with the terms hereof and of the Bonds, and will faithfully observe and perform all the agreements and covenants to be observed or performed by the County contained herein and in the Bonds.

### **Extension of Payment of Bonds**

The County shall not directly or indirectly extend or assent to the extension of the maturity of any of the Bonds or the time of payment of any claims for interest by the purchase of such Bonds or by any other arrangement, and in case the maturity of any of the Bonds or the time of payment of any such claims for interest shall be extended, such Bonds or claims for interest shall not be entitled, in case of any default hereunder, to the benefits of this Trust Agreement, except subject to the prior payment in full of the principal and Accreted Value of all of the Bonds then Outstanding and of all claims for interest thereon which shall not have been so extended. Nothing in this Section shall be deemed to limit the right of the County to issue Bonds for the purpose of refunding any Outstanding Bonds, and such issuance shall not be deemed to constitute an extension of maturity of the Bonds.

### **Additional Debt**

The County expressly reserves the right to enter into one or more other agreements or indentures for any of its corporate purposes, and reserves the right to issue other obligations for such purposes.

### **Power to Issue Bonds**

The County is duly authorized pursuant to law to issue the Bonds and to enter into this Trust Agreement. The Bonds and the provisions of this Trust Agreement are the legal, valid and binding obligations of the County in accordance with their terms. The Bonds constitute obligations imposed by law. In the event the County fails to deposit with the Trustee the amounts required to pay principal and Accreted Value of, premium, if any, and interest on the Bonds by an Interest Payment Date, in accordance with Section 31584 of the Retirement Law, the County Auditor shall forthwith transfer any lawfully available funds to the Trustee to the extent necessary to pay the principal and Accreted Value of, premium, if any, and interest coming due on the Bonds on such Interest Payment Date. The County may issue at any time, and from time to time, Additional Bonds in accordance with the Trust Agreement and any such Additional Bonds shall be subject to the benefits of the obligation imposed upon the County Auditor by the next preceding sentence.

### **Accounting Records and Reports**

The County will keep or cause to be kept proper books of record and accounts in which complete and correct entries shall be made of all transactions relating to the receipts, disbursements, allocation and application of moneys on deposit in the funds and accounts established under the Trust Agreement, and such books shall be available for inspection by the Trustee, at reasonable hours and under reasonable conditions. Not more than 180 days after the close of each Fiscal Year, the County shall furnish or cause to be furnished to the Trustee a complete financial statement covering receipts, disbursements, allocation and application of moneys on deposit in the funds and accounts established

under the Trust Agreement for such Fiscal Year. The Trustee shall have no duty to review or examine such statement.

### **Prosecution and Defense of Suits**

The County will defend against every suit, action or, proceeding at any time brought against the Trustee upon any claim to the extent involving the failure of the County to fulfill its obligations under the Trust Agreement; provided that the Trustee or any affected Holder at its election may appear in and defend any such suit, action or proceeding. The County will indemnify and hold harmless the Trustee against any and all liability claimed or asserted by any person to the extent arising out of such failure by the County, and will indemnify and hold harmless the Trustee against any attorney's fees or other expenses which it may incur in connection with any litigation to which it may become a party by reason of its actions under the Trust Agreement, except for any loss, cost, damage or expense resulting from the active or passive negligence, willful misconduct or breach of duty by the Trustee. Notwithstanding any contrary provision hereof, this covenant shall remain in full force and effect even though all Bonds secured hereby may have been fully paid and satisfied.

### **Further Assurances**

Whenever and so often as reasonably requested to do so by the Trustee or any Holder, the County will promptly execute and deliver or cause to be executed and delivered all such other and further assurances, documents or instruments, 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 Holders all rights, interests, powers, benefits, privileges and advantages conferred or intended to be conferred upon them hereby.

### **Waiver of Laws**

The County shall not at any time insist upon or plead in any manner whatsoever, or claim or take the benefit or advantage of, any stay or extension law now or at any time hereafter in force that may affect the covenants and agreements contained in the Trust Agreement or in the Bonds, and all benefit or advantage of any such law or laws is hereby expressly waived by the County to the extent permitted by law.

### **Costs of Issuance**

The County shall punctually pay or cause to be paid all costs of issuance relating to the Bonds.

### **Allocation of UAAL**

If at any time a court of competent jurisdiction were to finally determine that the proceeds of the Series 2004 Bonds that are contributed to the Association by the County have been improperly allocated to that portion of the Association's unfunded actuarially accrued liability (the "UAAL") attributable to the employees of the San Diego Superior Courts, then the County shall use its best efforts to cause the Association to allocate all such proceeds to that portion of the UAAL attributable to employees of the County.

## **CERTAIN PROVISIONS RELATING TO THE TRUSTEE**

### **Appointment of Trustee; Removal and Resignation**

BNY Western Trust Company shall serve as the Trustee for the Bonds for the purpose of receiving all money which the County is required to deposit with the Trustee under the Trust Agreement and for the purpose of allocating, applying and using such money as provided in the Trust Agreement and for the purpose of paying the interest on and principal and Accreted Value of and redemption premiums, if any, on the Bonds presented for payment at the Corporate Trust Office of the Trustee with the rights and obligations provided in the Trust Agreement. The County agrees that it will at all times maintain a Trustee having a corporate trust office in Los Angeles or San Francisco, California.

The County may at any time, unless there exists any event of default as defined in the Trust Agreement, remove the Trustee initially appointed and any successor thereto and may appoint a successor or successors thereto, in each case acceptable to the 2004B Insurer, by an instrument in writing; provided that any such successor shall be a bank or trust company doing business and having a corporate trust office in Los Angeles or San Francisco, California, having a combined capital (exclusive of borrowed capital) and surplus of at least one hundred million dollars (\$100,000,000) and subject to supervision or examination by federal or state authority. If such bank or trust company publishes a report of condition at least annually, pursuant to law or to the requirements of any supervising or examining authority above referred to, then for the purpose of this section the combined capital and surplus of such bank or trust company shall be deemed to be its combined capital and surplus as set forth in its most recent report of condition so published. The Trustee may at any time resign by giving written notice of such resignation to the County and by mailing to the Holders notice of such resignation. Upon receiving such notice of resignation, the County shall promptly appoint a successor Trustee by an instrument in writing. Any removal or resignation of a Trustee and appointment of a successor Trustee shall become effective only upon the acceptance of appointment by the successor Trustee. If, within 30 days after notice of the removal or resignation of the Trustee no successor Trustee shall have been appointed and shall have accepted such appointment, the removed or resigning Trustee may petition any court of competent jurisdiction for the appointment of a successor Trustee, which court may thereupon, after such notice, if any, as it may deem proper and prescribe and as may be required by law, appoint a successor Trustee having the qualifications required hereby.

The Trustee is authorized to pay or redeem the Bonds when duly presented for payment at maturity or on redemption prior to maturity. The Trustee shall cancel all Bonds upon payment thereof or upon the surrender thereof by the County and shall destroy such Bonds and a certificate of destruction shall be delivered to the County. The Trustee shall keep accurate records of all Bonds paid and discharged and cancelled by it.

The Trustee shall, prior to an event of default, and after the curing of all events of default that may have occurred, perform such duties and only such duties as are specifically set forth in the Trust Agreement and no implied duties or obligations shall be read into the Trust Agreement. The Trustee shall, during the existence of any event of default (that has not been cured), exercise such of the rights and powers vested in it by the Trust Agreement, and use the same degree of care and skill in their exercise, as a prudent person would exercise or use under the circumstances in the conduct of his own affairs.

### **Liability of Trustee**

The Trustee shall not be liable in connection with the performance of its duties under the Trust Agreement except for its own active or passive negligence, willful misconduct or breach of duty.

The Trustee shall not be bound, subject to the rights of the 2004B Insurer in connection with its Insurance Policy, to recognize any person as the Holder of a Bond unless and until such Bond is submitted for inspection, if required, and such Holder's title thereto satisfactorily established, if disputed.

The Trustee shall not be liable for any error of judgment made in good faith by a responsible officer, unless it shall be proved that the Trustee was negligent in ascertaining the pertinent facts.

The Trustee shall not be liable with respect to any action taken or omitted to be taken by it in good faith in accordance with the direction of the Holders of not less than a majority in aggregate principal amount and Accreted Value of the Bonds at the time Outstanding, relating to the time, method and place of conducting any proceeding for any remedy available to the Trustee, or exercising any trust or power conferred upon the Trustee under this Trust Agreement.

The Trustee shall be under no obligation to exercise any of the rights or powers vested in it by the Trust Agreement at the request, order or direction of any of the Bondholders pursuant to the provisions of the Trust Agreement unless such Bondholders shall have offered to the Trustee reasonable security or indemnity against the costs, expenses and liabilities that may be incurred therein or thereby. The Trustee has no obligation or liability to the Holders for the payment of interest on, principal of or redemption premium, if any, with respect to the Bonds from its own funds; but rather the Trustee's obligations shall be limited to the performance of its duties under the Trust Agreement.

The Trustee shall not be deemed to have knowledge of any event of default unless and until an officer at the Trustee's Corporate Trust Office responsible for the administration of its duties under the Trust Agreement shall have actual knowledge thereof or the Trustee shall have received written notice thereof at its Corporate Trust Office. The Trustee shall not be bound to ascertain or inquire as to the performance or observance of any of the terms, conditions, covenants or agreements in the Trust Agreement or of any of the documents executed in connection with the Bonds, or as to the existence of a default or event of default under the Trust Agreement. The Trustee shall not be responsible for the validity or effectiveness of any collateral given to or held by it.

The Trustee may execute any of the trusts or powers under the Trust Agreement or perform any duties under the Trust Agreement either directly or by or through attorneys-in-fact, agents or receivers, and shall be answerable for the negligence or misconduct or any such attorney-in-fact, agent or receiver. The Trustee shall be entitled to advice of counsel and other professionals concerning all matters of trust and its duty under the Trust Agreement, but the Trustee shall not be answerable for the professional malpractice of any attorney-in-law or certified public accountant in connection with the rendering of his professional advice in accordance with the terms of the Trust Agreement, if such attorney-in-law or certified public accountant was selected by the Trustee with due care.

