

In the opinion of Fulbright & Jaworski L.L.P., Los Angeles, California, Bond Counsel, under existing law, interest on the Bonds is exempt from personal income taxes of the State of California and, assuming compliance with the tax covenants described herein, interest on the Bonds is excluded pursuant to section 103(a) of the Internal Revenue Code of 1986 (the "Code") from the gross income of the owners thereof for federal income tax purposes and is not included in the computation of the alternative minimum taxable income of the owners thereof for federal income tax purposes. See "TAX EXEMPTION" herein regarding certain other tax considerations.

\$5,775,000

HERCULES PUBLIC FINANCING AUTHORITY REVENUE BONDS (ELECTRIC SYSTEM PROJECT) SERIES 2010

Dated: Date of Delivery**Due: August 1, as shown on the inside cover hereof**

The Hercules Public Financing Authority Revenue Bonds (Electric System Project) Series 2010 (the "Bonds") are being issued by the Hercules Public Financing Authority (the "Authority") to (i) finance certain improvements to the City of Hercules (the "City") electric system (the "Electric System"), namely, an electric substation (the "Improvements"), (ii) fund a Reserve Fund for, and capitalized interest on, the Bonds and (iii) pay costs of issuance of the Bonds.

The Bonds are being issued as fully registered bonds, registered in the name of Cede & Co. as nominee of The Depository Trust Company, New York, New York ("DTC"), and will be available to ultimate purchasers in the denomination of \$5,000 or any integral multiple thereof, under the book-entry system maintained by DTC. Ultimate purchasers of Bonds will not receive physical certificates representing their interest in the Bonds. So long as the Bonds are registered in the name of Cede & Co., as nominee of DTC, references herein to the owners shall mean Cede & Co., and shall not mean the ultimate purchasers of the Bonds. Interest on the Bonds will be payable on February 1 and August 1 of each year, commencing February 1, 2011. Payments of the principal of and interest on the Bonds will be made directly to DTC, or its nominee, Cede & Co., by Bank of New York Mellon Trust Company, N.A, Los Angeles, California (the "Trustee"), so long as DTC or Cede & Co. is the registered owner of the Bonds. Disbursements of such payments to DTC's Participants is the responsibility of DTC and disbursements of such payments to the Beneficial Owners is the responsibility of DTC's Participants and Indirect Participants, as more fully described herein. See "THE BONDS - Book-Entry System" and "APPENDIX F - BOOK-ENTRY ONLY SYSTEM" herein.

The Bonds are issued pursuant to that certain Indenture of Trust, dated as of August 1, 2010 (the "Indenture"), among the Authority, the City and the Trustee. The Bonds are special obligations of the Authority secured by and payable solely from Revenues as defined in the Indenture consisting primarily of (i) Installment Payments to be paid by the City under the Installment Sale Agreement, dated as of August 1, 2010 (the "Installment Sale Agreement"), by and between the City and the Authority, and (ii) City Advance payments to be made by the City under the Cooperation Agreement (the "Cooperation Agreement") dated as of August 1, 2010, by and between the City and the Authority in the event that there is a deficiency in the payments under the Installment Agreement. Pursuant to the Installment Agreement, the City shall purchase the Improvements (as defined herein) from the Authority in consideration for Installment Payments equal in time and amount to the debt service on the Bonds. See "SECURITY FOR THE BONDS" herein.

The City's obligation to make payments under the Installment Sale Agreement is secured by and payable from all Net Revenues, being Gross Revenues derived by the City from the ownership and operation of the Electric System (as described herein), excluding Operation and Maintenance Costs of the Electric System. See "SECURITY FOR THE BONDS" herein. The City has covenanted in the Cooperation Agreement to make City advances from any available revenues of the City.

The Bonds are subject to special mandatory redemption, mandatory sinking fund redemption and redemption from optional prepayment of Installment Payments prior to maturity as more fully described herein. See "THE BONDS - Redemption" herein.

The Bonds are limited obligations of the Authority and are not secured by a legal or equitable pledge of, or charge or lien upon, any property of the Authority or any of its income or receipts, except the Revenues. The full faith and credit of the Authority, the Hercules Redevelopment Agency (the "Agency") and the City (the Agency and the City being the parties to the agreement creating the Authority) is not pledged for the payment of the principal of or interest on the Bonds and no tax or other source of funds, other than the Revenues, is pledged to pay the principal of, or interest on, the Bonds. The payment of the principal of, or interest on, the Bonds does not constitute a debt, liability or obligation of the Authority, the City or the Agency for which any such entity is obligated to levy or pledge any form of taxation or for which any such entity has levied or pledged any form of taxation. The Authority has no taxing power. The Bonds are payable solely from the Revenues and other sources as described in this Official Statement, and the taxing power of the City, the County, the State of California (the "State") or any political subdivision thereof is not pledged to the payment of the Bonds.

For a discussion of some of the risks associated with the purchase of the Bonds, see "RISK FACTORS" herein.

This cover page contains information for quick reference only. It is not intended to be a summary of all factors relating to an investment in the Bonds. Investors should read the entire Official Statement before making any investment decision.

The Bonds are offered when, as and if delivered and received by the Underwriter, subject to the approval as to their legality by Fulbright & Jaworski L.L.P., Los Angeles, California, Bond Counsel. Certain legal matters will be passed upon for the Authority by Lewis Brisbois Bisgaard & Smith LLP, San Bernardino, California, Disclosure Counsel, and for the City and the Authority by the City Attorney, Alfred A. Cabral. It is anticipated that the Bonds will be available for delivery through the facilities of DTC on or about August 25, 2010.

CHILTON & ASSOCIATES, INC.

Dated: August 12, 2010

MATURITY SCHEDULE

\$5,775,000
Hercules Public Financing Authority
Revenue Bonds (Electric System Project) Series 2010
(Base CUSIP¹ 427065)

<u>Maturity (August 1)</u>	<u>Principal Amount</u>	<u>Interest Rate</u>	<u>Yield</u>	<u>CUSIP</u>
2012	\$105,000	2.000%	2.000%	AM9
2013	110,000	2.250%	2.450%	AN7
2014	110,000	2.500%	2.800%	AP2
2015	115,000	3.000%	3.200%	AQ0
2016	115,000	3.375%	3.600%	AR8
2017	120,000	3.500%	3.800%	AS6
2018	125,000	3.750%	4.050%	AT4
2019	130,000	4.000%	4.250%	AU1
2020	135,000	4.125%	4.400%	AV9
\$285,000	4.500%	Term Bonds Maturing August 1, 2022;	Yield 4.800%;	CUSIP AW7
\$1,045,000	5.000%	Term Bonds Maturing August 1, 2028;	Yield 5.270%;	CUSIP AX5
\$1,140,000	5.250%	Term Bonds Maturing August 1, 2033;	Yield 5.480%;	CUSIP AY3
\$2,240,000	5.375%	Term Bonds Maturing August 1, 2040;	Yield 5.580%;	CUSIP AZ0

¹ CUSIP is a registered trademark of the American Bankers Association. CUSIP data herein is provided by CUSIP Global Services, managed by Standard & Poor's Financial Services LLC on behalf of The American Bankers Association. This data is not intended to create a database and does not serve in any way as a substitute for the CUSIP Services. Neither the Underwriter, the City nor the Authority is responsible for the selection or correctness of the CUSIP numbers set forth herein.

This Official Statement is submitted in connection with the sale of the Bonds referred to herein and may not be reproduced or used, in whole or in part, for any other purpose. This Official Statement is not a contract between any bond owner and the City, the Authority or the Underwriter. No dealer, broker, salesperson or other person has been authorized by the City, the Authority or the Underwriter to give any information or to make any representations other than those contained in this Official Statement and, if given or made, such other information or representation must not be relied upon as having been authorized by the City, the Authority or the Underwriter. This Official Statement does not constitute an offer to sell or the solicitation of an offer to buy nor there any sale of the Bonds by a person in any jurisdiction in which it unlawful for such person to make such an offer, solicitation or sale.

The information set forth in this Official Statement has been furnished by the City, the Authority and other sources which are believed to be reliable, but it is not guaranteed as to accuracy or completeness. All summaries of the Indenture, the Installment Sale Agreement, the Cooperation Agreement or other documents referred to in this Official Statement are made subject to the provisions of such documents and qualified in their entirety to reference to such documents, and do not purport to be complete statements of any or all of such provisions. This Official Statement speaks only as of its date, and the information and expressions of opinion contained in this Official Statement are subject to change without notice. Neither the delivery of this Official Statement nor any sale of the Bonds will, under any circumstances, give rise to any implication that there has been no change in the affairs of the City, the Authority, the other parties described in this Official Statement, or the condition of the property within the City since the date of this Official Statement.

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

IN CONNECTION WITH THIS OFFERING, THE UNDERWRITER MAY OVER ALLOT OR EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKET PRICE OF THE BONDS AT A LEVEL ABOVE THAT WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.

CAUTIONARY STATEMENTS REGARDING FORWARD-LOOKING

STATEMENTS IN THIS OFFICIAL STATEMENT

Certain statements included or incorporated by reference in this Official Statement and the Appendices hereto constitute "forward-looking statements." Such statements are generally identifiable by the terminology used such as "plan," "expect," "estimate," "budget" or other similar words. Such forward-looking statements include, but are not limited to, certain statements contained in the information under the captions "THE IMPROVEMENTS," "THE ELECTRIC SYSTEM - Historical and Projected Customers, Retail Energy Sales, Revenues and Demand," "THE ELECTRIC SYSTEM - Capital Requirements," and "THE ELECTRIC SYSTEM - Projected Operating Results, Cash Flows and Coverage Ratio" in this Official Statement.

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

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**CITY OF HERCULES
AND
HERCULES PUBLIC FINANCING AUTHORITY**

AUTHORITY BOARD/CITY COUNCIL

Kris Valstad, President/Mayor
Ed Balico, Vice President/Vice Mayor
Joe Eddy McDonald, Councilmember/Board Member
Donald Kuehne, Councilmember/Board Member
Joanne Ward, Councilmember/Board Member

AUTHORITY/CITY STAFF

Nelson E. Oliva, Executive Director/City Manager
Gloria Leon, Finance Director/Treasurer
Alfred A. Cabral, Authority Counsel/City Attorney
Glenn Reddick, Utility Consultant
Michael Sakamoto Utility Consultant

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Disclosure Counsel

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Trustee and Dissemination Agent

The Bank of New York Mellon Trust Company, N.A.
Los Angeles, California

Underwriter

Chilton & Associates, Inc.
Los Angeles, California

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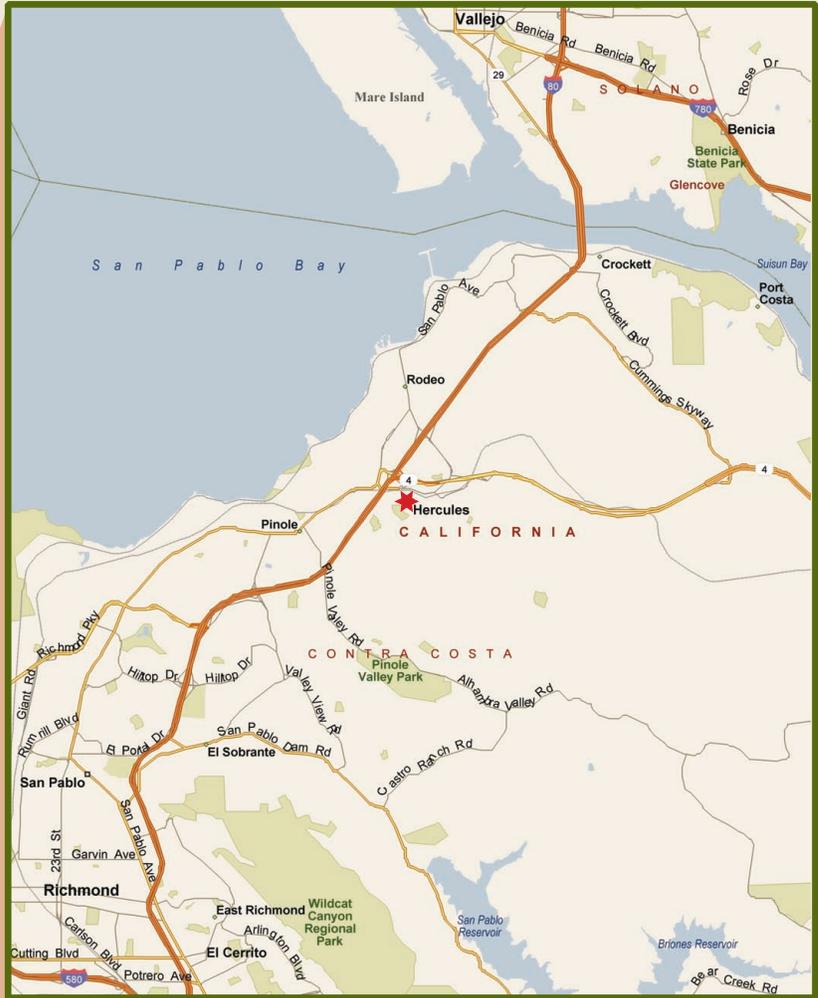
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HERCULES • CALIFORNIA



OFFICIAL STATEMENT

\$5,775,000

HERCULES PUBLIC FINANCING AUTHORITY REVENUE BONDS (ELECTRIC SYSTEM PROJECT) SERIES 2010

INTRODUCTION

This Introduction is not a summary of this Official Statement. It is only a brief description of, and guide to, and is qualified by, more complete and detailed information contained in the entire Official Statement, including the cover page and appendices hereto, and the documents summarized or described herein. A full review should be made of the entire Official Statement. The sale and delivery of the Bonds to potential investors are made only by means of the entire Official Statement.

General

The purpose of this Official Statement (which includes the cover page and the appendices attached hereto) is to provide information concerning the issuance, sale and delivery by the Hercules Public Financing Authority (the “Authority”) of its Revenue Bonds (Electric System Project) Series 2010 (the “Bonds”), in the aggregate principal amount of \$5,775,000. The proceeds of the sale of the Bonds will be used to (i) finance certain improvements to the City of Hercules (the “City”) electric system (the “Electric System”), namely, an electric substation (the “Improvements”), (ii) fund a Reserve Fund for, and capitalized interest on, the Bonds and (iii) pay costs of issuance of the Bonds. See “THE BONDS – Estimated Sources and Uses of Funds” and “THE IMPROVEMENTS” herein. The Authority and the City will enter into an Installment Sale Agreement, dated as of August 1, 2010 (the “Installment Sale Agreement”) pursuant to which the City shall purchase the Improvements (as defined herein) from the Authority in consideration for Installment Payments equal in time and amount to the debt service on the Bonds.

Authority for Issuance

The Bonds are being issued pursuant to the Marks-Roos Local Bond Pooling Act of 1985, constituting Article 4 of Chapter 5 of Division 7 of Title 1 of the Government Code of the State of California (the “Act”), and an Indenture of Trust, dated as of August 1, 2010 (the “Indenture”), among the Authority, the City and The Bank of New York Mellon Trust Company, N.A., as trustee (the “Trustee”).

The Authority

The Hercules Public Financing Authority (the “Authority”) is a joint exercise of powers agency organized and existing under and by virtue of the Joint Exercise of Powers Act, constituting Articles 1 through 4 (commencing with Section 6500) of Chapter 5, Division 7, Title 1 of the Government Code of the State of California (the “Joint Powers Act”). The City of Hercules (the “City”) and the Hercules Redevelopment Agency (the “Agency”) formed the Authority by the execution of a joint exercise of powers agreement dated as of July 24, 2001. The members of the City Council of the City comprise the Authority Board of Directors.

The City

The City of Hercules was incorporated as a general law city on December 15, 1900. The City is located in Contra Costa County (the “County”) approximately 40 minutes from San Francisco across the San Francisco Bay and approximately one hour from Sacramento. See “APPENDIX A – GENERAL INFORMATION REGARDING THE CITY OF HERCULES.”

The Improvements

A portion of the proceeds of the Bonds will be deposited into the Acquisition and Construction Fund for the purpose of financing an electric substation (the "Improvements") to support the Electric System. The new substation will be located on a parcel of land that is approximately 1.2 acres. The actual substation is expected to encompass approximately 30,000 square feet. The current load on the Electric System is approximately 2.8 megawatts. The substation will allow the Electric System the capacity to handle approximately 20 megawatts with redundancy built in. When the substation opens in 2011, it is expected that the load will be approximately 3.1 to 3.2 megawatts, however, shortly after the initial start up, it is expected that growth should increase to approximately 3.5 to 3.6 megawatts. See "THE ELECTRIC SYSTEM – The Improvements." The total cost of construction of the substation is estimated at \$6M. It is expected that the substation will be completed in June, 2011.

Security for the Bonds

The Bonds are special obligations of the Authority secured by and payable solely from the Revenues, consisting of (a) all amounts received by the Authority or the Trustee pursuant or with respect to the Installment Sale Agreement, including, without limiting the generality of the foregoing, all of the Installment Payments (including both timely and delinquent payments, any late charges, and whether paid from any source), prepayments, insurance proceeds, and condemnation proceeds, but excluding any Additional Payments; (b) all moneys and amounts held in the funds and accounts established under the Indenture; (c) investment income with respect to any moneys held by the Trustee pursuant to the Indenture; and (d) City Advances to be made by the City under the Cooperation Agreement dated as of August 1, 2010, by and between the City and the Authority.

The City's obligation to make payments under the Installment Sale Agreement is secured by and payable from Net Revenues, being Gross Revenues derived by the City from the ownership and operation of the Electric System (as described herein), excluding Operation and Maintenance Costs of the Electric System. See "SECURITY FOR THE BONDS" herein. Also, see "THE ELECTRIC SYSTEM - Rates and Charges; Recent Rate Increase" herein for a discussion of Electric System rate increases approved by the City Council of the City in February, 2010 for increases in April and November, 2010. Under the Cooperation Agreement executed in connection with the issuance of the \$7,425,000 Hercules Public Financing Authority Revenue Refunding Bonds (Electric System Project) Series 2010 (the "Prior Bonds") issued on June 28, 2010, the City advanced \$600,000 to the Electric System operating budget in order to cover any deficiencies in Electric System revenues for the 2010-11 Fiscal Year. The Bonds are on parity with the Prior Bonds.

The Authority and the City have entered into the Cooperation Agreement, dated as of August 1, 2010 (the "Cooperation Agreement"). Under the Cooperation Agreement, the City has agreed to make certain advances (the "City Advances") to the Authority to the extent Installment Payments are not sufficient to pay debt service on the Bonds. The City Advances are deemed to be loans to the Authority and shall be reimbursed to the City as provided in the Indenture. See "SECURITY FOR THE BONDS – Cooperation Agreement" herein. **The Bonds are limited obligations of the Authority and are not secured by a legal or equitable pledge of, or charge or lien upon, any property of the Authority or any of its income or receipts, except the Revenues. The full faith and credit of the Authority and the Agency and the City, which are parties to the agreement creating the Authority, are not pledged for the payment of the principal of, or interest on, the Bonds and no tax or other source of funds, other than the Revenues, is pledged to pay the principal of, or interest on, the Bonds. The payment of the principal of, or interest on, the Bonds does not constitute a debt, liability or obligation of the Authority, the Agency or the City for which any such entity is obligated to levy or pledge any form of taxation or for which any such entity has levied or pledged any form of taxation. The Authority has no taxing power. The Bonds are payable solely from the Revenues and other sources as**

described in this Official Statement, and the taxing power of the City, the County, the State of California (the “State”) or any political subdivision thereof is not pledged to the payment of the Bonds.

Description of the Bonds

For a more complete description of the Bonds and the Indenture pursuant to which they are being issued, see “THE BONDS” and “APPENDIX C - SUMMARY OF PRINCIPAL LEGAL DOCUMENTS” herein.

General. The Bonds will be dated as of, and bear interest from, their Delivery Date, at the rates set forth on the inside cover page hereof. See “THE BONDS.” The Bonds, when issued, will be registered in the name of Cede & Co., as nominee of The Depository Trust Company, New York, New York (“DTC”). DTC will act as securities depository of the Bonds. Individual purchases of the Bonds will be made in book-entry form only. Principal of and interest on the Bonds will be payable by DTC through the DTC participants. See “THE BONDS — Book-Entry Only System” and “APPENDIX F - BOOK-ENTRY ONLY SYSTEM” herein. Purchasers of the Bonds will not receive physical delivery of their Bonds.

Redemption. The Bonds are subject to special mandatory redemption, mandatory sinking fund redemption and redemption from optional prepayment of Installment Payments prior to maturity as more fully described herein. See “THE BONDS - Redemption” herein.

Denomination. The Bonds are being delivered in the minimum denominations of \$5,000 or any integral multiple thereof within a single maturity.

Registration, Transfers and Exchanges. The Bonds will be issued and delivered as fully registered Bonds and will be subject to transfer, exchange and replacement as described herein. See “THE BONDS” and “APPENDIX C - SUMMARY OF PRINCIPAL LEGAL DOCUMENTS” herein.

Payments. Interest on the Bonds will be payable semiannually on February 1 and August 1 of each year (each an “Interest Payment Date”) commencing February 1, 2011. Principal of the Bonds will be payable upon the presentation and surrender thereof at the corporate trust office of the Trustee, in Los Angeles, California when due. Interest on the Bonds is payable by check of the Trustee mailed on or before each Interest Payment Date to the persons in whose names such Bonds are registered at the close of business on the Record Date, which is the fifteenth (15th) calendar day of the month immediately preceding any Interest Payment Date, or by wire transfer pursuant to the procedure described herein.

Bond Owners’ Risks

Certain events could affect the ability of the Authority to make the payments of the principal of, and interest on, the Bonds when due. See “RISK FACTORS” herein for a discussion of certain factors which should be considered, in addition to other matters set forth herein, in evaluating an investment in the Bonds.

Changes Affecting the Electric Utility Industry

The electric utility industry has faced unprecedented changes in recent years, especially in California. See “DEVELOPMENTS IN THE CALIFORNIA ENERGY MARKETS” and “OTHER FACTORS AFFECTING THE ELECTRIC UTILITY INDUSTRY” herein.

Professionals Involved in the Offering

The Bank of New York Mellon Trust Company, N.A., Los Angeles, California, will act as Trustee with respect to the Bonds pursuant to the Indenture.

All proceedings in connection with the issuance of the Bonds are subject to the approval of Fulbright & Jaworski L.L.P., Los Angeles, California, and Bond Counsel. Certain legal matters will be passed on by Lewis Brisbois Bisgaard & Smith LLP, San Bernardino, California in its capacity as disclosure counsel, and by Alfred A. Cabral as City Attorney and Authority Counsel.

Offering and Delivery of the Bonds

The Bonds are offered when, as and if issued and received by the Underwriter, subject to approval as to their legality by Bond Counsel and the satisfaction of certain other conditions. It is anticipated that the Bonds will be available for delivery in New York, New York, on or about August 25, 2010.

Continuing Disclosure

The City has covenanted for the benefit of owners of the Bonds to provide certain financial information and operating data relating to the City, including the Electric System and the Improvements, and to provide notices of the occurrence of certain enumerated events, if material. See “CONTINUING DISCLOSURE” and “APPENDIX E – FORM OF CONTINUING DISCLOSURE AGREEMENT” herein.

Other Matters

The summaries of and references to documents, statutes, reports and other instruments referred to herein do not purport to be complete, comprehensive or definitive, and each such summary and reference is qualified in its entirety by reference to each document, statute, report, or instrument. The capitalization of any word not conventionally capitalized or otherwise defined herein, indicates that such word is defined in a particular agreement or other document and, as used herein, has the meaning given it in such agreement or document. See “APPENDIX C - SUMMARY OF PRINCIPAL LEGAL DOCUMENTS” for summaries of certain of such definitions.

THE BONDS

General

The Bonds will be dated the date of their initial delivery and will bear interest at the rates and mature on the dates and in the amounts set forth on the inside cover page of this Official Statement. The Bonds shall be payable on February 1, 2011, and semiannually thereafter on August 1 and February 1 of each year to the maturity of the Bonds. The Bonds are subject to redemption as provided herein. Each Bond shall bear interest from the Interest Payment Date next preceding the date of authentication thereof, unless (a) it is authenticated after a Record Date and on or before the following Interest Payment Date, in which event it shall bear interest from such Interest Payment Date, or (b) unless it is authenticated on or before the first Record Date, in which event it shall bear interest from the Closing Date; provided, however, that if, as of the date of authentication of any Bond, interest thereon is in default, such Bond shall bear interest from the Interest Payment Date to which interest has previously been paid or made available for payment thereon.

Interest on the Bonds shall be payable semiannually calculated based on a 360-day year of twelve (12) thirty-day months on each Interest Payment Date to the person whose name appears on the Registration Books as the Owner thereof as of the Record Date immediately preceding each such Interest Payment Date, such interest to be paid by check of the Trustee mailed on the Interest Payment Date by first class mail to the Owner at the address of such Owner as its appears on the Registration Books; provided however, that payment of interest will be made by wire transfer in immediately available funds to an account at a financial institution in the United States of America to any Owner of Bonds in the aggregate principal amount of \$1,000,000 or more who shall furnish written wire instructions to the Trustee before the applicable Record Date. Any such written request shall remain in effect until rescinded in writing by the Owner. Principal of any Bond and any premium upon redemption shall be paid by check of the Trustee upon presentation and surrender thereof at the Office of the Trustee. Principal of and interest and premium (if any) on the Bonds shall be payable in lawful money of the United States of America. So long as Cede & Co. is the registered owner of the Bonds, payments of principal and interest on the Bonds will be paid to DTC as registered owner of the Bonds. See “THE BONDS – Book-Entry System” and “APPENDIX F - BOOK-ENTRY ONLY SYSTEM” herein.

Redemption

Special Mandatory Redemption. The Bonds shall be subject to special mandatory redemption as a whole or in part, on any date, from proceeds of an eminent domain award or proceeds of casualty insurance not used to repair or rebuild the Improvements, which proceeds may be used for such purpose pursuant to the Installment Sale Agreement, at a redemption price equal to the principal amount of the Bonds to be redeemed plus interest accrued thereon to the date fixed for redemption, without premium.

Redemption from Prepayments of Installment Payments. The Bonds maturing on or before August 1, 2020 shall not be subject to optional redemption prior to maturity. The Bonds maturing on or after August 1, 2021 shall be subject to redemption prior to their respective maturity dates, at the option of the Authority, by lot within a maturity on any date on or after August 1, 2020, from prepayment of Installment Payments made at the option of the City at the redemption price equal to the principal amount of the Bonds to be redeemed, plus accrued interest thereon to the date of redemption, without premium.

Mandatory Sinking Fund Redemption. The Bonds maturing on August 1, 2022, August 1, 2028, August 1, 2033 and August 1, 2040, are also subject to redemption prior to their respective stated maturities, on any August 1, on or after August 1, 2021, August 1, 2023, August 1, 2029, and August 1, 2034, respectively, in part by lot, from mandatory sinking account payments at a redemption price equal to the principal amount thereof, plus accrued interest, if any, to the redemption date, without premium, as set forth below in the aggregate respective principal amounts and on the respective dates as set forth in the following tables; provided, however, that if some but not all of such Bonds have been redeemed pursuant to optional or special mandatory redemption provisions of the Indenture, the total amount of all future sinking fund payments shall be reduced by the aggregate principal amount of such Bonds so redeemed, to be allocated among such sinking fund payments on a pro rata basis in integral multiples of \$5,000.

**Schedule of Mandatory Sinking Fund Redemptions
Term Bonds Maturing August 1, 2022**

Redemption Date (August 1)	Principal Amount
2021	\$140,000
2022	\$145,000

**Schedule of Mandatory Sinking Fund Redemptions
Term Bonds Maturing August 1, 2028**

Redemption Date <u>(August 1)</u>	Principal <u>Amount</u>
2023	\$155,000
2024	\$160,000
2025	\$170,000
2026	\$180,000
2027	\$185,000
2028	\$195,000

**Schedule of Mandatory Sinking Fund Redemptions
Term Bonds Maturing August 1, 2033**

Redemption Date <u>(August 1)</u>	Principal <u>Amount</u>
2029	\$205,000
2030	\$215,000
2031	\$230,000
2032	\$240,000
2033	\$250,000

**Schedule of Mandatory Sinking Fund Redemptions
Term Bonds Maturing August 1, 2040**

Redemption Date <u>(August 1)</u>	Principal <u>Amount</u>
2034	\$275,000
2035	\$285,000
2036	\$300,000
2037	\$320,000
2038	\$335,000
2039	\$355,000
2040*	\$370,000

Maturity*

Notice of Redemption. The Trustee on behalf and at the expense of the Authority shall mail (by first-class mail, postage prepaid) notice of any redemption to: (i) the respective Owners of any Bonds designated for redemption, at least thirty (30) but not more than sixty (60) days prior to the redemption date, at their respective addresses appearing on the Registration Books, and (ii) the Securities Depositories and to one or more Information Services, at least thirty (30) but not more than sixty (60) days prior to the redemption; provided, however, that neither failure to receive any such notice so mailed nor any defect therein shall affect the validity of the proceedings for the redemption of such Bonds or the cessation of the accrual of interest thereon. In addition to mailed notice, the notice to the Securities Depositories and Information Service shall be given by telephonically confirmed facsimile transmission

or overnight delivery service or by such other means approved by such institutions. Such notice shall state the date of the notice, the redemption date, the redemption place and the redemption price and shall designate the CUSIP numbers, the bond numbers and the maturity or maturities (in the event of redemption of all of the Bonds of such maturity or maturities in whole) of the Bonds to be redeemed, and shall require that such Bonds be then surrendered at the Office of the Trustee for redemption at the redemption price, giving notice also that further interest on such Bonds will not accrue from and after the redemption date.

Selection of Bonds for Redemption. Whenever provision is made in the optional or special mandatory redemption of Bonds of more than one maturity, the Bonds to be redeemed shall be selected in inverse order of maturity or, at the election of the Authority evidenced by a Written Request of the Authority filed with the Trustee at least sixty (60) days prior to the date of redemption, on a pro rata basis among maturities (provided that, in any event, the principal and interest due on the Bonds Outstanding following such redemption shall be equal in time and amount to the unpaid payments due under the Installment Sale Agreement); and in each case, the Trustee shall select the Bonds to be redeemed within any maturity by lot in any manner which the Trustee in its sole discretion shall deem appropriate. For purposes of such selection, all Bonds shall be deemed to be comprised of separate \$5,000 portions and such portions shall be treated as separate Bonds which may be separately redeemed.

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) on the Bonds so called for redemption shall have been duly provided, such Bonds so called shall cease to be entitled to any benefit under the Indenture other than the right to receive payment of the redemption price, and no interest shall accrue thereon from and after the redemption date specified in such notice. All Bonds redeemed pursuant to the Indenture shall be canceled and shall be destroyed by the Trustee.

Transfer and Exchange of Bonds

The registration of any 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 duly authorized attorney, upon surrender of such 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. Bonds may be exchanged at the Office of the Trustee, for a like aggregate principal amount of Bonds of other authorized denominations of the same interest rate and maturity. The Authority shall pay all costs of the Trustee incurred in connection with any such exchange, except that the Trustee may require the payment by the Bond Owner requesting such exchange of any tax or other governmental charge required to be paid with respect to such exchange. The Trustee may refuse to transfer or exchange either (i) any Bond during the period established by the Trustee for the selection of Bonds for redemption pursuant to the Indenture, or (ii) the portion of any Bond which the Trustee has selected for redemption pursuant to the provisions of the Indenture.

Book-Entry System

The Depository Trust Company, New York, New York (“DTC”), will act as securities depository for the Bonds. The Bonds will be registered in the name of Cede & Co. (DTC’s partnership nominee), and will be available to ultimate purchasers in the denomination of \$5,000 or any integral multiple thereof, under the book-entry system maintained by DTC. Ultimate purchasers of Bonds will not receive physical certificates representing their interest in the Bonds. So long as the Bonds are registered in the name of Cede & Co., as nominee of DTC, references herein to the Owners shall mean Cede & Co., and shall not mean the ultimate purchasers of the Bonds. Payments of the principal of and interest on the Bonds will be made directly to DTC, or its nominee, Cede & Co., by the Trustee, so long as DTC or Cede & Co. is the registered owner of the Bonds. Disbursements of such payments to DTC’s Participants is the

responsibility of DTC and disbursements of such payments to the Beneficial Owners is the responsibility of DTC's Participants and Indirect Participants. See "APPENDIX G - BOOK-ENTRY ONLY SYSTEM."

Bond Debt Service

The following table sets forth the annual debt service schedule for the Bonds.

Bond Year Ending (August 1)	Principal	Interest	Total
2011	-	\$260,995.00	\$260,995.00
2012	\$105,000	\$279,637.50	\$384,637.50
2013	110,000	\$277,537.50	\$387,537.50
2014	110,000	\$275,062.50	\$385,062.50
2015	115,000	\$272,312.50	\$387,312.50
2016	115,000	\$268,862.50	\$383,862.50
2017	120,000	\$264,981.25	\$384,981.25
2018	125,000	\$260,781.25	\$385,781.25
2019	130,000	\$256,093.75	\$386,093.75
2020	135,000	\$250,893.75	\$385,893.75
2021	140,000	\$245,325.00	\$385,325.00
2022	145,000	\$239,025.00	\$384,025.00
2023	155,000	\$232,500.00	\$387,500.00
2024	160,000	\$224,750.00	\$384,750.00
2025	170,000	\$216,750.00	\$386,750.00
2026	180,000	\$208,250.00	\$388,250.00
2027	185,000	\$199,250.00	\$384,250.00
2028	195,000	\$190,000.00	\$385,000.00
2029	205,000	\$180,250.00	\$385,250.00
2030	215,000	\$169,487.50	\$384,487.50
2031	230,000	\$158,200.00	\$388,200.00
2032	240,000	\$146,125.00	\$386,125.00
2033	250,000	\$133,525.00	\$383,525.00
2034	275,000	\$120,400.00	\$395,400.00
2035	285,000	\$105,618.75	\$390,618.75
2036	300,000	\$90,300.00	\$390,300.00
2037	320,000	\$74,175.00	\$394,175.00
2038	335,000	\$56,975.00	\$391,975.00
2039	355,000	\$38,968.75	\$393,968.75
2040	370,000	\$19,887.50	\$389,887.50

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Estimated Sources and Uses of Funds

The following sets forth the estimated sources and uses of funds related to the issuance of the Bonds.

Sources of Funds:

Principal Amount of Bonds	5,775,000.00
Less: Original Issue Discount	(155,163.80)
Total Sources of Funds	<u>\$5,619,836.20</u>

Uses of Funds:

Deposit to Costs of Issuance Fund (1)	\$196,975.00
Deposit to Acquisition and Construction Fund	4,766,466.20
Deposit to the Bond Debt Service Account (2)	260,995.00
Deposit to Reserve Fund	395,400.00
Total Uses of Funds	\$5,619,836.20

(1) Costs of issuance include fees and expenses of Bond Counsel, Disclosure Counsel and the Trustee, rating agency fees, printing expenses, Underwriter's Discount of \$51,975 (.90%), and other costs of issuance of the Bonds.

(2) Represents capitalized interest on the Bonds through August 1, 2011.

EXPECTED GROWTH; CITY OF HERCULES

Expected Growth

The City has experienced substantial growth over the past few years. A number of new projects are currently under construction or have recently been completed. The City has entered into development agreements and other agreements with the developers of the projects listed below and it is expected that as additional construction projects are completed within the City, said new projects will be connected to the Electric System thereby generating additional Revenues. The following is a list of current development projects within the City:

Transportation /Waterfront Developments. The Intermodal Transit Center will combine three modes of public transportation (train, ferry and bus) in one Waterfront location along Bayfront Boulevard. Design of the train infrastructure improvements – track alignment, signals, pedestrian walkway, center-boarding platform and station structure– are nearly complete. Building design is continuing. In addition to the ferry, rail and bus improvements, an additional 1,300 homes will be located in the Waterfront as well as commercial, office and live-work units. The transit center will be easily accessible for bicyclists and pedestrians as well, particularly via the Bay Trail, which will connect to the cities of Pinole and Rodeo. The cost of the Intermodal Transit Center and all related infrastructure improvements is estimated at \$100M. The City is moving forward with the Intermodal Transit Center EIR, and it will evaluate the ferry service (described below) as part of the cumulative impacts. The Intermodal Transit Center is expected to be the largest in California. The first phase of this project, the train station should be completed in 2012.

The Water Emergency Transit Authority (WETA) (formerly the Water Transit Authority) has begun the process of funding new routes and terminals. The Hercules terminal is among the farthest ahead of these projects, with additional funds from Homeland Security committed to the project, but is not in the current WETA five-year plan. It is expected that the EIR will commence in 2013.

In August 2009, the new San Francisco Bay Area Rapid Transit District (“BART”) Park and Ride Facility (also referred to as the Hercules Transit Center) opened. It is located on Willow Avenue near the eastbound Interstate 80 off-ramp. The relocation of the Hercules Transit Center allows for both an expansion of the facility and for the completion of all three phases of the New Town Center project (described below).

The Union Pacific Railroad Company (UPRR) has given verbal approval of the proposed track alignment of the existing train station, and is reviewing plans for the on-going design effort. The project is expected to commence in October, 2010.

Business/Commercial Development. Hercules New Town Center (HNTC) is currently being developed by the Red Barn Co. and the City of Hercules Redevelopment Agency. This district will establish a new “downtown” for the community and the region. HNTC will include the relocated and expanded Hercules Transit Center at its core, combining a regional bus station and a location for a potential future BART extension. Surrounding these mass transit solutions will be a pedestrian-oriented mixed-use development. This will include retail, entertainment, office, and urban-density residential uses. A new “Main Street” will form the backbone of HNTC connecting various sub-districts.

The Hercules Waterfront (also referred to as Hercules Bayfront) is a 40-acre site planned to be a transit-oriented, mixed-use, traditional neighborhood project. The project represents the final phase of the Waterfront District Master Plan, one of the four major districts identified in the Central Hercules Plan. At buildout, it is proposed that the project will include up to 1,200 residential units, 93,500 sq. ft. of retail space, 224,000 sq. ft. of office space, and 51,500 sq. ft. of flex space. These figures may change as the plan develops. Planning efforts have focused on implementing New Urbanist and Smart Growth ideas to create a fully functional pedestrian- and transit-oriented community with an Inter-Modal Transit Station comprising water ferry, train, and bus transit at its center. Subject to the environmental impact report findings and the approval processes, it is anticipated that certain areas within the project area could begin construction in late 2010.

Sycamore Downtown is a proposed mixed use infill project at the corner of Sycamore and San Pablo Avenue, close to the intersection of Interstate 80 and Highway 4. The project provides for retail and restaurant space. The project has two main phases, Sycamore North, which is currently under construction, and Sycamore Crossing, which is located on the parcel directly to the south of Sycamore North. It is expected that construction on the project will commence in 2012.

Residential. On July 7, 2008, the Hercules Planning Commission adopted a resolution recommending that the City Council and Redevelopment Agency approve a development and owner participation agreement with Santa Clara Valley Housing Group, Inc., (SCVHG) for the Hilltown project. The Hilltown project will be approximately 450 attached single family units. It is proposed for a 44-acre parcel bounded by John Muir Parkway to the south, San Pablo Avenue to the west, the Victoria By The Bay development to the north and by Interstate 80 to the east. The site has dramatic differences in elevation, rising from approximately elevation 50 near John Muir Parkway to elevations in excess of 200 at the top. It is highly visible from several vantage points within the City, and presents a view of the City to thousands of cars traveling eastbound on Interstate 80. It is not known when construction will begin on this project.

SECURITY FOR THE BONDS

Assignment of Revenues; The Installment Sale Agreement and The Cooperation Agreement

The Bonds are special obligations of the Authority secured by and payable solely from the Revenues, consisting of (a) all amounts received by the Authority or the Trustee pursuant to the Installment Sale Agreement, (b) all moneys held in the funds and accounts established under the Indenture and investment income with respect thereto and (c) City Advance payments to be made by the City under the Cooperation Agreement dated as of August 1, 2010, by and between the City and the Authority in the event that there is a deficiency in the revenues payable to the Authority under the Installment Agreement.

The Installment Payments shall be made by the City from Net Revenues. Net Revenues are defined in the Indenture as Gross Revenues, namely income, rents, rates, fees, charges and other moneys derived from the ownership or operation of the Electric System, less Operation and Maintenance Costs defined as the reasonable and necessary costs and expenses paid by the City for maintaining and operating the Electric System. All of the Gross Revenues shall be deposited by the City immediately upon receipt in the Electric Fund held by the City. The City covenants in the Indenture to use funds in the Electric Fund to pay Operation and Maintenance Costs as such payments become due and payable. The City further covenants in the Indenture that all Net Revenues will be held by the City in the Electric Fund in trust for the benefit of the Trustee and paid to the Trustee for deposit to the Bond Service Fund as provided in the Indenture.

The lien of the Bonds on the revenues of the Electric System is on parity with the lien on such revenues held by the Prior Bonds issued on June 28, 2010.

The Cooperation Agreement

If, 60 days prior to any Interest Payment Date, the amount available in the Bond Service Fund shall be less than the amount of interest or principal (including sinking account payment) due with respect to the Bonds on such Interest Payment Date, the Trustee shall notify the City of the amount of such deficiency and shall request the City to make the City Advance payment required under the Cooperation Agreement for deposit to the Bond Service Fund. City Advances shall be made on an as-needed basis, in whole or in part, from any available funds of the City in the City's General Fund. In such event, the City shall take such actions as may be necessary to amend the City's General Fund budget to include the City Advances, in whole or in part, and make the necessary appropriations therefor. The covenants on the part of the City shall be deemed to be and shall be construed to be duties imposed by law and it shall be the duty of each and every public official of the City to take such action and do such things as are required by law in the performance of the official duty of such officials to enable the City to carry out and perform the covenants and agreements in the Cooperation Agreement agreed to be carried out and performed by the City.

All payments required by the City under the Cooperation Agreement shall be the absolute obligations of the City, not subject to deduction or offset of any kind, including, without limitation, offset of amounts owing to the City under the Cooperation Agreement and under the Indenture. City Advances made by the City shall be deemed to be a loan to the Authority and shall be reimbursable to the City as provided in the Indenture. See "CITY OF HERCULES - FINANCIAL INFORMATION" herein.

The City has also committed to make City advance payments under (i) a Cooperation Agreement between the City and the Authority dated as of July 1, 2009, in connection with the issuance by the Authority of its \$10,080,000 Hercules Public Financing Authority Taxable Lease Revenue Bonds, Series 2009 (Bio-Rad Project); (ii) a Cooperation Agreement between the City and the Authority dated as of

June 1, 2010, in connection with the issuance by the Authority of its \$7,425,000 Hercules Public Financing Authority Revenue Refunding Bonds (Electric System Project) Series 2010 issued on June 28, 2010 (under that agreement, the City advanced \$600,000 to the Electric System operating budget in order to cover any deficiencies in Electric System revenues for the 2010-11 Fiscal Year); and (iii) a Cooperation Agreement between the City and the Authority dated as of August 1, 2010, in connection with the issuance of the \$11,765,000 Hercules Public Financing Authority Wastewater Revenue Bonds, Series 2010.

Reserve Fund

Under the Indenture, a Reserve Fund is created for the Bonds (the "Reserve Fund") which shall be held in trust by the Trustee. An amount equal to the Reserve Requirement (as defined below) shall be maintained in the Reserve Fund at all times, subject to the provisions of the Indenture, and any deficiency therein shall be replenished from the first available Revenues pursuant to the Indenture. Under the Indenture, the "Reserve Requirement" means, as of any date of calculation by the City, the least of (i) ten percent (10%) of the proceeds (within the meaning of section 148 of the Code) of the Bonds; (ii) 125% of average Annual Debt Service of any Bond Year on the then Outstanding Bonds, or (iii) the Maximum Annual Debt Service for that and any subsequent year.

Under the Indenture, moneys in the Reserve Fund shall be used solely for the purpose of paying the principal of and interest on the Bonds, including the redemption price of the Bonds coming due and payable by operation of mandatory sinking fund redemption pursuant to the Indenture, in the event that the moneys in the Bond Service Fund are insufficient therefor. In the event that the amount on deposit in the Bond Service Fund on any date is insufficient to enable the Trustee to pay in full the aggregate amount of principal of and interest on the Bonds coming due and payable, including the redemption price of the Bonds coming due and payable by operation of mandatory sinking fund redemption, the Trustee shall withdraw the amount of such insufficiency from the Reserve Fund and transfer such amount to the Bond Service Fund.

In the event that the amount on deposit in the Reserve Fund exceeds the Reserve Requirement on the fifteenth calendar day of the month preceding any Interest Payment Date, the amount of such excess shall be withdrawn therefrom by the Trustee and transferred to the Bond Service Fund and credited against the Installment Payment or Installment Payments next due from the City.

Qualified Reserve Fund Credit Instrument

The Authority may fund all or a portion of the Reserve Requirement with one or more Qualified Reserve Fund Credit Instruments, which is defined in the Indenture as an irrevocable standby or direct-pay letter of credit or surety bond issued by a commercial bank or insurance company and deposited with the Trustee pursuant to the terms of the Indenture provided that all of the following requirements are met: (i) the long-term credit rating of such bank or insurance company at the time of delivery of such letter of credit or surety bond is rated in one of the two highest rating categories by Moody's or S&P; (ii) such letter of credit or surety bond has a term of at least twelve (12) months; (iii) such letter of credit or surety bond has a stated amount at least equal to the portion of the Reserve Requirement with respect to which funds are proposed to be released pursuant to the terms of the Indenture; and (iv) the Trustee is authorized pursuant to the terms of such letter of credit or surety bond to draw thereunder an amount equal to any deficiencies which may exist from time to time in the amounts available to repay the principal of and interest on the Bonds.

Upon deposit of any Qualified Reserve Fund Credit Instrument with the Trustee, the Trustee shall transfer any excess amounts then on deposit in the Reserve Fund into a segregated account of the Bond Service Fund, which monies shall be applied at the written direction of the Authority either (i) to the

payment within one year of the date of transfer of capital expenditures of the Authority permitted by law, or (ii) to the redemption of Bonds on the earliest succeeding date on which such redemption is permitted hereby, and pending such application shall be held either not invested in investment property (as defined in section 148(b) of the Code), or invested in such property to produce a yield that is not in excess of the yield on the Bonds; provided, however, that the Authority may by written direction to the Trustee cause an alternative use of such amounts if the Authority shall first have obtained a written opinion of nationally recognized bond counsel substantially to the effect that such alternative use will not adversely affect the exclusion pursuant to section 103 of the Code of interest on the Bonds from the gross income of the owners thereof for federal income tax purposes.

In any case where the Reserve Fund is funded with a combination of cash and a Qualified Reserve Fund Credit Instrument, the Trustee shall deplete all cash balances before drawing on the Qualified Reserve Fund Credit Instrument. With regard to replenishment, any available moneys provided by the Authority shall be used first to reinstate the Qualified Reserve Fund Credit Instrument and second, to replenish the cash in the Reserve Fund. In the event the Qualified Reserve Fund Credit Instrument is drawn upon, the Authority shall make payment of interest on amounts advanced under the Qualified Reserve Fund Credit Instrument after making any payments to the Bond Service Fund pursuant to the terms of the Indenture.

In the event the Qualified Reserve Fund Credit Instrument will lapse or expire, the Trustee shall draw upon such Qualified Reserve Fund Credit Instrument prior to its lapsing or expiring in the full amount of such Qualified Reserve Fund Credit Instrument, make deposits from available Revenues to the Reserve Fund to increase the amount on deposit therein to the Reserve Requirement or substitute such Qualified Reserve Fund Credit Instrument with a Qualified Reserve Fund Credit Instrument that satisfies the requirements described above.

Issuance of Additional Debt; Parity Obligations

The Authority may not issue additional bonds, notes or other indebtedness secured by the Revenues. Pursuant to the terms of the Installment Sale Agreement, in addition to the Installment Payments, the City may issue or incur other bonds, notes, loans, advances or indebtedness payable from Net Revenues on a parity with, or subordinate to, the Installment Payments to provide financing for the Electric System in such principal amount as shall be determined by the City.

Installment Payments

Under the Installment Sale Agreement, the City agrees to pay to the Authority, its successors and assigns, but solely from the "Net Revenues" (consisting of "Gross Revenues" less "Operation and Maintenance Costs") and other funds pledged under the Installment Sale Agreement, the "Purchase Price," together with interest on the unpaid principal balance payable in Installment Payments coming due and payable in the respective amounts and on the respective Installment Payment Dates specified in the Installment Sale Agreement. These terms are defined in the Installment Sale Agreement as follows:

"Net Revenues" is defined as meaning, for any period, an amount equal to all of the Gross Revenues received during such period minus the amount required to pay all Operation and Maintenance Costs becoming payable during such period.

"Gross Revenues" is defined as meaning all income, rents, rates, fees, charges and other moneys derived from the ownership or operation of the Electric System, including, without limiting the generality of the foregoing, (1) all income, rents, rates, fees, charges, business interruption insurance proceeds or other moneys derived by the City from the sale, furnishing and supplying of electric or other services, facilities, and commodities sold, furnished or supplied

through the facilities of or in the conduct or operation of the business of the Electric System (other than the non-by-passable usage based charge supporting the City's public benefit program), plus (2) the earnings on and income derived from the investment of such income, rents, rates, fees, charges, or other moneys, including City reserves and the Reserve Fund established under the Indenture, but excluding in all cases customer deposits or any other deposits or advances subject to refund until such deposits or advances have become the property of the City and excluding any proceeds of taxes required by law to be used by the City to pay bonds hereafter issued, and any amounts reimbursed to the Authority by the United States of America pursuant to Section 54AA of the Tax Code, or any future similar program.

"Electric System" is defined as meaning the entire electric system of the City, including all facilities, properties and improvements at any time owned, controlled or operated by the City for the provision of electricity, and any necessary lands, rights, entitlements and other property useful in connection therewith, together with all extensions thereof and improvements thereto at any time acquired, constructed or installed by the City, including the Improvements.

"Operation and Maintenance Costs" is defined as meaning the reasonable and necessary costs and expenses paid by the City for maintaining and operating the Electric System, including but not limited to (a) the cost of utilities, including electricity and other forms of energy supplied to the Electric System, (b) the reasonable expenses of management and repair and other costs and expenses necessary to maintain and preserve the Electric System in good repair and working order and (c) the reasonable administrative costs of the City attributable to the operation and maintenance of the Electric System, including insurance and other costs described in the Installment Sale Agreement, but in all cases excluding (i) debt service payable on obligations incurred by the City with respect to the Electric System, including but not limited to the Installment Payments and debt service payments on any Parity Obligations, (ii) depreciation, replacement and obsolescence charges or reserves therefor, (iii) amortization of intangibles or other bookkeeping entries of a similar nature, (iv) City's public benefit program expenditures, and (v) periodic administrative transfers to the City's general fund.

"Purchase Price" is defined as meaning the amount to be paid by the City under the Installment Sale Agreement as the purchase price of the Improvements, being equal to the aggregate principal amount of the Bonds.

Under the Installment Sale Agreement, all of the Net Revenues are irrevocably pledged, charged and assigned to the punctual payment of the Installment Payments and any Parity Obligations (described above) and except as otherwise provided in the Installment Sale Agreement the Net Revenues shall not be used for any other purpose so long as any of the Installment Payments remain unpaid. Such pledge, charge and assignment shall constitute a first lien on the Net Revenues and such other moneys for the payment of the Installment Payments and any Parity Obligations in accordance with the terms of the Installment Sale Agreement.

The obligations of the City to make the Installment Payments from the Net Revenues and to perform and observe the other agreements contained in the Installment Sale Agreement shall be absolute and unconditional and until such time as all of the Installment Payments and all other amounts coming due and payable under the Installment Sale Agreement shall have been fully paid or prepaid, the City may not suspend or discontinue payment of any Installment Payments or such other amounts, will perform and observe all other agreements contained in the Installment Sale Agreement, and will not terminate the Installment Sale Agreement for any cause. See "SECURITY FOR THE BONDS – Special Obligation" herein.

Under the Installment Sale Agreement, all of the Gross Revenues shall be deposited by the City immediately upon receipt in the Electric Utility Fund, which fund is established by the Installment Sale Agreement and held by the City. The City shall use funds in the Electric Utility Fund to pay Operation and Maintenance Costs as such payments become due and payable. The City covenants and agrees that all Net Revenues will be held by the City in the Electric Utility Fund in trust for the benefit of the Trustee (as assignee of the rights of the Authority under the Installment Sale Agreement) and the Bond Owners, and for the benefit of the owners of any Parity Obligations. On or before each Installment Payment Date, the City shall withdraw from the Electric Utility Fund, and transfer to the Trustee for deposit in the Revenue Fund, and to the trustee for any Parity Obligations, as applicable, an amount of Net Revenues which, together with the balance then on deposit in the Bond Service Fund (other than amounts resulting from the prepayment of the Installment Payments pursuant to the Installment Sale Agreement and other than amounts required for payment of principal of or interest on any Bonds and Parity Obligations which have matured or been called for redemption but which have not been presented for payment), is equal to the aggregate amount of the Installment Payments coming due and payable on the next succeeding Interest Payment Date, together with any amounts required to restore the balance in the Reserve Fund to the Reserve Requirement. In support of the foregoing, the City shall set aside each month equal amounts necessary to make such transfers on or before each Installment Payment Date.

The City is required under the Installment Sale Agreement to manage, conserve and apply the Gross Revenues on deposit in the Electric System Fund in such a manner that all deposits required to be made will be made at the times and in the amounts so required. Subject to the foregoing sentence, so long as no Event of Default shall have occurred and be continuing under the Installment Sale Agreement, the City may use and apply Net Revenues in the Electric Utility Fund for (i) the payment of Additional Payments (as defined in the Installment Sale Agreement), (ii) the payment of any subordinate obligations or any unsecured obligations, (iii) the acquisition and construction of extensions and betterments to the Electric System, (iv) the prepayment of any obligations of the City relating to the Electric System, (v) transfers from the Electric Utility Fund to the General Fund of the City for administrative costs, or (vi) any other lawful purposes of the Electric Utility Fund. All monies in the Electric System Fund may be invested by the City from time to time in any Authorized Investment.

Rate Covenant; Collection of Rates and Charges

Under the Installment Sale Agreement, the City agrees it will use its best efforts to fix, prescribe, revise and collect rates, fees and charges for the services and facilities furnished by the Electric System during each Fiscal Year, which are at least sufficient, after making allowances for contingencies and error in the estimates, to yield Gross Revenues sufficient to pay the following amounts in the following order of priority:

- (a) All Operation and Maintenance Costs estimated by the City to become due and payable in such Fiscal Year;
- (b) All Installment Payments and payments of principal of and interest on any Parity Obligations as they become due and payable during such Fiscal Year, without preference or priority, except to the extent Installment Payments or interest on any Parity Obligations are payable from proceeds of the Bonds or Parity Obligations deposited for such purpose;
- (c) All amounts, if any, required to restore the balance in the Reserve Fund and any reserve fund securing any Parity Obligations to the full amount of the Reserve Requirement and the reserve requirement with respect to any Parity Obligations; and

- (d) All payments required to meet any other obligations of the City which are charges, liens, encumbrances upon, or which are otherwise payable from, the Gross Revenues or the Net Revenues during such Fiscal Year.

See “THE ELECTRIC SYSTEM - Rates and Charges; Recent Rate Increase” herein for a discussion of Electric System rate increases approved by the City Council of the City in February, 2010 and commencing in April, 2010, and November, 2010. Also see “The Cooperation Agreement” for a discussion of the City’s commitment to make City Advances in the event that Net Revenues are insufficient to pay debt service on the Bonds.

CITY OF HERCULES - FINANCIAL INFORMATION

Assessed Valuation and Property Taxes

The following table sets forth a six-year history of the City’s assessed property valuation.

**CITY OF HERCULES
ASSESSED VALUATION HISTORY**

<u>Fiscal Year</u>	<u>Local Secured</u>	<u>Utility</u>	<u>Unsecured</u>	<u>Total</u>
2004-05	\$2,383,718,782	\$419,155	\$28,727,797	\$2,412,865,734
2005-06	2,785,164,540	418,560	28,687,771	2,814,270,871
2006-07	3,137,802,267	359,783	42,879,798	3,181,041,848
2007-08	3,375,323,975	0	46,134,335	3,421,458,310
2008-09	3,267,521,308	0	47,129,903	3,314,651,211
2009-10	2,819,611,160	0	60,481,068	2,880,092,228

Source: County of Contra Costa

The following table sets forth a five-year history of the City’s secured tax levy. The City operates under the Teeter Plan and receives 100% of the property tax levy from the County, irrespective of delinquencies. These amounts listed below are net of any Redevelopment Agency tax increment and the unsecured levy and do not include collections for the City’s general obligation bond issue, two assessment bond issues, and assessments for garbage delinquencies, sewer operations and landscaping and lighting.

**CITY OF HERCULES
TAX LEVIES**

<u>Fiscal Year</u>	<u>Secured Tax Levy</u>
2004-05	\$1,042,461
2005-06	1,027,071
2006-07	1,360,908
2007-08	1,252,585
2008-09	1,177,095

Source: County of Contra Costa

General Long-Term Debt

The following table sets forth the City's debt as of May 1, 2010.

**CITY OF HERCULES
GENERAL LONG-TERM DEBT**

<u>Description</u>	<u>Balance as of May 1, 2010</u>
H.E.L.P. Loan (1)	\$1,600,000
R.D.L.P. Loan (2)	3,750,000
SunTrust Lease (3)	1,976,482
Long Term Note (4)	<u>452,949</u>
Total General Long-Term Debt	\$7,779,431

Source: City of Hercules

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CITY OF HERCULES
DEBT SERVICE SCHEDULE ON LONG TERM DEBT CITY OF HERCULES
DEBT SERVICE SCHEDULE ON LONG TERM DEBT

	H.E.L.P. Loan (1)	R.D.L.P. Loan (2)	Sun Trust Lease (3)	Long Term Note (4)	Total
2010			\$102,549		\$102,549
2011		\$112,500	205,098	\$85,932	291,030
2012		112,500	205,098	85,705	290,803
2013		112,500	205,098	85,868	290,966
2014		112,500	205,098	85,662	290,760
2015	\$187,569	112,500	205,098	87,232	479,899
2016	187,569	112,500	205,098	87,231	479,898
2017	187,569	112,500	205,098		392,667
2018	187,569	112,500			187,569
2019	187,569	112,500			187,569
2020	187,569	112,500			187,569
2021	187,569	112,500			187,569
2022	187,569	112,500			187,569
2023	187,569	112,500			187,569
2024	187,569	112,500			187,569
TOTAL	\$1,875,690	\$1,575,000	\$1,538,235	\$517,630	\$3,931,555

(1) In April 2005, the City of Hercules entered into an agreement with the California Housing & Finance Agency (“Agency”), a public instrumentality and political subdivision of the State of California to develop a 50-unit multifamily rental project that is a component to a mixed-use development, also consisting of 26,825 square feet of ground-floor commercial space. The Agency has authorized the making of a loan in the amount of \$1,600,000 known as the Housing Enabled by Local Partnerships (“HELP”) to the City of Hercules for the purpose of assisting in operating a local housing program. Under the terms of this agreement the City of Hercules agrees to reimburse the California Housing & Finance Agency \$1,600,000, 10 years from April 11, 2005 at 3% simple per annum interest. Interest is to be charged only on funds disbursed. Debt service on the loan is \$187,569 per year from 2015 to 2024.

(2) The California Housing & Finance Agency loaned the City \$3,750,000 to finance site acquisition and predevelopment costs for 23 affordable housing units as a part of a 52-unit condominium mixed income development. Construction is in progress. The terms include a 3% simple interest deferred loan dated February 15, 2007.

(3) On September 27, 2007, the City entered into master lease agreements with SunTrust Leasing Corporation in order to provide funds for the financing of the EMS Project by Siemens Building Technologies in the amount of \$2,185,538. Payments are due semiannually on September 27 and March 27, at an interest rate of 4.73%. The Master Lease Agreement matures on September 27, 2017. Debt service on the loan is \$102,549 in 2010 and 205,098 each year for the years 2011 to 2017.

(4) In 1987, the Redevelopment Agency entered into Owner Participation Agreements with certain property owners in the Redevelopment Area. Under the terms of these agreements, the Redevelopment Agency signed notes under which it promised to reimburse the owners by the year 2016 for incremental assessments levied on their properties, up to the cost of constructing public improvements. Payment on these notes is contingent on the property taxes and special assessments levied on these owners. Debt service is between \$85,932 and \$87,231 for the years 2011 to 2016.

DIRECT AND OVERLAPPING GOVERNMENTAL ACTIVITIES DEBT
As of June 30, 2009
(Amounts Expressed In Thousands)

	Debt Outstanding	Estimated Percentage Applicable (1)	Estimated Share of Overlapping Debt
Overlapping Tax and Assessment Debt			
Bay Area Rapid Transit District	\$441,360	.0466%	\$2,057
Contra Costa Community College District	176,050	1.489%	2,621
John Swett Unified School District	9,425	8.741%	824
West Contra Costa Unified School District	636,220	9.245%	58,819
West Contra Costa Healthcare Parcel Tax Obligation	23,905	9.384%	2,243
East Bay Regional Park District	125,850	0.687%	865
California Statewide Comm Development Authority 1915 Act Bonds	1,232	100%	1,232
City of Hercules 1915 Act Bonds	11,850	100%	11,850
Total Gross Overlapping Tax and Assessment Debt	\$1,425,892		\$80,511
Direct and Overlapping General Fund Debt:			
Contra Costa County General Fund Obligations	285,315	1.484%	4,234
Contra Costa County Pension Obligations	465,455	1.484%	6,907
Contra Costa Community College District Certificates of Participation	1,050	1.489%	16
West Contra Costa Unified School District Certificates of Participation	23,390	9.245%	2,162
City of Hercules General Fund Obligations	14,880	100%	14,880
Total Direct and Overlapping General Fund Debt	790,090		28,199
Gross Combined Total Debt	2,215,982		108,710 (2)
Net Combined Total Debt	2,215,982		108,710

(1) Percentage of overlapping agency's assessed valuation located within boundaries of the City.

(2) Excludes tax and revenue anticipation notes, enterprise revenue, mortgage revenue and tax allocation bonds and non-bonded capital lease obligations

Ratios to 2008-09 Assessed Valuation: 2.43%
Total Gross Overlapping Tax and Assessment Debt

Ratios to Adjusted Assessed Valuation:
Combined Direct Debt (\$14,880,000) 0.72%

Gross Combined Total Debt 5.29%
STATE SCHOOL BUILDING AID REPAYABLE AS OF 6/30/09: \$0

Source: City of Hercules Finance Department

Financial Statements

The City is audited annually by an independent auditor. The table following presents audited general fund revenues, expenditures, and fund balances for Fiscal Years 2005-06, 2006-07, 2007-08 and 2008-09.

CITY OF HERCULES GENERAL FUND BALANCE SHEET Fiscal Years Ending June 30

	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009 (1)</u>
ASSETS				
Cash and investments	\$8,781,394	\$11,034,759	\$12,948,501	\$1,379,333
Accounts receivable	1,524,571	485,561	761,268	688,623
Interest receivable	--	47,304	147,383	252,354
Deposit receivable	--	--	--	365,300
Due from other funds	4,914,243	4,209,035	1,044,047	10,418,827
Advances to other funds	13,785,838	17,090,185	18,336,986	18,890,055
Prepaid expenditures	4,757	1,845	2,817	97,803
Loan receivable	100,000	250,000	250,000	250,000
Lease receivable	--	--	--	10,010,827
Total Assets	<u>\$29,110,803</u>	<u>\$33,118,689</u>	<u>\$33,491,002</u>	<u>\$42,353,122</u>
LIABILITIES AND FUND BALANCES				
Liabilities:				
Accounts payable	\$ 671,836	\$ 446,215	\$ 303,153	\$472,772
Accrued wages	290,925	311,511	348,244	451,596
Compensated absences	--	--	--	--
Deferred revenue	--	--	--	10,535,226
Claims and judgments payable	19,598	50,666	64,979	30,329
Deposits payable	1,440,544	517,987	424,781	70,739
Due to other funds	--	--	--	--
Advances from other funds	615,750	4,669,631	5,529,960	5,714,839
Total Liabilities	<u>\$3,038,653</u>	<u>\$5,996,010</u>	<u>\$6,991,117</u>	<u>\$17,275,501</u>
Fund Balances:				
Reserved	\$14,262,272	\$17,518,358	\$19,135,244	\$19,693,278
Unreserved, designated	11,809,878	9,604,321	7,364,641	5,384,343
Total Fund Balances	<u>\$26,072,150</u>	<u>\$27,122,679</u>	<u>\$26,499,885</u>	<u>\$25,077,621</u>
Total Liabilities and Fund Balances	<u>\$29,110,803</u>	<u>\$33,118,689</u>	<u>\$33,491,002</u>	<u>\$42,353,122</u>

- (1) The decrease in cash and investments for 2009 is due to a delay in the receipt of certain payments (ie certain grants, etc) as reflected in the row "Due from other funds". Approximately \$397,291 was replenished from the receipt of said grants and \$8,814,012 was replenished from certain 2009 Bond proceeds. \$1,207,523 is expected to be replenished from tax increment revenues in future years. The City's total assets increased during 2009 by approximately \$10M.

Source: City of Hercules

The following five-year summary of the City's general revenues has been prepared by the City's Finance Department from audited financial statements.

**CITY OF HERCULES
STATEMENT OF REVENUES AND EXPENDITURES – GENERAL FUND
(Fiscal Years Ended June 30)**

	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>
REVENUES					
Taxes and assessments	\$4,549,517	\$5,291,693	\$5,516,722	\$5,414,588	\$5,478,257
Intergovernmental revenues	1,950,564	1,862,909	1,951,792	1,991,472	1,930,293
Licenses and permits	1,078,260	752,861	508,550	337,291	491,663
Fines and forfeitures	57,368	63,565	167,635	134,502	146,835
Use of money and property	1,860,273	972,390	1,485,902	1,805,821	2,186,842
Charges for services	1,898,126	1,736,096	2,221,957	2,044,478	2,045,876
Lease revenue	--	--	--	--	69,173
Other revenues	1,143,705	924,515	2,048,683	2,199,002	2,389,350
Total revenues	<u>\$12,545,288</u>	<u>\$11,604,029</u>	<u>\$13,901,291</u>	<u>\$13,927,154</u>	<u>\$14,738,289</u>
EXPENDITURES					
Current:					
General government	\$3,266,213	\$3,237,801	\$3,509,624	\$4,373,374	\$5,205,822
Public safety	3,809,073	4,653,921	5,513,184	5,255,248	6,224,560
Streets and Public works	133,617	585,566	640,097	371,196	696,905
Community development	1,155,166	1,340,017	1,302,116	1,664,024	1,300,911
Parks and recreation	1,943,863	2,116,154	2,228,004	2,424,980	2,750,925
Capital outlay	338,834	124,680	--	16,593	--
Lease Expense	532,096	920,285	1,021,940	1,132,585	1,095,837
Total expenditures	<u>\$11,178,862</u>	<u>\$12,978,424</u>	<u>\$14,214,965</u>	<u>\$15,238,000</u>	<u>\$17,274,960</u>

Source: City of Hercules Finance Department

Budgetary Principles

The City follows these procedures in establishing the budgetary data reflected in the financial statements. The following policies may be re-evaluated and changed by the City Council at any time.

1. The City re-implemented a one-year budget program starting in Fiscal Year 2007-08. In June preceding the budget year, the City Manager submits to the City Council a proposed operating and capital budget for such budget year. This budget includes proposed expenditures, by fund and department, and the revenues expected to finance them.
2. Public hearings are conducted to obtain taxpayer comments.
3. The budget is legally enacted through passage of a resolution before July 1.
4. The City Manager is authorized to transfer budgeted amounts within the same department; however, any revisions which alter total expenditures of any fund, must be approved by the City Council.
5. Formal budgetary integration is employed as a management control device. Commitments for material and services, such as purchase orders and contracts are recorded during the year as encumbrances to assist in controlling expenditures. Appropriations, which are encumbered at year-end lapse, and then are added to the

following year's budgeted appropriations. However, encumbrances at year-end are reported as reservations of fund balance.

The following represents the City's general fund revenue projections for 2009-2010 as of December, 2009.

CITY OF HERCULES	
General Fund Revenue Projections	
FY 2009-2010 as of December, 2009	
	2009-2010 Budgeted Revenues
Taxes	\$5,612,039
State & County Fees	1,671,800
Licenses and Permits	834,817
Fines & Forfeitures	85,000
Use of Money & Property	2,632,210
Police Services	250,000
Planning/Building Services	1,146,460
Charges for Services	1,567,900
Miscellaneous Revenue	1,963,468
Repayment of HMU CIP	3,450,308
Transfers In	773,500
Total Revenues	\$19,987,502

Source: City of Hercules Finance Department

Revenue and Expenditure Analysis

Revenues from the general fund totaled \$13,927,154 in 2007/2008 compared to \$14,738,289 in Fiscal Year 2008/2009. Revenues from the General Fund for Fiscal Year 2009/2010 are projected to be \$19,987,502 as set forth in the previous table. The major revenue source for the general fund continues to be taxes, which represents approximately 39% of total general fund revenues. The following summarizes the various general fund revenue sources for Fiscal Year 2008/2009:

CITY OF HERCULES
GENERAL FUND REVENUE SOURCE
Fiscal Year Ending June 30, 2009

Taxes and assessments	\$ 5,478,257
Licenses and permits	491,663
Fines and forfeitures	146,835
Use of money and property	2,186,842
Intergovernmental revenues	1,930,293
Charges for services	2,045,876
Other revenues	2,389,350
TOTAL	\$14,738,289

Source: City of Hercules

The assessed valuation for Fiscal Year 2008/2009 totaled \$3,314,651,211, which represents a decrease over the prior fiscal year of approximately 3.1% due to general decrease in property values.

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

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

Expenditures for the general fund totaled \$17,274,960 in Fiscal Year 2008/2009. The major general fund expenditures are summarized as follows:

**CITY OF HERCULES
GENERAL FUND EXPENDITURE SOURCE
Fiscal Year Ending June 30, 2009**

General government	\$ 5,205,822
Public safety	6,224,560
Streets and public works	696,905
Parks and recreation	2,750,925
Community development	1,300,911
Lease expense	<u>1,095,837</u>
TOTAL	\$17,274,960

Source: City of Hercules

Public Employee Retirement System

Plan Description – The City contributes to the California Public Employees’ Retirement System (PERS), an agent multiple-employer defined benefit pension plan. PERS provides retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries. PERS acts as a common investment and administrative agent for participating public entities within the state of California. Benefit provisions and all other requirements are established by state statute and city ordinance. Copies of PERS’ annual financial report may be obtained from their Executive Office located at 400 P Street, Sacramento, California 95814.

Funding Policy – Active plan members are required by state statute to contribute 7% (9% for safety employees) of their annual covered salary. The City makes the contributions required of City employees on their behalf and for their account, which amounted to \$595,649 for the year ended June 30, 2009. The City is required to contribute for fiscal year 2008-2009 at an actuarially determined rate of

11.040% of annual covered payroll for miscellaneous employees and 27.187% for safety employees respectively. The contribution requirements of plan members and the City are established and may be amended by PERS.

Annual Pension Cost – For 2008-2009, the City’s annual pension cost of \$1,408,489 for PERS was equal to the City’s required and actual contribution. The required contribution was determined as part of the June 30, 2006 actuarial valuation using the entry age normal actuarial cost method. The actuarial assumptions included (a) 7.75% investment rate of return (net of administrative expenses), (b) projected salary increases ranging from 3.25% to 14.45% for miscellaneous employees and from 3.25% to 13.15% for safety employees depending on age, service, and type of employment, and (c) 3.25% per year cost-of-living adjustments. Both (a) and (b) included an inflation component of 3.00%. The actuarial value of PERS assets was determined using techniques that smooth the effects of short-term volatility in the market value of investments over a three-year period. PERS unfunded actuarial accrued liability (or surplus) is being amortized as a level percentage of projected payroll on a closed basis. The amortization period at June 30, 2009, was 16 years for miscellaneous and 16 years for safety employees for prior and current service unfunded liability.

**CITY OF HERCULES
THREE YEAR TREND INFORMATION FOR PERS**

<u>Fiscal Year</u>	<u>Annual Pension Cost (APC)</u>	<u>Percentage of APC Contributed</u>	<u>Net Pension Obligation</u>
June 30, 2007	\$1,341,288	100%	--
June 30, 2008	\$1,352,244	100%	--
June 30, 2009	\$1,408,489	100%	--

Labor Relations

As of June 30, 2009, the City had approximately 135 full-time and approximately 40 seasonal employees. The City has a Memorandum of Understanding with the Hercules Police Officers Association. Under California law, police officers are not allowed to strike. The City has one bargaining unit (Teamsters Local 315 Union) for miscellaneous full time and part time employees.

Litigation

There are several lawsuits and claims pending against the City. In the opinion of the City officials, the aggregate amount of liability that the City might incur as a result of adverse decisions in such cases would be covered under the insurance maintained by the City or if not covered by such insurance, would not significantly impact the City’s financial position.

On June 4, 2010, the City received a report issued by the Contra Costa County Grand Jury (the “Grand Jury”) on June 2, 2010. In the report, the Grand Jury concluded that some of the Hercules Redevelopment Agency’s practices relating to the Redevelopment Agency’s low and moderate affordable housing loan program, and the City’s competitive bidding practices for certain government contracts raise the specter of impropriety. However, the Grand Jury found no evidence of illegality or actual impropriety by City or Redevelopment Agency officials or staff. The Grand Jury Report provides the following recommendations: expand ethics and conflict of interest training; invite open bidding on all contracts; City Council Members confine their participation to policy direction on affordable housing issues; City Council openly publicize available properties for sale by the City; and minutes from all City Council committee meetings be recorded. The City submitted a response to the Grand Jury Report on July 14, 2010, in which the City refuted the majority of the report’s conclusions, and duly noted changes which have been made that directly address certain recommendations made by the Grand Jury.

Investments and Investment Policy

The basic premise underlying the City's investment policy is to insure that money is always safe and available when needed. Staff actively manages the City's portfolio in order to take advantage of changing economic conditions. Through daily projected cash flow analysis, the City will attempt to fully invest all idle cash. To ensure maximum safety of City assets, it is also the policy of the City to diversify its investment portfolio. To this extent, the Finance Director, with City Manager approval may, from time to time, make use of investment advisors and also may, from time to time, place certain City funds with investment managers in accordance with City policy.

The City also strives to make investments which benefit the local area and are consistent with municipal plans and policies. Priority is given to investments which promote community economic development, such as doing business with local banks, provided that the criteria for safety, liquidity and yield are met.

Criteria for selecting investments and order of priority are:

- 1. Safety: The safety and risk associated with an investment refers to the potential loss of principal, interest, or a combination of these amounts. The City only operates in those investments that are considered very safe.**
- 2. Liquidity: This refers to the ability to "cash in" at any moment in time with a minimal chance of losing some portion of principal or interest. Liquidity is an important investment quality, especially when the need for unexpected funds occurs occasionally.**
- 3. Yield: Yield is the potential dollar earnings an investment can provide and sometimes is described as the rate of return. Yield should become a consideration only after the basic requirement of safety and liquidity have been met.**

Pursuant to City policy, the Finance Director must render a monthly investment report to the City Manager and the City Council indicating the type of investment, institution, date of purchase, date of maturity, amount of deposit, coupon rate of interest, investment yield, and if applicable, current market value. The monthly report is intended to provide assurance that the investment portfolio is in compliance with the City's Investment Policy and that it is sufficiently liquid to meet the City's expenditures for the next six months.

Covenants of the City

In addition to the covenant described above under the caption "Rate Covenant; Collection of Rates and Charges," the City makes certain other covenants in the Installment Sale Agreement which are summarized below. See "APPENDIX C - SUMMARY OF PRINCIPAL LEGAL DOCUMENTS - The Installment Sale Agreement" herein.

Maintenance, Utilities, Taxes and Assessments. Throughout the term of the Installment Sale Agreement, all improvement, repair and maintenance of the Electric System shall be the responsibility of the City, and the City shall pay for or otherwise arrange for the payment of all utility services supplied to the Electric System, which may include, without limitation, janitor service, security, power, gas, telephone, light, heating, water and all other utility services, and shall pay for or otherwise arrange for the payment of the cost of the repair and replacement of the Electric System resulting from ordinary wear and tear.

The City shall also pay or cause to be paid all taxes and assessments of any type or nature, if any, charged to the Authority or the City affecting the Electric System or the respective interests or estates therein; provided, however, that with respect to special assessments or other governmental charges that may lawfully be paid in installments over a period of years, the City shall be obligated to pay only such installments as are required to be paid during the Term of this Agreement as and when the same become due.

Operation of the Electric System. The City covenants and agrees to operate the Electric System in an efficient and economical manner and to operate, maintain and preserve the Electric System in good repair and working order. The City covenants that, in order to fully preserve and protect the priority and security of the Bonds, the City shall pay from the Gross Revenues and discharge all lawful claims for labor, materials and supplies furnished for or in connection with the Electric System which, if unpaid, may become a lien or charge upon the Gross Revenues or the Net Revenues prior or superior to the lien granted under the Installment Sale Agreement, or which may otherwise impair the ability of the City to pay the Installment Payments in accordance therewith.

Public Liability and Property Damage Insurance. The City shall maintain or cause to be maintained, throughout the term of the Installment Sale Agreement, but only if and to the extent available at reasonable cost from reputable insurers, a standard comprehensive general insurance policy or policies in protection of the Authority, the City and their respective members, officers, agents and employees. Said policy or policies shall provide for indemnification of said parties against direct or contingent loss or liability for damages for bodily and personal injury, death or property damage occasioned by reason of the operation of the Electric System. Said policy or policies shall provide coverage in such liability limits and shall be subject to such deductibles as shall be customary with respect to works and property of a like character. Such liability insurance may be maintained as part of or in conjunction with any other liability insurance coverage carried by the City, and may be maintained in whole or in part in the form of self-insurance by the City, subject to the provisions of the Installment Sale Agreement, or in the form of the participation by the City in a joint powers agency or other program providing pooled insurance. The proceeds of such liability insurance shall be applied toward extinguishment or satisfaction of the liability with respect to which such proceeds shall have been paid.

Casualty Insurance. The City shall procure and maintain, or cause to be procured and maintained, throughout the term of the Installment Sale Agreement, but only in the event and to the extent available from reputable insurers at reasonable cost, casualty insurance against loss or damage to any improvements constituting any part of the Electric System, covering such hazards as are customarily covered with respect to works and property of like character. Such insurance may be subject to deductible clauses which are customary for works and property of a like character. Such insurance may be maintained as part of or in conjunction with any other casualty insurance carried by the City and may be maintained in whole or in part in the form of self-insurance by the City, subject to the provisions of the Installment Sale Agreement, or in the form of the participation by the City in a joint powers agency or other program providing pooled insurance. All amounts collected from insurance against accident to or destruction of any portion of the Electric System shall be used to repair, rebuild or replace such damaged or destroyed portion of the Electric System, and to the extent not so applied, shall be paid to the Trustee to be applied to pay or prepay the Installment Payments (and the Bonds, under the special mandatory redemption provisions of the Indenture) or any Parity Obligations, in accordance with written instructions of the City filed with the Trustee.

Eminent Domain. Any amounts received as awards as a result of the taking of all or any part of the Electric System by the lawful exercise of eminent domain, at the election of the City (evidenced by a Written Certificate of the City filed with the Trustee and the Authority) shall either (a) be used for the acquisition or construction of improvements and extension of the Electric System, or (b) be paid to the Trustee to be applied to pay or prepay the Installment Payments (and the Bonds, under the special

mandatory redemption provisions of the Indenture) or any Parity Obligations, in accordance with written instructions of the City filed with the Trustee.

Records and Accounts. The City shall keep proper books of record and accounts of the Electric System, separate from all other records and accounts, in which complete and correct entries shall be made of all transactions relating to the Electric System. Said books shall, upon prior request, be subject to the reasonable inspection by the Owners of not less than ten percent (10%) in aggregate principal amount of the Outstanding Bonds, or their representatives authorized in writing. The City shall cause the books and accounts of the Electric System to be audited annually by an Independent Accountant, not more than two hundred seventy (270) days after the close of each Fiscal Year, and shall make a copy of such report available for inspection by the Bond Owners at the office of the City.

Covenants Related to Tax-Exempt Status of the Bonds. The City makes certain covenants relating to the tax-exempt status of the Bond, including that it will take such actions as are necessary to insure: (i) that the interest on the Bonds will not become includable in the gross income of the owners thereof for federal income tax purposes; (ii) that no Bond will become a “private activity bond” within the meaning of section 141 of the Code; (iii) that the Bonds will not become “arbitrage bonds” within the meaning of section 148 of the Code; (iv) that the Bonds will not be treated as “federally guaranteed” within the meaning of section 149(b) of the Code and the Tax Regulations and rulings thereunder; and (v) take certain other actions relating to certain reports and to amounts rebatable to the United States under the Code.

Sale of the Electric System Property. Except as provided in the Installment Sale Agreement, the City covenants that the Electric System shall not be encumbered, sold, leased, pledged, any charge placed thereon, or otherwise disposed of, as a whole or substantially as a whole unless such sale is to a public entity. Neither the Net Revenues nor any other funds pledged or otherwise made available to secure payment of the Installment Payments shall be mortgaged, encumbered, sold, leased, pledged, any charge placed thereon, or disposed or used except as authorized by the terms of the Installment Sale Agreement. The City shall not enter into any agreement which impairs the operation of the Electric System or any part of it necessary to secure adequate Net Revenues to pay the Installment Payments, or which otherwise would impair the rights of the Bond Owners and the owners of any Parity Obligations with respect to the Net Revenues. If any substantial part of the Electric System shall be sold, the payment therefor shall either (a) be used for the acquisition or construction of improvements, extensions or replacements of facilities constituting part of the Electric System, or (b) to the extent not so used, be paid to the Trustee to be applied to pay or prepay the Installment Payments or any Parity Obligations, in accordance with written instructions of the City filed with the Trustee.