### **Compensation and Indemnification of Trustee**

The County covenants to pay to the Trustee from time to time, and the Trustee shall be entitled to, reasonable compensation for all services rendered by it in the exercise and performance of any of the powers and duties under the Trust Agreement of the Trustee, and the County will pay or reimburse the Trustee upon its request for all expenses, disbursements and advances incurred or made by the Trustee in accordance with any of the provisions of the Trust Agreement (including the reasonable compensation and the expenses and disbursements of its counsel and of all persons not regularly in its employ) except any such expense, disbursement or advance as may arise from its negligence, default or willful misconduct, including the negligence or willful misconduct of any of its officers, directors, agents or employees. The County, to the extent permitted by law, shall indemnify, defend and hold harmless the



Trustee against any loss, damages, liability or expense incurred without negligence, willful misconduct or bad faith on the part of the Trustee, arising out of or in connection with the acceptance or administration of the trusts created hereby, including costs and expenses (including attorneys' fees) of defending itself against any claim or liability in connection with the exercise or performance of any of its powers under the Trust Agreement. The rights of the Trustee and the obligations of the County described in this paragraph shall survive the discharge of the Bonds and the Trust Agreement and the resignation or removal of the Trustee.

## **AMENDMENT OF THE TRUST AGREEMENT**

### **Amendment of the Trust Agreement Upon Consent of the Holders**

The Trust Agreement and the rights and obligations of the County and of the Holders may be amended at any time by a Supplemental Trust Agreement which shall become binding when the written consents of the Holders of a majority in aggregate principal amount and Accreted Value of the Bonds then Outstanding, exclusive of Bonds disqualified as provided in the Trust Agreement, are filed with the Trustee. No such amendment may (1) extend the maturity of or reduce the interest rate on or amount of interest on or principal of or redemption premium, if any, on any Bond without the express written consent of the Holder of such Bond, or (2) reduce the percentage of Bonds required for the written consent to any such amendment.

### **Amendment of the Trust Agreement Without Consent of the Holders**

Subject to the rights of the 2002 Insurer, the Trust Agreement and the rights and obligations of the County and of the Holders may also be amended at any time by a Supplemental Trust Agreement which shall become binding upon adoption without the consent of any Holders, but only to the extent permitted by law and after receipt of an approving Opinion of Counsel for any purpose that will not materially adversely affect the interests of the Holders, including (without limitation) for any one or more of the following purposes --

- (a) to add to the agreements and covenants required in the Trust Agreement to be performed by the County other agreements and covenants thereafter to be performed by the County, to pledge or assign additional security for the Bonds (or any portion thereof), or to surrender any right or power reserved in the Trust Agreement to or conferred in the Trust Agreement on the County;
- (b) to make such provisions for the purpose of curing any ambiguity or of correcting, curing or supplementing any defective provision contained in the Trust Agreement and in any supplemental trust agreement or in regard to questions arising under the Trust Agreement which the County may deem desirable or necessary and not inconsistent herewith;
- (c) to provide for the issuance of any Additional Bonds and to provide the terms of such Additional Bonds, subject to the conditions and upon compliance with the procedure set forth in the Trust Agreement (which shall be deemed not to adversely affect Holders);
- (d) to modify, amend or add to the provisions in the Trust Agreement or in any supplemental agreement to permit the qualification thereof under the Trust Indenture Act of 1939, as amended, or any similar federal statutes hereafter in effect, and to add such other terms, conditions and provisions as may be permitted by such statute or similar statute; or

(e) to modify, amend or supplement the Trust Agreement and any supplemental agreement in any manner that does not materially adversely affect the interest of Holders of Bonds.

### **Disqualified Bonds**

Bonds owned or held by or for the account of the County shall not be deemed Outstanding for the purpose of any consent or other action or any calculation of Outstanding Bonds provided in the Trust Agreement, and shall not be entitled to consent to or take any other action provided in the Trust Agreement; provided, however, that Series 2004 Bonds covered by the Insurance Policy shall not be so disqualified.

### **Endorsement or Replacement of Bonds After Amendment**

After the effective date of any action taken as in the Trust Agreement above provided, the County may determine that the Bonds may bear a notation by endorsement in form approved by the County as to such action, and in that case upon demand of the Holder of any Outstanding Bonds and presentation of his Bond for such purpose at the office of the Trustee a suitable notation as to such action shall be made on such Bond. If the County shall so determine, new Bonds so modified as, in the opinion of the County, shall be necessary to conform to such action shall be prepared and executed, and in that case upon demand of the Holder of any Outstanding Bond a new Bond or Bonds shall be exchanged at the office of the Trustee without cost to each Holder for its Bond or Bonds then Outstanding upon surrender of such Outstanding Bonds.

### **Amendment by Mutual Consent**

The provisions of the Trust Agreement shall not prevent any Holder from accepting any amendment as to the particular Bonds held by him, provided that due notation thereof is made on such Bonds; provided that no Holder of a Series 2002 Bond insured by a financial guaranty insurance policy issued by the 2002 Insurer shall be permitted to accept such an amendment without the prior written consent of the 2002 Insurer.

## **EVENTS OF DEFAULT AND REMEDIES OF HOLDERS**

### **Events of Default and Acceleration of Maturities**

If one or more of the following events (herein called “events of default”) shall happen, that is to say:

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

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

(c) if default shall be made by the County in the performance of any of the agreements or covenants required herein to be performed by the County, and such default shall have continued for a period of sixty (60) days after the County shall have been given notice in writing of such default by the Trustee; specifying such default and requiring the same to be

remedied, shall have been given to the County by the Trustee or the Holders of not less than 25% in aggregate principal amount and Accreted Value of the Bonds at the time Outstanding; provided, however, if the default stated in the notice can be corrected, but not within the applicable period, the Trustee and such Holders shall not unreasonably withhold their consent to an extension of such time if corrective action is instituted by the County within the applicable period and diligently pursued until the default is corrected.

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

then and in each and every such case during the continuance of such event of default the Trustee may, and upon the written request of the Holders of not less than 51% in aggregate principal amount and Accreted Value of the Bonds then Outstanding shall, by notice in writing to the County, declare the principal and Accreted Value of all Bonds then Outstanding and the interest accrued thereon to be due and payable immediately, and upon any such declaration the same shall become due and payable, anything contained herein or in the Bonds to the contrary notwithstanding. The Trustee shall promptly notify all Holders of any such event of default which is continuing.

This provision, however, is subject to the condition that if at any time after the principal and Accreted Value of the Bonds then Outstanding shall have been so declared due and payable and before any judgment or decree for the payment of the money due shall have been obtained or entered the County shall deposit with the Trustee a sum sufficient to pay all matured interest on all the Bonds and all principal and Accreted Value of the Bonds matured prior to such declaration, with interest at the rate borne by such Bonds on such overdue interest, principal and Accreted Value, and the reasonable fees and expenses of the Trustee, and any and all other defaults known to the Trustee (other than in the payment of interest on and principal of the Bonds due and payable solely by reason of such declaration) shall have been made good or cured to the satisfaction of the Trustee or provision deemed by the Trustee to be adequate shall have been made therefor, then and in every such case the Holders of not less than 51% in aggregate principal amount and Accreted Value of Bonds then Outstanding, by written notice to the County and to the Trustee, may on behalf of the Holders of all the Bonds then Outstanding rescind and annul such declaration and its consequences; but no such rescission and annulment shall extend to or shall affect any subsequent default or shall impair or exhaust any right or power consequent thereon.

### **Application of Funds Upon Acceleration**

All moneys in the accounts and funds provided in the Trust Agreement upon the date of the declaration of acceleration by the Trustee and all amounts in such funds and accounts thereafter received by the County under the Trust Agreement shall be transmitted to the Trustee and shall be applied by the Trustee in the following order —

First, to the payment of the costs and expenses of the Trustee, if any, in carrying out the provisions of the Trust Agreement with respect to Events of Default and remedies thereon, including reasonable compensation to their accountants and counsel, and to the payment of the costs and expenses

of the Holders (including the 2002 Insurer) in providing for the declaration of such event of default, including reasonable compensation to its accountants and counsel; and

Second, upon presentation of the several Bonds, and the stamping thereon of the amount of the payment if only partially paid or upon the surrender thereof if fully paid, to the payment of the whole amount then owing and unpaid upon the Bonds for interest, Accreted Value, and principal, with (to the extent permitted by law) interest on the overdue interest, Accreted Value and principal at the rate borne by such Bonds, and in case such money shall be insufficient to pay in full the whole amount so owing and unpaid upon the Bonds, then to the payment of such interest, Accreted Value, principal and (to the extent permitted by law) interest on overdue interest, Accreted Value, and principal without preference or priority among such interest, Accreted Value, principal and interest on overdue interest, Accreted Value, and principal ratably to the aggregate of such interest, Accreted Value, principal, and interest on overdue interest, Accreted Value and principal.

### **Institution of Legal Proceedings by Trustee**

If one or more of the events of default shall happen and be continuing, the Trustee may with the prior written consent of the 2002 Insurer, and upon the written request of the Holders of a majority in principal amount of the Bonds then Outstanding, and upon being indemnified to its satisfaction therefor, shall, proceed to protect or enforce its rights or the rights of the Holders of Bonds under the Trust Agreement by a suit in equity or action at law, either for the specific performance of any covenant or agreement contained in the Trust Agreement, or in aid of the execution of any power in the Trust Agreement granted, or by mandamus or other appropriate proceeding for the enforcement of any other legal or equitable remedy as the Trustee shall deem most effectual in support of any of its rights and duties under the Trust Agreement.

### **Non-Waiver**

Nothing in any provision of the Trust Agreement or in the Bonds shall affect or impair the obligation of the County, which is absolute and unconditional, to pay the interest on and principal and Accreted Value of and redemption premiums, if any, on the Bonds to the respective Holders of the Bonds at the respective dates of maturity or upon prior redemption as provided herein, or shall affect or impair the right of such Holders, which is also absolute and unconditional, to institute suit to enforce such payment by virtue of the contract embodied herein and in the Bonds.

A waiver of any default or breach of duty or contract by the Trustee or any Holder shall not affect any subsequent default or breach of duty or contract or impair any rights or remedies on any such subsequent default or breach of duty or contract. No delay or omission by the Trustee or any Holder to exercise any right or remedy accruing upon any default or breach of duty or contract shall impair any such right or remedy or shall be construed to be a waiver of any such default or breach of duty or contract or an acquiescence in the Trust Agreement, and every right or remedy conferred upon the Holders by the Act or by the Trust Agreement may be enforced and exercised from time to time and as often as shall be deemed expedient by the Trustee or the Holders.

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

### **Actions by Trustee as Attorney-in-Fact**

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

### **Remedies Not Exclusive**

No remedy in the Trust Agreement conferred upon or reserved to the Holders is intended to be exclusive of any other remedy, and each such remedy shall be cumulative and shall be in addition to every other remedy given under the Trust Agreement or now or hereafter existing at law or in equity or by statute or otherwise and may be exercised without exhausting and without regard to any other remedy conferred by the Act or any other law.

### **Limitation on Bondholders' Right to Sue**

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

Such notification, request, tender of indemnity and refusal or omission are hereby declared, in every case, to be conditions precedent to the exercise by any Holder of Bonds of any remedy under the Trust Agreement; it being understood and intended that no one or more Holders of Bonds shall have any right in any manner whatever by his or their action to enforce any right under the Trust Agreement, except in the manner in the Trust Agreement provided; and that all proceedings at law or in equity to enforce any provision of the Trust Agreement shall be instituted, had and maintained in the manner in the Trust Agreement provided and for the equal benefit of all Holders of the Outstanding Bonds.

### **Absolute Obligation of County**

Nothing in any provision of the Trust Agreement or in the Bonds contained shall affect or impair the obligation of the County, which is absolute and unconditional, to pay the principal and Accreted Value of, premium, if any and interest on the Bonds to the respective Holders of the Bonds at their respective due dates as herein provided.

## **Rights of 2002 Insurer**

The 2002 Insurer shall be deemed the Holder and shall be treated as such for purposes of any provisions requiring the consent or approval of the Holders of Series 2002 Bonds or with respect to rights of such Holders other than the right to receive payments of principal, purchase price and interest, and tender and purchase rights under the Trust Agreement, but only for so long as the 2002 Insurer is in compliance with the Insurance Policy, and if the 2002 Insurer is in default under the Insurance Policy, the 2002 Insurer shall not have any rights granted to the 2002 Insurer under the Trust Agreement.

## **DEFEASANCE OF BONDS**

### **Discharge of Bonds**

If the County shall pay or cause to be paid or there shall otherwise be paid to the Holders of all Outstanding Bonds the interest and the principal and Accreted Value thereof and the redemption premiums, if any, thereon at the times and in the manner stipulated herein and therein, then all agreements, covenants and other obligations of the County to the Holders of such Bonds hereunder shall thereupon cease, terminate and become void and be discharged and satisfied. In such event, the Trustee shall execute and deliver to the County all such instruments as may be necessary or reasonably desirable to evidence such discharge and satisfaction, the Trustee shall pay over or deliver to the County all money or securities held by it pursuant hereto which are not required for the payment of the interest on and principal and Accreted Value of and redemption premiums, if any, on such Bonds.

Any Outstanding Bonds shall prior to the maturity date or redemption date thereof be deemed to have been paid within the meaning of and with the effect expressed in the preceding paragraph if (1) in case any of such Bonds are to be redeemed on any date prior to their maturity date, the County shall have given to the Trustee in form satisfactory to it irrevocable instructions to provide notice in accordance with the Trust Agreement, (2) except as described below under “2004 INSURER PROVISIONS—Defeasance Provisions” with respect to the Series 2004 Bonds, there shall have been deposited with the Trustee either (A) money in an amount which shall be sufficient or (B) Permitted Investments of the type described in clause (1) of the definition of Permitted Investments and which are not subject to redemption prior to maturity (including any such Permitted Investments issued or held in book entry form on the books of the County or the Treasury of the United States of America) or tax exempt obligations of a state or political subdivision thereof which have been defeased under irrevocable escrow instructions by the deposit of such money or Permitted Investments and which are then rated in the highest rating category by the Rating Agencies, the interest on and principal and Accreted Value of which when paid will provide money which, together with the money, if any, deposited with the Trustee at the same time, shall be sufficient, in the opinion of an Independent Certified Public Accountant, to pay when due the interest to become due on such Bonds on and prior to the maturity date or redemption date thereof, as the case may be, and the principal of and Accreted Value and redemption premiums, if any, on such Bonds, and (3) in the event such Bonds are not by their terms subject to redemption within the next succeeding 60 days, the County shall have given the Trustee in form satisfactory to it irrevocable instructions to mail as soon as practicable, a notice to the Holders of such Bonds that the deposit required by clause (2) above has been made with the Trustee and that such Bonds are deemed to have been paid in accordance with this section and stating the maturity date or redemption date upon which money is to be available for the payment of the principal and Accreted Value of and redemption premiums, if any, on such Bonds.

## **Unclaimed Money**

Anything contained in the Trust Agreement to the contrary notwithstanding, any money held by the Trustee in trust for the payment and discharge of any of the Bonds or interest thereon which remains unclaimed for two years after the date when such Bonds or interest thereon have become due and payable, either at their stated maturity dates or by call for redemption prior to maturity, if such money was held by the Trustee at such date, or for two years after the date of deposit of such money if deposited with the Trustee after the date when such Bonds have become due and payable, shall at the Written Request of the County be repaid by the Trustee to the County as its absolute property free from trust, and the Trustee shall thereupon be released and discharged with respect thereto and the Holders shall not look to the Trustee for the payment of such Bonds; provided, however, that before being required to make any such payment to the County, the Trustee may, and at the request of the County shall, at the expense of the County, cause to be published once a week for two successive weeks in a Financial Newspaper of general circulation in Los Angeles and in San Francisco, California and in the same or a similar Financial Newspaper of general circulation in New York, New York a notice that such money remains unclaimed and that, after a date named in such notice, which date shall not be less than 30 days after the date of the first publication of each such notice, the balance of such money then unclaimed will be returned to the County.

## **2004 INSURERS PROVISIONS**

### **2004 Insurers Deemed Holders**

The 2004A Insurer will be deemed the Holder of all of the Series 2004 A Bonds and all of the Series 2004 C Bonds and will be treated as such (1) for purposes of any provisions requiring the consent or approval of the Holders of the Series 2004 A Bonds and the Series 2004 C Bonds, (2) for purposes of the provisions of the Trust Agreement governing events of default and remedies (except the giving of notice of default to the Holders of the Series 2004 A Bonds and the Series 2004 C Bonds), and (3) with respect to rights of such Holders other than the right to receive payments of principal, purchase price and interest, and tender and purchase rights under the Trust Agreement, but only for so long as the 2004A Insurer is in compliance with the 2004A Insurance Policy, and if the 2004A Insurer is in default under the 2004A Insurance Policy, the 2004A Insurer shall not have any rights granted to the 2004A Insurer under the Trust Agreement.

The 2004B Insurer will be deemed the Holder of all of the Series 2004 B Bonds and will be treated as such (1) for purposes of any provisions requiring the consent or approval of the Holders of the Series 2004 B Bonds, (2) for purposes of the provisions of the Trust Agreement governing events of default and remedies (except the giving of notice of default to the Holders of the Series 2004 B Bonds), and (3) with respect to rights of such Holders other than the right to receive payments of principal, purchase price and interest, and tender and purchase rights under the Trust Agreement, but only for so long as the 2004B Insurer is in compliance with the 2004B Insurance Policy, and if the 2004B Insurer is in default under the 2004B Insurance Policy, the 2004B Insurer shall not have any rights granted to the 2004B Insurer under the Trust Agreement.

### **2004 Insurers Control Rights and Remedies**

For so long as the 2004A Insurer is in compliance with its obligations under the 2004A Insurance Policy, upon the occurrence and continuance of an event of default, the 2004A Insurer, acting alone, will be entitled to control and direct the enforcement of all rights and remedies granted to the Holders of the Series 2004 A Bonds and the Series 2004 C Bonds or the Trustee for the benefit of the Holders of the Series 2004 A Bonds and the Series 2004 C Bonds under the Trust Agreement, including,

without limitation, (1) the right to accelerate the principal of the Series 2004 A Bonds and Series 2004 C Bonds as described in the Trust Agreement; and (2) the right to annul any declaration of acceleration, and the 2004A Insurer shall also be entitled to approve all waivers of events of default. The Trustee shall be entitled to rely upon a certificate of an authorized officer of the 2004A Insurer to the effect that the 2004A Insurer is in compliance with its obligations under the 2004A Insurance Policy.

For so long as the 2004B Insurer is in compliance with its obligations under the 2004B Insurance Policy, upon the occurrence and continuance of an event of default, the 2004B Insurer, acting alone, will be entitled to control and direct the enforcement of all rights and remedies granted to the Holders of the Series 2004 B Bonds or the Trustee for the benefit of the Holders of the Series 2004 B Bonds under the Trust Agreement, including, without limitation, (1) the right to accelerate the principal of the Series 2004 B Bonds as described in the Trust Agreement; and (2) the right to annul any declaration of acceleration, and the 2004B Insurer shall also be entitled to approve all waivers of events of default. The Trustee shall be entitled to rely upon a certificate of an authorized officer of the 2004B Insurer to the effect that the 2004B Insurer is in compliance with its obligations under the 2004B Insurance Policy.

### **Parties In Interest**

The 2004 Insurers shall each be included as a party in interest and as a party entitled to (a) notify the County, the Trustee, if any, or any applicable receiver of the occurrence of an event of default and (b) request the Trustee or receiver to intervene in judicial proceedings that affect the Series 2004 A Bonds and the Series 2004 C Bonds, in the case of the 2004A Insurer, or the Series 2004 B Bonds, in the case of the 2004B Insurer. The Trustee or receiver shall be required to accept any notice of default from the 2004 Insurers.

### **Amendments**

The County will not enter into any amendment or modification of the Trust Agreement that, pursuant to the terms of the Trust Agreement, requires the written consents of the Holders of a majority in aggregate principal amount and Accreted Value of the Bonds then Outstanding, without the written consent of each of the 2004 Insurers.

The County hereby agrees that it will send to each Rating Agency then rating any of the Series 2004 Bonds a copy of any amendment to the Trust Agreement at least 15 days before its execution and delivery by the County. The County hereby agrees that it will send to each of the 2004 Insurers a copy of any executed amendments to the Trust Agreement or this Second Supplemental Trust Agreement and any executed Supplemental Trust Agreements reasonably promptly after execution thereof.