Special Obligation

The City’s obligation to pay the Installment Payments, the Additional Payments and any other amounts coming due and payable under the Installment Sale Agreement shall be a special obligation of the City limited solely to the Net Revenues. The City’s obligation to pay the City Advances under the Cooperation Agreement is a general obligation of the City.

The obligations of the City to make the Installment Payments and the Additional Payments from the Net Revenues, and to make City Advances and to perform and observe the other agreements contained in the Installment Sale Agreement and the Cooperation Agreement shall be absolute and unconditional. Said obligations of the City shall not be subject to any defense or any right of setoff, counterclaim or recoupment arising out of any breach of the City, the Authority or the Trustee of any obligation to the City or otherwise with respect to the Electric System, whether under the Installment Sale Agreement, Cooperation Agreement or otherwise, or out of indebtedness or liability at any time owing to the City by the Authority or the Trustee. Until such time as all of the Installment Payments, all of the

Additional Payments and all other amounts coming due and payable under the Installment Sale Agreement shall have been fully paid or prepaid, and the City (a) will not suspend or discontinue payment of any Installment Payments, Additional Payments or such other amounts, (b) will perform and observe all other agreements contained in the Installment Sale Agreement, and (c) will not terminate the Installment Sale Agreement for any cause, including, without limiting the generality of the foregoing, the occurrence of any acts or circumstances that may constitute failure of consideration, eviction or constructive eviction, destruction of or damage to the Electric System, the taking by eminent domain of title to or temporary use of any component of the Electric System, commercial frustration of purpose, any change in the tax or law other laws of the United States of America or the State or any political subdivision of either thereof or any failure of the Authority or the Trustee to perform and observe any agreement, whether express or implied, or any duty, liability or obligation arising out of or connected with the Indenture or the Installment Sale Agreement.

THE ELECTRIC SYSTEM

General

The Hercules Municipal Utility (the “Utility”) was established by the City as an enterprise fund within the City’s structure on January 9, 2001. The purpose of establishing the Utility was to position the City as a provider of electric services to retail end-user customers located within the City, and to the waste water treatment plant jointly owned by the City and the City of Pinole. Initial operations of the Utility began on March 19, 2003. The Utility owns distribution assets which accept electric power from the California power grid and delivers that power to its customers. Such assets include interconnection facilities, underground conduits and conductors, switches and fuses, and metering and communications equipment. The utility purchases the electricity it sells from the wholesale power market. In order to do this, it has entered into contracts with Pacific Gas and Electric (“PG&E”) for use of its distribution system and the California Independent System Operator (“CAISO”) in order to coordinate the Utility load with grid system operations. The contracts with PG&E and CAISO are subject to the jurisdiction of the Federal Energy Regulatory Commission. The City Council establishes its rates and publishes said rates in the Utility’s Tariff for services.

As shown in the City’s Audited Financial Statements for Fiscal Year 2008-09, the City’s Electric System fund had an income loss of \$800,000 for 2008-09 as opposed to \$700,000 in 2007-08. The management of the electric utility has implemented plans to reduce the deficit by reducing operating costs and raising customer service rates in future years to assist with the income shortfall. The City currently provides financial assistance to the Electric System and pursuant to the Cooperation Agreement between the City and the Authority dated as of June 1, 2010, the City has agreed to continue that financial assistance in order to fund any deficiencies in the payment of Installment Payments under the Installment Sale Agreement. See Tables 1 through 11 below and see “CITY OF HERCULES – FINANCIAL INFORMATION.”

The Improvements

A portion of the proceeds of the Bonds will be deposited into the Acquisition and Construction Fund for the purpose of financing an electric substation (the “Improvements”) to support the Electric System. The new substation will be located on a parcel of land that is approximately 1.2 acres. The actual substation is expected to encompass approximately 30,000 square feet. The current load on the Electric System is approximately 2.8 megawatts. The substation will allow the Electric System the capacity to handle approximately 20 megawatts with redundancy built in. When the substation opens in 2011, it is expected that the load will be approximately 3.1 to 3.2 megawatts, however, shortly after the initial start up, it is expected that growth should increase to approximately 3.5 to 3.6 megawatts. See

Tables 1 through 11 below. The total cost of construction of the substation is estimated at \$6M. It is expected that the substation will be completed in June, 2011.

Management and Employees

The following are biographical summaries of the Electric Utility officers, employees and consultants:

Nelson E. Oliva, City Manager/General Manager

Mr. Oliva has over 28 years of administration experience in the public, private and nonprofit sector. He previously served municipal government agencies in California as City Manager, City Administrator, Executive Director of Redevelopment, Housing Authority Director, Director of Public Works, Director of Economic Development, Director of Community and Recreation Services and Capital Projects Manager. He also served as the Executive Director of the Montebello Housing Development Corporation, a non-profit housing agency. Mr. Oliva was initially retained by the City of Hercules to assist in re-establishing the city's affordable housing program. Mr. Oliva is a graduate of California State University of Long Beach. Prior to pursuing his college education, Mr. Oliva served in the United States Air Force.

Gloria Leon, Finance Director/Treasurer

Gloria Leon serves as the Finance/Human Resources Director for the City of Hercules. She has held this position for 3 years. Prior to this position she served 2 years as the Deputy Finance Director for the City and 3 years as the Finance Director for another municipal government agency. She has over 10 years of municipal government, non-profit and private finance experience. Ms. Leon is responsible for planning, directing, managing and overseeing the activities and operations of the Finance and Human Resources Department including labor relations, affirmative action, employee training, recruitment, benefits administration, budget preparation, grant administration, analyzing revenue-generating and cost-reducing proposals for capital and operating programs; supervision of accounting procedures and the design and implementation of automated financial accounting systems and provides responsible and complex administrative support to the City Manager. Ms. Leon holds a Bachelor degree in Business Administration with an option in Accounting and a Masters degree in Human Resources.

Michael A. Sakamoto, Utility Consultant

Mr. Sakamoto has over thirty-five years of administration experience in the public, private and non-profit sectors. Mr. Sakamoto has served as a consultant to the City of Hercules for the past two years assisting the City with the operation of the Hercules Municipal Utility as well as consulting on annexation and wastewater issues for the City.

Prior to that, he served as a Senior Vice-President of Kinsell Newcomb and De Dios, an Investment Banking Firm. From 2000 until 2007, Mr. Sakamoto served as the City Manager/Executive Director of the Redevelopment Agency of the City of Hercules. During his tenure in Hercules, he has provided guidance to the City which resulted in the redevelopment and the construction of 1500 housing units on two environmentally challenged sites. His vision is responsible for the projected delivery of an additional 1,800 housing units and 220,000 square feet of commercial development.

Mr. Sakamoto has served as City Manager, Finance Director, Director of Community Development and Executive Director of Redevelopment and Municipal Utility General Manager for a number of California communities. He holds a Bachelor of Arts Degree in Political Science and a Juris Doctor Degree.

Glenn Reddick, P.E., Utility Consultant

Glenn Reddick is the owner of Glenn Reddick Professional Services. Mr. Reddick has been awarded a Bachelor of Science degree in Electrical Engineering. He has held management and technical positions with Hercules Municipal Utility, Navigant Consulting, Resource Management International, Greiner Engineering and Q. T. Colwell and Associates. Mr. Reddick is a registered professional engineer in four states and has over 30 years of broad based experience in the electric energy industry. He has served in a lead role for projects associated with transmission design, substation design, and distribution design. He is an expert in electric transmission and distribution planning, operations, maintenance and reliability. He has served as an expert witness before state and federal regulatory agencies on issues related to the planning, design, capital cost, operation and maintenance of transmission, substation and distribution facilities. Mr. Reddick has provided expertise in the valuation of transmission and distribution assets internationally and in the development of financial and engineering analysis to support financing activities.

Alfred Cabral, City Attorney

Alfred A. "Mick" Cabral is a partner in the law firm of Pelletreau, Alderson & Cabral a small, AV rated, West County law firm established in 1946 by founding partner Robert W. Pelletreau. Mr. Cabral is a 1977 graduate of the University of California, Berkeley and a 1980 graduate of the University of San Francisco School of Law (Kendrick Hall). Mr. Cabral is licensed to practice before the United States Supreme Court, the United States Ninth Circuit Court of Appeals, the United States District Court for the Northern and Eastern Districts of California and in all California courts. Mr. Cabral's practice emphasizes the representation of municipal entities. In addition to representing the City of Hercules and the Hercules Redevelopment Agency, Mr. Cabral is General Counsel to the West County Wastewater District, General Counsel to the West County Agency of Contra Costa County and Special Counsel to the City of Richmond Housing Authority.

As of January 1, 2010, the Electric System directly employed two people, a journey level line worker with 17 years of journey level experience and an apprentice with three years of experience. Both employees are represented by the Teamsters Union in all matters pertaining to wages, benefits and working conditions. In addition, two employees provided customer service support and billing services. These employees report to the City's Finance Department and are represented by the Teamsters Union. All employees are members of the California Public Employees Retirement System.

Electric System Facilities

The Electric System currently consists of nine miles of all underground distribution line. The system feeds three "island" areas within City boundaries from three interconnection points on Pacific Gas and Electric's 12kV distribution lines through a Federal Energy Regulatory Commission approved Wholesale Distribution tariff. The "islands" are central locations within the City at which points power is distributed throughout the City.

The distribution system is designed for 25kV operation, but is currently operated at 12kV. The seven miles of main line are 1100 kcmil aluminum with a normal rating of 16.6 mW at 12 kV. Taps serving small areas are 600 kcmil and 1/0 AWG. The capacity of the Electric System is constrained by a 3.7 mW load limit in the Wholesale Distribution tariff and by PG&E's existing capacity in the distribution lines.

The following table shows the valuation of the Electric System facilities for the five Fiscal Years ended June 30, 2009, and is presented for informational purposes only. **The Bonds are limited obligations of the Authority and are not secured by a legal or equitable pledge of, or charge or lien upon, any of the Electric System's facilities.**

Table 1
CITY OF HERCULES
ELECTRIC SYSTEM FACILITIES VALUATIONS
(Fiscal Years Ended June 30)

	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>
Utility Plant	\$ 4,176,802	\$ 5,118,381	\$ 8,624,658	\$ 8,793,923	\$ 8,962,544
Less Accumulated Depreciation	(588,427)	(211,490)	(343,381)	(547,609)	(755,773)
Construction in Progress	188,073	216,406	105,395	21,170	120,739
Total	\$ 3,776,448	\$ 5,123,297	\$ 8,386,672	\$ 8,267,484	\$ 8,327,510

Source: City of Hercules Finance Department

Power Supply Resources

Coincidental Peak demand for the Electric System has increased annually from 2.0 mW in Fiscal Year 2005 to 3.2 mW in Fiscal Year 2009. For the same period, total retail sales increased from 9,261 mWh to 15,092 mWh. For Fiscal Year 2009, total energy purchases equaled 16,042 mWh of electricity. Losses for Fiscal Year 2009 were 5.9 percent.

The following table sets forth certain information regarding the Electric System's power supply resources during the Fiscal Year ended June 30, 2006.

Table 2
CITY OF HERCULES
ELECTRIC SYSTEM POWER SUPPLY RESOURCES
(Fiscal Year Ended June 30, 2009)

<u>Source</u>	<u>Capacity Available (MW)</u>	<u>Actual Energy (MWh)</u>	<u>Percent of Total Energy</u>
Sempra Energy Solutions Firm Power LD Contracts	2.2	15,847	98.8%
Hourly Spot Market purchases	varies hourly	195	1.2%

Source: City of Hercules Electric Department

Future Power Resources

MRTU Filing. On February 9, 2006, the independent operator of the system ("CAISO") filed with FERC its Market Redesign and Technology Upgrade ("MRTU") tariff amendment to implement a comprehensive overhaul of the electricity markets administered by the CAISO. The proposed comprehensive changes include, but are not limited to, the following:

- (1) perform effective Congestion Management in the CAISO forward markets (Day-Ahead) by enforcing all transmission constraints so as to establish feasible forward schedules;
- (2) create a Day-Ahead Market for Energy;
- (3) automate Real-Time Dispatch so as to balance the system and manage Congestion in an optimal manner with minimal need for manual intervention; and (4) ensure consistency across market time frames (Day-Ahead through Real-Time) in the allocation of

transmission resources to grid users and in the pricing of transmission service and Energy.*

MRTU requires that Scheduling Coordinators (“SCs”) for all LSEs demonstrate that they meet standards concerning forward capacity and Energy procurement established by their Local Regulatory Authority, including the CPUC. The CAISO does not impose any obligation on LSEs or their regulators to specifically procure capacity to address local market power and reliability concerns.† The CAISO had originally requested that its MRTU filing be approved by FERC, without modification, suspension or hearing, to go into effect on November 1, 2007. On January 9, 2008, FERC issued an order conditionally accepting the MRTU filing, subject to further modification and significant changes. The CAISO Board voted to extend the MRTU implementation date until January 31, 2008.

Resource Adequacy Filing. In September 2005, the California Legislature enacted, and the Governor signed into law, AB 380, which requires all Load Serving Entities (LSE) to establish resource adequacy (RA) requirements. The CPUC establishes RA for investor owned utilities. The Local Regulatory Authority, the City Hercules City Council, establishes RA for the Electric System. The City Council has deemed the existing contracts to be sufficient for RA purposes. The California Energy Commission (CEC) monitors POU, including the City.

On March 13, 2006, the CAISO filed with FERC a Tariff amendment to establish an Interim Reliability Requirements Program (the “IRR Program”). The IRR Program is intended to incorporate the CPUC’s resource adequacy requirements into the CAISO Tariff, beginning in June 2006, and maintain these requirements until the MRTU Tariff amendment is implemented. The CAISO’s FERC filing would impose the IRR Program requirements on LSEs that are not CPUC-jurisdictional entities, including to some extent the City. On May 12, 2006, FERC approved, for the most part, the CAISO’s IRR Program filing. On January 27, 2007, FERC accepted the CAISO compliance filing of June 12, 2006, subject to further modifications. The latest modification of the CAISO’s reformed tariff was effective in FERC’s April 8, 2010 letter order accepting CAISO’s Forbidden Operating Regions Amendment on February 12, 2010 in Docket No. ER10-775-000.

The CEC reports on continuing progress by publicly owned utilities (POUs) to be resource adequate in the near- and long-term. For the state’s 16 largest POU with annual peak loads greater than 200 megawatts, CEC presented an assessment of resource commitments and plans through 2018. POU peak load requirements and annual energy deliveries will be summarized and analyzed using the filings submitted pursuant to 2009 IEPR forms and instructions. CEC will present assessments of utility plans to continue or reduce electricity imports from coal-fired resources, and plans to increase their procurement of renewable energy supplies. For the smaller POU, including the City, the CEC will report on current commitments to remain resource adequate.‡ The CEC requires that the Electric System file annual reports on its resource adequacy. The City’s Electric System has met this requirement.

The Electric System’s current power supply contracts meet all its customer energy needs and its projected peak demand. The Electric System incurs costs for the California Independent System Operator to provide the additional capacity and energy during hours the current contracts cannot meet demand and this solution is currently the most economical. The most recent resource adequacy filings with the California Energy Commission show the system to have resource adequacy with a 5 percent reserve. The City can also meet a portion of the additional capacity with existing distributed generation. The City anticipates adding an additional 0.3 mW of on-peak solar and wind distributed generation during the next twelve months. Of this addition, 0.1 mW is dependent on the City obtaining grant funding. This funding cannot be guaranteed and may not come to fruition. The City is currently analyzing the economics of

* CAISO transmittal Letter [pdf](#) page 2, 02/09/2006

† CAISO Transmittal Letter, page 4, 02/09/2006

‡ CEC Docket No. 09-IEP-1B , NOTICE OF STAFF WORKSHOP AUGUST 6, 2009 ON 2009 REPORT

installing other local peaking resources to satisfy its peaking requirements, instead of purchasing power from the market.

On August 21, 2006, SB-1 was signed into law in California. The law requires that POU's offer equivalent incentives to the IOU's for the installation of renewable energy resources. Hercules has met this requirement and expects to add up to 0.2 mW of solar PVs to its portfolio during the next twelve months as a result of these incentives. In further implementation, the bill requires POU's to obtain 20 percent of their power from renewable resources by 2012. Current indications from the California Energy Commission which monitors POU's implementation is that the City, due to its small size, will get an extension beyond 2012 to meet this requirement. The City of Hercules has existing fixed price contracts that provide renewable energy credits for 100 percent of its purchased power through 2012 and has a right of first refusal on future renewable energy credits from the small hydro-electric facility. The CEC requires that for renewable energy to be counted it must be accounted for through the WREGIS system which tracks renewable energy from the western five states. Hercules accepts and records its renewable energy certificates through WREGIS. The costs for renewable energy has risen sharply recently and pricing at the time of contract extension is uncertain and will depend on market conditions at the time. It is unlikely given current pricing that the City will continue to purchase 100 percent renewable energy after the existing contract term expires.

Wholesale Transactions

The City owns no generation resources and makes no wholesale sales. The City purchases virtually 100 percent of its energy needs through firm power LD contracts with Sempra Energy Solutions. All contracts are at a fixed rate per mWH and are not subject to escalation of any type under any condition. The existing contracts for 3.2 mW of on-peak deliveries run through June, 2011. Additionally, the City has contracts for base load supply of 2.2mW of on-peak deliveries which run through June 30, 2015. The contracts are at favorable rates and provide firm pricing.

The City also plans to enter into new firm LD contracts for additional power to serve new loads expected to come on line in late 2011 while conditions are favorable. The City sees no reason to believe it cannot secure additional power supply when and as needed.

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Historical and Projected Customers, Retail Energy Sales, Revenues and Demand

The following table sets forth the average number of customers, metered MWh sales and revenues derived from retail sales, by classification of service, and peak demand during the past five Fiscal Years.

Table 3
CITY OF HERCULES
ELECTRIC SYSTEM CUSTOMERS, RETAIL SALES,
REVENUES AND DEMAND - HISTORICAL
(Fiscal Years Ended June 30)

	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>
Number of Customers					
Residential	316	553	634	669	683
Commercial	48	168	155	121	132
Total	364	721	789	790	815
Mega-Watt Hour Sales(1)					
Residential	3,101.07	1,442.67	3,586.25	4,029.54	4,056.97
Commercial	6,159.74	8,705.27	10,154.69	10,624.28	11,035.89
Total	9,260.81	10,147.94	13,740.94	14,653.83	15,092.86
Revenues from Sales(1)					
Residential	\$ 252,868.00	\$ 341,861.00	\$ 494,519.00	\$ 569,241.00	\$ 616,610.00
Commercial	\$ 277,175.00	\$ 484,415.00	\$ 1,229,364.00	\$ 1,314,989.00	\$ 1,605,814.00
Total	\$ 530,043.00	\$ 826,276.00	\$ 1,723,883.00	\$ 1,884,230.00	\$ 2,222,424.00
Peak Demand (MW)	2.0	2.3	2.7	2.9	3.2

(1) Metered sales.

Source: City of Hercules Electric Department

For the Fiscal Year ended June 30, 2009 approximately 28 percent of the City's electric retail sales revenues were derived from sales to residential customers. Commercial and Industrial customers represented approximately 72 percent and zero percent of retail sales revenues, respectively.

Table 4 on the following page sets forth projections respecting the average number of customers, MWh sales and revenues derived from retail sales, by classification of service, and peak demand during the current and ensuing four Fiscal Years.

Table 4
CITY OF HERCULES
ELECTRIC SYSTEM CUSTOMERS, RETAIL SALES,
REVENUES AND DEMAND - PROJECTED
(Fiscal Years Ended June 30)

	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>
Number of Customers							
Residential	683	690	690	730	808	885	1077
Commercial	132	138	153	173	184	189	199
Industrial							
Other							
Total	815	828	843	903	992	1074	1276
Mega-Watt Hour Sales(1)							
Residential	4,057	4,237	4,237	4,404	4,678	4,912	5,278
Commercial	11,036	12,307	12,207	14,882	15,892	17,081	17,778
Industrial							
Other							
Total	15,093	16,544	16,444	19,286	20,570	21,993	23,056
Revenues from Sales(1)							
Residential	616,610	753,305	833,908	888,344	943,451	990,717	1,064,556
Commercial	1,605,814	1,861,092	1,888,631	2,540,689	2,783,504	3,075,579	3,246,853
Industrial	0	0	0	0	0	0	0
Other (street lights)		25,500	25,500	25,500	25,500	25,500	25,500
Total	\$2,222,424	\$2,614,397	\$2,722,539	\$3,429,033	\$3,726,955	\$4,066,296	\$4,336,908
Peak Demand (MW)	3.2	3.3	3.3	4.9	5.2	5.6	5.8

(1) Metered and Street Lighting Sales.

Source: City of Hercules Electric Department

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Largest Customers

Bio-Rad laboratories accounted for 25 percent of system sales. Bio-Rad has a multi-building campus in Hercules with over 50 separate accounts. With one exception no other customer accounted for more than 11 percent of revenue. Table 5 sets forth the ten largest retail customers of the Electric System, their type of business and the percentage of retail sales and consumption accounted for by each during Fiscal Year 2009.

Table 5
CITY OF HERCULES ELECTRIC SYSTEM
TEN LARGEST RETAIL CUSTOMERS
(Fiscal Year Ended June 30, 2009)

<u>Customer</u>	<u>Type of Business</u>	<u>% of Retail Sales</u>	<u>Consumption (kWh)</u>
Bio-Rad Laboratories	Corporate Headquarters	25.27	3,814,099
Pinole-Hercules Water Treatment Plant	Government	20.81	3,140,760
Home Depot	Retail Store	10.92	1,647,900
City of Hercules	Local Government	4.78	721,442
Willis Management Group	Medical Professional Group	4.74	715,140
John Compagno, MD	Medical Professional	.88	132,337
GMSX, LLC	Manufacturing Warehouse	.62	94,043
Kontur Kontakt Lens Co.	Contact Lenses Manufacturer	.60	91,038
Luk and Associates	Civil Engineering Services	.44	66,827
The Powder Keg	Restaurant/Bar	.36	54,238

Source: City of Hercules Electric Department

Capital Requirements

As shown in the following table, the City expects capital requirements for the Electric System to aggregate approximately \$8.8 million for the next five Fiscal Years. See “EXPECTED GROWTH – CITY OF HERCULES” herein.

<u>Fiscal Year</u>	<u>Capital Requirements</u>
2011	\$7,055,500
2012	\$ 550,000
2013	\$ 350,000
2014	\$ 425,000
2015	\$ <u>450,000</u>
Total	\$8,830,500

Source: City of Hercules Electric Department

Insurance

The City maintains self-insurance programs for workers' compensation and general liability claims. For general liability claims, coverage is maintained through the Municipal Pooling Authority of Northern California with coverage limits of \$10,000,000 per occurrence, with a deductible of \$10,000 per occurrence.

For workers' compensation claims, the City maintains coverage limits with no deductible of up to \$500,000 through Municipal Pooling Authority of Northern California; \$500,000-\$5,000,000 through CSAC-Excess Insurance Authority; \$5,000,000-\$145,000,000 through American Reinsurance, Renaissance Re, Davinci Re.

Property coverage on City facilities is provided through the Municipal Pooling Authority of Northern California. Coverage provided is up to \$100,000,000 guaranteed replacement cost coverage per facility location, with a deductible of up to \$5,000 per occurrence.

Indebtedness

The Electric System was initially financed with the proceeds of the 2003 Bonds. Said 2003 Bonds were redeemed with the proceeds of the Prior Bonds issued June 28, 2010. Other than the lien of the Bonds and the Prior Bonds, there are no other liens existing on revenues generated from the Electric System.

Rates and Charges; Rate Increase

Electric System retail rates are otherwise subject to change with the approval of the City Council of the City. City staff or an outside consultant perform an analysis of the cost of service for each Electric System customer type (residential, commercial, industrial or other) and prepare a report and recommendation to the City Council respecting any proposed rate changes. The City Council reviews the report and recommendation and either approves or rejects the proposed rate changes. Electric rates in the City are not subject to regulation by the California Public Utilities Commission or any other state agency. State Legislative Assembly Bill 1890 ("AB 1890") requires the imposition of a public benefits charge ("PBC") of 2.85 percent of annual electric retail sales. The City collects the PBC as a 2.85 percent charge applied to all electric charges.

In February, 2010, the City Council authorized a two step rate increase for residential and small commercial customers. The first step effective April 1, 2010, was a 10 percent increase in rates and the second step effective December 1, 2010 is an additional 7 percent increase. Additionally, the City Council authorized a renewable energy surcharge of \$0.0035/kWh effective March 1, 2010, for all customers.

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The following table sets forth the average rates for the indicated customer classes for the Fiscal Years ended June 30, 2005 through June 30, 2009.

Table 6
CITY OF HERCULES ELECTRIC SYSTEM
FIVE YEAR HISTORY OF RATES
AVERAGE RATE IN DOLLARS PER KILOWATT HOUR
(Fiscal Years Ended June 30)

<u>Customer Class</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>
Residential	\$ 0.0815	\$ 0.2370	\$ 0.1379	\$ 0.1413	\$ 0.1520
Commercial	\$ 0.0450	\$ 0.0556	\$ 0.1211	\$ 0.1238	\$ 0.1455

Source: City of Hercules Electric Department

The following table sets forth a comparison of rates charged by the City and other providers for certain customer classes.

Table 7
CITY OF HERCULES ELECTRIC SYSTEM
COMPARISON OF RATES CHARGED
(As of April 1, 2010)

<u>Utility</u>	<u>Residential</u> <u>(1,000 kWh - Summer Season)</u>	<u>Commercial General Service</u> <u>(5,000 kWh)</u>	<u>Large Commercial Demand</u> <u>(100 kW and 50,000 kWh –</u> <u>Summer Season)</u>
Hercules	\$ 234.15	\$ 1,086.32	\$ 8,652.75
PG&E	\$ 245.30	\$ 1,038.06	\$ 8,420.26
SMUD	\$ 132.94	\$ 629.55	\$ 5,534.37
Lodi	\$ 191.20	\$ 981.30	\$ 8,553.88
SCE	\$ 303.98	\$ 1,272.54	\$ 8,173.00

Source: City of Hercules Electric Department

Summary of Historical Operating Results

Table 8 sets forth a summary of operating results for the City's Electric System for the five Fiscal Years ended June 30, 2009. This information has been extracted from the City's audited financial statements. It has not been reviewed by the City's independent auditor. The City's audited financial statements for the Fiscal Year ended June 30, 2009, which include the operation of the Electric System, are attached to this Official Statement as APPENDIX B and should be reviewed in their entirety.

Table 8
CITY OF HERCULES ELECTRIC SYSTEM
HISTORICAL OPERATING RESULTS
(Fiscal Years Ended June 30)

	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>
Operating Revenues					
Sales and charges for services	\$1,412,508	\$1,592,668	\$1,717,561	\$1,950,453	\$2,324,452
Use of money and property		55,425			
Other operating revenue	2,300	52,524	8,972	2,626	29,421
Total Operating Revenues	1,414,808	1,700,617	1,726,553	1,953,079	2,353,873
Operating Expenses					
Contractual Services		518,991	59,917	36,389	101,928
Maintenance and operation				38,341	881,960
Purchase of electricity			1,218,133	1,504,481	1,736,116
Administration	1,208,843	1,488,812	675,753	701,923	221,174
Depreciation	69,937	105,369	339,213	325,886	226,164
Organizational costs amortization	207,322	207,322			
Total Operating Expenses	1,486,102	2,320,494	2,293,016	2,607,020	3,167,342
Operating Income (Loss)	-71,294	-619,877	-566,483	-653,941	-813,469
Non-operating Revenues (Expenses)					
Investment income (loss)			60,799	-23,812	-23,448
Interest expense				-210,530	-100,915
Reimbursements					411,053
Gain (Loss) on Disposal of Fixed Assets				-5,120	-11,189
Fees and taxes			-262,180	-324,493	-207,580
Total Non-operating Revenue (Expenses)			-201,381	-563,955	67,921
Income (Loss) Before Transfers	-71,294	-619,877	-767,864	-1,217,896	-745,548
Transfers:					
Transfers in from the City of Hercules	1,057,847	2,280,376	171,682		5,611,631
Transfers out to the City of Hercules	-319,921	-277,399	-442,758	-286,249	-196,553
Capital contribution	837,503		3,116,229		
Changes in Net Assets	1,504,135	1,383,100	2,077,289	-1,504,145	4,669,530
Net Assets					
Beginning of Fiscal Year	362,120	1,866,255	3,249,355	701,630	-1,073,049
Prior Period Adjustments			-4,625,014	-270,534	5,412,398
Beginning of Fiscal Year (As Restated)			-1,375,659	431,096	4,339,349
End of Fiscal Year	\$1,866,255	\$3,249,355	\$701,630	\$-1,073,049	\$9,008,879

Source: City of Hercules

Projected Operating Results, Cash Flows and Coverage Ratio

The City's projected operating results for the Electric System for the current and next five Fiscal Years are set forth in Table 9 below and the City's cash flows and coverage ratios are set forth in the following Table 10. These projections are based on the City's judgment as to the occurrence of certain future events. The footnotes to the tables include certain assumptions. These assumptions and the footnotes are material to the projections, and variations in the assumptions could produce substantially different financial results. Actual revenues and expenses may vary materially from these projections.

Table 9
CITY OF HERCULES ELECTRIC SYSTEM
PROJECTED OPERATING RESULTS
(Fiscal Year Ended June 30)

	2009	2010	2011	2012	2013	2014	2015
Operating Revenues							
Sales and charges for services	\$2,324,452	\$2,698,616	\$2,748,039	\$3,417,060	\$3,581,422	\$3,740,772	\$3,740,772
Other operating revenue	29,421	7,750	10,000	10,200	10,404	10,612	10,824
Total Operating Revenues	2,353,873	2,706,366	2,758,039	3,427,260	3,591,826	3,751,384	3,751,597
Operating Expenses	2009	2010	2011	2012	2013	2014	2015
Contractual Services	101,928						
Maintenance and operation	881,960	224,823	228,359	236,352	244,624	253,186	262,047
Purchase of electricity	1,736,116	1,760,939	1,574,876	1,612,316	1,755,373	1,754,729	1,786,367
Administration	221,174	494,156	469,287	485,712	502,712	520,307	538,518
Depreciation	226,164	300,000	264,000	405,110	416,110	423,110	431,610
Total Operating Expenses	3,167,342	2,779,917	2,536,522	2,739,489	2,918,819	2,951,331	3,018,542
Operating Income (Loss)	-813,469	(73,551)	221,517	687,770	673,007	800,053	733,055
Non-operating Revenues (Expenses)	2009	2010	2011	2012	2013	2014	2015
Investment income (loss)	(23,448)	30,000	0	0	0	0	0
Debt Service	(100,915)	(125,000)	(214,051)	(579,775)	(797,775)	(955,776)	(956,508)
Reimbursements	411,053	0	0	0	0	0	0
Rate Stabilization Account	0	0	600,000	0	0	0	0
Gain (Loss) on Disposal of Fixed Assets	(11,189)	0	0	0	0	0	0
Fees and taxes	(207,580)	(547,540)	(63,382)	(146,649)	(153,703)	(160,542)	(160,542)
Total Non-operating Revenue	67,921	(642,540)	322,567	(726,424)	(951,478)	(1,116,318)	(1,117,050)
Income (Loss) Before Transfers	(745,548)	(716,092)	544,084	(38,654)	(278,471)	(316,265)	(383,995)
Asset							
Transfers In	5,611,631	0	0	0	0	0	0
Transfers Out	(196,553)	0	0	0	0	0	0
Capital contribution	0	0	0	0	0	0	0
Changes in Net Assets	4,669,530	(716,092)	544,084	(38,654)	(278,471)	(316,265)	(383,995)
Net Assets							
Beginning of Fiscal Year	(1,073,049)	9,008,879	8,292,787	8,836,872	8,798,217	8,519,746	8,203,481
Prior Period Adjustments	5,412,398	0	0	0	0	0	0
Beginning of Fiscal Year (As Restated)	4,339,349	9,008,879	8,292,787	8,836,872	8,798,217	8,519,746	8,203,481
End of Fiscal Year	\$9,008,879	\$8,292,787	\$8,836,872	\$8,798,217	\$8,519,746	\$8,203,481	\$7,819,485

Source: City of Hercules

Table 10
CITY OF HERCULES ELECTRIC SYSTEM
PROJECTED CASH FLOW AND COVERAGE RATIO
(Fiscal Year Ended June 30)

	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>
Operating Income (Loss)	\$221,517	\$687,770	\$673,007	\$800,053	\$733,055
Add Back: Depreciation Expense	264,000	405,110	416,110	423,110	431,610
Use of Operating Reserves	0	0	0	0	31,000
Net Revenue Available for Bonds	485,517	1,092,880	1,089,117	1,223,163	1,195,665
Debt Service	214,051	579,775	797,775	955,776	956,508
Estimated Coverage Ratio	2.27	1.89	1.37	1.28	1.25
Cash at Beginning of Year	600,000	808,084	1,174,540	1,312,178	1,419,023
Add Back: Depreciation Expense	264,000	405,110	416,110	423,110	431,610
Net Revenue	(55,916)	(38,654)	(278,471)	(316,265)	(383,995)
Use of Reserves	0	0	0	0	(31,000)
Cash at End of Year	\$808,084	\$1,174,540	\$1,312,178	\$1,419,023	\$1,435,638

Table 11
CITY OF HERCULES ELECTRIC SYSTEM
PROJECTED DEBT SERVICE COVERAGE*

Fiscal Year	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>
Estimated Coverage**	2.27	1.89	1.37	1.28	1.25

*The expectations, projections and estimates contained in Tables 9, 10 and 11 involve known risks, uncertainties and other factors which may cause actual results to be materially different.

**Under the Cooperation Agreement, the City of Hercules has an obligation to advance an amount sufficient to cover debt service from any available source of the City.

Source: City of Hercules

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RISK FACTORS

The purchase of the Bonds involves investment risk. The following is a listing and discussion of certain risk factors that should be considered, in addition to the other matters discussed in this Official Statement, in evaluating the investment quality of the Bonds. Necessarily, this listing and discussion is neither comprehensive nor definitive and there can be no assurance that other risk factors will not become material in the future. The order in which the following risk factors are presented is not intended to reflect their relative importance.

The Bonds are Limited Obligations

The Bonds are limited obligations of the Authority and are not secured by a legal or equitable pledge of, or charge or lien upon, any property of the Authority or any of its income or receipts, except the Revenues. Neither the obligation of the Authority to pay principal of, or interest on, the Bonds from the Revenues, nor the obligation of the City to make City Advances as required under the Cooperation Agreement constitutes a debt, liability or obligation of the Authority or the City for which any such entity is obligated to levy or pledge any form of taxation or for which any such entity has levied or pledged any form of taxation. The Authority has no taxing power.

No Liability of the Authority to the Owners

Except as expressly provided in the Indenture, the Authority will have no obligation or liability to the Owners of the Bonds with respect to the Installment Payments when due, or with respect to the observance or performance of other agreements, conditions, covenants and terms required to be observed or performed by the City under the Installment Sale Agreement or any related documents or with respect to the performance by the Trustee of any duty required to be performed by it under the Indenture.

Limitations on Remedies

The ability of the City to comply with the covenants under the Installment Sale Agreement and to generate Net Revenues sufficient to pay all Installment Payments in a timely manner may be adversely affected by actions and events outside of the control of the City and may be adversely affected by actions taken (or not taken) by voters, property owners, taxpayers or payers of assessments, fees and charges. See “RISK FACTORS – California Constitution Articles XIII C and Article XIII D.” Furthermore, any remedies available to the Owners of the Bonds upon the occurrence of an event of default under the Indenture are in many respects dependent upon judicial actions which are often subject to discretion and delay and could prove both expensive and time consuming to obtain.

In addition to the limitations on remedies contained in the Indenture, the rights and obligations under the Bonds and the Indenture may be subject to bankruptcy, insolvency, reorganization, arrangement, fraudulent conveyance, moratorium and other laws relating to or affecting creditors’ rights, to the application of equitable principles, to the exercise of judicial discretion in appropriate cases and to limitations on legal remedies against public agencies in the State of California. The opinion to be delivered by Bond Counsel concurrently with the execution and delivery of the Bonds, that the Bonds evidence valid and binding obligations and the Indenture constitutes a valid and binding obligation of the Authority and the City will be subject to such limitations, and the various other legal opinions to be delivered concurrently with the execution and delivery of the Bonds will be similarly qualified. See “APPENDIX D – FORM OF OPINION OF BOND COUNSEL.” In the event the Authority or the City fail to comply with their respective covenants under the Indenture or to cause the timely payment of all principal or interest with respect to the Bonds, there can be no assurance that available remedies will be adequate to fully protect the interest of the holders of the Bonds.

Limited Recourse on Default

If the City defaults on its obligations to make Installment Payments, the Trustee, as assignee of the Authority, has the right to accelerate the Installment Payments. However, in the event of a default and such acceleration, there can be no assurance that the Trustee will have sufficient revenues to pay the accelerated Bonds.

Loss of Tax Exemption

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

Secondary Market

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

Forecasts

Although the Authority believes that the City’s projections of future operating results of the Electric System are reasonable, there can be no assurance that actual operating results will match the projections due to changes in general economic conditions and similar factors. In addition, the Electric System and economic development within the service area of the City are subject to comprehensive federal, state and local regulations. There can be no assurance that the Electric System will not be adversely affected by future economic conditions, governmental policies or other factors beyond the control of the City.

Natural Disasters; Earthquakes

Any natural disaster or other physical calamity, including earthquake, may have the effect of reducing Revenues through damage to the Electric System and/or adversely affecting the economy of the surrounding area. The Installment Sale Agreement requires the City to maintain insurance or self-insurance, but only if and to the extent available at reasonable cost from reputable insurers. The City is not expressly required to provide earthquake insurance. The State of California, including the Contra Costa County area, is a seismically active region. In the event of total loss of the Electric System there can be no assurance that insurance proceeds will be adequate to redeem all outstanding Bonds or that losses in excess of the insured amount will not occur.

Electric System Expenses and Collections

There can be no assurance that the City’s expenses for the Electric System will remain at the levels described in this Official Statement. Changes in technology, increases in energy and fuel costs, new environmental regulations or other expenses may reduce the Net Revenues and could require

substantial increases in the applicable rates or charges. Such rate increases could increase the likelihood of nonpayment, and could also decrease demand. Although the City has covenanted to fix, prescribe, revise and collect rates, fees and charges for the services and facilities furnished by the Electric System at certain levels, there can be no assurance that such amounts will be collected in the amounts and at the times necessary to make timely payments with respect to the Bonds.

Rate Regulation

The City sets rates and charges for electric service provided at retail within its boundaries. The authority of the City to impose and collect rates and charges for power service is not currently subject to the direct regulatory jurisdiction of the California Public Utilities Commission (“CPUC”) or the Federal Energy Regulatory Commission (“FERC”), and presently no other regulatory authority directly limits or restricts such rates and charges. See “THE ELECTRIC SYSTEM – Electric Rates and Charges.” It is possible that future Constitutional, legislative or regulatory changes could subject the rates, charges and/or service areas of the City to the direct jurisdiction of the CPUC or FERC or to other limitations or requirements under federal or State law.

Certain Factors Affecting the Electric Utility Industry

The electric utility industry in general has been, and in the future may be, affected by a number of other factors which could impact the financial condition and competitiveness of many electric utilities and the level of utilization of generating and transmission facilities. The Authority is unable to predict what impact such factors will have on the business operations and financial condition of the Electric System, but the impact could be significant. This Official Statement includes a brief discussion of certain of these factors. See “DEVELOPMENTS IN THE CALIFORNIA ENERGY MARKETS” and “OTHER FACTORS AFFECTING THE ELECTRIC UTILITY INDUSTRY.”

Proposition 218

The California Constitution grants the power of initiative and referenda to local electors with respect to legislative acts. (Cal. Const. art II, §§ 8 -11.) The initiative power authorizes electors to propose legislation, while referendum is the power of the electors to approve or reject certain legislation. The California Constitution prohibits the use of the referendum power with respect to legislation “providing for tax levies.” (Cal. Const. art II, § 9(a).)

In 1980, the California Court of Appeal for the Second District indicated that electric rates were not a tax matter and that they may also be subject to the initiative power. (*Bock v. City Council of Lompoc* (1980) 109 Cal.App.3d 52.)

On November 5, 1996, a State ballot initiative known as the “Right to Vote on Taxes Act” (Proposition 218) was approved by the voters of the State of California. Proposition 218 added Articles XIIIIC and XIIID to the State Constitution. Article XIIID creates additional requirements for the imposition by most local government agencies of general taxes, special taxes, assessments and “property-related” fees and charges. However, Article XIIID explicitly exempts fees for the provision of electric service from the requirements of that article.

Article XIIIIC extends the people’s initiative power to reduce or repeal previously-authorized local taxes, assessments, and fees and charges. The terms “fees and charges” are not defined in Article XIIIIC. In *Bighorn-Desert View Water Agency v. Verjil* (2006) 39 Cal.4th 205, the California Supreme Court stated that the absence of a restrictive definition of “fee” or “charge” in Article XIIIIC “suggests that those terms include all levies that are ordinarily understood to be fees or charges, including all of the property-related fees and charges subject to Article XIIID.” As such, the State’s Supreme Court left open

the possibility that the grant of initiative power contained in Article XIIC may extend to electric service rates and charges even though they are not “fees and charges” within the meaning of Article XIID.

No assurance can be given that voters within the City’s jurisdiction will not, in the future, approve initiatives or referenda that repeal, reduce or prohibit the future imposition of electric rates or charges. However, the City believes that even if its electric rates and charges are subject to the initiative power under Article XIIC or Article II of the California Constitution, the electorate would be precluded from reducing electric rates and charges in a manner adversely affecting the payment of the Bonds under the “impairments clause” of the United States Constitution.

The interpretation and application of Article XIIC and Article II may ultimately be determined by the courts with respect to the matters discussed above, and the Authority cannot predict the outcome of any such determination. The foregoing discussion of the referenda and initiative power in California should not be considered an exhaustive or authoritative treatment of the issues. The Authority does not expect to be in a position to control the consideration or disposition of these issues and cannot predict the timing or outcome of any judicial or legislative activity in this regard. Interim rulings, final decisions, legislative proposals and legislative enactments may all affect the impact of Article XIII C and Article II on the Bonds as well as the market for the Bonds. Legislative and court calendar delays and other factors may also prolong any uncertainty regarding the effects of Article XIII C and Article II.

Voter Initiatives -- State Constitutional Amendment

California’s voter initiative process allows measures which qualify for the ballot to be approved or disapproved by voters in a State of California statewide election. From time to time initiative measures could be adopted which adversely affect Net Revenues or the ability of the City to increase rates for electric services.

Bondholders’ Risks Relating to City Advances

General. The City Advances due under the Cooperation Agreement are payable from funds lawfully available to the City. All payments required by the City under the Cooperation Agreement shall be absolute obligations of the City, not subject to deduction or offset of any kind, including, without limitation, offset of amounts owing to the City under the Cooperation Agreement and under the Indenture. If the amounts which the City is obligated to loan the Authority in a fiscal year exceed the City’s revenues and available reserves for such year, the City may choose to make some payments rather than making other payments, including City Advances, based on the perceived needs of the City. See “CITY OF HERCULES - FINANCIAL INFORMATION” for a more detailed discussion of revenues deposited in and expenditures from the City’s General Fund. The same result could occur if, because of California Constitutional limits on expenditures, the City is not permitted to appropriate and spend all of its available revenues and available reserves or is required to expend available revenues and available reserves to preserve the public health, safety and welfare. For more information regarding California Constitutional limits on expenditures see “Proposition 218 and Voter Initiatives -- State Constitutional Amendment” above.

Nothing in the Cooperation Agreement prohibits the City from entering into other obligations which constitute additional charges against its revenues without the consent of Owners of the Bonds. To the extent that additional obligations are incurred by the City, the funds available to pay City Advances could decrease.

A variety of national, state or regional factors, which are beyond the control of the City’s fiscal policies, as well as the City’s fiscal policies could reduce the amount of the City’s General Fund revenues. To the extent that City revenues decrease, the funds available to pay City Advances could

decrease. A significant portion of the City's General Fund revenues for fiscal year 2010-11 are expected to come from taxes. If a slow-down in development occurs, the amounts of taxes, as well as many other types of revenues, collected by the City may be adversely affected. Property value and development growth in the City will be subject to the fluctuation of the real estate market throughout the term of the Bonds.

DEVELOPMENTS IN THE CALIFORNIA ENERGY MARKETS

Background; Electric Market Deregulation

In 1996, California partially deregulated its electric energy market and an independent system operator of the transmission system, the CAISO, was established. As a consequence of the partial deregulation, the California investor-owned utilities (the "IOUs") sold a large portion of their generation resources and began purchasing significant amounts of electricity. During portions of 2000 and 2001, the market price of electricity in California significantly exceeded capped retail prices for the IOUs, resulting in significant financial losses for the IOUs and other electric market participants.

State and Federal Investigations. State of California and federal authorities are conducting investigations and other proceedings concerning various aspects of the California energy markets. These include, for example, investigations by FERC into alleged overcharging for the sale of electricity (including sales by municipal utilities) and alleged manipulation of the electricity market. The Authority is unable to predict the outcome of existing investigations and proceedings regarding California's energy crisis or whether further investigations, proceedings, litigation or other actions will follow.

Shortages and Volatility Could Occur in the Future. During 2000 and 2001, California experienced extreme fluctuations in the prices and supplies of natural gas and electricity in much of the State. Licenses for new power plants have been issued by the State Energy Resources Conservation and Development Commission (the "CEC"), construction on several power plants has been completed and construction of additional power plants is underway. Progress on new transmission line projects within California has been slow. Also, there has been a substantial rise in the cost of natural gas, which is the fuel source for many of California's electric generating units. State agencies have issued warnings that further power shortages are possible for Southern California. While the City has secured its energy needs for the next five years, no assurance can be given that after that time the City will not be affected by shortages, price volatility or other energy problems that have adversely affected California electric utilities in the past.

State Legislation

A number of bills affecting the electric utility industry have been introduced or enacted by the California Legislature. In general, these bills provide for reduced greenhouse gas emission standards and greater investment in energy-efficient and environmentally friendly generation alternative through more stringent renewable resource portfolio standards. The following is a brief summary of certain of these bills.

Energy Procurement. Senate Bill 1037, signed by the Governor on September 29, 2005, requires that each local publicly-owned electric utility, including the City, prior to procuring new energy generation resources, first acquire all available energy efficiency, demand reduction and renewable resources that are cost effective, reliable and feasible. Senate Bill 1037 also requires each local publicly-owned electric utility to report annually to its customers and to the CEC its investment in energy efficiency and demand reduction programs.

Assembly Bill 2021, signed by the Governor on September 29, 2006, requires municipal electric utilities, including the Electric System, on or before June 1, 2007 and by June 1 of every third year thereafter, to identify all potentially achievable cost-effective electricity efficiency savings, to establish annual targets for energy efficiency savings and demand reduction over the next 10 years and to report those targets to the CEC within 60 days of adoption. Assembly Bill 2021 also requires each municipal electric utility to report annually to its customers and the CEC a description of its energy efficiency and demand reduction programs, expenditures, cost-effectiveness and actual results. The City has submitted its annual reports as required under Assembly Bill 2021.

Renewable Portfolio Standards (RPS). In September 2002, the California Legislature enacted and the Governor signed into law Senate Bill 1078 (“SB 1078”). SB 1078 requires that the IOUs adopt a Renewable Portfolio Standard (“RPS”) to meet a minimum of 1% of retail energy sales needs each year from renewable resources and to meet a goal of 20% of their retail energy needs from renewable energy resources by the year 2017. On September 26, 2006, the Governor signed Senate Bill 107 into law, which requires IOUs to have 20% of their electricity come from renewable sources by 2010. SB 1078 also directed the State’s publicly-owned electric utilities to implement and enforce an RPS that recognizes the intent of the legislature to encourage development of renewable resources, taking into consideration the impact on a utility’s standard on rates, reliability, financial resources, and the goal of environmental improvement. Publicly-owned electric utilities, including the City, are directed but not required to adopt a RPS under SB 1078. However, the City has secured sufficient renewable energy credits which meet 100% of its power needs through 2012 and the City reports to the CEC annually. Under current regulations, the City is considered 100% green. Currently various state agencies are reviewing their regulations, and in the future the City and other publicly-owned utilities may be subject to new requirements of these agencies including the Air Resources Board.

Since the implementation of SB 1078, there have been several actions taken by the CPUC and the CEC that have had an impact on the renewable energy goals set by the legislation. These actions seek primarily to accelerate the time line for meeting the renewable resource development goals and to provide additional standards for future extension of the goals. In order to overcome the challenges associated with meeting accelerated RPS goals, the CPUC and the CEC supported the implementation of a renewable energy certificate trading system to meet the accelerated RPS goals. Renewable energy certificate trading is now tracked by the Western Renewable Energy Generation Information System and the CEC has established rules regarding usage of the certificates. Proceedings at the CPUC are in progress that are investigating the potential use of tradable renewable energy certificates for use by Community Choice Aggregators and Energy Service Providers in order to facilitate meeting the accelerated RPS goal. Pursuant to SB 1078, in 2009, the CEC collaboratively with the Western Governors’ Association and the Western Electricity Coordinating Council has undertaken the development and establishment of the Western Renewable Energy Generation Information System, which is used to ensure the integrity of renewable energy certificates and prevent the double counting of certificates.

Solar Power. In August 2006, the Governor signed into law Senate Bill 1 (also known as the “California Solar Initiative”). This legislation requires municipal utilities, including the Electric System, to establish a program supporting the stated goal of the legislation to install 3,000 MW of photovoltaic energy in California. Municipal utilities are also required to establish eligibility criteria in collaboration with the CEC for the funding of solar energy systems receiving ratepayer funded incentives, which would be established through a public process no later than January 1, 2008. The legislation gives a municipal utility the choice of selecting an incentive based on the installed capacity, starting at \$2.80 per watt, or based on the energy produced by the solar energy system, measured in kilowatt-hours. The City uses both methods. Incentives are required to decrease at a minimum average rate of 7% per year. Municipal utilities also have to meet certain reporting requirements regarding the installed capacity, number of installed systems, number of applicants, and awarded incentives. See “THE ELECTRIC SYSTEM.”

Greenhouse Gas Emissions. In its 2003 Integrated Energy Policy Report, the CEC recommended that utilities account for the cost of greenhouse gas emission reductions in utility procurement decisions. In December 2004, the CPUC also established an \$8-\$25/ton carbon dioxide fossil fuel adder for the IOUs to reflect the amount of carbon dioxide that would be emitted by a fossil fuel electric generating unit. The adder represents an estimate of future costs associated with the purchase of carbon dioxide offsets and financial risk associated with potential future regulation of greenhouse emissions.

On June 1, 2005, the Governor signed Executive Order S-3-05, which placed an emphasis on such efforts to reduce greenhouse gas emissions by establishing statewide greenhouse gas reduction targets. The targets are: (i) a reduction to 2000 emissions levels by 2010; (ii) a reduction to 1990 levels by 2020; and (iii) a reduction to 80% below 1990 levels by 2050. The Executive Order also called for the California Environmental Protection Agency to lead a multi-agency effort to examine the impacts of climate change on California and develop strategies and mitigation plans to achieve the targets. On April 25, 2006, the Governor also signed Executive Order S-06-06 which directs the State to meet a 20% biomass utilization target within the renewable generation targets of 2010 and 2020 for the contribution to greenhouse gas emission reduction.

On September 27, 2006 the Governor signed into law Assembly Bill 32, the Global Warming Solutions Act of 2006 (“AB 32”). AB 32 prescribes a statewide cap on global warming pollution with a goal of reaching 1990 greenhouse gas emission levels by 2020 and 80% below 1990 levels by 2050. In addition, AB 32 establishes a mandatory reporting program to the Air Resources Board (“ARB”) for significant greenhouse gas emissions and requires the ARB to adopt regulations for significant greenhouse gas emission sources (allowing ARB to design a cap and trade program) and gives ARB the authority to enforce such regulations beginning in 2012.

In addition to AB 32, Senate Bill 1368, approved by the Governor on September 29, 2006, places a restriction on the negotiation of contracts with potential baseload fossil fuel electric generating resources that exceed the rate of emissions for greenhouse gases for existing combined-cycle natural gas baseload generation and requires the CEC to establish a regulatory framework necessary to enforce the greenhouse gas emission performance standard for publicly-owned utilities, such as the City’s Electric System. Also on September 26, 2006, the Governor signed Senate Bill 1686 into law, which authorizes the Wildlife Conservation Board (the “WCB”) to take into account the potential of forestlands to beneficially reduce or sequester greenhouse gas emissions when it prioritizes funds available for proposed acquisitions. Senate Bill 1686 also specifies that the WCB may use policies, protocols and other relevant information developed by the California Climate Action Registry in determining a project’s potential to reduce or sequester greenhouse gas emissions.

On November 17, 2008, the Governor signed Executive Order S-14-08, which established for California the Renewable Portfolio Standard (“RPS”) target that all retail sellers of electricity serve 33 percent of their load with renewable energy by 2020. The Order directs State government agencies to take all appropriate actions to implement the target in all regulatory proceedings. The Resources Agency leads the joint collaboration between the CEC and the Department of Fish and Game (“DFG”) to expedite the development of RPS eligible renewable energy resources through the actions outlined in the Order. DFG is required to create and implement a new internal division to ensure the timely completion of the timeline set forth in the Order. Beginning February 1, 2009, a special joint streamlining unit was created and reduce permit processing times by at least 50% for projects in renewable energy development areas, as such areas are defined by the REAT. Pursuant to the Order, by January 1, 2010, the CEC shall provide an estimate of total retail electricity sales in California by 2020, by utility and shall update this number every two years through the IEPR.

Impact of Developments on the City's Electric System

The effect of these developments in the California energy markets on the City's Electric System cannot be fully ascertained at this time. Volatility in energy prices in California may return due to a variety of factors which affect both the supply and demand for electric energy in the western United States. These factors include, but are not limited to, the adequacy of generation resources to meet peak demands, the availability and cost of renewable energy, the impact of greenhouse emission legislation and regulations, fuel costs and availability, weather effects on customer demand, transmission congestion, the strength of the economy in California and surrounding states and levels of hydroelectric generation within the region (including the Pacific Northwest). This price volatility may contribute to greater volatility in the Electric System's revenues from the sale (and purchase) of electric energy and, therefore, could materially affect the financial condition of the Electric System.

OTHER FACTORS AFFECTING THE ELECTRIC UTILITY INDUSTRY

Federal Energy Legislation

In August 2005, President Bush signed the Energy Policy Act of 2005 ("EPACT 2005"). EPACT 2005 addresses a wide array of energy matters that could affect the entire electric utility industry, including the City's Electric System. It expands FERC's jurisdiction to require open access transmission of municipal utilities that sell more than four million megawatt hours of energy and to order refunds under certain circumstances for municipal utilities that sell more than eight million megawatt hours of energy. The Authority is unable to predict when, if ever, Electric System sales of electricity would reach eight million megawatt hours. EPACT 2005 requires that FERC conclude its investigation into the allegations of overcharges during the California energy crisis in 2000 and 2001 and submit a report to Congress. It also provides for criminal penalties for manipulative energy trading practices and the repeal of the Public Utility Holding Company Act of 1935, which prohibited certain mergers and consolidations involving electric utilities. EPACT 2005 also requires the creation of an electric reliability organization ("ERO") to establish and enforce, under FERC supervision, mandatory reliability standards to increase system reliability and minimize blackouts. Failure to comply with such mandatory standards exposes a utility or electric system operator, including the Electric System, to significant fines and penalties by the ERO.

Under EPACT 2005, by February 2007 IOUs must offer each of its customer classes a time-based rate schedule to enable customers to manage energy use through advanced metering and communications technology. It authorizes FERC to exercise eminent domain powers to construct and operate transmission lines if FERC determines a state has unreasonably withheld approval. EPACT 2005 contains provisions designed to increase imports of liquefied natural gas and incentives to support renewable energy technologies, including a new two-year program for tax credit bonds for local governments, such as the City, to finance certain renewable energy facilities. EPACT 2005 also extends for 20 years the Price-Anderson Act, which concerns nuclear power liability protection, and provides incentives for the construction of new nuclear plants.

CAISO Market Redesign

MRTU Filing. On February 9, 2006, the CAISO filed with FERC its Market Redesign and Technology Upgrade ("MRTU") tariff amendment to implement a comprehensive overhaul of the electricity markets administered by the CAISO. According to the CAISO, the proposed comprehensive changes include, but are not limited to, the following: perform effective congestion management in the CAISO day-ahead market by enforcing all transmission constraints so as to establish feasible forward transmission schedules; create a day-ahead market for energy; automate real-time dispatch so as to balance the system and manage congestion in an optimal manner with minimal need for manual

intervention; and ensure consistency across market time frames in the allocation of transmission resources to grid users and the pricing of transmission service and energy. The MRTU also is intended to ensure that the CAISO has sufficient capacity available to maintain reliability on the CAISO grid. The MRTU requires that all scheduling coordinators for all load-serving entities (“LSEs”), which includes the City, meet standards concerning forward capacity and energy procurements to meet their load requirements. The CAISO had originally requested that its MRTU filing be approved by FERC, without modification, suspension or hearing, to go into effect on November 1, 2007. On September 21, 2006, FERC issued an order conditionally accepting the MRTU filing, subject to further modification and significant changes. On December 19, 2006, the CAISO Board voted to extend the MRTU implementation date until January 31, 2008.

Resource Adequacy Filing. In September 2005, the California Legislature enacted, and the Governor signed into law, AB 380, which requires the CPUC to establish resource adequacy requirements for all LSEs within the CPUC’s jurisdiction. In addition, AB 380 requires publicly-owned utilities, including the City’s Electric System, to procure adequate resources to meet their peak demands and reserves. In October 2005, the CPUC issued a decision stating that LSEs under its jurisdiction, which excludes the Electric System, would be required, by June 2006, to demonstrate that they have acquired capacity sufficient to serve their forecast retail customer load plus a 15-17% reserve margin.

On March 13, 2006, the CAISO filed with FERC a Tariff amendment to establish an Interim Reliability Requirements Program (the “IRR Program”). The IRR Program is intended to incorporate the CPUC’s resource adequacy requirements into the CAISO Tariff, beginning in June 2006, and maintain these requirements until the MRTU Tariff amendment is implemented. The CAISO’s FERC filing would impose the IRR Program requirements on LSEs that are not CPUC-jurisdictional entities, including to some extent the City. On May 12, 2006, FERC approved, for the most part, the CAISO’s IRR Program filing. On January 27, 2007, FERC accepted the CAISO compliance filing of June 12, 2006, subject to further modifications. On February 21, 2007, the CAISO made an additional compliance filing with FERC which has not been acted upon by FERC. In May, 2010, FERC released proposed regulations addressing certain compliance issues.

The Authority is unable to predict at this time the long term impacts that EPACT 2005, the MRTU or IRR Program proceedings will have on the operations and finances of the Electric System or the electric utility industry generally.

American Recovery and Reinvestment Act of 2009

In February, 2009, President Obama signed the American Recovery and Reinvestment Act of 2009 (“ARRA”), which provides for Federal investment in clean energy, the largest investment in energy efficiency and alternative energy in U.S. history. Such investments include funding for weatherizing homes and alternative energy sources. It is expected that these federal investments will help reduce utility bills by making U.S. homes and appliances more energy efficient. ARRA expanded tax credits for energy efficiency upgrades and also creates the infrastructure for, and expands access to, smart meters and customer systems so that consumers will be able to access pricing information and have the ability to save money by programming smart appliances and equipment to run when rates are lowest. Under ARRA, the U.S. Department of Energy (“DOE”) has also launched the “Retrofit Ramp Up” that, together with Recovery Through Retrofit, will simplify and reduce the cost of home retrofits to entire neighborhoods and towns. For low-income families the ARRA Weatherization Assistance Program will provide funding and technical assistance to local agencies to perform home energy audit and weatherization services, to increase efficiency and reduce energy costs. ARRA also provides new standards for home appliances such as refrigerators, microwaves and washer/dryers. An analysis by the Electric Power Research Institute estimates that the implementation of smart grid technologies could reduce electricity use by more than 4

percent by the year 2030. The Authority is unable to predict at this time the impact that ARRA will have on the operations and finances of the Electric System or the electric utility industry generally.

Certain Other Factors

The electric utility industry in general has been, or in the future may be, affected by a number of other factors which could impact the financial condition and competitiveness of many electric utilities and the level of utilization of generating and transmission facilities. In addition to the factors discussed above, such factors include, among others, (a) effects of compliance with rapidly changing environmental, safety, licensing, regulatory and legislative requirements other than those described above, (b) changes resulting from conservation and demand-side management programs on the timing and use of electric energy, (c) changes resulting from a national energy policy, (d) effects of competition from other electric utilities (including increased competition resulting from mergers, acquisitions, and “strategic alliances” of competing electric and natural gas utilities and from competitors transmitting less expensive electricity from much greater distances over an interconnected system) and new methods of, and new facilities for, producing low-cost electricity, (e) the repeal of certain federal statutes that would have the effect of increasing the competitiveness of many IOUs, (f) increased competition from independent power producers and marketers, brokers and federal power marketing agencies, (g) “self-generation” or “distributed generation” (such as microturbines and fuel cells) by industrial and commercial customers and others, (h) issues relating to the ability to issue tax-exempt obligations, including severe restrictions on the ability to sell to nongovernmental entities electricity from generation projects and transmission service from transmission line projects financed with outstanding tax-exempt obligations, (i) effects of inflation on the operating and maintenance costs of an electric utility and its facilities, (j) changes from projected future load requirements, (k) increases in costs and uncertain availability of capital, (l) shifts in the availability and relative costs of different fuels (including the cost of natural gas), (m) sudden and dramatic increases in the price of energy purchased on the open market that may occur in times of high peak demand in an area of the country experiencing such high peak demand, such as has occurred in California, (n) inadequate risk management procedures and practices with respect to, among other things, the purchase and sale of energy and transmission capacity, (o) other legislative changes, voter initiatives, referenda and statewide propositions, (p) effects of the changes in the economy and (q) effects of possible manipulation of the electric markets. Any of these factors (as well as other factors) could have an adverse effect on the financial condition of any given electric utility and likely will affect individual utilities in different ways.

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

THE AUTHORITY

The Authority was established pursuant to a Joint Exercise of Powers Agreement dated July 24, 2001 (the “Joint Powers Agreement”), by and between the City and the Hercules Redevelopment Agency (the “Agency”). The Joint Powers Agreement authorizes the Authority, among other things, to provide financing for public capital improvements and working capital for the City and Agency through the lease, acquisition or construction of such public capital improvements and working capital. The Authority is governed by the Governing Board comprised of all of the individuals who currently are members of the City Council of the City and the members of the Board of the Agency.

The Authority has no independent staff and consequently depends upon the City's officers and employees to administer the Authority and its programs. The Authority, City and Agency are each separate and distinct legal entities, and the debts and obligations of each of said entities are the sole debt of said entity and not the debt or obligation of the other entities. THE BONDS ARE LIMITED OBLIGATIONS OF THE AUTHORITY PAYABLE SOLELY FROM THE NET REVENUES PLEDGED UNDER THE INDENTURE AND THE CITY ADVANCES AS DEFINED IN THE INDENTURE.

CONTINUING DISCLOSURE

The City will undertake all responsibilities for any continuing disclosure with respect to holders of the Bonds as described below, and the Authority shall have no liability to the holders of the Bonds or any other person with respect to such disclosure matters.

The City has covenanted for the benefit of owners of the Bonds to provide certain financial information and operating data relating to the City, including the Electric System, not later than 270 days following the end of the City's Fiscal Year (currently its Fiscal Year ends on June 30), commencing with the reports for Fiscal Year ended June 30, 2010 (each, an "Annual Report"), and to provide notices of the occurrences of certain enumerated events, if material. The Annual Report will be filed by the Dissemination Agent on behalf of the City with each Nationally Recognized Municipal Securities Information Repository and with the appropriate State information depository, if any. Any notices of material events will be filed by the Dissemination Agent on behalf of the City with the Municipal Securities Rulemaking Board (and with the appropriate State information depository, if any). The specific nature of information to be contained in each Annual Report or the notice of material events is set forth in "APPENDIX E – FORM OF CONTINUING DISCLOSURE AGREEMENT." These covenants have been made by the City in order to assist the Underwriter in complying with Rule 15c2-12(b)(5) (the "Rule") promulgated by the Securities and Exchange Commission. The City has never failed to comply in all material respects with any previous undertakings with regard to said Rule to provide annual reports or notices of material events.

TAX EXEMPTION

The Internal Revenue Code of 1986 (the "Code"), imposes certain requirements that must be met subsequent to the issuance and delivery of the Bonds for interest thereon to be and remain excluded pursuant to section 103(a) of the Code from the gross income of the owners thereof for federal income tax purposes. Noncompliance with such requirements could cause the interest on the Bonds to be included in the gross income of the owners thereof for federal income tax purposes retroactive to the date of issuance of the Bonds. The Authority and the City have covenanted to maintain the exclusion of the interest on the Bonds from the gross income of the owners thereof for federal income tax purposes.

In the opinion of Fulbright & Jaworski L.L.P., Bond Counsel, under existing law interest on the Bonds is exempt from personal income taxes of the State of California and, assuming compliance with the aforementioned covenant, interest on the Bonds is excluded pursuant to section 103(a) of the Code from the gross income of the owners thereof for federal income tax purposes. Bond Counsel is also of the opinion that, assuming compliance with the aforementioned covenant, the interest on the Bonds is not included in the computation of the alternative minimum taxable income of the owners thereof for federal income tax purposes.

The excess, if any, of the stated redemption price at maturity of Bonds of a maturity over the initial offering price to the public of the Bonds of that maturity set forth on the cover of this Official Statement is "original issue discount" under the Code. Such original issue discount accruing on a Bond is treated as interest excluded from the gross income of the owner thereof for federal income tax purposes.

and exempt from California personal income tax to the same extent as would be stated interest on the Bond. Original issue discount on any Bond purchased at such initial offering price and pursuant to such initial offering will accrue on a semiannual basis over the term of the Bond on the basis of a constant yield method and, within each semiannual period, will accrue on a ratable daily basis. The amount of original issue discount on such a Bond accruing during each period is added to the adjusted basis of such Bond to determine taxable gain upon disposition (including sale, redemption or payment on maturity) of such Bond. The Code includes certain provisions relating to the accrual of original issue discount in the case of purchasers of Bonds who purchase such Bonds other than at the initial offering price and pursuant to the initial offering.

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

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

Although Bond Counsel is of the opinion that interest on the Bonds is exempt from state personal income tax and excluded from the gross income of the owners thereof for federal income tax purposes, an owner's federal, state or local tax liability may be otherwise affected by the ownership or disposition of the Bonds. The nature and extent of these other tax consequences will depend upon the owner's other items of income or deduction. Without limiting the generality of the foregoing, prospective purchasers of the Bonds should be aware that (i) section 265 of the Code denies a deduction for interest on indebtedness incurred or continued to purchase or carry the Bonds or, in the case of a financial institution, that portion of an owner's interest expense allocated to interest on the Bonds, (ii) with respect to insurance companies subject to the tax imposed by section 831 of the Code, section 832(b)(5)(B)(i) reduces the deduction for loss reserves by 15 percent of the sum of certain items, including interest on the Bonds, (iii) interest on the Bonds earned by certain foreign corporations doing business in the United States could be subject to a branch profits tax imposed by section 884 of the Code, (iv) passive investment income, including interest on the Bonds, may be subject to federal income taxation under section 1375 of the Code for Subchapter S corporations that have Subchapter C earnings and profits at the close of the taxable year if greater than 25% of the gross receipts of such Subchapter S corporation is passive investment income, (v) section 86 of the Code requires recipients of certain Social Security and certain Railroad Retirement benefits to take into account, in determining the taxability of such benefits, receipts or accruals of interest on the Bonds and (vi) under section 32(i) of the Code, receipt of investment income, including interest on the Bonds, may disqualify the recipient thereof from obtaining the earned income credit. Bond Counsel has expressed no opinion regarding any such other tax consequences.

Bond Counsel's opinion is not a guarantee of a result, but represents their legal judgment based upon their review of existing statutes, regulations, published rulings and court decisions and the covenants of the City and the Authority described above. No ruling has been sought from the Internal

Revenue Service (the “Service”) with respect to the matters addressed in the opinion of Bond Counsel, and Bond Counsel’s opinion is not binding on the Service. The Service has an ongoing program of auditing the tax-exempt status of the interest on municipal obligations. If an audit of the Bonds is commenced, under current procedures the Service is likely to treat the Authority as the “taxpayer,” and the owners would have no right to participate in the audit process. In responding to or defending an audit of the tax-exempt status of the interest on the Bonds, the Authority may have different or conflicting interests from the owners of the Bonds. Public awareness of any future audit of the Bonds could adversely affect the value and liquidity of the Bonds during the pendency of the audit, regardless of the ultimate outcome.

CERTAIN LEGAL MATTERS

Fulbright & Jaworski L.L.P., Los Angeles, California, Bond Counsel, will render an opinion with respect to the validity and enforceability of the Bonds, the Installment Sale Agreement, and the Indenture. See “APPENDIX D – FORM OF BOND COUNSEL OPINION.” Certain legal matters will be passed upon for the Authority by Lewis Brisbois Bisgaard & Smith LLP, San Bernardino, California, Disclosure Counsel. Certain legal matters will be passed upon for the City and the Authority by the City Attorney, Alfred A. Cabral.

ABSENCE OF LITIGATION

There is no action, suit or proceeding pending or, to the knowledge of the Authority or the City threatened at the present time seeking to restrain or to enjoin the execution or delivery of the Bonds or the Installment Sale Agreement or the Indenture or in any way contesting or affecting the validity or enforceability of the Bonds, the Installment Sale Agreement, the Indenture or any action of the Authority or the City contemplated with respect to the foregoing.

PROFESSIONAL FEES

In connection with the issuance of the Bonds, fees payable to certain professionals, including Fulbright & Jaworski L.L.P., as Bond Counsel and Lewis Brisbois Bisgaard & Smith LLP, as Disclosure Counsel, and The Bank of New York Mellon Trust Company, N.A., as Trustee, are contingent upon the issuance of the Bonds.

UNDERWRITING

The Underwriter purchased the Bonds at a purchase price of \$5,567,861.20 (being the aggregate principal amount of the Bonds totaling \$5,775,000, less Underwriter’s discount of \$51,975 (.90%), less original issue discount of \$155,163.80). The Underwriter intends to offer the Bonds to the public initially at the prices set forth on the inside front cover page of this Official Statement, which prices may subsequently change without any requirement of prior notice.

The Underwriter reserves the right to join with dealers and other underwriters in offering the Bonds to the public. The Underwriter may offer and sell the Bonds to certain dealers (including dealers depositing Bonds into investment trusts) at prices lower than the public offering prices, and such dealers may reallow any such discounts on sales to other dealers.

FINANCIAL STATEMENTS

The audited financial statements for the City for the Fiscal Year ended June 30, 2009, included in this Official Statement as APPENDIX B, have been audited by Moss, Levy & Hartzheim, CPA's (the "Auditor"), as stated in the Auditor's report appearing in APPENDIX B. The City has not requested, nor has the Auditor given, the Auditor's consent to the inclusion in this Official Statement of its report on such financial statements. No review or investigation with respect to subsequent events has been undertaken in connection with such financial statements by the Auditor.

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MISCELLANEOUS

There are descriptions herein of certain documents and reports which are brief summaries thereof and which 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.

Any statement in this Official Statement involving matters of opinion, whether or not expressly so stated, are intended as such and not as representations of fact. This Official Statement is not to be construed as a contract or agreement between any of the Authority, the City, and the purchasers or Owners of any of the Bonds.

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

HERCULES PUBLIC FINANCING AUTHORITY

By: /s/ Nelson Oliva
Nelson Oliva
Executive Director

APPENDIX A

GENERAL INFORMATION REGARDING THE CITY OF HERCULES

The following information relating to the City of Hercules (“Hercules” or the “City”) and the County of Contra Costa, California (the “County”) has been supplied by the City and is provided solely for purposes of information. The Bonds are payable solely from Revenues and other sources as described in this Official Statement, and the taxing power of the City, the County, the State of California (the “State”), or any political subdivision thereof, is not pledged to the payment of the Bonds.

General Information

The City of Hercules is located along the I-80 corridor in the western portion of Contra Costa County, one of the nine counties comprising the San Francisco Bay Area. The City occupies 7.6 square miles, stretching from San Pablo Bay inland to the rolling coastal hills, and is located about 40 minutes from San Francisco and about one hour from Sacramento. The City’s climate can best be described as Mediterranean, meaning that it experiences cool summer breezes and winter days which rarely fall far below 50° Fahrenheit. There is an abundance of open space areas and trails throughout the community providing the opportunity for spotting various types of wildlife and offering views of the bay.

As a newly developing city, Hercules offers residents a high standard of living with relatively new streets and other infrastructure, a design award-winning community park and a high level of city services.

Government Organization

The City was incorporated on December 15, 1900 under the general laws of the State of California and enjoys all the rights and privileges pertaining to “general law” cities. The City operates under the council/manager form of government. The five Council Members, including the Mayor, are elected at large for four-year overlapping terms. The City Council hires the City Manager, who is then responsible for all management functions of the City, including preparation of the budget, delivery of services, hiring of personnel and implementation of capital projects. The City has 135 full-time employees.

Transportation

The City is located on Interstate 80, the principal transcontinental route in Northern California. State Highway 4 intersects Interstate 80 in the City and runs east through Concord and to Stockton and beyond. Freeway connections can easily be made to San Francisco, Sacramento, San Jose, the Central Valley, and Los Angeles.

Bus service in the City is provided by WestCAT, which operates local fixed routes, Express routes and Paratransit within its service area. Express buses are timed to connect to BART (Bay Area Rapid Transit) trains at the Richmond and El Cerrito Del Norte stations, located nine miles southwest of the City.

Two transcontinental rail lines and Amtrak serve the City. There are 133 shipping companies in the West Contra Costa region. Nevada, warehouse capital of the West, is about four hours away by truck.

A regional executive airport in Concord, and international airports in San Francisco, Oakland and Sacramento are an easy drive from the City.

Deep water terminals at the Ports of Richmond and Oakland offer access to international markets.

Population

The following table provides a comparison of population growth for the City and the County between 2005 and 2009.

**TABLE A-1
CHANGE IN POPULATION
HERCULES AND CONTRA COSTA COUNTY
2005-2009**

Year	<u>HERCULES</u>		<u>CONTRA COSTA COUNTY</u>	
	Population	Percentage Change	Population	Percentage Change
2005	23,200	6.88	1,021,617	1.04
2006	23,535	1.44	1,029,181	.74
2007	23,859	1.37	1,041,428	1.19
2008	24,309	1.88	1,056,246	1.42
2009	24,480	.70	1,068,759	1.18

Source: State of California Department of Finance

Personal Income

Personal income information for the County and the State are summarized in the following table.

**TABLE A-2
PERSONAL INCOME
CONTRA COSTA COUNTY AND CALIFORNIA
2005-2009**

	<u>Median Household Income</u>	<u>Per Capital Income</u>	<u>Total Personal Income(1)</u>
2005			
Contra Costa County	\$69,463	\$50,097	\$50,199,803,000
California	53,627	38,767	1,387,682,421,000
2006			
Contra Costa County	74,058	53,571	53,876,204,000
California	56,646	41,567	1,495,559,996,000
2007			
Contra Costa County	76,317	55,580	56,396,753,000
California	59,928	43,402	1,572,270,587,000
2008			
Contra Costa County	78,469	N/A	N/A
California	61,017	43,852	1,604,112,764,000
2009			
Contra Costa County	N/A	N/A	N/A
California	N/A	42,325	1,564,388,897,000

Source: State of California Employment Development Department, Labor Market Information Division.

Employment and Industry

The City is located in the Oakland, Fremont, Hayward Metropolitan Division which includes all of Alameda and Contra Costa Counties. Annual average employment totals for the Oakland, Fremont, Hayward Metropolitan Division are reflected in the following table.

**TABLE A-3
OAKLAND, FREMONT, HAYWARD METROPOLITAN DIVISION
ANNUAL AVERAGE EMPLOYMENT
2005-2009**

INDUSTRY	2005	2006	2007	2008	2009
Natural Resources and Mining	1,100	1,200	1,200	1,200	1,200
Construction	72,800	73,300	71,700	64,900	53,500
Manufacturing	95,600	95,800	94,400	93,100	82,500
Durable Goods	60,800	61,200	59,500	58,200	49,700
Nondurable Goods	34,900	34,600	34,900	34,900	32,800
Wholesale Trade	48,600	48,800	48,700	47,600	43,900
Retail Trade	112,100	113,300	113,300	109,400	102,000
Transportation, Warehousing and Utilities	34,300	35,000	37,300	35,900	33,100
Information	30,700	30,100	29,000	27,800	25,200
Publishing Industries (except Internet)	7,200	6,900	6,500	6,600	5,700
Telecommunications	14,200	14,100	13,500	12,200	11,200
Finance and Insurance	50,800	49,400	45,400	40,700	37,100
Professional and Business Services	150,600	154,900	158,000	162,200	148,500
Educational and Health Services	118,500	121,800	124,200	128,700	130,000
Government	180,000	182,000	183,900	177,200	174,600

Source: State of California Employment Development Department, Labor Market Information Division.

The major employers operating within the City and their respective number of employees as of June 30, 2009, are as follows:

**TABLE A-4
CITY OF HERCULES
TOP FIVE EMPLOYERS**

<u>Name of Company</u>	<u>Employment</u>	<u>Type of Business/Product</u>
Bio-Rad	1,717	Life Sciences/Clinical Diagnostics
Mechanics Bank	250	Banking
Hercules Middle/High School	150	Public Education
City of Hercules	135	Municipal
Home Depot	126	Retail

Source: City of Hercules.

Commercial Activity

The following table summarizes the volume of retail sales and taxable transactions for the City for 2005 through 2009.

**TABLE A-5
CITY OF HERCULES
TOTAL TAXABLE TRANSACTIONS
2005-2009**

<u>Year</u>	<u>Retail Sales (\$000's)</u>	<u>% Change</u>	<u>Retail Sales Permits</u>	<u>Total Taxable Transactions (\$000's)</u>	<u>% Change</u>	<u>Issued Sales Permits</u>
2005	\$82,702	0.026	132	\$113,121	0.043	262
2006	94,036	0.137	126	127,680	0.129	251
2007	87,601	-0.068	128	124,879	-0.022	262
2008	87,916	0.004	121	128,453	0.029	250
2009(1)	17,553	N/A	170	27,527	N/A	229

(1) First quarter only.

Source: State Board of Equalization, "Taxable Sales in California (Sales & Use Tax)."

Taxable transactions by type for the City for 2005 through 2009 are summarized below:

**TABLE A-6
TAXABLE TRANSACTIONS* BY TYPE OF BUSINESS
2005-2009
(In Thousands of Dollars)**

	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>
Retail Stores					
Apparel Stores	#	#	#	#	N/A
General Merchandise Stores	5,869	6,219	6,550	6,474	N/A
Food Stores +	13,719	16,735	18,247	11,552	N/A
Eating/Drinking Places	10,532	10,694	10,837	11,078	N/A
Home Furnishing and Appliances	#	1,068	1,070	#	N/A
Building Materials and Farm Implements	#	#	#	#	N/A
Auto Dealers/Suppliers	#	#	#	#	N/A
Service Stations	#	#	#	#	N/A
Other retail stores	52,582 #	59,320 #	50,897 #	58,812 #	N/A
Total Retail Stores	82,702	94,036	87,601	87,916	N/A
All Other Outlets	30,419	33,644	37,278	40,537	N/A
Total All Outlets	113,121	127,680	124,879	128,453	N/A

Note: Detail may not compute to total due to rounding

*Taxable transactions represent sales subject to local sales taxes.

+Tax exempt sales for consumption rather than resale, consisting primarily of sales of food for off-premises consumption and prescription medicines, are not included in this table.

#Sales totals for some classes of retail businesses are not shown in this table because their publication would result in the disclosure of confidential information. These totals are included with Other Retail Stores unless otherwise indicated.

Source: State Board of Equalization, Research and Statistics Section

APPENDIX B
CITY AUDITED FINANCIAL STATEMENTS
FISCAL YEAR ENDING JUNE 30, 2010

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HERCULES REDEVELOPMENT AGENCY

FINANCIAL STATEMENTS

JUNE 30, 2009

HERCULES REDEVELOPMENT AGENCY
Financial Statements
June 30, 2009

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INDEPENDENT AUDITOR'S REPORT

Members of the Board of the Hercules Redevelopment Agency
Hercules Redevelopment Agency
Hercules, California

We have audited the accompanying financial statements of the governmental activities and each major fund of the Hercules Redevelopment Agency (Agency), a component unit of the City of Hercules, California (City) as of and for the fiscal year ended June 30, 2009, which collectively comprise the Agency's basic financial statements as listed in the foregoing table of contents. These basic financial statements are the responsibility of the Agency's management. Our responsibility is to express opinions on these basic financial statements based on our audit.