### **Notifications and Reports**

The County shall send to each of the 2004 Insurers written notice of the resignation or removal of the Trustee and the appointment of any successor thereto.

The Trustee and the County hereby severally agree that they will each send written notice to the 2004 Insurers of event of default known them within 30 days of the Trustee's or the County's respective knowledge thereof.

The County hereby agrees that it will send to the 2004 Insurers the following:

(1) Notice of the redemption, other than mandatory sinking fund redemption, or any defeasance pursuant to the Trust Agreement of any of the Series 2004 Bonds, including the principal



amount, Accreted Value, maturities, and CUSIP numbers thereof, provided, that notice need only be sent to the 2004A Insurer if the Series 2004 A Bonds or Series 2004 C Bonds are affected and to the 2004B Insurer if the Series 2004 B Bonds are affected;

(2) Notice of the downgrading by any Rating Agency then rating the County's underlying rating on the Series 2004 Bonds to "non-investment grade";

(3) Notice of any material events pursuant to Rule 15c2-12 under the Securities Exchange Act of 1934, as amended; and

(4) Such additional information as either of the 2004 Insurers may reasonable request from time to time.

The County agrees in the Second Supplemental Trust Agreement that it will pay or reimburse the 2004 Insurers for any and all charges, fees, costs, and expenses that the 2004 Insurers may reasonably pay or incur in connection with the following: (i) the administration, enforcement, defense, or preservation of any rights or security under the Trust Agreement; (ii) the pursuit of any remedies under the Trust Agreement; (iii) any amendment, waiver, or other action with respect to or related to the Trust Agreement whether or not executed or completed; (iv) the violation by the County of any law, rule, or regulation or any judgment, order or decree applicable to it; (v) any advances or payments made by the 2004 Insurers to cure defaults of the County under the Trust Agreement; or (vi) any litigation or other dispute in connection with the Trust Agreement or the issuance of the Series 2004 Bonds, other than amounts resulting from the failure of either of the 2004 Insurers to honor their respective payment obligations under the 2004A Insurance Policy or the 2004B Insurance Policy, as applicable; provided, that to the extent that Section 1717 of the California Civil Code governs the payment of litigation expenses, that section will apply. The 2004 Insurers reserve their respective rights to charge a reasonable fee as a condition to executing any amendment, waiver, or consent proposed in respect of the Trust Agreement. The obligations of the County to the 2004 Insurers will survive discharge and termination of the Trust Agreement.

### **Defeasance Provisions**

If, in connection with any defeasance pursuant to the Trust Agreement with respect to any of the Series 2004 Bonds, a forward supply contract is employed in connection with such defeasance, (1) the opinion of the Independent Certified Public Accountant referenced in the defeasance provisions of the Trust Agreement (as described above under "DEFEASANCE OF BONDS—Discharge of Bonds" above) must expressly state that the adequacy of the escrow to accomplish the defeasance relies solely on the initial escrowed investments and the maturing principal thereof and interest income thereon and does not assume performance under or compliance with the forward supply contract, and (2) the applicable escrow agreement must provide that in the event of any discrepancy or difference between the terms of the forward supply contract and the escrow agreement (or the Trust Agreement, if no separate escrow agreement is utilized), the terms of the escrow agreement or the Trust Agreement, if applicable, shall be controlling.

Notwithstanding the Trust Agreement, to defease any of the Series 2004 Bonds pursuant to the defeasance provisions of the Trust Agreement (as described above under "DEFEASANCE OF BONDS—Discharge of Bonds" above), then, in addition to having met the requirements of clauses (1) and (3) therein, there shall have been deposited with the Trustee either (A) money in an amount which shall be sufficient or (B) Federal Securities which are not subject to redemption prior to maturity, the interest on and principal of which when paid will provide money which, together with the money, if any, deposited with the Trustee at the same time, shall be sufficient, in the opinion of an Independent Certified

Public Accountant, to pay when due the interest to become due on such Series 2004 Bonds on and prior to the maturity date or redemption date thereof, as the case may be, and the principal of, Accreted Value, and redemption premiums, if any, on such Series 2004 Bonds.

### **Subrogation**

If principal, interest or both due on any Series 2004 A Bonds or the Series 2004 C Bonds shall be paid by the 2004A Insurer, such Series 2004 A Bonds or the Series 2004 C Bonds, as applicable, shall remain outstanding under the Trust Agreement for all purposes, and shall not be deemed defeased or otherwise satisfied, or paid by the County, and all covenants, agreements and other obligations of the County to the Holders of such Series 2004 A Bonds or the Series 2004 C Bonds, as applicable, shall continue to exist and shall run to the benefit of the 2004A Insurer, and the 2004A Insurer shall be subrogated to the rights of such Holders.

If principal, interest or both due on any Series 2004 B Bonds shall be paid by the 2004B Insurer, such Series 2004 B Bonds shall remain outstanding under the Trust Agreement for all purposes, and shall not be deemed defeased or otherwise satisfied, or paid by the County, and all covenants, agreements and other obligations of the County to the Holders of such Series 2004 B Bonds shall continue to exist and shall run to the benefit of the 2004B Insurer, and the 2004B Insurer shall be subrogated to the rights of such Holders.

### **Consent to Acceleration; Determination of Default**

Notwithstanding the Trust Agreement, the Trustee may not declare the principal and Accreted Value of any of the Series 2004 A Bonds or the Series 2004 C Bonds and the interest accrued thereon to be due and payable unless the 2004A Insurer so consents, and may not declare the principal of any of the Series 2004 B Bonds and the interest accrued thereon to be due and payable unless the 2004B Insurer so consents.

In determining whether an event of default described under the provisions of the Trust Agreement regarding default in the payment of interest, principal and Accreted Value, no effect shall be given to payments made under the 2004A Insurance Policy or the 2004B Insurance Policy, as the case may be.

**APPENDIX D**

**2004 BOND COUNSEL APPROVING OPINION**

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ORRICK

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June 29 , 2004

County of San Diego  
1600 Pacific Highway  
San Diego, California 92101

Re: County of San Diego Taxable Pension Obligation Bonds,  
Series 2004 A, Series 2004 B and Series 2004 C  
(Final Opinion)

Ladies and Gentlemen:

We have acted as bond counsel in connection with the issuance by the County of San Diego (the "County") of \$454,112,915.70 aggregate principal amount of County of San Diego Taxable Pension Obligation Bonds, Series 2004 A, Series 2004 B and Series 2004 C (collectively, the "Bonds"), pursuant to Articles 10 and 11 of Chapter 3 of Division 2 of Title 5 of the California Government Code (the "Act"), and a Trust Agreement, dated as of February 1, 1994, between the County and U.S. Trust Company of California, N.A., as trustee, as amended and supplemented by a First Supplemental Trust Agreement, dated as of September 1, 2002 (collectively, the "Existing Trust Agreement"), and as further amended and supplemented by a Second Supplemental Trust Agreement, dated as of June 1, 2004 (the "Supplemental Trust Agreement" and together with the Existing Trust Agreement, the "Trust Agreement"), between the County and BNY Western Trust Company, as successor trustee (the "Trustee").

In such connection, we have reviewed the Trust Agreement, the opinions of counsel to the Trustee and the County, the report prepared by the County's Actuary (the "Actuary") regarding the valuation of the assets and liabilities of the County Employees' Retirement Association, certificates of the County, the Trustee, the Actuary and others and such other documents, matters and opinions to the extent we deemed necessary to render the opinions set forth herein.

The opinions expressed herein are based on an analysis of existing laws, regulations, rulings and court decisions, including the default judgment rendered on December 16, 1993, by the Superior Court of the County of San Diego in the action entitled *County of San Diego v. All Persons*, No. 670668, filed November 10, 1993, 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 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)



O R R I C K

County of San Diego  
June 29, 2004  
Page Two

and the due and legal execution and delivery thereof by, and validity against, any parties other than the County. We have not undertaken to verify independently, and have assumed, the accuracy of the factual matters represented, warranted or certified in the documents referred to in the second paragraph hereof. We call attention to the fact that the rights and obligations under the Bonds and the Trust Agreement may be subject to bankruptcy, insolvency, reorganization, arrangement, fraudulent conveyance, moratorium and other laws relating to or affecting creditors' rights, to the application of equitable principles, to the exercise of judicial discretion in appropriate cases and to the limitations on legal remedies against counties in the State of California. We express no opinion with respect to any indemnification, contribution, choice of law, choice of forum or waiver provisions contained in the foregoing documents. Finally, we undertake no responsibility for the accuracy, completeness or fairness of the Official Statement or other offering material relating to the Bonds and express no opinion with respect thereto.

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

1. The Bonds constitute valid and binding obligations of the County.
2. The Supplemental Trust Agreement has been duly executed and delivered by, and constitutes a valid and binding obligation of, the County.
3. The Bonds do not constitute an obligation of the County for which the County is obligated to levy or pledge any form of taxation or for which the County has levied or pledged any form of taxation, and neither the Bonds nor the obligation of the County to make payment of the interest on or the principal of the Bonds constitutes an indebtedness of the County or the State, or any of its political subdivisions, in contravention of any constitutional or statutory debt limitation or restriction.
4. Interest on the Bonds is not excludable from gross income for federal income tax purposes and is exempt from State of California personal income taxes. We express no opinion regarding other tax consequences related to the ownership or disposition of, or the accrual or receipt of interest on, the Bonds.