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

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities and each major fund of the Agency as of June 30, 2009, and the respective changes in financial position thereof for the fiscal year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 of the notes to the basic financial statements effective July 1, 2008, the Hercules Redevelopment Agency adopted Governmental Accounting Standards Board (GASB) Statement No. 45, *Accounting and Financial Reporting by Employers for Post Employment Benefits Other than Pensions*; GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*; GASB Statement No. 52, *Land and Other Real Estate Held as Investments by Endowments*; GASB Statement No. 55, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*; and GASB Statement No. 56, *Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards*.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 23, 2009, on our consideration of the Agency's internal control over financial reporting and 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 on financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting and compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The accompanying Required Supplementary Information, such as Management's Discussion and Analysis on page 3 to 10 and the Schedules of Revenues, Expenditures, and Changes in Fund Balances – Budget and Actual – Redevelopment Operating Special Revenue Fund on page 36 and Affordable Housing Special Revenue Fund on page 37 are not required parts of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures which consisted principally of inquiries of management regarding the methods of measurement and presentation of the Required Supplementary Information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Agency's basic financial statements. The Schedules of Revenues, Expenditures, and Changes in Fund Balances – Budget and Actual – Redevelopment Agency Debt Service Fund on page 39 and Capital Projects Fund on page 40 are presented for the purpose of additional analysis and are not a required part of the basic financial statements. The Schedules of Revenues, Expenditures, and Changes in Fund Balances – Budget and Actual – Redevelopment Agency Debt Service Fund and Capital Projects Fund have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly presented, in all material respects, in relation to the basic financial statements taken as a whole.

Moss, Levy & Hartzheim

Moss, Levy & Hartzheim, LLP
Beverly Hills, California
December 23, 2009

City of Hercules Redevelopment Agency

Management's Discussion and Analysis

For The Fiscal Year Ended June 30, 2009

The management of the City of Hercules Redevelopment Agency (the Agency) offers readers of the Agency's Financial Statements this narrative overview and analysis of the basic financial activities of the Agency for the fiscal year ended June 30, 2009.

Governmental Accounting and Standards Board Statement No. 34, "Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments", known as GASB 34, requires, among other things, that the Agency provide this management discussion and analysis of its financial activities for the fiscal year. GASB 34 represents an effort to make governmental reporting clearer and more understandable to readers. It allows a reader to focus on longer term financial issues as well as short-term financial aspects of the Agency. This document should be read in conjunction with the accompanying Basic Financial Statements and the notes to those statements to get a complete picture of the Agency's finances.

I. Financial Highlights

This year the Agency's assessed property value is reflected in the decrease of tax increment revenue, and that revenue is sufficient to cover debt related expenses and to provide funding for both housing and non-housing priorities. The Agency continues to generate benefits from projects initiated in prior fiscal years. Of particular note for the 2008-2009 fiscal year is the Affordable Housing Program which provided housing opportunities via the First Time Homebuyer Program to 21 households. In addition, four educational classes were provided for first-time homebuyers, which included credit counseling as a requirement prior to acquiring a loan. Four homes were relieved from going into foreclosure proceedings.

At the former Gelsar/RFI/Lewis site, on May 12, 2009, construction commenced on "Sycamore North", a set of mixed-use buildings. Upon completion in 2011, Sycamore North will provide 96 units of affordable and market-rate housing of which 75 units will be affordable; 49 rentals and 26 for ownership. The site will include 36,046 square feet of leasable shopfront retail space. In anticipation of availability, the Agency has retained professional asset and property management services.

Major entitlements were attained in February for the 35-acre New Town Center transit-oriented district. The district received new General Plan land use designation and zoning for higher-density mixed use around transit. The conveyance of the Park-N-Ride parcel to a Developer under the 2005 Disposition Development Agreement (DDA) occurred in August, 2009. The Developer is proceeding to prepare construction documents for the first phase, on the Park-N-Ride site at Sycamore and San Pablo Avenues. The Agency is providing financial assistance to Developer in accordance with the 2005 DDA. The Agency is also assisting in the advance planning of the future phases by engaging environmental consultants to prepare applications for mitigating anticipated impacts to wetlands and critical habitat.

As of June 30, 2009 the Agency's exchange of property with BART was substantially complete, with close of escrow occurring on July 13, 2009. The conclusion of construction and grand opening of a \$4.3 million Transit Center occurred on August 3, 2009. In July 2009, BART and the Agency executed an agreement whereby the Agency will provide parking management services at the new Transit Center.

The Agency continues to progress the civil engineering and environmental studies in support of obtaining approvals from Caltrans for the relocation of freeway access ramps around the New Town Center district. This ramp relocation will enable the assembly of parcels for modern development and improved access and circulation citywide. Caltrans approval of the Project Study Report is anticipated by the end of calendar year 2009. The Agency will be pursuing agreements with Caltrans to receive excess land created by the ramp relocation.

On June 23, 2009 the Agency appropriated \$2.013 million to conclude a purchase of a 3.8 acre improved parcel located just outside the City limits, from YRC, Inc., successor to the Yellow motor freight carrier, for the purpose of relocating a Caltrans maintenance facility which is now located within the New Town Center district.

Just south of the Gelsar/RFI/Lewis site, the Agency continues land-use planning and engineering studies on the 11-acre “Sycamore Crossings” district, which will provide retail, commercial, and hospitality opportunities in a distinctively urban format of blocks and streets.

In June of 2009 the Redevelopment Agency extended the life of the Dynamite portion of the Merged Project Area and added both the Hill Town and Sycamore Crossing sites to the Project Area. These combined actions will potentially provide the Agency with up to \$400 million extra in tax increment over the life of the Project Area.

The Agency is researching the requirements for development of its 17-acre parcel, acquired from Wal-Mart, and its 6.37-acre parcel at San Pablo Avenue at Victoria Crescent, with the objective of providing opportunities for biotech, research and development, and manufacturing businesses to expand or relocate from other Bay Area locations. These two parcels have the potential to expand the existing North Shore business park.

The Waterfront Project and Intermodal Transit Center on 42 acres continues to move forward. The design for the track and rail improvements to facilitate the Capitol Corridor train and station facility is 60% complete as of June 30, 2009. Other aspects of the project that are making progress are: utility agreements to relocate the five utility lines in the area; environmental documents for the Intermodal Transit center and Hercules Bayfront project; project team meetings are held on a regular basis with the City, the developer (Anderson Pacific), and a host of consultants; design of short-term and long-term parking facilities; and planning for the straightening of Refugio Creek. The station design has been approved and several public outreach meetings took place before the fiscal year ended. Additional public outreach meetings have been scheduled for fiscal year 2009-2010.

All of this development has, and will continue to help the City of Hercules’ (City) growing electric utility to develop into a viable and beneficial asset to the City.

The following are the amounts received from tax increments in fiscal year 2007-08 with comparative totals for the previous five fiscal years:

Fiscal Year Receipt	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09
Total for the Fiscal Year	<u>\$5,003,025</u>	<u>\$9,449,358</u>	<u>\$10,366,886</u>	<u>\$13,409,462</u>	<u>\$13,473,319</u>	<u>\$12,750,860</u>

The liabilities of the Agency exceeded its assets at the close of the fiscal year by \$32.5 million (Net Assets). The Agency’s investment in assets is primarily in City owned property, as, other than property held for resale, it does not hold property in its own name. The factors impacting the negative net assets are the contribution of capital assets from construction-in-progress projects that are taking place in the Redevelopment Project Areas as mentioned above, the purchase of the Wal-Mart parcel, and advances from the City to the Redevelopment Agency. The Agency projects that future resources will be sufficient to pay long-term obligations as they become due.

The Agency's total net assets decreased by \$42.2 million during the fiscal year. The decrease is primarily due to increases in tenant improvements which were made on a leased property, advances from the City of Hercules in the amount of \$33 million to provide financing for City Hall construction, Refugio Creek Realignment Project, Williamson Property Purchase, Wells Fargo Bank Building purchase and expansion, Farber settlement, Frog Pad Park, Teen Center, and upgrades to the sanitary sewer plant and Hercules Municipal Utility's infrastructure.

As of the close of the fiscal year, the Agency's funds (all governmental) reported combined ending fund balances of \$67.3 million as opposed to \$107.3 million in 2008, representing a decrease of \$40 million in comparison with the prior fiscal year. This was primarily due to a decrease in the use of money and property because of unfavorable interest rates, drawdowns of bond proceeds, and an increase in loan receivables for affordable housing programs.

The total net debt of the Agency increased by \$19.4 million during the fiscal year. The reason for this increase was the advances from the City of Hercules to provide financing for the projects mentioned above. Annual repayments of \$4.4 million were made for bonded debt, notes payable, and advances from the City of Hercules.

II. Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the Agency's basic financial statements. The City of Hercules Redevelopment Agency basic financial statements are comprised of three components: 1) Government-Wide Financial Statements, 2) Fund Financial Statements, and 3) Notes to the Basic Financial Statements. This report also contains other supplementary information in addition to the Basic Financial Statements themselves.

The basic financial statements include only the Agency, which is a component unit of the City and is reported in the City's Comprehensive Annual Financial Report (CAFR) using the blended method.

Government-Wide Financial Statements: The Government-Wide Financial Statements are statements required by GASB 34 that present the financial picture of the Agency and provide readers with a broad view of the Agency's finances. These statements present governmental activities and include all assets of the Agency (including capital assets) as well as all liabilities (including long-term debt). Additionally, certain interfund receivables, payables, and other interfund activity have been eliminated as prescribed by GASB 34.

The Statement of Net Assets and the Statement of Activities report information about the Agency as a whole and about its activities. These statements include *all* assets and liabilities of the Agency using the *accrual basis of accounting*, which is similar to the accounting used by most private-sector companies. All of the current year's revenues and expenses are taken into account, regardless of when cash is received or paid.

The Statement of Net Assets presents information on all of the Agency's assets and liabilities, with the difference between the two reported as net assets. The Agency, while a separate legal entity, acts as a financial conduit for the City and as such does not hold title to the assets it helps construct. Therefore, its net assets are not necessarily any indication of its financial health.

The Statement of Activities presents information showing how the government's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods (e.g., uncollected taxes). Additionally, certain interfund receivables, payables, and other interfund activity have been eliminated as prescribed by GASB 34.

The Agency only has governmental activities, including public works related activity and administration, which are reflected in the Statement of Net Assets and the Statement of Activities. Property tax increment and interest income finance these activities.

Fund Financial Statements: The Fund Financial Statements provide detailed information about the Agency's most significant funds, called Major Funds. The concept of Major Funds, and the determination of which are Major Funds, was established by GASB 34 and replaces the concept of combining like funds and presenting them in total. Instead, each Major Fund is presented individually, with all Non-major Funds combined in a single column on each fund statement. Subordinate schedules present the detail of these Non-major Funds. Major Funds present the major activities of the Agency for the fiscal year. All funds have been determined to be major funds.

Fund Financial Statements include statements for the governmental activities. The Agency has no business-type activities.

Fund Financial Statements are prepared on the modified accrual basis of accounting, which means they measure only current financial resources and uses. The capital assets and other long-lived assets, along with long-term liabilities, are presented only in the Government-Wide Financial Statements.

In order to better understand the Agency's long-term and short-term requirements, it is useful to compare the Agency's Governmental Fund Statements with the governmental activities in the Government-Wide Financial Statements. A reconciliation is provided for both the Governmental Funds Balance Sheet to the Government-Wide Statement of Net Assets, and the Governmental Funds Statement of Revenues, Expenditures, and Changes in Fund Balances to the Government-Wide Statement of Activities to facilitate this comparison.

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The Agency, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the Agency's funds were determined to be Major Funds. These funds include the Operating Fund, the Capital Projects Fund, the Affordable Housing Fund, and the Debt Service Fund, which are reported in detail in the Fund Financial Statements.

Operating Special Revenue Fund: The Operating Special Revenue Fund is used to account for staff time and other operating costs of the Agency (e.g., non-capital studies or analysis and other consultants)

Capital Projects Fund: The Capital Projects Fund is used to account for the capital expenditures of the Agency, other than housing.

Debt Service Fund: The Debt Service Fund is used to account for the repayment of principal and interest on debt as well as pass through obligations to other taxing agencies or non-taxing entities.

Affordable Housing Fund: The Affordable Housing Fund is used to account for the 20% set aside of the tax increment that is required by State Law to be used for low and moderate income housing purposes.

The Agency adopts an annual appropriated budget for all of its funds. A set of budgetary comparison schedules has been provided to demonstrate compliance with this budget on pages 36 through 40 of this report.

Notes to the Basic Financial Statements: The notes provide additional information that is essential to a full understanding of the data provided in the Government-Wide and Fund Financial Statements. The notes to the basic financial statements can be found on pages 19 through 34 of this report.

Other Information: In addition to the basic financial statements and accompanying notes, this report also presents certain Required Supplementary Information concerning the Agency's budget to actual results in its Special Revenue Funds. Required Supplementary Information can be found on pages 35 through 37 of this report.

III. Government-Wide Financial Analysis

The largest portion of the Agency's net assets reflects amounts invested in capital assets (e.g., land, buildings, machinery, and equipment). Unlike most other types of governmental bodies, which provide day-to-day services, the main purpose of the Agency is to provide capital funds for the development of a certain geographical area of the City.

The following analysis focuses on the net assets and changes in net assets of the Agency's Governmental Activities, presented in the Government-Wide Statement of Net Assets and Statement of Activities.

Redevelopment Agency Net Assets
At June 30,
(Amounts expressed in millions of dollars)

	2009	2008
Current assets	\$ 81.1	\$ 115.3
Noncurrent assets	73.8	56.7
Total assets	154.9	172.0
Current liabilities	19.7	14.9
Noncurrent liabilities	167.7	147.4
Total liabilities	187.4	162.3
Net assets:		
Invested in capital assets, net of related debt		
Restricted	82.2	28.4
Unrestricted	(114.7)	(18.7)
Total net asset (deficit)	\$ (32.5)	\$ 9.7

The Agency's total net assets decreased by \$42.2 million during the fiscal year. The decrease is primarily due to purchases of land and buildings which were later transferred to the City of Hercules, advances from the City of Hercules in the amount of \$33 million to provide financing for City Hall construction, Refugio Creek Realignment Project, Williamson Property Purchase, Wells Fargo Bank Building purchase and expansion, Farber settlement, Frog Pad Park, Teen Center, upgrades to the sanitary sewer plan and Hercules Municipal Utility's infrastructure. The Venture Commerce Center Project was completed during the fiscal year ended June 30, 2009 and was transferred to the City of Hercules in the amount of \$15,075,022.

Governmental Activities: All the activities of the Agency are governmental-type and it has no business-type activities.

Redevelopment Agency
Changes in Net assets
Fiscal year ended June 30,
(Amounts expressed in millions of dollars)

	2008-09	2007-08
General Revenues:		
Property tax (tax increment)	\$ 12.8	\$ 13.5
Investment Income	2.0	3.1
Miscellaneous	(0.1)	1.0
Total general revenue	14.7	17.6
Net expenses	33.0	15.3
Change in net assets (decrease)	(18.3)	2.3
Net assets, July 1,	9.7	7.4
Prior Period Adjustment	(23.9)	-
Net assets - July 1, restated	(14.2)	7.4
Net assets - June 30,	\$ (32.5)	\$ 9.7

Tax increment revenues decreased by \$.7 million because of the downturn in property values and a decreased development growth in the merged project area. In addition interest rates decreased creating less use of money and property because of the economic downturn. Expenses increased by \$17.7 million from prior fiscal year due to payment of interest on the 2005 Tax Allocation Bonds, 2007 Housing Tax Allocation Bonds, Series A, 2007 Housing Tax Allocation Bonds, Series B, and the 2007 Tax Allocation Bond. The increase was also due to the transfer of the Ventura Commerce Center Project from the Agency to the City of Hercules in the amount of \$15,075,022. A prior period adjustment of negative \$23,721,046 was made on the government-wide Statement of Activities due to an understatement of advances from the City of Hercules. A prior period adjustment of negative \$196,104 was made on the Redevelopment Agency Capital Projects due to an understatement of due to the City of Hercules.

IV. Financial Analysis of the Agency's Funds

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

Governmental funds: The focus of the Agency's Governmental Funds is to provide information on near-term inflows, outflows, and balances of spendable resources. Such information is useful in assessing the Agency's financing requirements. In particular, unreserved fund balances may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year. It should, however, be noted that most of the unreserved amounts have been designated by the Agency for specific uses.

The Agency is required by State law to set aside 20% of the tax increment revenue in a separate fund for low and moderate-income housing purposes. This fund had total revenue of \$2.7 million and expenditures/transfers out of \$5.5 million. The ending fund balance was negative \$.9 million, a decrease of \$2.8 million from the prior fiscal year. The decrease in the fund balance was due in part to the acquisition of four foreclosed properties and the increase activity in the first time homebuyers program, homeownership retention program, and the revitalization beautification program. The deficit fund balance is expected to be eliminated in future years through tax increment revenue.

The debt service fund had total revenues and transfers-in the amount of \$27.5 million. The expenditures including debt service principal and interest and pass-through payments to other taxing agencies amounted to \$14.4 million. The fund balance decreased by \$32.6 million due primarily to the transferring out of bond proceeds from the 2005 Tax Allocation Bonds, 2007 A and B Tax Allocation Bonds and 2007 Series A Tax Allocation Bonds for completion and construction in progress of redevelopment capital projects.

V. Budgetary Highlights

The original budget was from a one year budget and was structured differently than how the Agency ultimately accounted for its programs. The funds were restructured as indicated above and the budget was redistributed to those new funds. There were adjustments to the budgets during the fiscal year that included over \$30.2 million in projects and programs from the Capital Projects, Operating Special Revenue Fund, and Affordable Housing Funds.

The variances between budget-to-actual in the various funds had mostly to do with the Capital Projects Fund. There were less Capital Projects completed or in progress than were anticipated in the Capital Improvement Program. As is the case every year, there were projects and programs that were not completed by fiscal year-end. On the revenue side, the actual cumulative tax increment revenue received was \$.6 million greater than originally anticipated due to the unknown assessed valuation of properties.

VI. Capital Asset and Debt Administration

Capital assets: As noted earlier the Agency acts as financial conduit for the City of Hercules and as a result, its investments in capital assets are usually recorded as City assets rather than Agency assets.

The capital expenditures during the fiscal year were minimal with money being spent on the Sycamore Downtown project and the train station project. Most of the year was spent in planning the development of the coming projects.

Long-term debt: At the end of the current fiscal year, the Agency had total bonded debt outstanding of \$171.2 million. The tax increment revenue of the Agency secures all debt of the Agency.

The Agency's bonded debt decreased by \$4.4 million during the fiscal year. The decrease was due to the scheduled annual repayment of existing debt.

Additional information on the Agency long-term debt can be found in note number 6 on pages 29 through 32 of this report.

VII. Economic Factors and Next Year's Budgets

Since the Agency's primary source of revenue is tax increments, property values and new construction in the redevelopment area are the key economic factors that define the future resources of the agency. The Agency does have some undeveloped land; however there are discussions with developers underway to develop most of the land that is left in the Agency. Those discussions indicate that there will be a combination of retail, commercial, market rate and affordable housing, and open space. Therefore, most of the revenue growth is expected to come from that development over the next few years with some of the increase attributable to normal assessed value growth.

These factors were considered in preparing the Agency's one year budget for the fiscal year 2009-10.

Requests for Information

This financial report is designed to provide a general overview of the City of Hercules Redevelopment Agency's finances for residents, taxpayers, investors, creditors, and anyone else with an interest in the government's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Finance Department, 111 Civic Drive, Hercules, California 94547.

BASIC FINANCIAL STATEMENTS

GOVERNMENT-WIDE FINANCIAL STATEMENTS

HERCULES REDEVELOPMENT AGENCY

STATEMENT OF NET ASSETS

June 30, 2009

	<u>Governmental Activities</u>
ASSETS	
Current assets:	
Cash and investments	\$ 5,994,071
Cash and investments with fiscal agents	69,994,761
Accounts receivable	1,697
Interest receivable	392,239
Land held for resale	4,714,568
Total current assets	<u>81,097,336</u>
Noncurrent assets:	
Loans receivable	10,445,878
Deferred charges - net of accumulated amortization	3,875,788
Total other noncurrent assets	<u>14,321,666</u>
Capital assets:	
Non-depreciable:	
Land	29,638,038
Construction in progress	22,954,912
Depreciable:	
Land improvements, buildings and improvements, machinery and equipment, and infrastructure	9,326,325
Accumulated depreciation	<u>(2,470,938)</u>
Total capital assets	<u>59,448,337</u>
Total noncurrent assets	<u>73,770,003</u>
Total assets	<u>154,867,339</u>
LIABILITIES	
Current liabilities:	
Accounts payable	1,913,796
Accrued wages	26,534
Accrued interest payable	2,744,665
Due to City of Hercules	11,532,141
Long-term debt - due within one year	3,446,449
Total current liabilities	<u>19,663,585</u>
Noncurrent liabilities:	
Advance from the City of Hercules	32,783,013
Long-term debt - due in more than one year	134,930,514
Total noncurrent liabilities	<u>167,713,527</u>
Total liabilities	<u>187,377,112</u>
NET ASSETS	
Restricted for:	
Capital projects	73,179,556
Affordable housing	8,984,092
Unrestricted	<u>(114,673,421)</u>
Total net assets	<u>\$ (32,509,773)</u>

See Accompanying Notes to Basic Financial Statements

HERCULES REDEVELOPMENT AGENCY

STATEMENT OF ACTIVITIES

For the Fiscal Year Ended June 30, 2009

Functions/Programs	Expenses	Program Revenues		Net (Expense) Revenue and Change in Net Assets
		Charges for Services	Capital Contributions and Grants	
Governmental activities:				
Community development	\$ 24,970,552	\$ 47,434		\$ (24,923,118)
Interest on long-term debt	8,091,359			(8,091,359)
Total governmental activities	\$ 33,061,911	\$ 47,434	\$ -	(33,014,477)
General Revenues:				
Taxes and assessments				12,750,860
Use of money and property				2,040,981
Miscellaneous revenue				91,734
Transfer to City of Hercules				(201,803)
Total general revenues and transfers				14,681,772
Change in net assets				(18,332,705)
Net assets, July 1, 2008				9,740,082
Prior period adjustments				(23,917,150)
Net assets, July 1, 2008, restated				(14,177,068)
Net assets, June 30, 2009				\$ (32,509,773)

See Accompanying Notes to Basic Financial Statements

GOVERNMENTAL FUND FINANCIAL STATEMENTS

Redevelopment Agency Operating Special Revenue Fund

This fund accounts for the operating costs of the Redevelopment Agency.

Affordable Housing Special Revenue Fund

This fund accounts for Redevelopment Area tax increment monies to be expended for low and moderate income housing purposes.

Redevelopment Agency Debt Service Fund

This fund accounts for the accumulation of resources used for the payment of principal and interest on the Redevelopment Agency tax allocation bonds and notes payable. It is funded primarily through tax increment revenue and transfers from other City funds.

Redevelopment Agency Capital Projects Fund

This fund accounts for major capital projects undertaken by the Redevelopment Agency.

HERCULES REDEVELOPMENT AGENCY
GOVERNMENTAL FUNDS
BALANCE SHEET
June 30, 2009

	Redevelopment Agency Operating Special Revenue Fund	Affordable Housing Special Revenue Fund	Redevelopment Agency Debt Service Fund
ASSETS			
Cash and investments	\$ 525,122	\$ -	\$ 5,468,949
Cash and investments with fiscal agents			69,994,761
Accounts receivable		1,697	
Interest receivable		362,966	29,273
Due from the City of Hercules			
Due from other funds			
Loans receivable	1,638,159	9,507,719	
Advances to other funds			
Land held for resale		852,528	
	<hr/>	<hr/>	<hr/>
Total assets	<u>\$ 2,163,281</u>	<u>\$ 10,724,910</u>	<u>\$ 75,492,983</u>
LIABILITIES AND FUND BALANCES			
Liabilities:			
Accounts payable	\$ 38,469	\$ 4,969	\$ 171,119
Accrued wages	23,331	3,203	
Deferred revenue	1,638,159	9,870,685	
Due to the City of Hercules		1,732,646	5,399,758
Due to other funds			2,146,788
Advances from other funds			5,399,758
	<hr/>	<hr/>	<hr/>
Total liabilities	<u>1,699,959</u>	<u>11,611,503</u>	<u>13,117,423</u>
Fund Balances:			
Reserved:			
Capital projects			67,869,946
Advances			
Future commitments	207,580		
Land held for resale		852,528	
Unreserved, undesignated			
Reported in:			
Special Revenue Funds	255,742	(1,739,121)	
Capital Projects Fund			
Debt Service Fund			(5,494,386)
	<hr/>	<hr/>	<hr/>
Total fund balances	<u>463,322</u>	<u>(886,593)</u>	<u>62,375,560</u>
	<hr/>	<hr/>	<hr/>
Total liabilities and fund balances	<u>\$ 2,163,281</u>	<u>\$ 10,724,910</u>	<u>\$ 75,492,983</u>

See Accompanying Notes to Basic Financial Statements

Redevelopment Agency Capital Projects Fund	Total
\$ -	\$ 5,994,071
	69,994,761
	1,697
	392,239
4,414,275	4,414,275
2,146,788	2,146,788
	11,145,878
5,399,758	5,399,758
3,862,040	4,714,568
<u>\$ 15,822,861</u>	<u>\$ 104,204,035</u>
\$ 1,699,239	\$ 1,913,796
	26,534
	11,508,844
8,814,012	15,946,416
	2,146,788
	5,399,758
<u>10,513,251</u>	<u>36,942,136</u>
	67,869,946
5,399,758	5,399,758
	207,580
3,862,040	4,714,568
	(1,483,379)
(3,952,188)	(3,952,188)
	(5,494,386)
<u>5,309,610</u>	<u>67,261,899</u>
<u>\$ 15,822,861</u>	<u>\$ 104,204,035</u>

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HERCULES REDEVELOPMENT AGENCY
RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET
TO THE GOVERNMENT-WIDE STATEMENT OF NET ASSETS
June 30, 2009

TOTAL FUND BALANCES - GOVERNMENTAL FUNDS \$ 67,261,899

Amounts reported for Governmental Activities in the Statement of Net Assets are different from those reported in the Governmental Funds because of the following:

Capital assets net of accumulated depreciation used in Governmental Activities are not current assets or financial resources and therefore are not reported in the Governmental Funds.

Non-depreciable	\$	52,592,950	
Depreciable		9,326,325	
Accumulated depreciation		<u>(2,470,938)</u>	
Total capital assets, net			59,448,337

Revenues which are deferred on the Governmental Funds Balance Sheet because they are not available currently are reported as revenues in the Statement of Activities and Changes in Net Assets and accordingly increase the net assets on the Statement of Net Assets.

Deferred revenue	\$	11,145,878	
Interest receivable		362,966	
Allowance for forgiveness loan		<u>(700,000)</u>	10,808,844

Interest payable on long-term debt does not require current financial resources. Therefore, interest payable is not reported as a liability in the Governmental Funds Balance Sheet. (2,744,665)

Issuance costs related to long-term liabilities are expenditures in the Governmental Funds financial statements. However, these costs are capitalized and amortized over the life of the bonds in the Government-wide financial statements, and reported net of accumulated amortization as deferred charges. 3,875,788

Long-term liabilities are not due and payable in the current period and therefore they are not reported in the Governmental Funds Balance Sheet.

2005 Tax Allocation Bonds	\$	(52,180,000)	
Premium on 2005 Tax Allocation Bonds		(1,885,840)	
Deferred loss on refunding for the 2005 Tax Allocation Bonds		252,340	
2007 Housing Tax Allocation Bonds, Series A		(12,910,000)	
2007 Housing Tax Allocation Bonds, Series B		(12,525,000)	
Premium on 2007 Housing Tax Allocation Bonds, Series B		(75,514)	
2007 Tax Allocation Bonds, Series A		(58,410,000)	
Long-term Notes Payable		(452,949)	
Advances from the City of Hercules		<u>(32,973,013)</u>	
Total long-term liabilities			<u>(171,159,976)</u>

NET ASSETS OF GOVERNMENTAL ACTIVITIES \$ (32,509,773)

See Accompanying Notes to Basic Financial Statements

HERCULES REDEVELOPMENT AGENCY
GOVERNMENTAL FUNDS
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES
For the Fiscal Year Ended June 30, 2009

	Redevelopment Agency Operating Special Revenue Fund	Affordable Housing Special Revenue Fund	Redevelopment Agency Debt Service Fund
	<u> </u>	<u> </u>	<u> </u>
Revenues:			
Taxes and assessments	\$ 10,200,688	\$ 2,550,172	\$ -
Use of money and property	(85,278)	2,804	2,123,455
Program income	213,699	104,493	
Charges for services		47,434	
Miscellaneous	28,812	13,234	
	<u> </u>	<u> </u>	<u> </u>
Total revenues	<u>10,357,921</u>	<u>2,718,137</u>	<u>2,123,455</u>
Expenditures:			
Current:			
Community development	4,791,222	3,939,493	2,764,615
Capital outlay			
Debt service:			
Principal			4,297,244
Interest and fiscal agent fees			7,341,043
	<u> </u>	<u> </u>	<u> </u>
Total expenditures	<u>4,791,222</u>	<u>3,939,493</u>	<u>14,402,902</u>
Excess of revenues over (under) expenditures	<u>5,566,699</u>	<u>(1,221,356)</u>	<u>(12,279,447)</u>
Other Financing Sources (Uses):			
Transfer in from the City of Hercules			
Transfer out to the City of Hercules	(341,000)	(32,682)	(5,656,011)
Transfers in	823,593	394,394	25,345,445
Transfers out	(10,967,787)	(1,952,379)	(39,961,182)
	<u> </u>	<u> </u>	<u> </u>
Total other financing sources (uses)	<u>(10,485,194)</u>	<u>(1,590,667)</u>	<u>(20,271,748)</u>
Net changes in fund balances	<u>(4,918,495)</u>	<u>(2,812,023)</u>	<u>(32,551,195)</u>
Fund balances - July 1, 2008	5,381,817	1,925,430	94,926,755
Prior period adjustments	<u> </u>	<u> </u>	<u> </u>
Fund balances - July 1, 2008, restated	<u>5,381,817</u>	<u>1,925,430</u>	<u>94,926,755</u>
Fund balances - June 30, 2009	<u>\$ 463,322</u>	<u>\$ (886,593)</u>	<u>\$ 62,375,560</u>

See Accompanying Notes to Basic Financial Statements

Redevelopment Agency Capital Projects Fund	Total
\$ -	\$ 12,750,860
	2,040,981
	318,192
	47,434
49,688	91,734
<u>49,688</u>	<u>15,249,201</u>
	11,495,330
31,029,330	31,029,330
	4,297,244
746,990	8,088,033
<u>31,776,320</u>	<u>54,909,937</u>
<u>(31,726,632)</u>	<u>(39,660,736)</u>
5,827,890	5,827,890
	(6,029,693)
26,317,916	52,881,348
	(52,881,348)
<u>32,145,806</u>	<u>(201,803)</u>
<u>419,174</u>	<u>(39,862,539)</u>
5,086,540	107,320,542
<u>(196,104)</u>	<u>(196,104)</u>
<u>4,890,436</u>	<u>107,124,438</u>
<u>\$ 5,309,610</u>	<u>\$ 67,261,899</u>

HERCULES REDEVELOPMENT AGENCY
RECONCILIATION OF THE GOVERNMENTAL FUNDS STATEMENT OF
REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES
TO THE GOVERNMENT-WIDE STATEMENT OF ACTIVITIES
For the Fiscal Year Ended June 30, 2009

The schedule below reconciles the Net Changes in Fund Balances reported on the Governmental Funds Statement of Revenues, Expenditures, and Changes in Fund Balances, which measures only changes in current assets and current liabilities on the modified accrual basis, with the Change in Net Assets of Governmental Activities reported in the Statement of Activities, which is prepared on the full accrual basis.

NET CHANGE IN FUND BALANCES - GOVERNMENTAL FUNDS \$ (39,862,539)

Amounts reported for governmental activities in the Statement of Activities are different because of the following:

Governmental Funds report capital outlays as expenditures. However, in the Statement of Activities the cost of those assets is capitalized and allocated over their estimated useful lives and reported as depreciation expense.

Capital outlay expenditures are therefore added back to fund balances	30,235,206
Depreciation expense not reported in governmental funds	(302,183)

The construction in progress project was completed and transferred to the City of Hercules during the current year. This included land, buildings, and improvements.	(15,075,022)
--	--------------

Certain revenues are offset by deferred revenue in the governmental funds because they are not available to pay for current period expenditures. This amount represents the amount by which current year deferred revenue exceeded prior year and includes the \$700,000 allowance for forgiveness loan.	2,377,915
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Addition and amortization of premium, deferred bond discounts and loss on refunding does not require the use of current available resources, and therefore, is not included in the funds. This activity is included in the Statement of Activities.	(68,071)
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Bond proceeds provide current financial resources to governmental funds, but issuing debt increases long-term liabilities in the Statement of Net Assets. Costs associated with the issuance of long-term debt are reported as expenditures in the governmental funds, but in the Statement of Net Assets, the costs are deferred and amortized throughout the period during which the related debt is outstanding. Repayment of bond principal is an expenditure in the governmental funds, but in the Statement of Net Assets the repayment reduces long-term liabilities:

Repayment of debt principal is added back to fund balance	4,297,244
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The amounts below included in the Statement of Activities do not provide (require) the use of current financial resources and therefore are not reported as revenue or expenditures in governmental funds (net change):

Interest payable	64,745
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CHANGE IN NET ASSETS OF GOVERNMENTAL ACTIVITIES	<u><u>\$ (18,332,705)</u></u>
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See Accompanying Notes to Basic Financial Statements

NOTES TO BASIC FINANCIAL STATEMENTS

HERCULES REDEVELOPMENT AGENCY
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2009

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The basic financial statements of the Redevelopment Agency (Agency) of the City of Hercules, California, (City) have been prepared in conformity with accounting principles generally accepted in the United States of America (USGAAP) as applied to governmental agencies. The Governmental Accounting Standards Boards (GASB) is the accepted standard setting body for establishing governmental accounting and financial reporting principles. The more significant of the Agency's accounting policies are described below.

A. Reporting Entity

The Agency was formed in 1983 for the purpose of renovating designated Redevelopment Project Areas within the limits of the City. The Agency is a component unit of the City, and is accounted for as separate funds in the City's basic financial statements.

B. Basis of Accounting/Measurement Focus

The accounts of the Agency are organized on the basis of funds, each of which is considered a separate accounting entity. The operations of each fund are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues, and expenditures. Governmental resources are allocated to and accounted for in individual funds based upon the purposes for which they are to be spent and the means by which spending activities are controlled.

Government-Wide Financial Statements

The Agency's government-wide financial statements include a Statement of Net Assets and a Statement of Activities. These statements present summaries of governmental activities for the Agency.

These statements are presented on an "*economic resources*" measurement focus and the accrual basis of accounting. Accordingly, all of the Agency's assets and liabilities, including capital assets, as well as infrastructure assets and long-term liabilities, are included in the accompanying Statement of Net Assets. The Statement of Activities presents changes in net assets. Under the accrual basis of accounting, revenues are recognized in the period in which they are earned while expenses are recognized in the period in which the liability is incurred. The type of transactions reported as program revenues for the Agency is charges for services.

Certain eliminations have been made as prescribed by GASB Statement No. 34 in regards to interfund activities, payables and receivables. All internal balances in the Statement of Net Assets have been eliminated. The following interfund activities have been eliminated:

- Transfers in/out
- Due from/to other funds
- Advances from/to other funds

Governmental Fund Financial Statements

Governmental fund financial statements include a Balance Sheet and a Statement of Revenues, Expenditures, and Changes in Fund Balances for all major governmental funds. An accompanying schedule is presented to reconcile and explain the differences in the balance sheet as presented in these statements to the net assets presented in the government-wide financial statements. All of the Agency's funds are presented as major funds.

HERCULES REDEVELOPMENT AGENCY
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2009

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

B. Basis of Accounting/Measurement Focus (Continued)

Governmental Fund Financial Statements (Continued)

All governmental funds are accounted for on a spending or “*current financial resources*” measurement focus and the modified accrual basis of accounting. Accordingly, only current assets and current liabilities are included on the balance sheets. The Statement of Revenues, Expenditures, and Changes in Fund Balances presents increases (revenues and other financing sources) and decreases (expenditures and other financing uses) in net current assets.

Revenues are recorded when received in cash, except for those revenues subject to accrual (generally 60 days after year-end) are recognized when due. The primary revenue sources, which have been treated as susceptible to accrual by the Agency, are property tax and investment earnings. Expenditures are recorded in the accounting period in which the related fund liability is incurred.

Deferred revenues arise when potential revenues do not meet both the “measurable” and “available” criteria for recognition in the current period. Deferred revenues also arise when the government receives resources before it has a legal claim to them, as when grant monies are received prior to incurring qualifying expenditures. In subsequent periods, when both revenue recognition criteria are met or when the government has a legal claim to the resources, the deferred revenue is removed and revenue is recognized.

The Reconciliation of the Fund Financial Statements to the Government-wide Financial Statements is provided to explain the differences created by the integrated approach of GASB Statement No. 34.

C. Cash and Investments

The Agency pools cash resources from all funds within the City of Hercules in order to facilitate the management of cash. The balance in the pooled cash account is available to meet current operating requirements. Cash in excess of current requirements is invested in various interest-bearing accounts and other investments for varying terms.

In accordance with GASB Statement No. 40, *Deposit and Investment Disclosures (Amendment of GASB Statement No. 3)*, certain disclosure requirements for Deposits and Investment Risks were made in the following areas:

- Interest Rate Risk
- Credit Risk
 - Overall
 - Custodial Credit Risk
 - Concentrations of Credit Risk

In addition, other disclosures are specified including use of certain methods to present deposits and investments, highly sensitive investments, credit quality at fiscal year-end and other disclosures.

The Agency has implemented GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*. Highly liquid market investments with maturities of one year or less at time of purchase are stated at amortized cost. All other investments are stated at fair value. Market value is used as fair value for those securities for which market quotations are not readily available. Interest earned on investments is allocated using the LAIF factor to selected funds by the City.

HERCULES REDEVELOPMENT AGENCY
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2009

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

C. Cash and Investments (Continued)

The Agency participates in an investment pool managed by the State of California titled Local Agency Investment Fund (LAIF) which has invested a portion of the pool funds in Structured Notes and Asset-Backed Securities. LAIF's investments are subject to credit and market risk with the full faith and credit of the State of California collateralizing these investments. In addition, these Structured Notes and Asset-Backed Securities are subject to market risk as to change in interest rates.

Cash equivalents are considered amounts in demand deposits and short-term investments with a maturity date within three months of the date acquired by the Agency and are presented as "Cash and investments" in the basic financial statements.

D. Capital Assets

The Agency's assets are capitalized at historical cost or estimated historical cost. Agency policy has set the capitalization threshold for reporting capital assets at \$2,500. Gifts or contributions of capital assets are recorded at fair value when received. Depreciation is recorded on the straight-line basis over the estimated useful lives of the assets as follows:

Buildings and improvements	25 years
Machinery and equipment	5 – 20 years
Improvements other than buildings	15 years
Infrastructure	15 – 50 years

E. Long-Term Obligations

In the government-wide financial statements, long-term debt and other long-term obligations are reported as liabilities in the applicable governmental activities. Bond premiums and discounts and issuance costs, if material, 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 or discount. Bond issuance costs are reported as deferred charges and amortized over the term of the related debt.

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 issuance are reported as other financing sources while discounts on debt issuance are reported as other financing uses. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures.

F. Fund Balances

In the fund financial statements, governmental funds report reservations of fund balances for amounts that are not available for appropriation or are legally restricted by outside parties for use for a specific purpose. Designations of fund balances represent tentative management plans that are subject to change.

The following is a listing of the Agency's reserves and designations:

Reserved for Land Held for Resale – Represents amounts provided to indicate that land held for resale is not "available" as a resource to meet expenditures of the current year.

HERCULES REDEVELOPMENT AGENCY
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2009

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

F. Fund Balances (Continued)

Reserved for Advances to Other Funds represents funds that are to be received from other funds on a long-term basis.

Reserved for Capital Projects represents the portion of fund balance that are reserved for capital projects per debt agreements.

Reserved for Future Commitments represents funds that are reserved for future miscellaneous commitments.

G. Net Assets

In the government-wide financial statements, net assets are classified in the following categories:

Restricted Net Assets – This amount is restricted by external creditors, grantors, contributors, or laws or regulations of other governments.

Unrestricted Net Assets – This amount is all net assets that do not meet the definition of “invested in capital assets, net of related debt” or “restricted net assets.”

H. Use of Restricted/Unrestricted Net Assets

When an expense is incurred for purposes for which both restricted and unrestricted net assets are available, the Agency’s policy is to apply restricted net assets first.

I. Property Taxes

Under California law, property taxes are assessed and collected by the County of Contra Costa (County). Under the Teeter plan, the County remits the full assessment regardless of the amounts received. The County assesses, bills, and collects property taxes as follows:

Lien Date	January 1
Levy Date	July 1
Due Date	November 1 and February 1
Collection Date	December 10 and April 10

The Agency is required to set aside a portion of tax increments received to increase and improve the community’s supply of low and moderate-income housing. The amount set aside each year is required to equal 20% of the tax increment receipts from the redevelopment area which amounted to \$2,550,172 for the fiscal year ended June 30, 2009.

Unsecured personal property taxes do not constitute a lien against real property unless the taxes become delinquent. Payment must be made in one installment, which is delinquent if not paid by August 31 of the fiscal year. Significant penalties are imposed by the county for late payments.

J. Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. Actual results could differ from those estimates.

HERCULES REDEVELOPMENT AGENCY
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2009

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

K. New Accounting Pronouncements

The Agency implemented the requirements of GASB Statements No. 45, No. 49, No. 52, No. 55, and No. 56 during the fiscal year ended June 30, 2009.

Governmental Accounting Standards Board Statement No. 45

For the fiscal year ended June 30, 2009, the Agency implemented Governmental Accounting Standards Board (GASB) Statement No. 45, “Accounting and Financial Reporting by Employers for Postemployment Benefits Other than Pensions”. This Statement is effective for periods beginning after December 15, 2007 for a Phase 2 government (1999 total revenues less the \$100 million and more than \$10 million). This Statement establishes standards for accounting and financial reporting for state and local government employees that offer “Other Postemployment Benefits” (OPEB) and requires accrual basis measurement and recognition of OPEB expenses and liabilities that will result in recognition of expenses over periods that approximate employees’ years of service. See the City of Hercules’ Comprehensive Annual Financial Report for more details of the City’s Plan and the effect on the financial statements.

Governmental Accounting Standards Board Statement No. 49

For the fiscal year ended June 30, 2009 the Agency implemented Governmental Accounting Standards Board (GASB) Statement No. 49, “Accounting and Financial Reporting for Pollution Remediation Obligations.” The Statement is effective for periods beginning after December 15, 2007. The Statement addresses accounting and financial reporting standards for pollution (including contamination) remediation obligations, which are obligations to address the current or potential detrimental effects of existing pollution by participating in pollution remediation activities such as site assessments and cleanups. The scope of the document excludes pollution prevention or control obligations with respect to current operations, and future pollution remediation activities that are required upon retirement of net assets, such as landfill closure and postclosure care and nuclear power plant decommissioning.

Governmental Accounting Standards Board Statement No. 52

For the fiscal year ended June 30, 2009, the Agency implemented GASB Statement No. 52, “Land and Other Real Estate Held as Investments by Endowments”. The Statement is effective for periods beginning after June 15, 2008. This Statement establishes consistent standards for the reporting of land and other real estate held as investments by essentially similar entities. It requires endowments to report their land and other real estate investments at fair value. Governments also are required to report the changes in fair value as investment income and to disclose the methods and significant assumptions employed to determine fair value, and other information that they currently present for other investments reported at fair value.

Governmental Accounting Standards Board Statement No. 55

For the fiscal year ended June 30, 2009, the Agency implemented GASB Statement No. 55, “The hierarchy of Generally Accepted Accounting Principles for State and Local Governments”. The Statement is effective as of April 2, 2009. The objective of this Statement is to incorporate the hierarchy of generally accepted accounting principles (GAAP) for state and local governments into the Governmental Accounting Standards Board’s authoritative literature. The “GAAP hierarchy” consists of the sources of accounting principles used in the preparation of financial statements of state and local governmental entities that are presented in conformity with GAAP, and the framework for selecting those principles.

**HERCULES REDEVELOPMENT AGENCY
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2009**

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

K. New Accounting Pronouncements (Continued)

Governmental Accounting Standards Board Statement No. 56

For the fiscal year ended June 30, 2009, the Agency implemented GASB Statement No. 56, “Codification of Accounting and Financing Reporting Guidance Contained in the AICPA Statements of Auditing Standards”. The Statement is effective as of April 16, 2009. The objective of this Statement is to incorporate into the Governmental Accounting Standards Board’s (GASB) authoritative literature certain accounting and financial reporting guidance presented in the American Institute of Certified Public Accountants’ Statements on Auditing Standards. This Statement addresses three issues not included in the authoritative literature that establishes accounting principles – related party transactions, going concern considerations, and subsequent events. The presentation of principles used in the preparation of financial statements is more appropriately included in accounting and financial reporting standards rather than in the auditing literature.

NOTE 2 – CASH AND INVESTMENTS

Cash and investments at June 30, 2009 consisted of the following:

Cash and investments pooled with the City of Hercules	\$	5,994,071
Cash and investments held with fiscal agents		69,994,761
Total cash and investments	<u>\$</u>	<u>75,988,832</u>

The Agency pools its cash and investments with the City in order to achieve a higher return on investment. Certain funds, which are held and invested by independent outside custodians through contractual agreements, are not pooled. These funds include cash with fiscal agents.

The investments made by the Agency are limited to those allowable under State statutes and the Agency’s investment policy and may include the following types of investments:

Certificates of Deposit	Government Agency Securities
Bankers Acceptances	Treasury Bills and Notes
Commercial Paper	Passbook Savings Accounts
Repurchase Agreements	Mutual Funds
Medium-Term Corporate Notes	State of California Local Agency Investment Fund

Investments Authorized by Debt Agreements

Investment of debt proceeds held by trustees is governed by provisions of the debt agreements, rather than the general provisions of the California Government Code or the Agency’s investment policy. The table below identifies the investment types that are authorized for investments held by trustee. The table also identifies certain provisions of the debt agreements that address interest rate risk, credit risk, and concentration of credit risk.

HERCULES REDEVELOPMENT AGENCY
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2009

NOTE 2 – CASH AND INVESTMENTS (CONTINUED)

Investments Authorized by Debt Agreements (Continued)

Authorized Investment Type	Maximum Maturity	Maximum Percentage of Portfolio	Maximum Investment in One Issuer
Local Agency Investment Fund (State Pool)	N/A	None	None
U.S. Treasury Obligations	30 years	20%	None
U.S. Government Agency Issues	30 years	20%	None
Insured Deposits with Banks and Savings and Loans	N/A	None	None
Bankers Acceptance (must be dollar denominated)	6 months	40%	30%
Commercial Paper	6 months	15%	10%
Negotiable Time Certificates of Deposit	5 years	30%	\$100,000
Non-negotiable Time Certificates of Deposit	5 years	30%	\$100,000
Federally insured Time Deposits	1 year	20%	None
Repurchase Agreements	30 days	None	None
Reverse Repurchase Agreements	92 days	20%	None
Medium-Term Notes	5 years	30%	15%
Money Market Funds	N/A	None	None
Mutual Funds	N/A	20%	None
Insured or Passbook Savings Accounts	N/A	None	\$100,000
Guaranteed Investment Contracts	N/A	None	None

Disclosures Relating to Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. One of the ways that the Agency manages its exposure to interest rate risk is by purchasing a combination of shorter term and longer term investments and by timing cash flows from maturities so that a portion of the portfolio is maturing or coming close to maturity evenly over time as necessary to provide the cash flows and liquidity needed for operations.

Information about the sensitivity of the fair values of the Agency's investments (including investments held by bond trustees) to market interest rate fluctuations is provided by the following table that shows the distribution of the Agency's investments by maturity:

Investment Type	Totals	Remaining Maturity (in Months)					
		12 Months Or Less	13 to 24 Months	25-36 Months	37-48 Months	49-60 Months	More Than 60 Months
Held by debt trustees:							
Money Market Funds	\$ 69,994,761	\$ 69,994,761	\$ -	\$ -	\$ -	\$ -	\$ -
	<u>\$ 69,994,761</u>	<u>\$ 69,994,761</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

Investments with Fair Values Highly Sensitive to Interest Rate Fluctuations

Interest rate risk is the market value fluctuation due to overall changes in the interest rates. It is mitigated by limiting the average maturity of the Agency's portfolio not to exceed three years. The Agency has no investments that are highly sensitive to interest rate fluctuations.

**HERCULES REDEVELOPMENT AGENCY
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2009**

NOTE 2 – CASH AND INVESTMENTS (CONTINUED)

Investments with Fair Values Highly Sensitive to Interest Rate Fluctuations (Continued)

As a means of maintaining liquidity and minimizing interest rate risk, the Agency’s investment policy limits are as follows:

<u>Maturity</u>	<u>% of Portfolio</u>
Up to one year	10% (Minimum)
one year to five years	60% (Maximum)
more than five years	30% (Maximum)

Disclosures Relating to Credit Risk

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

Investment Type	Amount	Minimum Legal Rating	Exempt From Disclosure	Rating as of Fiscal Year End			
				AAA	AA	A	Not Rated
Held by debt trustees:							
Money Market Funds	\$ 69,994,761	N/A	\$ -	\$ 69,994,761	\$ -	\$ -	\$ -
Total	\$ 69,994,761		\$ -	\$ 69,994,761	\$ -	\$ -	\$ -

Concentration of Credit Risk

The investment policy of the Agency contains limitations on the amount that can be invested in any one issuer. The Agency has no investments (other than the money market funds) that are more than 5% of total Agency investments.

Custodial Credit Risk

Custodial credit risk for *deposits* is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for *investments* is the risk that, in the event of the failure of the counterparty (e.g. broker-dealer) to a transaction, a government will not be able to recover the value of its investment or collateral securities that are in the possession of another party. The California Government Code and the Agency’s investment policy do not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits or investments, other than the following provision for deposits. The California Government Code requires that a financial institution secure deposits made by state or local governmental units by pledging securities in an undivided collateral pool held by a depository regulated under state law (unless so waived by the governmental unit). The fair value of the pledged securities in the collateral pool must equal at least 110% of the total amount deposited by the public agencies. California law also allows financial institutions to secure Agency deposits by pledging first trust deed mortgage notes having a value of 150% of the secured public deposits.

See the City of Hercules’ Comprehensive Annual Financial Report for more information relating to custodial credit risk for amounts reported as cash and investments pooled with the City.

The Agency’s investments are carried at fair value as required by accounting principles generally accepted in the United States of America. The Agency adjusts the carrying value of its investments to reflect their fair value at each fiscal year-end, and it includes the effects of these adjustments in investment income for that fiscal year.

HERCULES REDEVELOPMENT AGENCY
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2009

NOTE 3 – LOANS RECEIVABLE

Loans receivable at June 30, 2009 consisted of the following:

Bridge Housing Corporation	\$	1,762,566
Eden Housing		700,000
Radston's Office Plus		250,000
First Time Homebuyers		3,496,740
Affordable Housing		3,898,284
Business Development Loans		1,388,159
Home Emergency Loans		<u>13,095</u>
Subtotal		11,508,844
Less: Reported as interest receivable		362,966
Allowance for uncollectible loan		<u>700,000</u>
Total	\$	<u>10,445,878</u>

The Agency loaned the Bridge Housing Corporation (Corporation) \$1,400,000 to finance construction of a sixty unit senior citizen housing development next to City Hall. On September 8, 1998, the Agency approved an addition to the loan of \$114,600 for a total of \$1,514,600. On January 1, 1999, the loan began to accrue interest at the rate of 3.5% per year and is repayable in 2041, subject to certain conditions. The construction was completed in September 1999. On March 2, 2000, the Corporation repaid \$115,000 to the Agency. As of June 30, 2009, the Corporation's loan balance was \$1,762,566, which includes \$362,966 of interest presented as interest receivable.

On July 1, 2002, the Agency loaned Eden Housing, Inc. \$700,000 to assist in the development of low and moderate income housing for senior citizens. The loan does not bear interest. The repayment of the loan is only due and payable if a default has been declared by the Agency and the borrower fails to cure the default. Upon expiration of the 55-year Regulatory Agreement, the loan will be forgiven and the promissory note will be cancelled by the Agency. The balance outstanding as of June 30, 2009 was \$700,000. An allowance of \$700,000 has been established for this loan, due to its terms.

On December 5, 2000, the Agency entered into a promissory note agreement with the Radston's Office Plus (Payors) in the amount of \$250,000 with interest at 5% per annum. All principal and interest are deferred until December 5, 2010. Commencing on December 5, 2010, the Payors shall pay a lump-sum cash amount of \$125,000 which represents all deferred and unpaid interest only. The principal balance of \$250,000 will be fully amortized and paid over the next ten years at \$2,652 per month, principal and interest, commencing on December 5, 2010. The loan is secured by a Deed of Trust on real property. As of June 30, 2009, the outstanding balance of the loan was \$250,000.

The Agency has provided various loan programs for First Time Homebuyers. In general, they provide secondary financing for low and moderate buyers in the City of Hercules that have deferred payments in order to allow the buyer to maximize their purchasing capacity. The loan has a repayment period of 20 years and payment is deferred in the first 10 years of the loan. The loan has a simple interest rate is at 3%, which will not be accrued during the deferred period. The balance outstanding as of June 30, 2009 was \$3,496,740.

The Agency has provided various loan programs for Affordable Housing assistance. The first is the Below Market Rate Program, which provides secondary financing for low to moderate income persons who currently earn less than one hundred twenty percent of the current annual median income for the Contra Costa County area. This is available to City employees as well. The repayment period varies from 10 to 30 years with a deferred period of 10 to 20 years and no interest will be accrued. The second is the Rehabilitation and Beautification Program, which provides financial assistance to rehabilitate properties. Borrowers are individuals and families who currently earn less than one hundred twenty percent of the current annual median income for the Contra Costa County area. The loan has a repayment period of 20 years and payment is deferred in the first 10 years of the loan. The loan has a simple interest rate is at 3%, which will not be accrued during the deferred period. The balance outstanding of the Affordable Housing Assistance loans as of June 30, 2009 was \$3,898,284.

HERCULES REDEVELOPMENT AGENCY
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2009

NOTE 3 – LOANS RECEIVABLE (CONTINUED)

The City and Agency established the Business Development Loan Program (BDLP) to provide low cost financial assistance to businesses within the City of Hercules. The BDLP offers a secured loan of up to \$75,000, a term not greater than 20 years, and a simple interest rate of 3% per annum. All applicants are evaluated and prioritized according to established program criteria and if funded are subject to various terms, conditions, and fees. These fees will be deducted from the final loan award by the escrow administrator at the time of funding. The balance outstanding as of June 30, 2009 was \$1,388,159.

On September 19, 2002, the Agency entered into several home emergency loans in various amounts with interest at 5% per annum. The principal amount of the loans including interest is to be due and payable in one lump sum if the owners cease to occupy the property or upon any transfer, refinance, sale, or conveyance of all or a part of the property. The balance outstanding as of June 30, 2009 was \$13,095.

NOTE 4 – LAND HELD FOR RESALE

Land held for resale of \$3,862,040 is comprised of one parcel of land in the Dynamite Project area and \$852,528 is comprised of three parcels of land that were purchased by the Agency. The parcel are purchases within the project area and is being held for future development. The properties are being carried at a net realizable value, which approximates to cost.

NOTE 5 – CAPITAL ASSETS

Capital asset activity for the fiscal year ended June 30, 2009, consisted of the following:

	Balance July 1, 2008	Additions	Deletions	Transfers	Balance June 30, 2009
Governmental Activities					
Nondepreciable capital assets:					
Land	\$ 16,937,825	\$ 17,563,963	\$ -	\$ (4,863,750)	\$ 29,638,038
Construction in progress	20,748,343	10,800,511		(8,593,942)	22,954,912
Total nondepreciable capital assets	37,686,168	28,364,474		(13,457,692)	52,592,950
Depreciable capital assets:					
Land improvements	11,379				11,379
Buildings and improvements	4,965,778	1,617,330		(1,617,330)	4,965,778
Machinery and equipment		116,445			116,445
Infrastructure	4,095,766	136,957			4,232,723
Total depreciable capital assets	9,072,923	1,870,732		(1,617,330)	9,326,325
Accumulated depreciation:					
Land improvements	(9,401)	(572)			(9,973)
Buildings and improvements	(1,950,093)	(99,437)			(2,049,530)
Infrastructure	(209,261)	(202,174)			(411,435)
Total accumulated depreciation	(2,168,755)	(302,183)			(2,470,938)
Net depreciable capital assets	6,904,168	1,568,549		(1,617,330)	6,855,387
Net capital assets	\$ 44,590,336	\$ 29,933,023	\$ -	\$ (15,075,022)	\$ 59,448,337

The Venture Commerce Center Project was completed during the fiscal year ended June 30, 2009 and was transferred to the City of Hercules in the amount of \$15,075,022.

Depreciation expense for the fiscal year ended June 30, 2009 was \$302,183, which was allocated to community development expense on the Statement of Activities.

HERCULES REDEVELOPMENT AGENCY
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2009

NOTE 6 – LONG-TERM OBLIGATIONS

The Agency's long-term obligation transactions for the fiscal year ended June 30, 2009, were as follows:

	Balance July 1, 2008	Prior Period Adjustments	Additions	Reductions	Balance June 30, 2009	Due within one year
Governmental activities:						
2005 Tax Allocation Bonds	\$ 53,640,000	\$ -	\$ -	\$ (1,460,000)	\$ 52,180,000	\$ 1,520,000
Premium on 2005 Tax Allocation Bonds	1,958,372			(72,532)	1,885,840	72,532
Deferred loss on refunding for the 2005 Tax Allocation Bonds	(262,045)			9,705	(252,340)	(9,705)
2007 Housing Tax Allocation Bonds, Series A	13,130,000			(220,000)	12,910,000	240,000
2007 Housing Tax Allocation Bonds, Series B	12,760,000			(235,000)	12,525,000	250,000
Premium on 2007 Housing Tax Allocation Bonds, Series B	78,660			(3,146)	75,514	3,146
2007 Tax Allocation Bonds, Series A	60,555,000			(2,145,000)	58,410,000	1,130,000
Long-term Notes Payable	500,193			(47,244)	452,949	50,476
Advances from the City of Hercules	9,441,967	23,721,046		(190,000)	32,973,013	190,000
Total long-term obligations	\$ 151,802,147	\$ 23,721,046	\$ -	\$ (4,363,217)	\$ 171,159,976	\$ 3,446,449

A. 2005 Tax Allocation Bonds

On August 5, 2005, the Redevelopment Agency issued Hercules Merged Project Area Tax Allocation Bonds, Series 2005, in the amount of \$56,260,000. The proceeds of the bonds were used to finance certain public capital improvements within the Agency's Merged Project Area and refund the Agency Subordinate Tax Allocation Bonds, Series 2001. The Bonds mature annually each August 1 from 2006 to 2035, in amounts ranging from \$740,000 to \$2,960,000 and bear interest at rates ranging from 3.50% to 5.00%. Interest is payable semi-annually on February 1 and August 1. The Bonds maturing on or after August 1, 2016, are subject to optional redemption prior to maturity at the option of the Agency on or after August 1, 2015, as a whole or in part, on any interest payment date, at a price equal to the principal amount, plus accrued interest on the redemption date. The bonds are payable exclusively from pledged tax revenues to be derived from the project area and from the amounts on deposit in certain funds and accounts, including the reserve account and the revenue account.

The annual debt service requirements to maturity at June 30, 2009, were as follows:

Fiscal Year Ended June 30,	Principal	Interest	Total
2010	\$ 1,520,000	\$ 2,450,645	\$ 3,970,645
2011	1,575,000	2,390,335	3,965,335
2012	1,640,000	2,327,265	3,967,265
2013	1,705,000	2,264,855	3,969,855
2014	1,765,000	2,199,535	3,964,535
2015-2019	10,110,000	9,637,244	19,747,244
2020-2024	8,310,000	7,391,618	15,701,618
2025-2029	10,575,000	5,073,644	15,648,644
2030-2034	13,465,000	3,182,813	16,647,813
2035-2036	1,515,000	113,288	1,628,288
Subtotal	52,180,000	37,031,242	89,211,242
Plus Premium	1,885,840		1,885,840
Total	\$ 54,065,840	\$ 37,031,242	\$ 91,097,082

HERCULES REDEVELOPMENT AGENCY
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2009

NOTE 6 – LONG-TERM OBLIGATIONS (CONTINUED)

A. 2005 Tax Allocation Bonds (Continued)

In connection with the issuance of the 2005 Tax Allocation Bonds, the Agency recorded a deferred loss on refunding of debt which is reported as part of long-term debt. This deferred loss was in connection with interest payments made to the escrow agent for future payments of interest. The total amount of the deferred loss was \$291,160 which will be amortized over the life of the bond. The amortization for the fiscal year 2008-2009 was \$9,705, and the accumulated amortization at June 30, 2009 was \$38,820.

B. 2007 Housing Tax Allocation Bonds Series A and B

On July 26, 2007, the Redevelopment Agency issued Hercules Merged Project Area Housing Tax Allocation Bonds, 2007 Series A, in the amount of \$13,130,000 and 2007 Series B, in the amount of 12,760,000. The proceeds of the bonds were used to finance certain public capital improvements within the Agency's Merged Project Area. The Bonds mature annually each August 1 from 2009 to 2033, in amounts ranging from \$220,000 to \$950,000 and bear interest at rates ranging from 3.50% to 6.125%. Interest is payable semi-annually on February 1 and August 1. The Bonds maturing on or after August 1, 2018, are subject to optional redemption prior to maturity at the option of the Agency on or after August 1, 2017, as a whole or in part, on any interest payment date, at a price equal to the principal amount, plus accrued interest on the redemption date. The bonds are payable exclusively from pledged tax revenues to be derived from the project area and from the amounts on deposit in certain funds and accounts, including the reserve account and the revenue account.

The annual debt service requirements to maturity at June 30, 2009 of the 2007 Series A and B bonds were as follows:

Fiscal Year Ended June 30,	Principal	Interest	Total
2010	\$ 240,000	\$ 767,669	\$ 1,007,669
2011	255,000	754,056	1,009,056
2012	270,000	739,619	1,009,619
2013	285,000	724,356	1,009,356
2014	300,000	707,969	1,007,969
2015-2019	1,770,000	3,255,676	5,025,676
2020-2024	2,365,000	2,648,138	5,013,138
2025-2029	3,165,000	1,812,234	4,977,234
2030-2034	4,260,000	682,938	4,942,938
Total	<u>\$ 12,910,000</u>	<u>\$ 12,092,655</u>	<u>\$ 25,002,655</u>

Fiscal Year Ended June 30,	Principal	Interest	Total
2010	\$ 250,000	\$ 574,986	\$ 824,986
2011	260,000	564,786	824,786
2012	315,000	553,241	868,241
2013	325,000	540,351	865,351
2014	340,000	526,775	866,775
2015-2019	1,910,000	2,406,883	4,316,883
2020-2024	2,360,000	1,944,423	4,304,423
2025-2029	2,985,000	1,305,569	4,290,569
2030-2034	3,780,000	484,644	4,264,644
Subtotal	12,525,000	8,901,658	21,426,658
Plus Premium	75,514		75,514
Total	<u>\$ 12,600,514</u>	<u>\$ 8,901,658</u>	<u>\$ 21,502,172</u>

HERCULES REDEVELOPMENT AGENCY
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2009

NOTE 6 – LONG-TERM OBLIGATIONS (CONTINUED)

C. 2007 Tax Allocation Bonds Series A

On December 20, 2007, the Redevelopment Agency issued Hercules Merged Project Area Tax Allocation Bonds, 2007 Series A, in the amount of \$60,555,000. The proceeds of the bonds will be used to finance certain public capital improvements within the Agency’s Merged Project Area. The Bonds mature annually each August 1 from 2009 to 2043, in amounts ranging from \$260,000 to \$3,315,000 and bear interest at rates ranging from 3.50% to 5.00%. Interest is payable semi-annually on February 1 and August 1. The Bonds maturing on or after August 1, 2018, are subject to optional redemption prior to maturity at the option of the Agency on or after February 1, 2018, as a whole or in part, on any interest payment date, at a price equal to the principal amount, plus accrued interest on the redemption date. The bonds are payable exclusively from pledged tax revenues to be derived from the project area and from the amounts on deposit in certain funds and accounts, including the reserve account and the revenue account.

The annual debt service requirements to maturity at June 30, 2009, were as follows:

Fiscal Year Ended June 30,	Principal	Interest	Total
2010	\$ 1,130,000	\$ 2,723,209	\$ 3,853,209
2011	1,185,000	2,670,984	3,855,984
2012	1,240,000	2,610,359	3,850,359
2013	1,300,000	2,546,859	3,846,859
2014	1,360,000	2,480,359	3,840,359
2015-2019	2,515,000	11,831,813	14,346,813
2020-2024	5,585,000	11,088,600	16,673,600
2025-2029	6,315,000	9,672,099	15,987,099
2030-2034	7,090,000	8,107,049	15,197,049
2035-2039	18,315,000	4,965,803	23,280,803
2040-2044	12,375,000	1,231,275	13,606,275
Total	<u>\$ 58,410,000</u>	<u>\$ 59,928,409</u>	<u>\$ 118,338,409</u>

D. Long-Term Notes Payable

In 1987, the Agency entered into Owner Participation Agreements with certain property owners (East Group and Bio Rad Laboratories) in the Redevelopment Area. Under the terms of these agreements, the Agency signed notes under which it promised to reimburse the owners by the year 2016 for the amount of incremental assessments levied on their properties, up to the cost of constructing public improvements. Payment on these notes is contingent on the property taxes and special assessments levied on these owners. As of June 30, 2009, the Agency’s long-term notes payables were as follows:

East Group	\$ 170,604
Bio Rad Laboratories	282,345
Total	<u>\$ 452,949</u>

HERCULES REDEVELOPMENT AGENCY
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2009

NOTE 6 – LONG-TERM OBLIGATIONS (CONTINUED)

D. Long-Term Notes Payable (Continued)

The annual debt service requirements to maturity for the East Group Notes Payable as of June 30, 2009 are as follows:

Fiscal Year Ended June 30,	Principal	Interest	Total
2010	\$ 19,092	\$ 13,094	\$ 32,186
2011	20,601	11,614	32,215
2012	22,112	10,018	32,130
2013	23,887	8,304	32,191
2014	25,661	6,453	32,114
2015-2016	59,251	6,781	66,032
Total	<u>\$ 170,604</u>	<u>\$ 56,264</u>	<u>\$ 226,868</u>

The annual debt service requirements to maturity for the Bio Rad Laboratories Note Payable as of June 30, 2009 are as follows:

Fiscal Year Ended June 30,	Principal	Interest	Total
2010	\$ 31,384	\$ 21,833	\$ 53,217
2011	34,351	19,366	53,717
2012	36,871	16,704	53,575
2013	39,830	13,847	53,677
2014	42,788	10,760	53,548
2015-2016	97,121	11,306	108,427
Total	<u>\$ 282,345</u>	<u>\$ 93,816</u>	<u>\$ 376,161</u>

E. Defeased Debt

2001 Tax Allocation Bonds

The Agency issued 2005 Tax Allocation Bonds to refund the 2001 Tax Allocation Bonds. The Agency issued subordinate tax allocation bonds, series 2001, dated September 4, 2001, totaling \$6,500,000. The purpose of the bonds was to provide funds to finance certain redevelopment activities within, and of benefit to, the Hercules Merged Project Area. The interest rate on the bonds ranges from 4.50% to 6.40%. The interest is payable on each March 1 and September 1 commencing March 1, 2002. The bonds are subject to optional and mandatory early redemption provisions. The bonds are payable from and secured by a pledge of tax revenues in the Merged Project Area. Principal is due annually beginning on September 1, 2005, in amounts ranging from \$215,000 to \$575,000. The economic effect of refunding the bonds was a gain of \$293,279. The outstanding balance as of June 30, 2009 was \$5,080,000. The liability for these bonds has been removed from the Agency's books and records, as they are considered defeased.

HERCULES REDEVELOPMENT AGENCY
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2009

NOTE 7 – ADVANCES FROM CITY OF HERCULES

Advances from City of Hercules amounted to \$32,973,013. These funds were to provide financing for City Hall Construction, Refugio Creek Realignment Project, Williamson Property Purchase, Wells Fargo Bank building purchase and expansion, Farber settlement, Frog Pad Park, Teen Center, upgrades to the sewer plant, and Hercules Municipal Utility's infrastructure. The interest rate charged by the City to the Agency is based on the Board's resolution approved in the fiscal year ended June 30, 2009, which was 8% as of June 30, 2009.

NOTE 8 – PUBLIC EMPLOYEE RETIREMENT SYSTEM

Plan Description . The Agency participates in the City's pension plan. California Public Employees' Retirement System (PERS), an agent multiple-employer defined benefit pension plan. PERS provides retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries. PERS acts as a common investment and administrative agent for participating public entities within the State of California. Benefit provisions and all other requirements are established by state statute and City ordinance. Refer to the City's basic financial statements as of June 30, 2009, for detailed information regarding the pension plan.

NOTE 9 – COMMITMENTS

Hercules LLC - An agreement with Hercules LLC was established with the Agency to assist with development of a 206 acre mixed-use project consisting of 880 residential units, 6 acres of commercial, residential or mixed-use projects, and open space and park uses. Project Tax Increment is defined to include all increases in value over the base year amount of \$7,654,000, less statutory payments to affected taxing entities. The agreement states that the Agency shall pay the developer the first 75% of the unrestricted portion (net of affordable housing set aside and required payments to affected taxing entities), and the first 90% of the housing portion (affordable housing set aside) of the project tax increment funds for properties located within the project site. The financing term for these payments is for 45 years from the adoption date of Ordinance No. 351 or April 13, 1999.

Pro Media - To assist with development of a 57,600 square foot and a 27,000 square foot building at the Project Site, the Agency entered into an agreement with Pro Media Corporation. The Agreement provides for the owner to expend at least \$4 million in hard construction costs. The Agreement provides for the Agency to pay the owner 60% of the Project Tax Increment, as defined above, over the financing term. The financing term commences on the date any increased property tax assessment first becomes effective on the project site from any improvements, and ends on the earliest of the following: (i) fifteen years from the commencement of the financing term, (ii) termination of the agreement, (iii) expiration of the Redevelopment Plan, or (iv) the remaining life of the Agency.

NOTE 10 – CONTINGENCIES

The Agency is presently involved in certain matters of litigation that have arisen in the normal course of conducting Agency business. Agency management believes, based upon consultation with the Agency's Attorney, that these cases, in the aggregate, are not expected to result in a material adverse financial impact on the Agency. Additionally, Agency management believes that the Agency's insurance programs are sufficient to cover any potential losses should an unfavorable outcome materialize.

**HERCULES REDEVELOPMENT AGENCY
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2009**

NOTE 11 – INTERFUND ACTIVITY

The following represents the interfund activity of the Agency for the fiscal year ended June 30, 2009.

A. Advances To/From Other Funds

Funds	Interfund Receivable	Interfund Payable
Major Funds:		
Debt Service Fund	\$ -	\$ 5,399,758
Capital Projects Fund	5,399,758	
	<u>\$ 5,399,758</u>	<u>\$ 5,399,758</u>

B. Due To/From Other Funds

Funds	Interfund Receivable	Interfund Payable
Major Funds:		
Debt Service Fund	\$ -	\$ 2,146,788
Capital Projects Fund	2,146,788	
	<u>\$ 2,146,788</u>	<u>\$ 2,146,788</u>

B. Transfers To/From Other Funds

Funds	Transfers In	Transfers Out
Major Funds:		
Operating Special Revenue Fund	\$ 823,593	\$ 10,967,787
Affordable Housing Special Revenue Fund	394,394	1,952,379
Debt Service Fund	25,345,445	39,961,182
Capital Projects Fund	26,317,916	
	<u>\$ 52,881,348</u>	<u>\$ 52,881,348</u>

NOTE 12 – PRIOR PERIOD ADJUSTMENTS

A prior period adjustment of (\$196,104) was made on the Redevelopment Agency Capital Projects due to an understatement of due to the City of Hercules.

A prior period adjustment of (\$23,721,046) was made on the government-wide Statement of Activities due to an understatement of advances from the City of Hercules.

NOTE 13 – STEWARDSHIP, COMPLIANCE, AND ACCOUNTABILITY

Deficit Fund Balances/Net Assets

As of June 30, 2009 the Affordable Housing Special Revenue fund had deficit fund balances of (\$886,593). The deficit fund balances are expected to be eliminated in future years through tax increment revenue.

NOTE 14 – DEFICIT NET ASSETS

As of June 30, 2009, the Statement of Net Assets of the Hercules Redevelopment Agency has a deficit net assets balance of \$32,509,773. The Agency projects that future resources will be sufficient to pay long-term obligations as they become due.

REQUIRED SUPPLEMENTAL INFORMATION

**HERCULES REDEVELOPMENT AGENCY
REQUIRED SUPPLEMENTAL INFORMATION
JUNE 30, 2009**

1. BUDGETARY PRINCIPLES

In establishing the budgetary data reflected in the financial statements, the Agency follows the below listed procedures:

1. Public hearings are conducted to obtain public comments.
2. The Executive Director is authorized to transfer budgetary amounts within a single fund; however, any revisions that alter the total expenditures of any fund must be approved by the Agency Board.
3. Legally adopted budgets and formal budgetary integration is employed as a management control device during the year.
4. Budgets are adopted on a basis consistent with USGAAP.
5. Budgeted revenue amounts represent the original budget modified by adjustments authorized during the year. Budgeted expenditure amounts represent original appropriations adjusted for supplemental appropriations during the year which were contingent upon new or additional revenue sources and reappropriated amounts for prior year encumbrances. The Executive Director must approve adjustments to departmental budgets; however, management may amend the budgeted amounts within departmental expenditure classifications.
6. Certain appropriations carry over at the end of the fiscal year and then are rebudgeted for the coming fiscal year.

HERCULES REDEVELOPMENT AGENCY
SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE -
BUDGET AND ACTUAL
REDEVELOPMENT AGENCY OPERATING SPECIAL REVENUE FUND
For the Fiscal Year Ended June 30, 2009

	<u>Budgeted Amounts</u>			Variance with
	<u>Original</u>	<u>Final</u>	<u>Actual</u>	Final Budget Positive (Negative)
Revenues:				
Taxes and assessments	\$ 9,681,979	\$ 9,681,979	\$ 10,200,688	\$ 518,709
Use of money and property	40,000	40,000	(85,278)	(125,278)
Program income	231,000	231,000	213,699	(17,301)
Miscellaneous			28,812	28,812
	<u>9,952,979</u>	<u>9,952,979</u>	<u>10,357,921</u>	<u>404,942</u>
Expenditures:				
Current:				
Community development	5,194,281	7,408,084	4,791,222	2,616,862
	<u>5,194,281</u>	<u>7,408,084</u>	<u>4,791,222</u>	<u>2,616,862</u>
Excess of revenues over (under) expenditures	<u>4,758,698</u>	<u>2,544,895</u>	<u>5,566,699</u>	<u>3,021,804</u>
Other Financing Sources (Uses):				
Transfer out to the City of Hercules			(341,000)	(341,000)
Transfers in			823,593	823,593
Transfers out	(12,987,778)	(17,450,802)	(10,967,787)	6,483,015
	<u>(12,987,778)</u>	<u>(17,450,802)</u>	<u>(10,485,194)</u>	<u>6,965,608</u>
Net changes in fund balance	(8,229,080)	(14,905,907)	(4,918,495)	9,987,412
Fund balance - July 1, 2008	5,381,817	5,381,817	5,381,817	
Fund balance (deficit) - June 30, 2009	<u>\$ (2,847,263)</u>	<u>\$ (9,524,090)</u>	<u>\$ 463,322</u>	<u>\$ 9,987,412</u>

HERCULES REDEVELOPMENT AGENCY
SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE -
BUDGET AND ACTUAL
AFFORDABLE HOUSING SPECIAL REVENUE FUND
For the Fiscal Year Ended June 30, 2009

	<u>Budgeted Amounts</u>			Variance with Final Budget Positive (Negative)
	<u>Original</u>	<u>Final</u>	<u>Actual</u>	
Revenues:				
Taxes and assessments	\$ 2,420,495	\$ 2,420,495	\$ 2,550,172	\$ 129,677
Use of money and property	65,000	65,000	2,804	(62,196)
Program income	36,510	36,510	104,493	67,983
Charges for services	82,400	82,400	47,434	(34,966)
Miscellaneous			13,234	13,234
	<hr/>			
Total revenues	<u>2,604,405</u>	<u>2,604,405</u>	<u>2,718,137</u>	<u>113,732</u>
Expenditures:				
Current:				
Community development	<u>2,647,440</u>	<u>4,591,480</u>	<u>3,939,493</u>	<u>651,987</u>
	<hr/>			
Total expenditures	<u>2,647,440</u>	<u>4,591,480</u>	<u>3,939,493</u>	<u>651,987</u>
	<hr/>			
Excess of revenues over (under) expenditures	<u>(43,035)</u>	<u>(1,987,075)</u>	<u>(1,221,356)</u>	<u>765,719</u>
Other Financing Sources (Uses):				
Transfer out to the City of Hercules	(29,700)	(32,200)	(32,682)	(482)
Transfers in			394,394	394,394
Transfers out	<u>(1,071,017)</u>	<u>(2,757,778)</u>	<u>(1,952,379)</u>	<u>805,399</u>
	<hr/>			
Total other financing sources (uses)	<u>(1,100,717)</u>	<u>(2,789,978)</u>	<u>(1,590,667)</u>	<u>1,199,311</u>
	<hr/>			
Net changes in fund balance	(1,143,752)	(4,777,053)	(2,812,023)	1,965,030
	<hr/>			
Fund balance - July 1, 2008	<u>1,925,430</u>	<u>1,925,430</u>	<u>1,925,430</u>	
	<hr/>			
Fund balance (deficit) - June 30, 2009	<u>\$ 781,678</u>	<u>\$ (2,851,623)</u>	<u>\$ (886,593)</u>	<u>\$ 1,965,030</u>

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OTHER SUPPLEMENTAL INFORMATION

HERCULES REDEVELOPMENT AGENCY
SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE -
BUDGET AND ACTUAL
REDEVELOPMENT AGENCY DEBT SERVICE FUND
For the Fiscal Year Ended June 30, 2009

	<u>Final Budget</u>	<u>Actual</u>	Variance with Final Budget Positive (Negative)
Revenues:			
Use of money and property	\$ 2,285,000	\$ 2,123,455	\$ (161,545)
Total revenues	<u>2,285,000</u>	<u>2,123,455</u>	<u>(161,545)</u>
Expenditures:			
Current:			
Community development	9,891,103	2,764,615	7,126,488
Debt service:			
Principal	4,250,000	4,297,244	(47,244)
Interest and fiscal agent fees	<u>6,276,356</u>	<u>7,341,043</u>	<u>(1,064,687)</u>
Total expenditures	<u>20,417,459</u>	<u>14,402,902</u>	<u>6,014,557</u>
Excess of revenues over (under) expenditures	<u>(18,132,459)</u>	<u>(12,279,447)</u>	<u>5,853,012</u>
Other Financing Sources (Uses):			
Transfer out to the City of Hercules		(5,656,011)	(5,656,011)
Transfers in	20,178,580	25,345,445	5,166,865
Transfers out	<u>(55,703,942)</u>	<u>(39,961,182)</u>	<u>15,742,760</u>
Total other financing sources (uses)	<u>(35,525,362)</u>	<u>(20,271,748)</u>	<u>15,253,614</u>
Net changes in fund balance	(53,657,821)	(32,551,195)	21,106,626
Fund balance - July 1, 2008	<u>94,926,755</u>	<u>94,926,755</u>	
Fund balance - June 30, 2009	<u>\$ 41,268,934</u>	<u>\$ 62,375,560</u>	<u>\$ 21,106,626</u>

HERCULES REDEVELOPMENT AGENCY
SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE -
BUDGET AND ACTUAL
REDEVELOPMENT AGENCY CAPITAL PROJECTS FUND
For the Fiscal Year Ended June 30, 2009

	Final Budget	Actual	Variance with Final Budget Positive (Negative)
Revenues:			
Miscellaneous	\$ -	\$ 49,688	\$ 49,688
Total revenues		49,688	49,688
Expenditures:			
Capital outlay	89,084,720	31,029,330	58,055,390
Debt service:			
Interest and fiscal agent fees		746,990	(746,990)
Total expenditures	89,084,720	31,776,320	57,308,400
Excess of revenues over (under) expenditures	(89,084,720)	(31,726,632)	57,358,088
Other Financing Sources (Uses):			
Transfer in from the City of Hercules	7,303,294	5,827,890	(1,475,404)
Transfers in	55,733,942	26,317,916	(29,416,026)
Total other financing sources (uses)	63,037,236	32,145,806	(30,891,430)
Net changes in fund balance	(26,047,484)	419,174	26,466,658
Fund balance - July 1, 2008	5,086,540	5,086,540	
Prior period adjustments		(196,104)	(196,104)
Fund balance - July 1, 2008, restated	5,086,540	4,890,436	(196,104)
Fund balance - June 30, 2009	<u>\$ (20,960,944)</u>	<u>\$ 5,309,610</u>	<u>\$ 26,270,554</u>



PARTNERS
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**INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL
OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS
BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE
WITH *GOVERNMENT AUDITING STANDARDS***

Members of the Board of the Hercules Redevelopment Agency
Hercules Redevelopment Agency
Hercules, California

We have audited the accompanying financial statements of the governmental activities and each major fund of the Hercules Redevelopment Agency (Agency), a component unit of the City of Hercules, California (City) as of and for the fiscal year ended June 30, 2009, and have issued our report thereon dated December 23, 2009. 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.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Agency's internal control over financial reporting as a basis for designing auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Agency's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Agency's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects Agency's ability to initiate, authorize, record, process, or report financial data reliably in accordance with accounting principles generally accepted in the United States of America such that there is more than a remote likelihood that a misstatement of Agency's financial statements that is more than inconsequential will not be prevented or detected by Agency's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the Agency's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Agency's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. Such provisions include those provisions of laws and regulations identified in the *Guidelines for Compliance Audits of California Redevelopment Agencies* issued by the California State Controller. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of management, others within the organization, Board of Directors, bond trustees, and the California State Controller's Office Division of Accounting and Reporting, and is not intended to be and should not be used by anyone other than these specified parties.