Faithfully yours,

ORRICK, HERRINGTON & SUTCLIFFE LLP

per 

**APPENDIX E**

**2004 CONTINUING DISCLOSURE AGREEMENT**

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## CONTINUING DISCLOSURE AGREEMENT

relating to

\$454,112,915.70 County of San Diego  
Taxable Pension Obligation Bonds, Series 2004A (Current Interest Bonds)  
Taxable Pension Obligation Bonds, Series 2004B (Auction Rate Securities)  
Taxable Pension Obligation Bonds, Series 2004C (Capital Appreciation Bonds)

This Continuing Disclosure Agreement, dated as of June 1, 2004, (the "Disclosure Agreement") is executed and delivered by the County of San Diego, California (the "County") and BNY Western Trust Company, a banking corporation duly organized and existing under and by virtue of the laws of the State of California, as successor trustee (the "Trustee") and as Dissemination Agent (the "Dissemination Agent") in connection with the authorization and sale of the County's Taxable Pension Obligation Bonds, Series 2004A (Current Interest Bonds) (the "Series 2004 A Bonds") in the aggregate principal amount of \$241,360,000, Taxable Pension Obligation Bonds, Series 2004B (Auction Rate Securities) (the "Series 2004 B Bonds") in the aggregate principal amount of \$147,825,000, and Taxable Pension Obligation Bonds, Series 2004C (Capital Appreciation Bonds) (the "Series 2004 C Bonds" and, together with the 2004 Series A Bonds and the 2004 Series B Bonds, the "Bonds") in the aggregate principal amount of \$64,927,915.70. The Bonds are being executed and delivered pursuant to a Trust Agreement, dated as of February 1, 1994, between the County and BNY Western Trust Company, as trustee (the "Trustee") as supplemented, including by a Second Supplemental Trust Agreement dated as of June 1, 2004, between the County and the Trustee (as so supplemented, the "Trust Agreement"). The County and the Dissemination Agent covenant and agree as follows:

**Section 1. Purpose of the Disclosure Agreement.** This Disclosure Agreement is being executed and delivered by the County and the Dissemination Agent for the benefit of the Owners and Beneficial Owners of the Bonds and in order to assist the Participating Underwriter in complying with S.E.C. Rule 15c2-12(b)(5).

**Section 2. Definitions.** In addition to the definitions set forth in the Trust Agreement, which apply to any capitalized term used in this Disclosure Agreement unless otherwise defined in this Section, the following capitalized terms shall have the following meanings:

"Annual Report" shall mean any Annual Report provided by the County pursuant to, and as described in, Sections 3 and 4 of this Disclosure Agreement.

"Beneficial Owner" shall mean any person which has or shares the power, directly or indirectly, to make investment decisions concerning ownership of any Bonds (including persons holding Bonds through nominees, depositories or other intermediaries).

"Disclosure Representative" shall mean the Chief Financial Officer of the County or his or her designee, or such other officer or employee as the County shall designate in writing to the Dissemination Agent from time to time.

"Dissemination Agent" shall mean BNY Western Trust Company, a banking corporation duly organized and existing under and by virtue of the laws of the State of California, acting in its capacity as Dissemination Agent hereunder, or any successor Dissemination Agent designated in writing by the County and which has filed with the Trustee a written acceptance of such designation.

"Insurer" shall mean with respect to the Series 2004 A Bonds and the Series 2004 C Bonds, Financial Guaranty Insurance Company, doing business in California as FGIC Insurance Company, and with respect to the Series 2004 C Bonds, XL Capital Assurance Inc.

"Listed Events" shall mean any of the events listed in Section 5(a) of this Disclosure Agreement.

"National Repository" shall mean any Nationally Recognized Municipal Securities Information Repository for purposes of the Rule. As of the date hereof, the National Repositories approved by the Securities and Exchange Commission are at <http://www.sec.gov/info/municipal/nrmsir.htm>.

"Participating Underwriter" shall mean any of the original Underwriters of the Bonds required to comply with the Rule in connection with offering of the Bonds.

"Repository" shall mean each National Repository and the State Repository.

"Rule" shall mean Rule 15c2-12(b)(5) adopted by the Securities and Exchange Commission under the Securities Exchange Act of 1934, as the same may be amended from time to time.

"State" shall mean the State of California.

"State Repository" shall mean any public or private repository or entity designated by the State as the state repository for the purpose of the Rule and recognized as such by the Securities and Exchange Commission. As of the date of this Agreement, there is no State Repository.

**Section 3. Provision of Annual Reports.** (a) The County shall, or shall cause the Dissemination Agent to, not later than 180 days after the end of the County's fiscal year (which currently ends on June 30), commencing with the report for the County's fiscal year ended June 30, 2004, provide to each Repository and the Insurer (so long as its financial guaranty insurance policy shall be in full force and effect and so long as the Insurer is not in default under its financial guaranty insurance policy) an Annual Report which is consistent with the requirements of Section 4 of this Disclosure Agreement. The Annual Report may be submitted as a single document or as separate documents comprising a package, and may include by reference other information as provided in Section 4 of this Disclosure Agreement; provided that the audited financial statements of the County may be submitted separately from the balance of the Annual Report and later than the date required above for the filing of the Annual Report if they are not available by that date. If the County's fiscal year changes, it shall give notice of such change to the Dissemination Agent in the same manner as for a Listed Event under Section 5(f).

(b) Not later than fifteen (15) Business Days prior to the date specified in subsection (a) for providing the Annual Report to Repositories, the County shall provide the Annual Report to the Dissemination Agent and the Trustee (if the Trustee is not the Dissemination Agent). If by such date the Dissemination Agent has not received a copy of the Annual Report, the Dissemination Agent shall contact the County and the Trustee to determine if the County is in compliance with the first sentence of this subsection (b).

(c) If the Dissemination Agent is unable to verify that an Annual Report has been provided to Repositories by the date required in subsection (a), the Dissemination Agent shall send a notice to each Repository and the Insurer (so long as its financial guaranty insurance policy shall be in full force and effect and so long as the Insurer is not in default under its financial guaranty insurance policy) substantially the form attached as Exhibit A.

(d) The Dissemination Agent shall:

(i) determine each year prior to the date for providing the Annual Report the name and address of each National Repository and the State Repository, if any; and

(ii) file a report with the County and (if the Dissemination Agent is not the Trustee) the Trustee certifying that the Annual Report has been provided pursuant to this Disclosure Agreement, stating the date it was provided and listing all the Repositories to which it was provided.

**Section 4. Content of Annual Reports.** The County's Annual Report shall contain or include by reference the following:

1. The audited financial statements of the County for the prior fiscal year, prepared in accordance with generally accepted accounting principles as promulgated to apply to governmental entities from time to time by the Governmental Accounting Standards Board. If the County's audited financial statements are not available by the time the Annual Report is required to be filed pursuant to Section 3(a), the Annual Report shall contain unaudited financial statements in a format similar to the financial statements contained in the final Official Statement, and the audited financial statements shall be filed in the same manner as the Annual Report when they become available.
2. An update of the information contained in the last paragraph under the heading "Assessed Valuations" and in the tables with the following headings in the Appendix A to the Official Statement under the caption "COUNTY FINANCIAL INFORMATION" for the then current fiscal year:

ASSESSED VALUATION OF PROPERTY SUBJECT  
TO AD VALOREM TAXATION

TEN LARGEST TAXPAYERS

SECURED TAX ROLL STATISTICS

GENERAL FUND COMBINED BALANCE SHEET

GENERAL FUND COMPARISON OF REVENUES,  
EXPENDITURES AND FUND BALANCES

COUNTY OF SAN DIEGO GENERAL FUND BUDGET

HISTORICAL FUNDING STATUS

TRANSFERS OF INVESTMENT EARNINGS TO NON-VALUATION  
ASSETS

PAYMENTS TO HEALTH RESERVE

TOTAL COUNTY EMPLOYEES

SUMMARY OF GENERAL LONG-TERM OBLIGATIONS  
PAYABLE FROM THE GENERAL FUND

An update of the financial and operating data relating solely to the County contained under the heading "SAN DIEGO COUNTY INVESTMENT POOL" in the Official Statement.

Any or all of the items listed above may be included by specific reference to other documents, including official statements of debt issues of the County or related public entities, which have been submitted to each of the Repositories or the Securities and Exchange Commission. If the document included by reference is a final official statement, it must be available from the Municipal Securities Rulemaking Board. The County shall clearly identify each such other document so included by reference.

**Section 5. Reporting of Significant Events.** (a) Pursuant to the provisions of this Section 5, the County shall give, or cause to be given, notice of the occurrence of any of the following events with respect to the Bonds, if material:

- (1) principal and interest payment delinquencies;
- (2) non-payment related defaults;
- (3) modifications to rights of owners of the Bonds;
- (4) optional, contingent or unscheduled Bond calls;

- (5) defeasances;
- (6) rating changes;
- (7) adverse tax opinions or events adversely affecting the tax-exempt status of the Bonds;
- (8) unscheduled draws on the debt service reserves reflecting financial difficulties;
- (9) unscheduled draws on credit enhancements reflecting financial difficulties;
- (10) substitution of credit or liquidity providers, or their failure to perform; and
- (11) release, substitution or sale of property securing repayment of the Bonds.

(b) The Dissemination Agent shall, within one (1) Business Day or as soon as reasonably practicable thereafter, of obtaining actual knowledge of the occurrence of any of the Listed Events, contact the Disclosure Representative, inform such person of the event, and request that the County promptly notify the Dissemination Agent in writing whether or not to report the event pursuant to subsection (f); provided, however, that the Dissemination Agent shall have no liability to Bond owners for any failure to provide such notice. For purposes of this Disclosure Agreement, "actual knowledge" of the occurrence of the Listed Events described under clauses (2), (3), (6), (10) and (11) above shall mean actual knowledge by an officer responsible for the Dissemination Agent services to be provided in connection with the Bonds at the corporate trust office of the Dissemination Agent. The Dissemination Agent shall have no responsibility for determining the materiality of any of the Listed Events.

(c) Whenever the County obtains knowledge of the occurrence of a Listed Event, whether because of a notice from the Dissemination Agent pursuant to subsection (b) or otherwise, the County shall as soon as possible determine if such event would be material under applicable federal securities laws.

(d) If the County has determined that knowledge of the occurrence of a Listed Event would be material under applicable federal securities laws, the County shall promptly notify the Dissemination Agent in writing. Such notice shall instruct the Dissemination Agent to report the occurrence pursuant to subsection (f). The County shall provide the Dissemination Agent with a form of notice of such event in a format suitable for reporting to the Municipal Securities Rulemaking Board and each State Repository, if any.

(e) If in response to a request under subsection (b), the County determines that the Listed Event would not be material under applicable federal securities laws, the County shall so notify the Dissemination Agent in writing and instruct the Dissemination Agent not to report the occurrence pursuant to subsection (f).

(f) If the Dissemination Agent has been instructed by the County to report the occurrence of a Listed Event, the Dissemination Agent shall file a notice of such occurrence with the Repositories and the Insurer (so long as its financial guaranty insurance policy shall be in full force and effect and so long as the Insurer is not in default under its financial guaranty insurance policy). Notwithstanding the foregoing, notice of Listed Events described in subsections (a)(4) and (5) need not be given under this subsection any earlier than the notice (if any) of the underlying event is given to Owners of affected Bonds pursuant to the Trust Agreement.

**Section 6. Termination of Reporting Obligation.** The County's obligations under this Disclosure Agreement shall terminate upon the legal defeasance, prior prepayment or payment in full of all of the Bonds. If such termination occurs prior to the final maturity of the Bonds, the County shall give notice of such termination in the same manner as for a Listed Event under Section 5(f).

**Section 7. Dissemination Agent.** The County may, from time to time, appoint or engage a Dissemination Agent to assist it in carrying out its obligations under this Disclosure Agreement, and may discharge any such Dissemination Agent, with or without appointing a successor Dissemination Agent. The Dissemination Agent may resign by providing thirty days' written notice to the County and the Trustee. The Dissemination Agent shall have no duty to prepare the Annual Report nor shall the Dissemination Agent be responsible for filing any Annual Report not provided to it by the County in a timely manner and in a form suitable for filing. The initial Dissemination Agent shall be BNY Western Trust Company.

**Section 8. Amendment; Waiver.** Notwithstanding any other provision of this Disclosure Agreement, the County and the Dissemination Agent may amend this Disclosure Agreement (and the Dissemination Agent shall agree to any amendment so requested by the County, so long as such amendment does not adversely affect the rights or obligations of the Dissemination Agent), and any provision of this Disclosure Agreement may be waived, provided that the following conditions are satisfied:

(a) If the amendment or waiver relates to the provisions of Sections 3(a), 4, or 5(a), it may only be made in connection with a change in circumstances that arises from a change in legal requirements, change in law, or change in the identity, nature or status of an obligated person with respect to the Bonds, or the type of business conducted;

(b) The undertaking, as amended or taking into account such waiver, would, in the opinion of nationally recognized bond counsel, have complied with the requirements of the Rule at the time of the original sale and delivery of the Bonds, after taking into account any amendments or interpretations of the Rule, as well as any change in circumstances; and

(c) The amendment or waiver either (i) is approved by the owners of the Bonds in the same manner as provided in the Trust Agreement for amendments to the Trust Agreement with the consent of Owners, or (ii) does not, in the opinion of nationally recognized bond counsel, materially impair the interests of the Owners or Beneficial Owners of the Bonds.

In the event of any amendment or waiver of a provision of this Disclosure Agreement, the County shall describe such amendment in the next Annual Report, and shall include, as applicable, a narrative explanation of the reason for the amendment or waiver and its impact on the type (or, in the case of a change of accounting principles, on the presentation) of financial information or operating data being presented by the County. In addition, if the amendment relates to the accounting principles to be followed in preparing financial statements, (i) notice of such change shall be given in the same manner as for a Listed Event under Section 5(f), and (ii) the Annual Report for the year in which the change is made should present a comparison (in narrative form and also, if feasible, in quantitative form) between the financial statements as prepared on the basis of the new accounting principles and those prepared on the basis of the former accounting principles.

**Section 9. Additional Information.** Nothing in this Disclosure Agreement shall be deemed to prevent the County from disseminating any other information, using the means of dissemination set forth in this Disclosure Agreement or any other means of communication, or including any other information in any Annual Report or notice of occurrence of a Listed Event, in addition to that which is required by this Disclosure Agreement. If the County chooses to include any information in any Annual Report or notice of occurrence of a Listed Event in addition to that which is specifically required by this Disclosure Agreement, the County shall have no obligation under this Disclosure Agreement to update such information or include it in any future Annual Report or notice of occurrence of a Listed Event.

**Section 10. Default.** In the event of a failure of the County or the Dissemination Agent to comply with any provision of this Disclosure Agreement, the Trustee (at the request of the Purchaser or the Owners of at least 25% aggregate principal amount of Outstanding Bonds upon providing the Trustee security and indemnity satisfactory to it against the costs, expenses and liabilities to be incurred therein or thereby) shall, or any holder or beneficial owner of the Bonds may take such actions as may be necessary and appropriate, including seeking mandate or specific performance by court order, to cause the County or Dissemination Agent, as the case may be, to comply with its obligations under this Disclosure Agreement. A default under this Disclosure Agreement shall not be deemed an Event of Default under the Trust Agreement, and the sole remedy under this Disclosure Agreement in the event of any failure of the County or the Trustee to comply with this Disclosure Agreement shall be an action to compel performance.

**Section 11. Duties, Immunities and Liabilities of Trustee and Dissemination Agent.** Article VI of the Trust Agreement is hereby made applicable to this Disclosure Agreement as if this Disclosure Agreement were (solely for this purpose) contained in the Trust Agreement, and the Dissemination Agent shall be entitled to the protections, limitations from liability and indemnities afforded to the Trustee thereunder. The Dissemination Agent shall have only such duties as are specifically set forth in this Disclosure Agreement, and the County agrees to indemnify and save the Dissemination Agent, its officers, directors, employees and agents, harmless against any loss, expense and liabilities which it may incur arising out of or in the exercise or performance of its powers and duties hereunder, including the costs and expenses (including attorneys fees) of defending against any claim of liability, but excluding liabilities due to the Dissemination Agent's negligence or willful misconduct. The obligations of the County under this Section shall survive resignation or removal of the Dissemination Agent and payment

of the Bonds. Neither the Trustee nor the Dissemination Agent shall have any responsibility whatsoever for the content of the reports and notices required to be prepared by the County hereunder or to determine the sufficiency thereof.

**Section 12. Notices.** Any notices or communications to or among any of the parties to this Disclosure Agreement may be given as follows:

To the County:	If to the County: County of San Diego 1600 Pacific Highway, Room 166 San Diego, California 92101 Attention: Chief Financial Officer
	County of San Diego 1600 Pacific Highway, Room 112 San Diego, California 92101 Attention: County Treasurer-Tax Collector
To the Insurers:	Financial Guaranty Insurance Company 125 Park Avenue New York, New York 10017 Attention: Risk Management
	XL Capital Assurance Inc. 1221 Avenue of Americas New York, New York 10020 Attn: Surveillance
To the Trustee:	BNY Western Trust Company 700 South Flower Street, Suite 500 Los Angeles, California 90017 Attention: Corporate Trust Department
To the Dissemination Agent:	BNY Western Trust Company 700 South Flower Street, Suite 500 Los Angeles, California 90017 Attention: Corporate Trust Department

Any person may, by written notice to the other persons listed above, designate a different address or telephone number(s) to which subsequent notices or communications should be sent.

**Section 13. Beneficiaries.** This Disclosure Agreement shall inure solely to the benefit of the County, the Dissemination Agent, the Participating Underwriter and Owners and Beneficial Owners from time to time of the Bonds, and shall create no rights in any other person or entity.



**Section 16. Counterparts.** This Disclosure Agreement may be executed in several counterparts, each of which shall be an original and all of which shall constitute but one and the same instrument.

COUNTY OF SAN DIEGO

By Donald F. Steuer  
Donald F. Steuer  
Chief Financial Officer

BNY WESTERN TRUST COMPANY, as  
Dissemination Agent

By Carl Becker  
Authorized Officer

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**EXHIBIT A**

**NOTICE TO REPOSITORIES OF FAILURE TO FILE ANNUAL REPORT**

Name of Obligor: County of San Diego

Name of Issue: \$454,112,915.70 County of San Diego  
Taxable Pension Obligation Bonds, Series 2004A (Current Interest Bonds)  
Taxable Pension Obligation Bonds, Series 2004B (Auction Rate Securities)  
Taxable Pension Obligation Bonds, Series 2004C (Capital Appreciation Bonds)

Date of Delivery: June 29, 2004

NOTICE IS HEREBY GIVEN that the County of San Diego (the "County") has not provided an Annual Report with respect to the above-named Bonds as required by Section 5.12 of the Trust Agreement, dated as of February 1, 1994, between the County and BNY Western Trust Company, as trustee (the "Trustee") as supplemented, including by a Second Supplemental Trust Agreement dated as of June 1, 2004, between the County and the Trustee. [The County anticipates that the Annual Report will be filed by \_\_\_\_\_.]

Dated: \_\_\_\_\_

BNY WESTERN TRUST COMPANY, on behalf  
of the County of San Diego

By \_\_\_\_\_  
Authorized Officer

cc: County of San Diego

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## APPENDIX F

### BOOK-ENTRY ONLY SYSTEM AND GLOBAL CLEARANCE PROCEDURES

#### BOOK-ENTRY ONLY SYSTEM

*The information in this Appendix F concerning DTC and DTC's book-entry system has been obtained from DTC and the County, the Trustee and the Remarketing Agents take no responsibility for the completeness or accuracy thereof. The County, the Trustee and the Remarketing Agents cannot and do not give any assurances that DTC, DTC Participants or Indirect Participants (each as herein defined) will distribute to the Beneficial Owners (a) payments of interest and principal with respect to the Series 2004B Bonds, (b) certificates representing ownership interest in or other confirmation or ownership interest in the Series 2004B Bonds, or (c) notices sent to DTC or Cede & Co., its nominee, as the registered owner of the Series 2004B Bonds, or that they will do so on a timely basis, or that DTC, DTC Participants or DTC Indirect Participants will act in the manner described in this Appendix F. The current "Rules" applicable to DTC are on file with the U.S. Securities and Exchange Commission and the current "Procedures" of DTC to be followed in dealing with DTC Participants are on file with DTC.*

DTC will act as securities depository for the Series 2004B Bonds. The Series 2004B Bonds will be issued as fully-registered securities registered in the name of Cede & Co. (DTC's partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully registered security certificate will be issued for each Series of the Series 2004B Bonds, each in the aggregate principal amount of such Series, and will be deposited with DTC.