Moss, Levy & Hartzheim

Moss, Levy & Hartzheim, LLP
Beverly Hills, California
December 23, 2009

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APPENDIX C

SUMMARY OF PRINCIPAL LEGAL DOCUMENTS

The following definitions and summaries of the Indenture and the Installment Sale Agreement are summaries only and are not to be considered full descriptions thereof. Reference is made to further provisions of the documents described in the body of this Official Statement, and to the documents themselves.

DEFINITIONS

“Acquisition and Construction” means, with respect to any of the Improvements, the acquisition, construction, improvement, equipping, renovation, remodeling or reconstruction thereof.

“Acquisition and Construction Costs” means, with respect to the Improvements, all costs of the Acquisition and Construction thereof which are paid from moneys on deposit in the Acquisition and Construction Fund, including but not limited to:

(a) all costs required to be paid to any person under the terms of any agreement for or relating to the Acquisition and Construction of the Improvements;

(b) obligations incurred for labor and materials in connection with the Acquisition and Construction of the Improvements;

(c) the cost of performance or other bonds and any and all types of insurance that may be necessary or appropriate to have in effect in connection with the Acquisition and Construction of the Improvements;

(d) all costs of engineering and architectural services, including the actual out-of-pocket costs for test borings, surveys, estimates, plans and specifications and preliminary investigations therefor, development fees, sales commissions, and for supervising construction, as well as for the performance of all other duties required by or consequent to the proper Acquisition and Construction of the Improvements;

(e) any sums required to reimburse the Authority or the City for advances made for any of the above items or for any other costs incurred and for work done which are properly chargeable to the Acquisition and Construction of the Improvements;

(f) all financing costs incurred in connection with the Acquisition and Construction of the Improvements, including but not limited to Costs of Issuance and other costs incurred in connection with the Installment Sale Agreement and the financing of the Improvements; and

(g) the interest components of the Installment Payments during the period of Acquisition and Construction of the Improvements, to the extent not paid from the proceeds of the Bonds deposited in the Interest Account pursuant to the Indenture.

“Additional Payments” means the amounts payable by the City pursuant to the Installment Sale Agreement.

“Additional Revenues” means, with respect to the issuance of any Parity Obligations, any or all of the following amounts:

(i) An allowance for Net Revenues from any additions or improvements to or extensions of the Electric System to be financed from the proceeds of such Parity Obligations or from any other source, all in an amount equal to seventy-five percent (75%) of the estimated additional Net Revenues to be derived from such additions, improvements and extensions for the first twelve (12) month period in which each addition, improvement or extension is respectively to be in operation, all as shown by the certificate or opinion of a qualified independent engineer employed by the City.

(ii) An allowance for Net Revenues arising from any increase in the charges made for service from the Electric System which has become effective prior to the incurring of such Parity Obligations, in an amount equal to the total amount by which the Net Revenues would have been increased if such increase in charges had been in effect during the whole of the most recent completed Fiscal Year or during any more recent twelve (12) month period selected by the City, all as shown by the certificate or opinion of an Independent Accountant.

“Agency” means the Hercules Redevelopment Agency.

“Annual Debt Service” means, for each Bond Year with respect to each of the Bonds, the sum of (a) the interest payable on the Outstanding Bonds in such Bond Year, and (b) the principal amount of the Outstanding Bonds scheduled to be paid in such Bond Year, including from mandatory sinking fund payments.

“Authority” means the Hercules Public Financing Authority, a public body corporate and politic duly organized and existing pursuant to a Joint Exercise of Powers Agreement, dated as of July 24, 2001, between the City and the Agency.

“Authorized Investments” means any securities in which the City may legally invest funds subject to its control.

“Authorized Representative” means: (a) with respect to the Authority, its President, Vice President, Treasurer, Executive Director, Secretary or any other person designated as an Authorized Representative of the Authority by a Written Certificate of the Authority signed by its President, Vice President, Treasurer, Controller or Executive Director and filed with the City and the Trustee; and (b) with respect to the City, its Mayor, Mayor Pro Tem, City Manager, Finance Director, City Clerk or any other person designated as an Authorized Representative of the City by a Written Certificate of the City signed by its Mayor, Mayor Pro Tem, City Manager, Finance Director or City Clerk and filed with the Trustee.

“Bond Counsel” means (a) Fulbright & Jaworski L.L.P., or (b) any other attorney or firm of attorneys appointed by or acceptable to the City of nationally recognized experience in the issuance of obligations the interest on which is excludable from gross income for federal income tax purposes under the Tax Code.

“Bond Law” means the Marks-Roos Local Bond Pooling Act of 1985, constituting Article 4 (commencing with Section 6584) of Chapter 5 of Division 7 of Title 1 of the Government Code of the State, as in existence on the Closing Date or as thereafter amended from time to time.

“Bond Year” means any twelve-month period commencing on August 2 in a year and ending on the next succeeding August 1, both dates inclusive; except that the first Bond Year shall commence on the Closing Date and end on August 1, 2011.

“Business Day” means a day (other than a Saturday or a Sunday) on which banks are not required or authorized to remain closed in the city in which the Office of the Trustee is located.

“City Advances” means amounts advanced by the City pursuant to the Cooperation Agreement.

“Closing Date” means the date of delivery of the Bonds to the Original Purchaser.

“Costs of Issuance” means all items of expense directly or indirectly relating to the authorization, issuance, sale and delivery of the Bonds, including but not limited to printing expenses, rating agency fees, filing and recording fees, fees, expenses and charges of the City, the Authority, the Trustee, and their respective counsel, including the Trustee’s first annual administrative fee, costs of obtaining a Qualified Reserve Fund Credit Instrument or Permitted Investment for monies held in the funds and accounts created and held under the Indenture, fees, charges and disbursements of attorneys, financial advisors, accounting firms, consultants and other professionals, fees and charges for preparation, execution and safekeeping of the Bonds and any other cost, charge or fee in connection with the original issuance of the Bonds and the execution and delivery of the Installment Sale Agreement.

“Depository” means DTC and its successors and assigns or if (a) the then Depository resigns from its functions as securities depository of the Bonds, or (b) the Authority discontinues use of the Depository pursuant to the Indenture, any other securities depository which agrees to follow the procedures requested to be followed by a securities depository in connection with the Bonds and which is selected by the Authority with the consent of the Trustee.

“Depository Participant” means a member of, or participant in, the Depository.

“DTC” means The Depository Trust Company, New York, New York, and its successors and assigns.

“Electric System” means the entire electric system of the City, including all facilities, properties and improvements at any time owned, controlled or operated by the City for the provision of electricity, and any necessary lands, rights, entitlements and other property useful in connection therewith, together with all extensions thereof and improvements thereto at any time acquired, constructed or installed by the City, including the Improvements.

“Electric Utility Fund” means the fund by that name established and held by the City under the Installment Sale Agreement.

“Fair Market Value” means the price at which a willing buyer would purchase the investment from a willing seller in a bona fide, arm’s length transaction (determined as of the date the contract to purchase or sell the investment becomes binding) if the investment is traded on an established securities market (within the meaning of section 1273 of the Tax Code) and, otherwise, the term “fair market value” means the acquisition price in a bona fide arm’s length transaction (as referenced above) if (i) the investment is a certificate of deposit the value of which is determined in accordance with applicable regulations under the Tax Code, (ii) the investment is an agreement with specifically negotiated withdrawal or reinvestment provisions and a specifically negotiated interest rate (for example, a guaranteed investment contract, a forward supply contract or other investment agreement) the value of which is determined in accordance with applicable regulations under the Tax Code, (iii) the investment is a United States Treasury Security-State and Local Government Series that is acquired in accordance with applicable regulations of the United States Bureau of Public Debt, or (iv) the investment is the Local Agency Investment Fund of the State of California, but only if at all times during which the investment is held its yield is reasonably expected to be equal to or greater than the yield on a reasonably comparable direct obligation of the United States.

“Gross Revenues” means all income, rents, rates, fees, charges and other moneys derived from the ownership or operation of the Electric System, including, without limiting the generality of the foregoing, (1) all income, rents, rates, fees, charges, business interruption insurance proceeds or other moneys derived by the City from the sale, furnishing and supplying of electric or other services, facilities, and commodities sold, furnished or supplied through the facilities of or in the conduct or operation of the business of the Electric System (other than the non-by-passable usage based charge supporting the City’s public benefit program), plus (2) the earnings on and income derived from the investment of such income, rents, rates, fees, charges, or other moneys, including City reserves and the Reserve Fund established under the Indenture, but excluding in all cases customer deposits or any other deposits or advances subject to refund until such deposits or advances have become the property of the City, any proceeds of taxes required by law to be used by the City to pay bonds issued thereafter, and any amounts reimbursed to the City by the United States of America pursuant to Section 54AA of the Tax Code, or any future similar program.

“Improvements” means the capital improvements to the Electric System as described in Exhibit B attached to the Installment Sale Agreement, as such description may be amended by the City from time to time pursuant to and in accordance with the Installment Sale Agreement.

“Independent Accountant” means any accountant or firm of such accountants appointed and paid by the City or the Authority, and who, or each of whom (a) is in fact independent and not under domination of the City or the Authority; (b) does not have any substantial interest, direct or indirect, with the City or the Authority; and (c) is not connected with the City or the Authority as an officer or employee of the City or the Authority, but who may be regularly retained to make annual or other audits of the books of or reports to the City or the Authority.

“Information Services” means Electronic Municipal Market Access System (referred to as “EMMA”), a facility of the Municipal Securities Rulemaking Board, at www.emma.msrb.org; provided, however, in accordance with then current guidelines of the Securities and Exchange Commission, Information Services shall mean such other organizations providing information with respect to called Bonds as the Authority may designate in writing to the Trustee.

“Installment Payment Date” means June 1 and December 1 of each year, commencing December 1, 2010.

“Installment Payments” means the payments required to be paid by the City pursuant to the Installment Sale Agreement, including all prepayments thereof.

“Interest Payment Date” means February 1 and August 1 in each year, beginning February 1, 2011, and continuing so long as any Bonds remain Outstanding.

“Maximum Annual Debt Service” means the largest of the sums obtained for any Bond Year after totaling the following for each such Bond Year:

A. The principal amount of all Outstanding Bonds maturing or required to be redeemed by mandatory sinking account redemption in such year; and

B. The interest which would be due during such year on the aggregate principal amount of Bonds which would be Outstanding in such year if the Bonds Outstanding on the date of such computation were to mature or be redeemed in accordance with the applicable maturity or mandatory sinking account redemption schedule. At the time and for the purpose of making such computation, the amount of Bonds already retired in advance of the above mentioned schedule or schedules shall be deducted pro rata from the remaining amounts thereon.

“Moody’s” means Moody’s Investors Service, a corporation organized and existing under the laws of the State of Delaware, its successors and their assigns, or, if such corporation shall be dissolved or liquidated or shall no longer perform the functions of a securities rating agency, any other nationally recognized securities rating agency designated by the Authority.

“Net Revenues” means, for any period, an amount equal to all of the Gross Revenues received during such period minus the amount required to pay all Operation and Maintenance Costs becoming payable during such period.

“Nominee” means the nominee of the Depository, which may be the Depository, as determined from time to time pursuant to the Indenture.

“Office” means the corporate trust office of the Trustee in Los Angeles, California, or at such other or additional offices as may be specified in writing to the Authority and the City except that with respect to presentation of Bonds for payment or for registration of transfer and exchange such term shall mean the office or agency of the Trustee at which, at any particular time, its corporate trust agency business shall be conducted.

“Operation and Maintenance Costs” means the reasonable and necessary costs and expenses paid by the City for maintaining and operating the Electric System, including but not limited to (a) the cost of utilities, including electricity and other forms of energy supplied to the Electric System, (b) the reasonable expenses of management and repair and other costs and expenses necessary to maintain and preserve the Electric System in good repair and working order and (c) the reasonable administrative costs of the City attributable to the operation and maintenance of the Electric System, including insurance and other costs described in the Installment Sale Agreement, but in all cases excluding (i) debt service payable on obligations incurred by the City with respect to the Electric System, including but not limited to the Installment Payments and debt service payments on any Parity Obligations, (ii) depreciation, replacement and obsolescence charges or reserves therefor, and (iii) amortization of intangibles or other bookkeeping entries of a similar nature, (iv) City’s public benefit program expenditures, and (v) periodic administrative transfers to the City’s general fund.

“Original Purchaser” means Chilton & Associates as the original purchaser of the Bonds upon their delivery by the Trustee on the Closing Date.

“Outstanding”, when used as of any particular time with reference to Bonds, means all Bonds theretofore, or thereupon being, authenticated and delivered by the Trustee under the Indenture, except: (a) Bonds theretofore canceled by the Trustee or surrendered to the Trustee for cancellation; (b) Bonds with respect to which all liability of the Authority shall have been discharged in accordance with the Indenture; and (c) Bonds for the transfer or exchange of or in lieu of or in substitution for which other Bonds shall have been authenticated and delivered by the Trustee pursuant to the Indenture.

“Owner”, when used with respect to any Bond, means the person in whose name the ownership of such Bond shall be registered on the Registration Books.

“Parity Obligations” means any leases, loan agreements, installment sale agreements, bonds, notes or other obligations of the City payable from and secured by a pledge of and lien upon any of the Net Revenues on a parity with the Installment Payments, entered into or issued pursuant to and in accordance with the Installment Sale Agreement.

“Permitted Investments” means any of the following which at the time of investment are legal investments under the laws of the State for the moneys proposed to be invested therein (the Trustee is entitled to conclusively rely upon a Written Request of the City directing investments as a certification to

the Trustee that such investments are legal investment), but only to the extent that the same are acquired at Fair Market Value:

(1) Direct obligations of the United States of America (including obligations issued or held in book-entry form on the books of the Department of the Treasury of the United States of America) or obligations the timely payment of the principal of and interest on which are fully guaranteed by the United States of America, including instruments evidencing a direct ownership interest in securities described in this clause such as Stripped Treasury Coupons rated or assessed in the highest Rating Category by S&P and Moody's and held by a custodian for safekeeping on behalf of holders of such securities.

(2) Bonds or notes which are exempt from federal income taxes and for the payment of which cash or obligations described in clause (1) of this definition in an amount sufficient to pay the principal of, premium, if any, and interest on when due have been irrevocably deposited with a trustee or other fiscal depository and which are rated in the highest Rating Category by S&P and Moody's.

(3) Obligations, debentures, notes or other evidence of indebtedness issued or guaranteed by any of the following: Federal Home Loan Bank System, Government National Mortgage Association, Farmer's Home Administration, Federal Home Loan Mortgage Corporation or Federal Housing Administration; provided that with respect to the funds and accounts established under the Indenture, such obligations shall at no time exceed an amount equal to ten percent (10%) of the aggregate principal amount of the Bonds Outstanding.

(4) Deposit accounts, certificates of deposit or savings accounts (i) fully insured by the Federal Deposit Insurance Corporation or (ii) with banks whose short term obligations are rated no lower than A-1 by S&P and P-1 by Moody's, including those of the Trustee and its affiliates.

(5) Federal funds or banker's acceptances with a maximum term of one year of any bank that has an unsecured, uninsured and unguaranteed obligation rating of "Prime-1" or "A3" by Moody's and "A-1" or "A" or better by S&P (including the Trustee and its affiliates).

(6) Repurchase obligations with a term not exceeding 30 days pursuant to a written agreement between the Trustee and either a primary dealer on the Federal Reserve reporting dealer list which falls under the jurisdiction of the SIPC or a federally chartered commercial bank whose long-term debt obligations are rated A or better by S&P and Moody's, with respect to any security described in clause (1); provided that the securities which are the subject of such repurchase obligation (i) must be free and clear of all liens, (ii) in the case of a SIPC dealer, were not acquired pursuant to a repurchase or reverse repurchase agreement, (iii) must be deposited with the Trustee and maintained through weekly market valuations in an amount equal to 104% of the invested funds plus accrued interest; and further provided that the Trustee must have a valid first perfected security interest in such securities.

(7) Taxable government money market portfolios that have a rating by S&P of Am-G or Am or better and rated in one of the three highest rating categories of Moody's consisting of securities issued or guaranteed as to payment of principal and interest by the full faith and credit of the United States, subject to a maximum permissible limit equal to six months of principal and interest on the Bonds, including those portfolios of the Trustee and its affiliates.

(8) Tax-exempt government money market portfolios that have a rating by S&P of Am-G or Am or better and rated in one of the three highest rating categories of Moody's consisting of securities which are rated in the highest Rating Categories of S&P and Moody's subject to a maximum permissible limit equal to six months of principal and interest on the Bonds.

(9) Money market funds registered under the Investment Company Act of 1940, the shares in which are registered under the Securities Act of 1933 and that have a rating by S&P of AAAM-G or AAAM and rated in one of the two highest Rating Categories of Moody's, including those managed or advised by the Trustee or its affiliates.

(10) The Local Agency Investment Fund of the State, created pursuant to Section 16429.1 of the California Government Code, to the extent the Trustee is authorized to register such investment in its name.

(11) Investment agreements with a domestic or foreign bank or corporation the long-term debt or claims paying ability of which, or, in the case of a guaranteed corporation the long-term debt, or, in the case of a monoline financial guaranty insurance company, claims paying ability, of the guarantor is rated at least "AA" by S&P and "Aa" by Moody's; provided that by the terms of the investment agreement:

(a) interest payments are to be made to the Trustee at times and in amounts as necessary to pay debt service on the Bonds;

(b) the invested funds are available for withdrawal without penalty or premium, pursuant to the investment agreement upon not more than seven days' prior notice; the Authority and the Trustee agree to give or cause to be given notice in accordance with the terms of the investment agreement so as to receive funds thereunder with no penalty or premium paid;

(c) the investment agreement shall state that it is the unconditional and general obligation of, and is not subordinated to any other general unsecured obligation of, the provider thereof;

(d) the Authority or the Trustee receives the opinion of domestic counsel (which opinion shall be addressed to the Authority and the Trustee) that such investment agreement is legal, valid, binding and enforceable upon the provider in accordance with its terms and of foreign counsel (if applicable) in form and substance acceptable, and addressed to, the Trustee and Authority;

(e) the investment agreement shall provide that if during its term

(i) the provider's (or its guarantor's) rating by either S&P or Moody's falls below "AA" or "Aa", respectively, the provider shall, at its option, within 10 days of receipt of publication of such downgrade, either (i) collateralize the investment agreement by delivering or transferring in accordance with applicable state and federal laws (other than by means of entries on the provider's books) to the Authority, the Trustee or a third party acting solely as agent therefor (the "Holder of the Collateral") collateral free and clear of any third-party liens or claims the market value of which collateral is maintained at levels and upon such conditions as would be acceptable to S&P and Moody's to maintain an "A" rating in an "A" rated structured financing (with a market value

approach); or (ii) repay the principal of and accrued but unpaid interest on the investment, and

(ii) the provider's (or its guarantor's) rating by either S&P or Moody's is withdrawn or suspended or falls below "A" or "A", respectively, the provider must at the direction of the Authority or the Trustee, within 10 days of receipt of such direction, repay the principal of and accrued but unpaid interest on the investment, in either case with no penalty or premium to the Authority or Trustee: and

(f) the investment agreement shall state and an opinion of counsel shall be rendered, in the event collateral is required to be pledged by the provider under the terms of the investment agreement, at the time such collateral is delivered, that the Holder of the Collateral has a perfected first priority security interest in the collateral, any substituted collateral and all proceeds thereof (in the case of bearer securities, this means the Holder of the Collateral is in possession);

(g) the investment agreement must provide that if during its term

(i) the provider shall default in its payment obligations, the provider's obligations under the investment agreement shall, at the direction of the Authority or the Trustee, be accelerated and amounts invested and accrued but unpaid interest thereon shall be repaid to the Authority or Trustee, as appropriate, and

(ii) the provider shall become insolvent, not pay its debts as they become due, be declared or petition to be declared bankrupt, etc. ("event of insolvency"), the provider's obligations shall automatically be accelerated and amounts invested and accrued but unpaid interest thereon shall be repaid to the Authority or Trustee, as appropriate.

"Purchase Price" means the amount to be paid by the City under the Installment Sale Agreement as the purchase price of the Improvements, being equal to the aggregate principal amount of the Bonds.

"Qualified Reserve Fund Credit Instrument" means an irrevocable standby or direct-pay letter of credit or surety bond issued by a commercial bank or insurance company and deposited with the Trustee pursuant to the Indenture provided that all of the following requirements are met: (i) the long-term credit rating of such bank or insurance company at the time of delivery of such letter of credit or surety bond is rated in one of the two highest rating categories by Moody's and S&P; (ii) such letter of credit or surety bond has a term of at least twelve (12) months; (iii) such letter of credit or surety bond has a stated amount at least equal to the portion of the Reserve Requirement with respect to which funds are proposed to be released pursuant to the Indenture; and (iv) the Trustee is authorized pursuant to the terms of such letter of credit or surety bond to draw thereunder an amount equal to any deficiencies which may exist from time to time in the amounts available to repay the principal of and interest on the Bonds.

"Record Date" means, with respect to any Interest Payment Date, the fifteenth (15th) calendar day of the month preceding such Interest Payment Date.

"Registration Books" means the books maintained by the Trustee pursuant to the Indenture for the registration and transfer of ownership of the Bonds.

“Reserve Requirement” means, as of any date of calculation by the City, the least of (i) ten percent (10%) of the proceeds (within the meaning of section 148 of the Tax Code) of the Bonds; (ii) 125% of average Annual Debt Service of any Bond Year on the then Outstanding Bonds; or (iii) the Maximum Annual Debt Service for that and any subsequent year.

“Responsible Officer” means any Vice President, Assistant Vice President or Trust Officer or any other officer of the Trustee having regular responsibility for corporate trust matters related to the Indenture.

“Revenues” means (a) all amounts received by the Authority or the Trustee pursuant or with respect to the Installment Sale Agreement, including, without limiting the generality of the foregoing, all of the Installment Payments (including both timely and delinquent payments, any late charges, and whether paid from any source), prepayments, insurance proceeds, and condemnation proceeds, but excluding any Additional Payments; (b) City Advances; (c) all moneys and amounts held in the funds and accounts established under the Indenture; and (d) investment income with respect to any moneys held by the Trustee under the Indenture.

“S&P” means Standard & Poor’s Ratings Services, a division of McGraw-Hill, Inc., a corporation organized and existing under the laws of the State of New York, its successors and their assigns, or, if such corporation shall be dissolved or liquidated or shall no longer perform the functions of a securities rating agency, any other nationally recognized securities rating agency designated by the Authority.

“Securities Depositories” means The Depository Trust Company, 55 Water Street, New York, New York 10041, Fax: (212) 855-1000 or 7320; and, in accordance with then current guidelines of the Securities and Exchange Commission, such other addresses and/or such other securities depositories as the Authority may designate in a Written Request of the Authority delivered to the Trustee.

“State” means the State of California.

“Supplemental Indenture” means any indenture, agreement, resolution or other instrument duly adopted or executed in accordance with the provisions of the Indenture.

“Tax Code” means the Internal Revenue Code of 1986 as in effect on the date of issuance of the Bonds or (except as otherwise referenced in the Indenture) as it may be amended to apply to obligations issued on the date of issuance of the Bond, together with applicable proposed, temporary and final regulations promulgated, and applicable official public guidance published, under the Tax Code.

“Tax Regulations” means temporary and permanent regulations promulgated under or with respect to Section 103 of the Tax Code.

“Trustee” means The Bank of New York Mellon Trust Company, N.A. appointed by the Authority to act as trustee pursuant to the Indenture, and its assigns or any other corporation or association which may at any time be substituted in its place, as provided therein.

“Written Certificate”, “Written Request” and “Written Requisition” of the Authority or the City mean, respectively, a written certificate, request or requisition signed in the name of the Authority or the City by its Authorized Representative. Any such instrument and supporting opinions or representations, if any, may, but need not, be combined in a single instrument with any other instrument, opinion or representation, and the two or more so combined shall be read and construed as a single instrument.

THE INDENTURE

Receipt, Deposit and Application of Revenues

Except as provided in the Indenture with regard to the deposit of earnings on investments, all of the Revenues (other than City Advances) shall be deposited by the Trustee immediately upon receipt in the Revenue Fund (which the Trustee shall establish and hold in trust under the Indenture). Amounts in the Revenue Fund shall be applied solely for the uses and purposes set forth in the Indenture. The Trustee shall withdraw amounts on deposit in the Revenue Fund and apply such amounts at the times and for the purposes, and in the priority, as follows:

(a) Bond Service Fund. On or before 60 days prior to each Interest Payment Date, so long as any Bonds remain Outstanding, the Trustee shall withdraw from the Revenue Fund and deposit into the Bond Service Fund (which the Trustee shall establish and hold in trust) an amount which, together with other available amounts then on deposit in the Bond Service Fund, is at least equal to the sum of (i) the aggregate amount of principal of and interest coming due and payable on the Bonds on such Interest Payment Date, and (ii) the redemption price of the Term Bonds coming due and payable on such Interest Payment Date by operation of mandatory sinking fund redemption pursuant to the Indenture.

Amounts in the Bond Service Fund shall be applied by the Trustee solely for the purpose of paying principal of and interest on the Outstanding Bonds when and as such principal and interest becomes due and payable (including accrued interest on any Bonds purchased or redeemed pursuant to the Indenture), and for the purpose of paying the principal of the Term Bonds at the maturity thereof or upon the mandatory sinking fund redemption thereof pursuant to the Indenture.

If after all of the Bonds have been paid or deemed to have been paid, there are moneys remaining in the Bond Service Fund, such moneys shall be transferred by the Trustee to the City, after the payment of any outstanding fees and expenses of the Trustee.

(b) Reserve Fund. In the event that the amount on deposit in the Reserve Fund at any time falls below the Reserve Requirement, the Trustee shall promptly notify the City and the Authority of such fact and the Trustee shall promptly (i) withdraw the amount of such insufficiency from available Revenues on deposit in the Revenue Fund, and (ii) transfer such amount to the Reserve Fund. No deposit need be made in the Reserve Fund so long as the balance therein at least equals the Reserve Requirement.

(c) City Advance Reimbursement Fund. On August 2 of each year, the Trustee shall deposit in the City Advance Reimbursement Fund, amounts required to reimburse the City Advances pursuant to the Cooperation Agreement and the Indenture.

(d) Redemption Fund. The Trustee shall deposit into the Redemption Fund all amounts required to redeem any Bonds which are subject to special mandatory redemption and redemption from prepayments of base rental pursuant to the Indenture, when and as such amounts become available. Amounts in the Redemption Fund shall be applied by the Trustee solely for the purpose of paying the redemption price of Bonds to be redeemed pursuant to the provisions of the Indenture governing special mandatory redemption. Following any redemption of all of the Bonds, any moneys remaining in the Redemption Fund shall be transferred by the Trustee to the City.

Investments

All moneys in any of the funds or accounts established with the Trustee pursuant to the Indenture shall be invested by the Trustee solely in Permitted Investments, as directed by the Authority. In the absence of any such directions from the Authority, the Trustee shall invest any such moneys in Permitted Investments described in paragraph (9) of the definition thereof; provided, however, that any such investment shall be made by the Trustee only if, prior to the date on which such investment is to be made, the Trustee shall have received a Written Request of the City specifying a specific money market fund that satisfies the requirements of said paragraph in which such investment is to be made and, if no such Written Request of the City is so received, the Trustee shall hold such moneys uninvested. Obligations purchased as an investment of moneys in any fund shall be deemed to be part of such fund or account. All interest or gain derived from the investment of amounts in any of the funds or accounts established under the Indenture shall be deposited in the fund or account from which such investment was made; except that all interest or gain derived from the investment of amounts in the Reserve Fund shall be deposited in the Bond Service Fund to the extent not required to maintain the Reserve Requirement on deposit in the Reserve Fund. For purposes of acquiring any investments under the Indenture, the Trustee may commingle funds held by it under the Indenture. The Trustee may act as sponsor, principal or agent in the acquisition or disposition of any investment. The Trustee shall incur no liability for losses arising from any investments made pursuant to the Indenture.

The Trustee may sell, or present for prepayment, any Permitted Investment so purchased by the Trustee whenever it shall be necessary in order to provide moneys to meet any required payment, transfer, withdrawal or disbursement from the fund to which such Permitted Investment is credited, and the Trustee shall not be liable or responsible for any loss resulting from any such Permitted Investment.

Acquisition, Disposition and Valuation of Investments

All investments of amounts deposited in any fund or account created by or pursuant to the Indenture, or otherwise containing gross proceeds of the Bonds (within the meaning of section 148 of the Tax Code) shall be acquired and disposed of (as of the date that valuation is required by the Indenture or the Tax Code) at Fair Market Value. Except as required by the covenants to maintain tax-exempt status contained in the Indenture, the value of investments shall be determined as of the end of each month, and shall be calculated as follows: (a) as to investments the bid and asked prices of which are published on a regular basis in The Wall Street Journal (or, if not there, then in The New York Times): the average of the bid and asked prices for such investments so published on or most recently prior to such time of determination; (b) as to investments the bid and asked prices of which are not published on a regular basis in The Wall Street Journal or The New York Times: the average bid price at such time of determination for such investments by any two nationally recognized government securities dealers (selected by the Trustee in its absolute discretion) at the time making a market in such investments or the bid price published by a nationally recognized pricing service; (c) as to certificates of deposit and bankers acceptances: the face amount thereof, plus accrued interest; and (d) as to any investment not specified above: the value thereof established by prior agreement between the Authority and the Trustee.

Deposit of City Advances

If, 60 days prior to any Interest Payment Date, the amount available in the Bond Service Fund shall be less than the amount of interest due with respect to the Bonds on such Interest Payment Date, or the amount available in the Bond Service Fund shall be less than the amount of the principal (including sinking account payment) due on such Interest Payment Date, the Trustee shall notify the City of the amount of such deficiency and shall request the City to make the payment required under the Cooperation Agreement. Upon receipt thereof, the Trustee shall deposit such payment in the Bond Service Fund. All amounts so received by the Trustee from the City shall be deemed City Advances.

City Advance Reimbursement Fund

The Trustee shall establish, maintain and hold a separate fund to be known as the “City Advance Reimbursement Fund.” The Trustee shall use all amounts deposited in the City Advance Reimbursement Fund, as such amounts become available, to reimburse the City for all outstanding City Advances, plus interest accrued thereon. City Advances shall accrue interest at the yield on the Bonds, as calculated by the Authority, until repaid.

Covenants of the Authority; Special Tax Covenants

Punctual Payment; Compliance With Documents. The Authority shall punctually pay or cause to be paid the interest and principal to become due with respect to all of the Bonds in strict conformity with the terms of the Bonds and of the Indenture, and will faithfully observe and perform all of the conditions, covenants and requirements of the Indenture and all Supplemental Indentures.

Extension of Payment of Bonds. The Authority 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 under the Indenture, to the benefits of the Indenture, except subject to the prior payment in full of the principal of all of the Bonds then Outstanding and of all claims for interest thereon which shall not have been so extended. Nothing in the Indenture shall be deemed to limit the right of the Authority 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.

Against Encumbrances. The Authority shall not create, or permit the creation of, any pledge, lien, charge or other encumbrance upon the Revenues and other assets pledged or assigned under the Indenture while any of the Bonds are Outstanding, except the pledge and assignment created by the Indenture. Subject to this limitation, the Authority expressly reserves the right to enter into one or more other indentures for any of its corporate purposes, and reserves the right to issue other obligations for such purposes.

Power to Issue Bonds and Make Pledge and Assignment. The Authority is duly authorized pursuant to law to issue the Bonds and to enter into the Indenture and to pledge and assign the Revenues and other assets purported to be pledged and assigned, respectively, under the Indenture in the manner and to the extent provided in the Indenture. The Bonds and the provisions of the Indenture are and will be the legal, valid and binding special obligations of the Authority in accordance with their terms, and the Authority and the Trustee shall at all times, subject to the provisions of the Indenture and to the extent permitted by law, defend, preserve and protect said pledge and assignment of Revenues and other assets and all the rights of the Bond Owners under the Indenture against all claims and demands of all persons whomsoever.

Accounting Records and Financial Statements. The Trustee shall at all times keep, or cause to be kept, proper books of record and account, prepared in accordance with corporate trust industry standards, in which complete and accurate entries shall be made of all transactions made by it relating to the proceeds of Bonds, the Revenues, the Installment Sale Agreement and all funds and accounts held by the Trustee under the Indenture. Such books of record and account shall be available for inspection by the Authority and the City, during business hours and under reasonable circumstances.

No Additional Obligations. The Authority covenants that no additional bonds, notes or other indebtedness shall be issued or incurred which are payable out of the Revenues in whole or in part.

Tax Covenants Relating to Bonds. The Authority and the City shall not use, permit the use of, or omit to use Gross Proceeds or any other amounts (or any property the acquisition, construction or improvement of which is to be financed or refinanced directly or indirectly with Gross Proceeds) in a manner that if made or omitted, respectively, would cause the interest on any of the Bonds to become includable in the gross income, as defined in section 61 of the Code, of the owner thereof for federal income tax purposes.

Installment Sale Agreement. The Trustee shall promptly collect all amounts due from the City pursuant to the Installment Sale Agreement. Subject to the provisions of the Indenture, the Trustee shall enforce, and take all steps, actions and proceedings which the Trustee determines to be reasonably necessary for the enforcement of all of its rights thereunder as assignee of the Authority and for the enforcement of all of the obligations of the City under the Installment Sale Agreement.

Waiver of Laws. The Authority 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 thereafter in force that may affect the covenants and agreements contained in the Indenture or in the Bonds, and all benefit or advantage of any such law or laws is thereby expressly waived by the Authority to the extent permitted by law.

Further Assurances. The Authority will adopt, make, execute and deliver any and all such further resolutions, instruments and assurances as may be reasonably necessary or proper to carry out the intention or to facilitate the performance of the Indenture, and for the better assuring and confirming unto the Trustee and Owners of the Bonds the rights and benefits provided in the Indenture.

Continuing Disclosure. The City covenants and agrees that it will comply with the continuing disclosure requirements with respect to the Bonds promulgated under Securities and Exchange Commission Rule 15c2-12(b)(5) as it may from time to time thereafter be amended or supplemented. The Authority shall have no liability to the Bondholders or to any other person with respect to such disclosure matters. Failure of the City to comply with the Continuing Disclosure Agreement shall not be considered an Event of Default; however, any Bondholder or Beneficial Owner may take, and the Trustee shall take, at the request of the Holders of at least 25% aggregate principal amount of Outstanding Bonds, and upon receipt of satisfactory indemnification, such actions as may be necessary and appropriate, including seeking mandate or specific performance by court order, to cause the City to comply with its continuing disclosure obligations under the Continuing Disclosure Agreement.

Modification and Amendment of the Indenture

The Indenture and the rights and obligations of the Authority and of the Owners of the Bonds may be modified or amended at any time by a Supplemental Indenture which shall become binding when the written consents of the Owners of a majority in aggregate principal amount of the Bonds then Outstanding, exclusive of Bonds held by or for the account of the City or the Authority, are filed with the Trustee. No such modification or amendment shall (a) extend the maturity of or reduce the interest rate on any Bond or otherwise alter or impair the obligation of the Authority to pay the principal, interest or redemption premiums at the time and place and at the rate and in the currency provided therein of any Bond without the express written consent of the Owner of such Bond, (b) reduce the percentage of Bonds required for the written consent to any such amendment or modification, or (c) without its written consent thereto, modify any of the rights or obligations of the Trustee.

The Indenture and the rights and obligations of the Authority and of the Owners of the Bonds may also be modified or amended at any time by a Supplemental Indenture which shall become binding upon adoption, without the consent of any Bond Owners, but only to the extent permitted by law and only for any one or more of the following purposes:

(a) to add to the covenants and agreements of the Authority in the Indenture contained, other covenants and agreements thereafter to be observed, or to limit or surrender any rights or power reserved to or conferred upon the Authority under the Indenture; or

(b) to make such provisions for the purpose of curing any ambiguity, or of curing, correcting or supplementing any defective provision contained in the Indenture, or in any other respect whatsoever as the Authority may deem necessary or desirable, provided under any circumstances that such modifications or amendments shall not materially adversely affect the interests of the Owners of the Bonds, in the opinion of Bond Counsel; or

(c) to make such additions, deletions or modifications as may be necessary or desirable to assure exemption from federal income taxation of interest on the Bonds.

Events of Default and Remedies of Bond Owners

Events of Default and Acceleration of Maturities. The following events shall be Events of Default under the Indenture:

(a) Default in the due and punctual payment of the principal of any Bond when and as the same shall become due and payable, whether at maturity as therein expressed, by proceedings for mandatory sinking fund redemption, by declaration or otherwise.

(b) Default in the due and punctual payment of any installment of interest on any Bond when and as such interest installment shall become due and payable.

(c) Default by the Authority in the observance of any of the other covenants, agreements or conditions on its part in the Indenture or in the Bonds contained, if such default shall have continued for a period of thirty (30) days after written notice thereof, specifying such default and requiring the same to be remedied, shall have been given to the City and the Authority by the Trustee; provided, however, that if in the reasonable opinion of the Authority the default stated in the notice (other than a default in the payment of any fees and expenses owing to the Trustee) can be corrected, but not within such thirty (30) day period, such default shall not constitute an Event of Default under the Indenture if the Authority shall commence to cure such default within such thirty (30) day period and thereafter diligently and in good faith cure such failure in a reasonable period of time.

(d) The filing by the Authority of a petition or answer seeking reorganization or arrangement under the Federal bankruptcy laws or any other applicable law of the United States of America, or if a court of competent jurisdiction shall approve a petition, filed with or without the consent of the Authority, seeking reorganization under the Federal bankruptcy laws or any other applicable law of the United States of America, or if, under the provisions of any other law for the relief or aid of debtors, any court of competent jurisdiction shall assume custody or control of the Authority or of the whole or any substantial part of its property.

(e) The occurrence and continuation of an Event of Default under and as defined in the Installment Sale Agreement.

Upon the occurrence and during the continuance of any Event of Default the Trustee may, and at the written direction of the Owners of a majority in aggregate principal amount of the Bonds at the time Outstanding, the Trustee shall, declare the principal of all of the Bonds then Outstanding, and the interest accrued thereon, to be due and payable immediately, and upon any such declaration the same shall become and shall be immediately due and payable. This provision, however, is subject to the condition that if, at

any time after the principal of the Bonds shall have been so declared due and payable and before any judgment or decree for the payment of the moneys due shall have been obtained or entered, the Authority shall deposit with the Trustee a sum sufficient to pay all of the principal of and interest on the Bonds having come due prior to such declaration, with interest on such overdue principal and interest calculated at the net effective rate of interest per annum then borne by the Outstanding Bonds, and the reasonable fees and expenses of the Trustee, together with interest thereon at the prime rate of the Trustee then in effect, and any and all other defaults known to the Trustee (other than in the payment of the principal of and interest on the Bonds having come 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 Trustee or the Owners of a majority in aggregate principal amount of the Bonds at the time Outstanding may, by written notice to the Authority and to the Trustee, on behalf of the Owners of all of the Outstanding Bonds, rescind and annul such declaration and its consequences. However, 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 amounts received by the Trustee pursuant to any right given or action taken by the Trustee under the provisions of the Indenture shall be applied by the Trustee in the following order 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:

First, to the payment of reasonable fees, charges and expenses of the Trustee (including reasonable fees and disbursements of its counsel) incurred in and about the performance of its powers and duties under the Indenture; and

Second, to the payment of the whole amount then owing and unpaid upon the Bonds for interest and principal, with interest on such overdue amounts to the extent permitted by law at the net effective rate of interest then borne by the Outstanding Bonds, and in case such moneys shall be insufficient to pay in full the whole amount so owing and unpaid upon the Bonds, then to the payment of such interest, principal and interest on overdue amounts without preference or priority among such interest, principal and interest on overdue amounts ratably to the aggregate of such interest, principal and interest on overdue amounts.

Other Remedies; Rights of Bond Owners. Upon the occurrence of an Event of Default, the Trustee may pursue any available remedy, in addition to the remedy at law or in equity to enforce the payment of the principal of, premium, if any, and interest on the Outstanding Bonds, and to enforce any rights of the Trustee under or with respect to the Indenture.

If an Event of Default shall have occurred and be continuing and if requested so to do by the Owners of a majority in aggregate principal amount of Outstanding Bonds and indemnified as provided in the Indenture, the Trustee shall be obligated to exercise such one or more of the rights and powers conferred by the Indenture, as the Trustee, being advised by counsel, shall deem most expedient in the interests of the Bond Owners.