DTC is a limited-purpose trust company organized under the New York Banking Law, a "banking organization" within the meaning of the New York Banking Law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code, and a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for over 2.2 million issues of U.S. and non-U.S. equity issues, corporate and municipal debt issues, and money market instruments from over 100 countries that DTC's Participants ("Direct Participants") deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities, through electronic computerized book-entry transfers and pledges between Direct Participants' accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non- U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation ("DTCC"). DTCC, in turn, is owned by a number of Direct Participants of DTC and Members of the National Securities Clearing Corporation, Fixed Income Clearing Corporation and Emerging Markets Clearing Corporation (respectively, "NSCC," "FICC," and "EMCC," also subsidiaries of DTCC), as well as by the New York Stock Exchange, Inc., the American Stock Exchange LLC, and the National Association of Securities Dealers, Inc. Access to the DTC system is also available to others such as both U.S. and non- U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly ("Indirect Participants"). DTC has Standard & Poor's highest rating: AAA. The DTC Rules applicable to its Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at [www.dtcc.com](http://www.dtcc.com).

Purchases of the Series 2004B Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Series 2004B Bonds on DTC's records. The ownership

interest of each actual purchaser of each Series 2004B Bond (“Beneficial Owner”) is in turn to be recorded on the Direct and Indirect Participants’ records. Beneficial Owners will not receive written confirmation from DTC of their purchase. Beneficial Owners are, however, expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the Series 2004B Bonds are to be accomplished by entries made on the books of Direct and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in the Series 2004B Bonds, except in the event that use of the book-entry system for the Series 2004B Bonds is discontinued. To facilitate subsequent transfers, all Series 2004B Bonds deposited by Direct Participants with DTC are registered in the name of DTC’s partnership nominee, Cede & Co., or such other name as may be requested by an authorized representative of DTC. The deposit of the Series 2004B Bonds with DTC and their registration in the name of Cede & Co. or such other DTC nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Series 2004B Bonds; DTC’s records reflect only the identity of the Direct Participants to whose accounts such Series 2004B Bonds are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. Beneficial Owners of the Series 2004B Bonds may wish to take certain steps to augment the transmission to them of notices of significant events with respect to the Series 2004B Bonds. For example, Beneficial Owners of the Series 2004B Bonds may wish to ascertain that the nominee holding the Series 2004B Bonds for their benefit has agreed to obtain and transmit notices to Beneficial Owners. In the alternative, Beneficial Owners may wish to provide their names and addresses to the registrar and request that copies of notices be provided directly to them.

The conveyance of notices and other communications by DTC to DTC Participants, by DTC Participants to Indirect Participants and by DTC 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. Any failure of DTC to advise any DTC Participant, or of any DTC Participant or Indirect Participant to notify a Beneficial Owner, of any such notice and its content or effect will not affect the validity of any action premised on such notice.

Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to the Series 2004B Bonds unless authorized by a Direct Participant in accordance with DTC’s Procedures. Under its usual procedures, DTC mails an Omnibus Proxy to the Participants as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.’s consenting or voting rights to those Direct Participants to whose accounts the Series 2004B Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Payments of principal of and interest on the Series 2004B Bonds will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC’s practice is to credit Direct Participants’ accounts upon DTC’s receipt of funds and corresponding detail information from the County or the Trustee, on payable date in accordance with their respective holdings shown on DTC’s records. Payments by the County 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 the County or the Trustee and not of DTC (nor its nominee), the Trustee or the County, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of principal and interest on the Series 2004B Bonds to Cede &

Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the County or the Trustee, disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners will be the responsibility of Direct and Indirect Participants.

NEITHER THE COUNTY NOR THE TRUSTEE WILL HAVE ANY RESPONSIBILITY OR OBLIGATION TO DTC PARTICIPANTS, INDIRECT PARTICIPANTS OR BENEFICIAL OWNERS WITH RESPECT TO THE PAYMENTS OR THE PROVIDING OF NOTICE TO DTC PARTICIPANTS, INDIRECT PARTICIPANTS OR BENEFICIAL OWNERS OR THE SELECTION OF SERIES 2004B BONDS FOR PREPAYMENT.

The County, the Trustee and the Remarketing Agents cannot or do not give any assurances that DTC, the DTC Participants or others will distribute payments of principal or interest on the Series 2004B Bonds paid to DTC or its nominee as the registered owner, or will distribute any notices, to the Beneficial Owners, or that they will do so on a timely basis or will serve and act in the manner described in this Reoffering Statement. The County, the Trustee and the Remarketing Agents are not responsible or liable for the failure of DTC or any DTC Participant to make any payment or give any notice to a Beneficial Owner with respect to the Series 2004B Bonds or an error or delay relating thereto.

DTC may discontinue providing its services as depository with respect to the Series 2004B Bonds at any time by giving reasonable notice to the County 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 County may decide to discontinue use of the system of book-entry transfers through DTC (or a successor securities depository). In that event, security certificates will be printed and delivered. In the event that the book-entry system is discontinued as described above, the requirements of the Trust Agreement will apply.

## **GLOBAL CLEARANCE PROCEDURES**

*The information that follows is based solely on information provided by the Euroclear Operator. No representation is made as to the completeness or the accuracy of such information or as to the absence of material adverse changes in such information subsequent to the date hereof.*

### **Clearstream International and Clearstream**

Clearstream International is the product of the merger of Deutsche Borse and Cedel International, the European international clearing depository founded in 1970, and a number of its subsidiaries including Cedelbank. Clearstream International is registered in Luxembourg and has two subsidiaries: Clearstream Banking and Clearstream Services. Clearstream Banking (“Clearstream”) contains the core clearing and settlement business and consists of Clearstream Banking Luxembourg, Clearstream Banking Frankfurt and six regional offices in Dubai, Hong Kong, London, New York, São Paulo and Tokyo. Clearstream holds securities for its participating organizations (“Clearstream Participants”) and facilitates the clearance and settlement of securities transactions between Clearstream Participants through electronic book-entry changes in accounts of Clearstream Participants, thereby eliminating the need for physical movement of certificates. As a professional depository, Clearstream is subject to regulation by the Luxembourg Monetary Institute. Indirect access to Clearstream is also available to others, such as banks, brokers, dealers and trust companies that clear through or maintain a custodial relationship with a Clearstream Participant, either directly or indirectly.

## **Euroclear System**

The Euroclear System (“Euroclear”) was created in 1968 to hold securities for its participants and to clear and settle transactions between its participants through simultaneous electronic book-entry delivery against payment, thereby eliminating the need for physical movement of certificates and any risk from lack of simultaneous transfers of securities and cash. The Euroclear System is owned Euroclear plc and operated through a license agreement by Euroclear Bank S.A./N.V., a bank incorporated under the laws of the Kingdom of Belgium (the “Euroclear Operator”).

The Euroclear Operator holds securities and book-entry interests in securities for participating organizations and facilitates the clearance and settlement of securities transactions between Euroclear Participants, and between Euroclear Participants and Participants of certain other securities intermediaries through electronic book-entry changes in accounts of such Participants or other securities intermediaries. The Euroclear Operator provides Euroclear Participants, among other things, with safekeeping, administration, clearance and settlement, securities lending and borrowing, and related services.

Non-Participants of Euroclear may hold and transfer book-entry interests in the Securities through accounts with a direct Participant of Euroclear or any other securities intermediary that holds a book-entry interest in the Securities through one or more securities intermediaries standing between such other securities intermediary and the Euroclear Operator

The Euroclear Operator is regulated and examined by the Belgian Banking and Finance Commission and the National Bank of Belgium.

Securities clearance accounts and cash accounts with the Euroclear Operator are governed by the Terms and Conditions Governing Use of Euroclear and the related Operating Procedures of the Euroclear System, and applicable Belgian law (collectively, the “Terms and Conditions”). The Terms and Conditions govern transfers of securities and cash within Euroclear, withdrawals of securities and cash from Euroclear, and receipts of payments with respect to securities in Euroclear. All securities in Euroclear are held on a fungible basis without attribution of specific certificates to specific securities clearance accounts. The Euroclear Operator acts under the Terms and Conditions only on behalf of Euroclear participants and has no record of or relationship with Persons holding through Euroclear participants.

## **Distribution of the Series 2004B Bonds through Clearstream or Euroclear**

Distributions with respect to the Series 2004B Bonds held through Clearstream or Euroclear are to be credited to the cash accounts of Clearstream Participants or Euroclear Participants, as applicable, in accordance with the relevant system’s rules and procedures, to the extent received by its Depository (as defined below). Such distributions will be subject to tax reporting in accordance with relevant United States tax laws and regulations. Clearstream or the Euroclear Operator, as the case may be, will take any other action permitted to be taken by an Owner of the Series 2004B Bonds under the Trust Agreement on behalf of a Clearstream Participant or Euroclear Participant only in accordance with the relevant rules and procedures and subject to the relevant Depository’s ability to effect such actions on its behalf through DTC. Owners of the Series 2004B Bonds may hold their Series 2004B Bonds through DTC (in the United States) or Clearstream or Euroclear (in Europe) if they are participants of such systems, or indirectly through organizations which are participants in such systems.



The Series 2004B Bonds will initially be registered in the name of Cede & Co., the nominee of DTC. Clearstream and Euroclear may hold omnibus positions on behalf of their participants through customers' securities accounts in Clearstream's and Euroclear's names on the books of their respective depositories which in turn are to hold such positions in customers' securities accounts in the depositories' names on the books of DTC. Citibank, N.A. acts as depository for Clearstream and the Euroclear Operator acts as depository for Euroclear (in such capacities, individually, the "Depository" and, collectively, the "Depositories").

Transfers of the Series 2004B Bonds between DTC Participants are to occur in accordance with DTC Rules. Transfers between Clearstream Participants and Euroclear Participants are to occur in accordance with their respective rules and operating procedures. Because of time-zone differences, credits of securities received in Clearstream or Euroclear as a result of a transaction with a Participant may be made during subsequent securities settlement processing and dated the business day following the DTC settlement date. Such credits or any transactions in such securities settled during such processing would be reported to the relevant Euroclear or Clearstream Participants on such business day. Cash received in Clearstream or Euroclear as a result of sales of securities by or through a Clearstream Participant or Euroclear Participant to a Participant are to be received with value on the DTC settlement date but will be available in the relevant Clearstream or Euroclear cash account only as of the business day following settlements in DTC.

Cross-market transfers between persons holding directly or indirectly through DTC, on the one hand, and directly or indirectly through Clearstream Participants or Euroclear Participants, on the other, are to be effected in DTC in accordance with DTC Rules on behalf of the relevant European international clearing system by its Depository; however, such cross-market transactions require delivery of instructions to the relevant European international clearing system by the counterparty in such system in accordance with its rules and procedures and within its established deadlines (European time). The relevant European international clearing system if the transaction meets its settlement requirements, is to deliver instructions to its Depository to take action to effect final settlement on its behalf by delivering or receiving securities in DTC, and making or receiving payment in accordance with normal procedures for same-day funds settlement applicable to DTC. Clearstream Participants and Euroclear Participants may not deliver instructions to the Depositories.

THE COUNTY AND THE TRUSTEE CANNOT AND DO NOT GIVE ANY ASSURANCES THAT DTC, DIRECT PARTICIPANTS OR INDIRECT PARTICIPANTS OF DTC, CLEARSTREAM, CLEARSTREAM PARTICIPANTS, EUROCLEAR OR EUROCLEAR PARTICIPANTS WILL DISTRIBUTE TO THE BENEFICIAL OWNERS OF THE SERIES 2004B BONDS (I) PAYMENTS OF PRINCIPAL OF OR INTEREST ON THE SERIES 2004B BONDS (II) CONFIRMATIONS OF THEIR OWNERSHIP INTERESTS IN THE SERIES 2004B BONDS OR (III) OTHER NOTICES SENT TO DTC OR CEDE & CO., ITS PARTNERSHIP NOMINEE, AS THE REGISTERED OWNER OF THE SERIES 2004B BONDS, OR THAT THEY WILL DO SO ON A TIMELY BASIS, OR THAT DTC, DIRECT PARTICIPANTS OR INDIRECT PARTICIPANTS, CLEARSTREAM, CLEARSTREAM PARTICIPANTS, EUROCLEAR OR EUROCLEAR PARTICIPANTS WILL SERVE AND ACT IN THE MANNER DESCRIBED IN THIS REOFFERING STATEMENT.

NEITHER THE COUNTY NOR THE TRUSTEE WILL HAVE ANY RESPONSIBILITY OR OBLIGATIONS TO DTC, THE DIRECT PARTICIPANTS, THE INDIRECT PARTICIPANTS OF DTC, CLEARSTREAM, CLEARSTREAM PARTICIPANTS, EUROCLEAR, EUROCLEAR PARTICIPANTS OR THE BENEFICIAL OWNERS WITH RESPECT TO (1) THE ACCURACY OF ANY RECORDS MAINTAINED BY DTC OR ANY DIRECT PARTICIPANTS OR INDIRECT PARTICIPANTS OF DTC, CLEARSTREAM, CLEARSTREAM PARTICIPANTS, EUROCLEAR OR EUROCLEAR PARTICIPANTS; (2) THE PAYMENT BY DTC OR ANY DIRECT PARTICIPANTS

OR INDIRECT PARTICIPANTS OF DTC, CLEARSTREAM, CLEARSTREAM PARTICIPANTS, EUROCLEAR OR EUROCLEAR PARTICIPANTS OF ANY AMOUNT DUE TO ANY BENEFICIAL OWNER IN RESPECT OF THE PRINCIPAL AMOUNT OF OR INTEREST ON SERIES 2004B BONDS; (3) THE DELIVERY BY DTC OR ANY DIRECT PARTICIPANTS OR INDIRECT PARTICIPANTS OF DTC, CLEARSTREAM, CLEARSTREAM PARTICIPANTS, EUROCLEAR OR EUROCLEAR PARTICIPANTS OF ANY NOTICE TO ANY BENEFICIAL OWNER THAT IS REQUIRED OR PERMITTED TO BE GIVEN TO OWNERS UNDER THE TERMS OF THE TRUST AGREEMENT; OR (4) ANY CONSENT GIVEN OR OTHER ACTION TAKEN BY DTC AS OWNER OF THE SERIES 2004B BONDS.

**APPENDIX G**

**SPECIMEN OF 2004 FINANCIAL GUARANTY INSURANCE POLICY**

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# **XL** CAPITAL ASSURANCE

1221 Avenue of the Americas  
New York, New York 10020  
Telephone: (212) 478-3400

## **MUNICIPAL BOND INSURANCE POLICY**

**ISSUER:** County of San Diego, California

**Policy No:** CA01044A

**BONDS:** \$147,825,000 Taxable Pension Obligation Bonds,  
Series 2004B (Auction Rate Securities)

**Effective Date:** June 29, 2004

**XL Capital Assurance Inc. (XLCA)**, a New York stock insurance company, in consideration of the payment of the premium and subject to the terms of this Policy (which includes each endorsement attached hereto), hereby agrees unconditionally and irrevocably to pay to the trustee (the "Trustee") or the paying agent (the "Paying Agent") (as set forth in the documentation providing for the issuance of and securing the Bonds) for the benefit of the Owners of the Bonds or, at the election of XLCA, to each Owner, that portion of the principal and interest on the Bonds that shall become Due for Payment but shall be unpaid by reason of Nonpayment.

XLCA will pay such amounts to or for the benefit of the Owners on the later of the day on which such principal and interest becomes Due for Payment or one (1) Business Day following the Business Day on which XLCA shall have received Notice of Nonpayment (provided that Notice will be deemed received on a given Business Day if it is received prior to 10:00 a.m. Pacific time on such Business Day; otherwise it will be deemed received on the next Business Day), but only upon receipt by XLCA, in a form reasonably satisfactory to XLCA, of (a) evidence of the Owner's right to receive payment of the principal or interest then Due for Payment and (b) evidence, including any appropriate instruments of assignment, that all of the Owner's rights with respect to payment of such principal or interest that is Due for Payment shall thereupon vest in XLCA. Upon such disbursement, XLCA shall become the owner of the Bond, any appurtenant coupon to the Bond or the right to receipt of payment of principal and interest on the Bond and shall be fully subrogated to the rights of the Owner, including the Owner's right to receive payments under the Bond, to the extent of any payment by XLCA hereunder. Payment by XLCA to the Trustee or Paying Agent for the benefit of the Owners shall, to the extent thereof, discharge the obligation of XLCA under this Policy.

In the event the Trustee or Paying Agent has notice that any payment of principal or interest on a Bond which has become Due for Payment and which is made to an Owner by or on behalf of the Issuer of the Bonds has been recovered from the 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, such Owner will be entitled to payment from XLCA to the extent of such recovery if sufficient funds are not otherwise available.

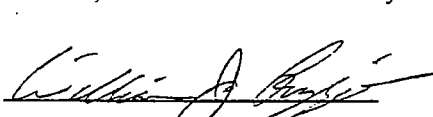
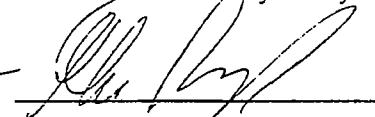
The following terms shall have the meanings specified for all purposes of this Policy, except to the extent such terms are expressly modified by an endorsement to this Policy. "Business Day" means any day other than (a) a Saturday or Sunday or (b) a day on which banking institutions in the State of California, the State of New York or the Insurer's Fiscal Agent are authorized or required by law or executive order to remain closed. "Due for Payment", when referring to the principal of Bonds, is when the stated maturity date or a mandatory redemption date for the application of a required sinking fund installment has been reached and does not refer to any earlier date on which payment is due by reason of call for redemption (other than by application of required sinking fund installments), acceleration or other advancement of maturity, unless XLCA shall elect, in its sole discretion, to pay such principal due upon such acceleration; and, when referring to interest on the Bonds, is when the stated date for payment of interest has been reached. "Nonpayment" means the failure of the Issuer to have provided sufficient funds to the Trustee or Paying Agent for payment in full of all principal and interest on the Bonds which are Due for Payment. "Notice" means telephonic or telecopied notice, subsequently confirmed in a signed writing, or written notice by registered or certified mail, from an Owner, the Trustee or the Paying Agent to XLCA which notice shall specify (a) the person or entity making the claim, (b) the Policy Number, (c) the claimed amount and (d) the date such claimed amount became Due for Payment. "Owner" means, in respect of a Bond, the person or entity who, at the time of Nonpayment, is entitled under the terms of such Bond to payment thereof, except that "Owner" shall not include the Issuer or any person or entity whose direct or indirect obligation constitutes the underlying security for the Bonds.

XLCA may, by giving written notice to the Trustee and the Paying Agent, appoint a fiscal agent (the "Insurer's Fiscal Agent") for purposes of this Policy. From and after the date of receipt by the Trustee and the Paying Agent of such notice, which shall specify the name and notice address of the Insurer's Fiscal Agent, (a) copies of all notices required to be delivered to XLCA pursuant to this Policy shall be simultaneously delivered to the Insurer's Fiscal Agent and to XCLA and shall not be deemed received until received by both and (b) all payments required to be made by XLCA under this Policy may be made directly by XLCA or by the Insurer's Fiscal Agent on behalf of XLCA. The Insurer's Fiscal Agent is the agent of XLCA only and the Insurer's Fiscal Agent shall in no event be liable to any Owner for any act of the Insurer's Fiscal Agent or any failure of XLCA to deposit or cause to be deposited sufficient funds to make payments due hereunder.

Except to the extent expressly modified by an endorsement hereto, (a) this Policy is non-cancelable by XLCA, and (b) the Premium on this Policy is not refundable for any reason. This Policy does not insure against loss of any prepayment or other acceleration payment which at any time may become due in respect of any Bond, other than at the sole option of XLCA, nor against any risk other than Nonpayment. This Policy sets forth the full undertaking of XLCA and shall not be modified, altered or affected by any other agreement or instrument, including any modification or amendment thereto.

**IN THE EVENT THAT XLCA WERE TO BECOME INSOLVENT, ANY CLAIMS ARISING UNDER THIS POLICY ARE NOT COVERED BY THE CALIFORNIA GUARANTY INSURANCE FUND SPECIFIED IN ARTICLE 12119(b) OF THE CALIFORNIA INSURANCE CODE.**

In witness whereof, XLCA has caused this Policy to be executed on its behalf by its duly authorized officers.

	
Name: William J. Rizzo	Name: Thomas Randazzo
Title: Associate General Counsel	Title: Managing Director





PACIFIC FINANCIAL PRINTING