No remedy by the terms of the Indenture conferred upon or reserved to the Trustee (or to the Bond Owners) is intended to be exclusive of any other remedy, but each and every such remedy shall be cumulative and shall be in addition to any other remedy given to the Trustee or to the Bond Owners thereunder or thereafter existing at law or in equity.

No delay or omission to exercise any right or power accruing upon any Event of Default shall impair any such right or power or shall be construed to be a waiver of any such Event of Default or acquiescence therein; such right or power may be exercised from time to time as often as may be deemed expedient.

A waiver of any default or breach of duty or contract by the Trustee or any Bond Owners 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. No delay or omission of the Trustee or any Owner of any of the Bonds to exercise any right or power accruing upon any default shall impair any such right or power or shall be construed to be a waiver of any such default or an acquiescence therein; and every power and remedy conferred upon the Trustee or Bond Owners by the Bond Law or by the Indenture may be enforced and exercised from time to time and as often as shall be deemed expedient by the Trustee or the Bond Owners, as the case may be.

Rights and Remedies of Bond Owners. No Owner of any Bond shall have the right to institute any suit, action or proceeding at law or in equity, for any remedy under or upon the Indenture or the Installment Sale Agreement, unless (a) such Owner shall have previously given to the Trustee written notice of the occurrence of an Event of Default; (b) the Owners of a majority in aggregate principal amount of all the Bonds then Outstanding shall have made written request upon the Trustee to exercise the powers granted in the Indenture or to institute such action, suit or proceeding in its own name; (c) said Owners shall have tendered to the Trustee indemnity reasonably acceptable to the Trustee against the costs, expenses and liabilities to be incurred in compliance with such request; (d) the Trustee shall have refused or omitted to comply with such request for a period of sixty (60) days after such written request shall have been received by, and said tender of indemnity shall have been made to, the Trustee; and (e) the Trustee has not received any inconsistent direction during such 60-day period from the Owners of a majority in aggregate principal amount of the Outstanding Bonds.

Such notification, request, tender of indemnity and refusal or omission are conditions precedent to the exercise by any Owner of Bonds of any remedy under the Indenture; it being understood and intended that no one or more Owners of Bonds shall have any right in any manner whatever by his or their action to enforce any right under the Indenture or the Installment Sale Agreement, except in the manner provided in the Indenture, and that all proceedings at law or in equity to enforce any provision of the Indenture shall be instituted, had and maintained in the manner provided in the Indenture and for the equal benefit of all Owners of the Outstanding Bonds.

The right of any Owner of any Bond to receive payment of the principal of and interest and premium (if any) on such Bond or to institute suit for the enforcement of any such payment, shall not be impaired or affected without the written consent of such Owner.

Termination of Proceedings. In case the Trustee shall have proceeded to enforce any right under the Indenture by the appointment of a receiver or otherwise, and such proceedings shall have been discontinued or abandoned for any reason, or shall have been determined adversely, then and in every such case, the Authority, the Trustee and the Bond Owners shall be restored to their former positions and rights with regard to the property subject to the Indenture, and all rights, remedies and powers of the Trustee shall continue as if no such proceedings had been taken.

Discharge of Indenture

If the Authority shall pay and discharge each Outstanding Bond in any one or more of the following ways -

(a) by well and truly paying or causing to be paid the principal of and interest and premium (if any) on such Bonds, as and when the same become due and payable;

(b) by irrevocably depositing with the Trustee, in trust, at or before maturity, money which, together with the available amounts then on deposit in the funds and accounts established

pursuant to the Indenture, is fully sufficient to pay such Bonds, including all principal, interest and redemption premiums;

(c) by irrevocably depositing with the Trustee, in trust, Permitted Investments described in paragraph (1) or (2) of the definition thereof in such amount as Bond Counsel or an Independent Accountant shall determine will, together with the interest to accrue thereon and available moneys then on deposit in the funds and accounts established pursuant to the Indenture, be fully sufficient to pay and discharge the indebtedness on such Bonds (including all principal, interest and redemption premiums) at or before their respective maturity dates; and if such Bonds are to be redeemed prior to the maturity thereof notice of such redemption shall have been mailed pursuant to the Indenture or provision satisfactory to the Trustee shall have been made for the mailing of such notice; or

(d) by delivering such Bonds to the Trustee for cancellation -

then, at the election of the Authority, and notwithstanding that any of such Bonds shall not have been surrendered for payment, the pledge of the Revenues and other funds provided for in the Indenture with respect to such Bonds, and all other pecuniary obligations of the Authority under the Indenture with respect to all such Bonds, shall cease and terminate, except only the obligation of the Authority to pay or cause to be paid to the Owners of such Bonds not so surrendered and paid all sums due thereon from amounts set aside for such purpose as aforesaid, and all expenses and costs of the Trustee. Notice of such election shall be filed with the Trustee. Any funds thereafter held by the Trustee, which are not required for said purposes, shall be paid over to the City.

THE INSTALLMENT SALE AGREEMENT

Acquisition and Construction of the Improvements

The Authority agrees with due diligence to supervise and provide for, or cause to be supervised and provided, for the Acquisition and Construction of the Improvements in accordance with plans and specifications, construction contracts and other documents relating thereto and approved by the City pursuant to all applicable requirements of law.

The City shall have the right from time to time in its sole discretion to amend the description of the Improvements to be financed and improved the Installment Sale Agreement.

Sale of Improvements; Installment Payments

Sale. In consideration for the Installment Payments and other consideration set forth in the Installment Sale Agreement, the Authority agrees to sell, transfer and convey to the City all of the Authority's right title and interest in and to the Improvements, and the City agrees to purchase the Improvements from the Authority, upon the terms and conditions set forth in the Installment Sale Agreement.

Term. The Term of the Installment Sale Agreement shall commence on the Closing Date, and shall end on the date on which the City shall have paid all of the Installment Payments and all other amounts due and payable thereunder.

Title. On the Closing Date, title to the Improvements shall be deemed conveyed to and vested in the City. The Authority and the City shall execute, deliver and cause to be recorded any and all documents necessary to convey such title to the City.

Installment Payments. The City agrees to pay to the Authority, its successors and assigns, but solely from the Net Revenues and other funds pledged under the Installment Sale Agreement, the Purchase Price, together with interest on the unpaid principal balance, payable in Installment Payments coming due and payable in the respective amounts and on the respective Installment Payment Dates specified in the Installment Sale Agreement. The Installment Payments shall be paid by the City to the Trustee, as assignee of the Authority pursuant to the Indenture, in the amounts and at the times as set forth in the Installment Sale Agreement. The City shall receive a credit against any Installment Payment due under the Installment Sale Agreement to the extent of any monies on deposit in the Bond Service Fund on the applicable Installment Payment Date.

In the event that the City prepays all remaining Installment Payments in full pursuant to Article IX of the Installment Sale Agreement, the City's obligations under the Installment Sale Agreement shall thereupon cease and terminate, including but not limited to the City's obligation to pay Installment Payments therefor; provided, however, that the City's obligations to compensate and indemnify the Trustee shall survive such prepayment. In the event that the City prepays the Installment Payments in part but not in whole, the principal component of each succeeding Installment Payment shall be reduced in inverse order of Installment Payment Date or pro rata among such dates, as determined by the City, and the interest component of each remaining Installment Payment shall be reduced by the aggregate corresponding amount of interest which would otherwise be payable on the Bonds thereby redeemed pursuant to the Indenture. In any event, the remaining Installment Payments shall equal in time and amount the remaining debt service on the Bonds.

In the event the City should fail to make any of the payments required under the Installment Sale Agreement, the payment in default shall continue as an obligation of the City until the amount in default shall have been fully paid, and the City agrees to pay the same with interest thereon, from the date of default to the date of payment, at a rate of interest per annum equal to the rate borne by the Outstanding Bonds.

Superior and Subordinate Obligations. The City shall not issue or incur any additional bonds or other obligations during the Term of the is Agreement having any priority in payment of principal or interest out of the Gross Revenues or the Net Revenues over the Installment Payments. Nothing in the Installment Sale Agreement is intended or shall be construed to limit or affect the ability of the City to issue or incur (a) Parity Obligations pursuant to the Installment Sale Contract, or (b) obligations which are either unsecured or which are secured by an interest in the Net Revenues which is junior and subordinate to the pledge of and lien upon the Net Revenues established under the Installment Sale Contract.

Additional Payments. In addition to the Installment Payments, the City shall pay when due all costs and expenses incurred by the Authority to comply with the provisions of the Indenture, including without limitation all Costs of Issuance (to the extent not paid from amounts on deposit in the Costs of Issuance Fund or the Acquisition and Construction Fund).

Maintenance; Taxes; Insurance; and Other Matters

Maintenance, Utilities, Taxes and Assessments. Throughout the Term of the Installment Sale Agreement, all improvement, repair and maintenance of the Electric System shall be the responsibility of the City, and the City shall pay for or otherwise arrange for the payment of all utility services supplied to the Electric System, which may include, without limitation, janitor service, security, power, gas, telephone, light, heating, water and all other utility services, and shall pay for or otherwise arrange for the payment of the cost of the repair and replacement of the Electric System resulting from ordinary wear and tear.

The City shall also pay or cause to be paid all taxes and assessments of any type or nature, if any, charged to the Authority or the City affecting any Electric System or the respective interests or estates

therein; provided, however, that with respect to special assessments or other governmental charges that may lawfully be paid in installments over a period of years, the City shall be obligated to pay only such installments as are required to be paid during the Term of the Installment Sale Agreement as and when the same become due.

The City may, at the City's expense and in its name, in good faith contest any such taxes, assessments, utility and other charges and, in the event of any such contest, may permit the taxes, assessments or other charges so contested to remain unpaid during the period of such contest and any appeal therefrom unless the Authority shall notify the City that, in its opinion, by nonpayment of any such items, the interest of the Authority under the Installment Sale Agreement or under the Indenture will be materially adversely affected, in which event the City shall promptly pay such taxes, assessments or charges or provide the Authority with full security against any loss which may result from nonpayment, in form satisfactory to the Authority.

Operation of Electric System. The City covenants and agrees to operate the Electric System in an efficient and economical manner and to operate, maintain and preserve the Electric System in good repair and working order. The City covenants that, in order to fully preserve and protect the priority and security of the Bonds, the City shall pay from the Gross Revenues and discharge all lawful claims for labor, materials and supplies furnished for or in connection with the Electric System which, if unpaid, may become a lien or charge upon the Gross Revenues or the Net Revenues prior or superior to the lien granted under the Installment Sale Agreement, or which may otherwise impair the ability of the City to pay the Installment Payments in accordance therewith.

Public Liability and Property Damage Insurance. The City shall maintain or cause to be maintained, throughout the Term of the Installment Sale Agreement, but only if and to the extent available at reasonable cost from reputable insurers, a standard comprehensive general insurance policy or policies in protection of the Authority, the City and their respective members, officers, agents and employees. Said policy or policies shall provide for indemnification of said parties against direct or contingent loss or liability for damages for bodily and personal injury, death or property damage occasioned by reason of the operation of the Electric System. Said policy or policies shall provide coverage in the such liability limits and shall be subject to such deductibles as shall be customary with respect to works and property of a like character. Such liability insurance may be maintained as part of or in conjunction with any other liability insurance coverage carried by the City, and may be maintained in whole or in part in the form of self-insurance by the City, subject to the provisions of the Installment Sale Agreement, or in the form of the participation by the City in a joint powers agency or other program providing pooled insurance. The proceeds of such liability insurance shall be applied toward extinguishment or satisfaction of the liability with respect to which such proceeds shall have been paid.

Casualty Insurance. The City shall procure and maintain, or cause to be procured and maintained, throughout the Term of the Installment Sale Agreement, but only in the event and to the extent available from reputable insurers at reasonable cost, casualty insurance against loss or damage to any improvements constituting any part of the Electric System, covering such hazards as are customarily covered with respect to works and property of like character. Such insurance may be subject to deductible clauses which are customary for works and property of a like character. Such insurance may be maintained as part of or in conjunction with any other casualty insurance carried by the City and may be maintained in whole or in part in the form of self-insurance by the City, subject to the provisions of the Installment Sale Agreement, or in the form of the participation by the City in a joint powers agency or other program providing pooled insurance. All amounts collected from insurance against accident to or destruction of any portion of the Electric System shall be used to repair, rebuild or replace such damaged or destroyed portion of the Electric System, and to the extent not so applied, shall be paid to the Trustee to be applied to pay or prepay the Installment Payments (and the Bonds, under the Indenture) or any Parity Obligations, in accordance with written instructions of the City filed with the Trustee.

Insurance Net Proceeds: Form of Policies. The City shall pay or cause to be paid when due the premiums for all insurance policies required by the Installment Sale Agreement. The Trustee shall not be responsible for the sufficiency of any insurance required by the Installment Sale Agreement and shall be fully protected in accepting payment on account of such insurance or any adjustment, compromise or settlement of any loss. In the event that any insurance required pursuant to the Installment Sale Agreement shall be provided in the form of self-insurance, the City shall file with the Trustee annually, within ninety (90) days following the close of each fiscal year, a statement of an independent actuarial consultant identifying the extent of such self-insurance and stating that such consultant has determined that the City maintains sufficient reserves with respect thereto. On or before July 1 of each year, the City shall certify to the Trustee that all policies of insurance are in conformance with the requirements of the Installment Sale Agreement and the Trustee shall be entitled to rely on such certification without independent investigation.

Eminent Domain. Any amounts received as awards as a result of the taking of all or any part of the Electric System by the lawful exercise of eminent domain, at the election of the City (evidenced by a Written Certificate of the City filed with the Trustee and the Authority) shall either (a) be used for the acquisition or construction of improvements and extension of the Electric System, or (b) be paid to the Trustee to be applied to pay or prepay the Installment Payments (and the Bonds, under the Indenture) or any Parity Obligations, in accordance with written instructions of the City filed with the Trustee.

Records and Accounts. The City shall keep proper books of record and accounts of the Electric System, separate from all other records and accounts, in which complete and correct entries shall be made of all transactions relating to the Electric System. Said books shall, upon prior request, be subject to the reasonable inspection by the Owners of not less than ten percent (10%) in aggregate principal amount of the Outstanding Bonds, or their representatives authorized in writing. The City shall cause the books and accounts of the Electric System to be audited annually by an Independent Accountant, not more than two hundred ten (210) days after the close of each Fiscal Year, and shall make a copy of such report available for inspection by the Bond Owners at the office of the City.

Further Assurances. The City will adopt, make, execute and deliver any and all such further resolutions, instruments and assurances as may be reasonably necessary or proper to carry out the intention or to facilitate the performance of the Installment Sale Agreement and the Indenture, and for the better assuring and confirming unto the Trustee and Owners of the Bonds the rights and benefits provided in the Installment Sale Agreement and in the Indenture.

Sale of Electric System Property

Except as provided in the Installment Sale Agreement, the City covenants that the Electric System shall not be encumbered, sold, leased, pledged, any charge placed thereon, or otherwise disposed of, as a whole or substantially as a whole unless such sale is to a public entity. Neither the Net Revenues nor any other funds pledged or otherwise made available to secure payment of the Installment Payments shall be mortgaged, encumbered, sold, leased, pledged, any charge placed thereon, or disposed or used except as authorized by the terms of the Installment Agreement. The City shall not enter into any agreement which impairs the operation of the Electric System or any part of it necessary to secure adequate Net Revenues to pay the Installment Payments, or which otherwise would impair the rights of the Bond Owners and the owners of any Parity Obligations with respect to the Net Revenues. If any substantial part of the Electric System shall be sold, the payment therefor shall either (a) be used for the acquisition or construction of improvements, extensions or replacements of facilities constituting part of the Electric System, or (b) to the extent not so used, be paid to the Trustee to be applied to pay or prepay the Installment Payments or any Parity Obligations, in accordance with written instructions of the City filed with the Trustee.

Amendment of the Installment Sale Agreement

The City and the Authority shall have the right to modify or amend the Installment Sale Agreement, without the consent of the Trustee or any of the Bond Owners or any of the owners of Parity Obligations, but only if such amendment or modification (a) does not cause interest represented by the Bonds to be includable in gross income for federal income tax purposes in the opinion of Bond Counsel, (b) does not materially adversely affect the interests of the Owners of the Bonds or the owners of any Parity Obligations in the opinion of Bond Counsel, and (c) is for any one or more of the following purposes:

(i) to provide for the issuance of Parity Obligations pursuant to the Installment Sale Agreement;

(ii) to add to the covenants and agreements of the City contained in the Installment Sale Agreement, other covenants and agreements thereafter to be observed, or to limit or surrender any rights or power reserved to or conferred upon the City in the Installment Sale Agreement;

(iii) to cure any ambiguity, or to cure, correct or supplement any defective provision contained in the Installment Sale Agreement, or in any other respect whatsoever as the Authority and the City may deem necessary or desirable; or

(iv) to amend any provision thereof for the purpose of complying with the applicable requirements of the Tax Code.

Events of Default

Events of Defaults Defined. The following events shall be Events of Default under the Installment Sale Agreement:

(a) Failure by the City to pay any Installment Payment when and as the same become due and payable under the Installment Sale Agreement.

(b) Failure by the City to pay any Additional Payment when due and payable, and the continuation of such failure for a period of thirty (30) days.

(c) Failure by the City to observe and perform any covenant, condition or agreement on its part to be observed or performed, other than as referred to in the preceding causes (a) or (b), for a period of ninety (90) days after written notice specifying such failure and requesting that it be remedied has been given to the City by the Authority or the Trustee; provided, however, that if the City shall notify the Authority and the Trustee that in its reasonable opinion the failure stated in the notice can be corrected, but not within such 90-day period, such failure shall not constitute an event of default if the City shall commence to cure such failure within such ninety (90) day period and thereafter diligently and in good faith cure such failure in a reasonable period of time.

(d) The filing by the City of a voluntary petition in bankruptcy, or failure by the City promptly to lift any execution, garnishment or attachment, or adjudication of the City as a bankrupt, or assignment by the City for the benefit of creditors, or the entry by the City into an agreement of composition with creditors, or the approval by a court of competent jurisdiction of a petition applicable to the City in any proceedings instituted under the provisions of the Federal Bankruptcy Code, as amended, or under any similar acts which may be enacted.

(e) The occurrence and continuation of any event of default under and as defined in the instruments authorizing the issuance of any Parity Obligations.

Remedies on Default. Whenever any Event of Default shall have happened and be continuing, the Trustee as assignee of the Authority shall have the right, at its option and without any further demand or notice, but subject in all respects to the provisions of Article VIII of the Indenture, to:

(a) declare all principal components of the unpaid Installment Payments, together with accrued interest thereon at the net effective rate of interest per annum then borne by the Outstanding Bonds from the immediately preceding Interest Payment Date on which payment was made, to be immediately due and payable, whereupon the same shall immediately become due and payable;

(b) take whatever action at law or in equity may appear necessary or desirable to collect the Installment Payments then due or thereafter to become due during the Term of the Installment Sale Agreement, or enforce performance and observance of any obligation, agreement or covenant of the City under the Installment Sale Agreement; and

(c) as a matter of right, in connection with the filing of a suit or other commencement of judicial proceedings to enforce the rights of the Trustee and the Bond Owners under the Installment Sale Agreement, cause the appointment of a receiver or receivers of the Gross Revenues and other amounts pledged under the Installment Sale Agreement, with such powers as the court making such appointment shall confer.

The provisions of the preceding clause (a), however, are subject to the condition that if, at any time after the principal components of the unpaid Installment Payments shall have been so declared due and payable pursuant to the preceding clause (a), and before any judgment or decree for the payment of the moneys due shall have been obtained or entered, the City shall deposit with the Trustee a sum sufficient to pay all principal components of the Installment Payments coming due prior to such declaration and all matured interest components (if any) of the Installment Payments, with interest on such overdue principal and interest components calculated at the net effective rate of interest per annum then borne by the Outstanding Bonds, and the reasonable fees and expenses of the Trustee (including any fees and expenses of its attorneys), and any and all other defaults known to the Trustee (other than in the payment of the principal and interest components of the Installment Payments due and payable solely by reason of such declaration) shall have been made good, then, and in every such case, with the written consent of the Trustee, shall rescind and annul such declaration and its consequences. However, 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.

No Remedy Exclusive. No remedy in the Installment Sale Agreement conferred upon or reserved to the Authority is intended to be exclusive and every such remedy shall be cumulative and shall be in addition to every other remedy given under the Installment Sale Agreement or thereafter existing at law or in equity. No delay or omission to exercise any right or power accruing upon any default shall impair any such right or power or shall be construed to be a waiver thereof, but any such right and power may be exercised from time to time and as often as may be deemed expedient.

Prepayment of Installment Payments

Special Mandatory Prepayment. The principal component of the Installment Payments shall be prepaid in whole or in part on any date, in inverse order of Installment Payment Dates or pro rata among Installment Payment Dates as determined by the City, in integral multiples of \$5,000, by paying a prepayment price equal to the aggregate principal components of the Installment Payments to be prepaid, together with the interest component of the Installment Payment required to be prepaid on or accrued to such date, as required by the Installment Sale Agreement, and as required in the event of special mandatory redemption pursuant to the Indenture.

Optional Prepayment. The City may exercise its option to prepay the principal components of the Installment Payments in whole or in part (in integral multiples of \$5,000) to the extent the Authority has the ability to effect an optional redemption of the Bonds under the Indenture. The City shall give the Trustee and the Authority written notice of its intention to exercise its option under this provision not less than sixty (60) days in advance of the date of exercise (or such lesser period of time as shall be consented to by the Trustee and the Authority).

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APPENDIX D

FORM OF OPINION OF BOND COUNSEL

[Closing Date]

Hercules Public Financing Authority
Hercules, California

City of Hercules
Hercules, California

\$5,775,000
Hercules Public Financing Authority
Revenue Bonds (Electric System Project) Series 2010

Ladies and Gentlemen:

In our role as Bond Counsel to the Hercules Public Financing Authority (the “Authority”), we have examined certified copies of the proceedings taken in connection with the issuance by the Authority of its Revenue Bonds (Electric System Project) Series 2010 (the “Bonds”) in the aggregate principal amount of \$5,775,000. We have also examined supplemental documents furnished to us and have obtained such certificates and documents from public officials as we have deemed necessary for the purposes of this opinion. The Bonds are issued under Article 4 of Chapter 5 of Division 7 of Title 1 of the California Government Code (the “Bond Law”), pursuant to an Indenture of Trust, dated as of August 1, 2010 (the “Indenture”), by and among the Authority, the City of Hercules (the “City”) and The Bank of New York Mellon Trust Company, N.A. (the “Trustee”), and pursuant to the authorizing resolution of the governing board of the Authority adopted on May 11, 2010. The Authority and the City will enter into an Installment Sale Agreement, dated as of August 1, 2010 (the “Installment Sale Agreement”), pursuant to which the Authority will sell certain assets of the Purchased Assets to the City in consideration for Installment Payments. Capitalized terms used herein and not otherwise defined shall have the meanings assigned to them in the Indenture and the Installment Sale Agreement, as applicable.

The Bonds are issued as fully registered bonds in the denomination of \$5,000 or any integral multiple thereof. Interest on the Bonds is payable semiannually on February 1 and August 1 of each year, commencing February 1, 2011.

The Bonds are subject to redemption prior to maturity as provided in the Indenture.

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

1. The Indenture has been duly and validly authorized, executed and delivered by the Authority and the City and, assuming such Indenture constitutes the legally valid and binding obligation of the Trustee, constitutes the legally valid and binding obligation of the Authority and the City, enforceable against the Authority and the City in accordance with its terms, and the Bonds are entitled to the benefits of the Indenture.

2. The Installment Sale Agreement has been duly and validly authorized, executed and delivered by the Authority and the City, and constitutes the legally valid and binding obligation of the Authority and the City, enforceable against the Authority and the City in accordance with its terms.

3. The proceedings for the issuance of the Bonds have been taken in accordance with the laws and Constitution of the State of California, and the Bonds, having been issued in duly authorized form and executed by the proper officials and delivered to and paid for by the purchasers, constitute legal and binding special obligations of the Authority enforceable in accordance with their terms.

4. The Bonds are payable from the Revenues, subject to the application thereof on the terms and conditions as set forth in the Indenture.

5. The Internal Revenue Code of 1986 (the "Code") sets forth certain requirements that must be met subsequent to the issuance and delivery of the Bonds for interest thereon to be and remain excluded from the gross income of the owners thereof for federal income tax purposes. Noncompliance with such requirements could cause the interest on the Bonds to be included in gross income retroactive to the date of issue of the Bonds. The Authority and the City have covenanted in the Indenture to maintain the exclusion of interest on the Bonds from the gross income of the owners thereof for federal income tax purposes.

In our opinion, under existing law, interest on the Bonds is exempt from personal income taxes of the State of California and, assuming compliance with the aforementioned covenant, interest on the Bonds is excluded pursuant to section 103(a) of the Code from the gross income of the owners thereof for federal income tax purposes and interest on the Bonds is not included in the computation of the alternative minimum taxable income of the owners thereof for federal income tax purposes.

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

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

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

Respectfully submitted,

APPENDIX E

FORM OF CONTINUING DISCLOSURE AGREEMENT

This Continuing Disclosure Agreement (the “Disclosure Agreement”) is executed and delivered by the City of Hercules (the “City”) and The Bank of New York Mellon Trust Company, N.A., as dissemination agent (the “Dissemination Agent”) in connection with the issuance of \$5,775,000 aggregate principal amount of Hercules Public Financing Authority Revenue Bonds (Electric System Project) Series 2010 (the “Bonds”). The Bonds are being issued pursuant to an Indenture of Trust, dated as of August 1, 2010 (the “Indenture”), among the Hercules Public Financing Authority, the City and The Bank of New York Mellon Trust Company, N.A., as trustee (the “Trustee”). In connection therewith the City and the Dissemination Agent covenant and agree as follows:

Section 1. Purpose of this Disclosure Agreement. This Disclosure Agreement is being executed and delivered by the City and the Dissemination Agent for the benefit of the Bondholders and Beneficial Owners of the Bonds and in order to assist the Participating Underwriters (as defined herein) in complying with Securities and Exchange Commission Rule 15c2-12(b)(5).

Section 2. Definitions. In addition to the definitions set forth above and in the Indenture, 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 City pursuant to, and as described in, Sections 3 and 4 of this Disclosure Agreement.

“Beneficial Owner” shall mean any person who (a) has the power, directly or indirectly, to vote or consent with respect to, or to dispose of ownership of, any Bonds (including persons holding Bonds through nominees, depositories or other intermediaries); or (b) is treated as the owner of any Bonds for federal income tax purposes.

“Disclosure Representative” shall mean the City Manager of the City or his or her designee, or such other officer or employee as the City shall designate in writing to the Dissemination Agent from time to time.

“Dissemination Agent” shall mean the Trustee, acting in its capacity as Dissemination Agent hereunder, or any successor Dissemination Agent designated in writing by the City and which has filed with the Trustee a written acceptance of such designation.

“Holder” shall mean either the registered owners of the Bonds or, if the Bonds are registered in the name of The Depository Trust Company or another recognized depository, any applicable participant in such depository system.

“Listed Event” shall mean any of the events listed in Section 5(a) of this Disclosure Agreement.

“MSRB” shall mean the Municipal Securities Rulemaking Board established pursuant to Section 15B(b)(1) of the Securities Exchange Act of 1934 or any other entity designated or authorized by the Securities and Exchange Commission to receive reports pursuant to the Rule. Until otherwise designated by the MSRB or the Securities and Exchange Commission, filings with the MSRB are to be made through the Electronic Municipal Marketplace Access (EMMA) website of the MSRB, currently located at <http://emma.msrb.org>.

“Official Statement” shall mean the Official Statement for the Bonds dated August 12, 2010.

“Participating Underwriter” shall mean any of the original underwriters of the Bonds listed on the cover page of the Official Statement required to comply with the Rule in connection with offering of the Bonds.

“Rule” shall mean Rule 15c2-12(b)(5) adopted by the SEC under the Securities Exchange Act of 1934, as the same may be amended from time to time.

“SEC” shall mean the United States Securities and Exchange Commission.

“State” shall mean the State of California.

Section 3. Provision of Annual Reports.

(a) The City shall, or shall cause the Dissemination Agent to, not later than 270 days after the end of the City’s Fiscal Year (presently June 30), commencing with the report for the 2009-10 Fiscal Year, provide to the MSRB an Annual Report which is consistent with the requirements of Section 4 of this Disclosure Agreement. The Annual Report must be submitted in electronic format, accompanied by such identifying information as prescribed by the MSRB. The Annual Report may be submitted as a single document or as separate documents comprising a package, and may cross-reference other information as provided in Section 4 of this Disclosure Agreement; *provided* that if the audited financial statements of the City are not available by the date required above for the filing of the Annual Report, the City shall submit the audited financial statements as soon as available. If the City’s Fiscal Year changes, it shall give notice of such change in the same manner as for a Listed Event under Section 5(f).

(b) If the City is unable to provide to the MSRB an Annual Report by the date required in subsection (a), the City shall send to the MSRB a notice in substantially the form attached hereto as Exhibit A.

(c) The Dissemination Agent shall:

- (i) determine the electronic filing address of, and then-current procedures for submitting Annual Reports to, the MSRB each year prior to the date for providing the Annual Report; and
- (ii) file a report with the City and (if the Dissemination Agent is not the Trustee) the Trustee certifying that the Annual Report has been provided to the MSRB pursuant to this Disclosure Agreement, and stating the date it was provided.

Section 4. Content of Annual Reports. The City’s Annual Report shall contain or include by reference the following categories or similar categories of information updated to incorporate information for the most recent fiscal or calendar year, as applicable (the tables referred to below are those appearing in the Official Statement relating to the Bonds):

(a) The audited financial statements of the City 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 City’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;

(b) Updated information comparable to the information in the following tables in the section of the Official Statement entitled “CITY OF HERCULES – FINANCIAL INFORMATION”:

1. Assessed Valuation History
2. General Fund Balance Sheet
3. Statement of Revenues and Expenditures – General Fund
4. General Fund Revenue Source
5. General Fund Expenditure Source

(c) Updated information comparable to the information in the following tables in the section of the Official Statement entitled “THE ELECTRIC SYSTEM”:

1. Electric System Power Supply Resources
2. Electric System Customers, Retail Sales, Revenues and Demand – Historical
3. Ten Largest Retail Customers
4. Five Year History of Rates
5. Historical Operating Results

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 City or related public entities, which have been submitted to the MSRB or the SEC. If any document included by reference is a final official statement, it must be available from the MSRB. The City shall clearly identify each such other document so included by reference.

Section 5. Reporting of Significant Events.

(a) Pursuant to the provisions of this section, the City shall give, or cause to be given, notice of the occurrence of any of the following events with respect to the Bonds, if material:

1. Principal or interest payment delinquencies.
2. Non-payment related defaults.
3. Modifications to the rights of the Bondholders.
4. Optional, contingent or unscheduled 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 the credit enhancements reflecting financial difficulties.
10. Substitution of the credit or liquidity providers or their failure to perform.
11. Release, substitution or sale of property securing repayment of the Bonds.

(b) The Dissemination Agent shall, as soon as is reasonably practicable after 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 City promptly notify the Dissemination Agent in writing whether or not to report the event pursuant to Section 5(f). For purposes of this Disclosure Agreement, “actual knowledge” of the occurrence of such Listed Event shall mean actual knowledge by the Dissemination Agent, if other than the Trustee, and if the Dissemination Agent is the Trustee, then by the officer at the corporate trust office of the Trustee with regular responsibility for the administration of matters related to the Indenture. The Dissemination Agent shall have no responsibility to determine the materiality of any of the Listed Events.

(c) Whenever the City obtains knowledge of the occurrence of a Listed Event, whether because of a notice from the Dissemination Agent pursuant to Section 5(b) or otherwise, the City shall as soon as possible determine if knowledge of such event would be material under applicable federal securities laws.

(d) If the City determines that knowledge of the occurrence of a Listed Event would be material under applicable federal securities laws, the City shall promptly notify the Dissemination Agent in writing and instruct the Dissemination Agent to report the occurrence pursuant to Section 5(f).

(e) If in response to a request under Section 5(b), the City determines that the Listed Event is not material under applicable federal securities laws, the City shall so notify the Dissemination Agent in writing and instruct the Dissemination Agent not to report the occurrence pursuant to Section 5(f).

(f) If the Dissemination Agent has been instructed by the City to report the occurrence of a Listed Event, the Dissemination Agent shall as soon as possible file a notice of such occurrence with the MSRB. Notwithstanding the foregoing, notice of Listed Events described in Section 5(a)(4) and Section 5(a)(5) need not be given under this subsection any earlier than the notice (if any) of the underlying event is given to Holders of affected Bonds pursuant to the Indenture.

Section 6. Termination of Reporting Obligation. The City’s obligations under this Disclosure Agreement shall terminate upon the legal defeasance, prior redemption or payment in full of all of the Bonds. If such termination occurs prior to the final maturity of the Bonds, the City shall give notice of such termination in the same manner as for a Listed Event under Section 5(f).

Section 7. Dissemination Agent. The City may, from time to time, appoint or engage a Dissemination Agent to assist it in carrying out its obligations under this Disclosure Agreement, and may discharge any such Dissemination Agent, with or without appointing a successor Dissemination Agent. If at any time there is not any other designated Dissemination Agent, the Trustee, upon notice from the City, shall be the Dissemination Agent. The initial Dissemination Agent shall be the Trustee. The Dissemination Agent shall not be responsible in any manner for the content of any notice or report prepared by the City pursuant to this Disclosure Agreement. The Dissemination Agent shall receive compensation for the services provided pursuant to this Disclosure Agreement. The Dissemination Agent may resign by providing thirty days written notice to the City and the Trustee.

Section 8. Amendment; Waiver. Notwithstanding any other provision of this Disclosure Agreement, the City and the Dissemination Agent may amend this Disclosure Agreement, (and, to the extent that any such amendment does not materially change or increase its obligations hereunder, the Dissemination Agent shall agree to any amendment so requested by the City), 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 Section 3(a), Section 4 or Section 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, or for the purpose of curing any ambiguity, or of curing, correcting or supplementing any defective provision;

(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 issuance 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 does not, in the opinion of nationally recognized bond counsel, materially impair the interests of the Holders or Beneficial Owners of the Bonds.

In the event of any amendment or waiver of a provision of this Disclosure Agreement, the City shall describe such amendment in the next Annual Report, and shall include, as applicable, a narrative explanation of the reason for the amendment or waiver and its impact on the type (or in the case of a change of accounting principles, on the presentation) of financial information or operating data being presented by the City. In addition, if the amendment relates to the accounting principles to be followed in preparing financial statements, (i) notice of such change shall be given in the same manner as for a Listed Event under Section 5(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. Filings with the MSRB. All information, operating data, financial statements, notices and other documents provided to the MSRB in accordance with this Disclosure Agreement shall be provided in an electronic format prescribed by the MSRB and shall be accompanied by identifying information as prescribed by the MSRB.

Section 10. Additional Information. Nothing in this Disclosure Agreement shall be deemed to prevent the City from disseminating any other information, using the means of dissemination set forth in this Disclosure Agreement or any other means of communication, or including any other information in any Annual Report or notice of occurrence of a Listed Event, in addition to that which is required by this Disclosure Agreement. If the City chooses to include any information in any Annual Report or notice of

occurrence of a Listed Event in addition to that which is specifically required by this Disclosure Agreement, the City shall 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 11. Default. In the event of a failure of the City or the Dissemination Agent to comply with any provision of this Disclosure Agreement, the Trustee may (and, at the request of any Participating Underwriter or the Holders of at least 25% of the aggregate principal amount of Outstanding Bonds and upon provision of indemnification satisfactory to the Trustee, 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 City or the Dissemination Agent, as the case may be, to comply with its obligations under this Disclosure Agreement. A default under this Disclosure Agreement shall not be deemed an Event of Default under the Indenture, and the sole remedy under this Disclosure Agreement in the event of any failure of the City or the Dissemination Agent to comply with this Disclosure Agreement shall be an action to compel performance hereunder.

Section 12. Duties, Immunities and Liabilities of Trustee and Dissemination Agent. Article VI of the Indenture is hereby made applicable to this Disclosure Agreement as if the Disclosure Agreement were (solely for this purpose) contained in the Indenture. The Dissemination Agent shall be entitled to the protections and limitations on liability afforded to the Trustee thereunder. The Dissemination Agent (if other than the Trustee in its capacity as Dissemination Agent) shall have only such duties as are specifically set forth in this Disclosure Agreement, and the City agrees to indemnify and save the Dissemination Agent, its officers, directors, employees and agents, harmless against any loss, expense and liabilities which it may incur arising out of or in the exercise or performance of its powers and duties hereunder, including the costs and expenses (including attorneys fees) of defending against any claim of liability, but excluding any loss, expense and liabilities due to the Dissemination Agent's negligence or willful misconduct. The obligations of the City under this Section 12 shall survive resignation or removal of the Dissemination Agent and payment of the Bonds.

Section 13. Notices. Any notices or communications to or among any of the parties to this Disclosure Agreement may be given as follows:

To the City:

City of Hercules
111 Civic Drive
Hercules, California 94547
Attention: Executive Director
Phone: 510-799-8200
Fax: 510-799-2521

To the Dissemination Agent:

The Bank of New York
Mellon Trust Company, N.A.
700 South Flower Street, Suite 500
Los Angeles, California 90017
Phone: 213-630-6229
Fax: 213-630-6215

Section 14. Beneficiaries. This Disclosure Agreement shall inure solely to the benefit of the Authority, the City, the Trustee, the Dissemination Agent, the Participating Underwriters and the Holders and Beneficial Owners from time to time of the Bonds, and shall create no rights in any other person or entity.

Section 15. 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.

IN WITNESS WHEREOF, this Disclosure Agreement has been executed on behalf of the City and the Trustee by their duly authorized representatives as of August 1, 2010.

CITY OF HERCULES

By: _____
City Manager

THE BANK OF NEW YORK MELLON TRUST
COMPANY, N.A., as Dissemination Agent

By: _____
Authorized Officer

EXHIBIT A

NOTICE TO MSRB OF FAILURE TO FILE ANNUAL REPORT

Name of Obligated Party: CITY OF HERCULES

Name of Bond Issue: \$5,775,000 Hercules Public Financing Authority Revenue Bonds
 (Electric System Project) Series 2010

Date of Issuance: August 25, 2010

NOTICE IS HEREBY GIVEN that the City of Hercules (the "City") has not provided an Annual Report with respect to the above-named Bonds as required by Section 3(a) of the Continuing Disclosure Agreement, dated as of August 1, 2010, by and between the City and The Bank of New York Mellon Trust Company, N.A., as dissemination agent (the "Dissemination Agent"). The City anticipates that the Annual Report will be filed by _____, 20__.

Dated: _____, 20__

THE BANK OF NEW YORK MELLON TRUST
COMPANY, N.A., as Dissemination Agent on behalf of
the City

By: _____
 Authorized Officer

cc: Hercules Public Financing Authority

APPENDIX F

BOOK-ENTRY ONLY SYSTEM

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

The Depository Trust Company ("DTC"), New York, NY, will act as securities depository for the Bonds. The 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 Bond will be issued for each maturity of the Bonds, each in the aggregate principal amount of such maturity, and will be deposited with DTC.

DTC, the world's largest depository, is a limited-purpose trust company organized under the New York Banking Law, a "banking organization" within the meaning of the New York Banking Law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code, and a "Clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for over 2.2 million issues of U.S. and non-U.S. equity, corporate and municipal debt issues, and money market instrument from over 100 countries that DTC's participants ("Direct Participants") deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities through electronic computerized book-entry transfers and pledges between Direct Participants' accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation ("DTCC"). DTCC, in turn, is owned by a number of Direct Participants of DTC and Members of the National Securities Clearing Corporation, Fixed Income Clearing Corporation, and Emerging Markets Clearing Corporation (NSCC, FICC, and EMCC, also subsidiaries of DTCC), as well as by the New York Stock Exchange, Inc., the American Stock Exchange LLC, and the National Association of Securities Dealers, Inc. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly ("Indirect Participants"). DTC has standard & Poor's highest rating: AAA. The DTC Rules applicable to its Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at www.dtcc.com and www.dtc.org.

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

To facilitate subsequent transfers, all Bonds deposited by Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co. or such other name as requested by an authorized representative of DTC. The deposit of 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 Bonds; DTC's records reflect only the identity of the Direct Participants to whose accounts such Bonds are credited, which may or may not be the Beneficial Owners. The Participants will remain responsible for keeping account of their holdings on behalf of their customers.

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

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

Neither DTC nor Cede & Co. (nor such other DTC nominee) will consent or vote with respect to Bonds. Under its usual procedures, DTC mails an Omnibus Proxy to the Authority (or the Trustee on behalf thereof) 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 Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Principal, redemption price and interest payments on the 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 Authority or the Trustee, on payable date in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of such Participant and not of DTC (nor its nominee), the Authority or the Trustee, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of principal, redemption price and interest to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the Authority or the Trustee, disbursement of such payments to Direct Participants is the responsibility of DTC, and disbursement of such payments to Beneficial Owners is the responsibility of Direct and Indirect Participants.

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

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



FOR ADDITIONAL BOOKS: ELABRA.COM OR (888) 935-2272