

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

\$9,725,000

CITY OF DESERT HOT SPRINGS JUDGMENT OBLIGATION BONDS

Dated: Date of Delivery

Due: March 1, as shown below

The City of Desert Hot Springs Judgment Obligation Bonds (the “Bonds”) are being issued by the City of Desert Hot Springs (the “City”) pursuant to an Indenture (the “Indenture”), dated as of October 1, 2004, by and between the City and Wells Fargo Bank, National Association, as Trustee (the “Trustee”). The proceeds of the Bonds will be used to (i) provide money for the payment of the City’s obligations evidenced by the Silver Sage Judgment and Settlement Agreement (each as defined herein) and (ii) pay the costs incurred in connection with the authorization and issuance of the Bonds. SEE “THE JUDGMENT AND THE PLAN OF FINANCE.”

The obligation of the City to pay the Judgment Obligees (as defined herein) pursuant to the terms of the Silver Sage Judgment and Settlement Agreement is an existing obligation of the City and is an obligation imposed by law. The Bonds do not constitute an obligation of the City for which the City is obligated to levy or pledge any form of taxation or for which the City has levied or pledged any form of taxation. The City has covenanted in the Indenture to include in its budget in each Fiscal Year a provision for funds in an amount sufficient to pay the principal of and interest on the Bonds coming due in such Fiscal Year.

The Bonds will be dated as their date of initial delivery and will mature on March 1 of each year and will bear interest (calculated on the basis of a 360-day year comprised of twelve 30-day months) at the rates per annum as shown below. Interest on the Bonds will be payable on March 1 and September 1 of each year, commencing March 1, 2005, so long as any Bonds remain Outstanding. See “THE BONDS” herein. The Bonds will be initially delivered only in book-entry form and will be registered in the name of Cede & Co., as nominee of The Depository Trust Company, New York, New York (“DTC”), which will act as securities depository for the Bonds. Individual purchases of the Bonds will be made in book-entry form only. Purchasers of Bonds will not receive certificates representing their ownership interests in the Bonds purchased. The Bonds are issuable as fully registered Bonds without coupons in denominations of \$5,000 or any integral multiple thereof. Payments of principal of and interest on the Bonds are payable directly to DTC by Wells Fargo Bank, National Association, as trustee. Upon receipt of payments of principal and interest, DTC will in turn distribute such payments to the beneficial owners of the Bonds. See APPENDIX E — “BOOK-ENTRY-ONLY SYSTEM.”

The Bonds are subject to optional redemption prior to maturity, as described herein. See “THE BONDS — Redemption Provisions.”

Payment of principal of and interest on the Bonds will be insured in accordance with the terms of a financial guaranty insurance policy to be issued simultaneously with the delivery of the Bonds by RADIAN ASSET ASSURANCE INC.

Radian Asset Assurance Inc.

RADIAN

THE OBLIGATIONS OF THE CITY UNDER THE BONDS, INCLUDING THE OBLIGATION TO MAKE ALL PAYMENTS OF THE INTEREST ON AND THE PRINCIPAL OF THE BONDS WHEN DUE OR UPON PRIOR REDEMPTION, ARE OBLIGATIONS OF THE CITY IMPOSED BY LAW AND ARE ABSOLUTE AND UNCONDITIONAL, WITHOUT ANY RIGHT OF SET-OFF OR COUNTERCLAIM. THE BONDS DO NOT CONSTITUTE AN OBLIGATION OF THE CITY FOR WHICH THE CITY IS OBLIGATED TO LEVY OR PLEDGE ANY FORM OF TAXATION OR FOR WHICH THE CITY HAS LEVIED OR PLEDGED ANY FORM OF TAXATION, AND NEITHER THE BONDS NOR THE OBLIGATION OF THE CITY TO MAKE PAYMENT OF THE INTEREST ON OR THE PRINCIPAL OF THE BONDS CONSTITUTES AN INDEBTEDNESS OF THE CITY OR THE STATE, OR ANY OF ITS POLITICAL SUBDIVISIONS, IN CONTRAVENTION OF ANY CONSTITUTIONAL OR STATUTORY DEBT LIMITATION OR RESTRICTION.

MATURITY SCHEDULE

\$725,000 Serial Bonds

Maturity Date (March 1)	Principal Amount	Interest Rate	Yield	CUSIP NO.*
2023	\$165,000	4.75%	4.80%	25041TAA2
2024	275,000	4.75	4.85	25041TAB0
2025	285,000	4.75	4.90	25041TAC8
\$1,290,000 4.75% Term Bonds Due March 1, 2029 — Priced to Yield 4.930% CUSIP No. 25041TAD6*				
\$1,985,000 4.75% Term Bonds Due March 1, 2034 — Priced to Yield 4.970% CUSIP No. 25041TAE4*				
\$5,725,000 5.00% Term Bonds Due March 1, 2044 — Priced to Yield 5.080% CUSIP No. 25041TAF1*				

* Copyright 2004, American Bankers Association. CUSIP data herein is provided by Standard & Poor’s, CUSIP Service Bureau, a division of the McGraw-Hill Companies, Inc. and is set forth for convenience of reference only. The City and the Underwriter assume no responsibility for the accuracy of such information.

Investment in the Bonds involves risks which may not be appropriate for some investors. See “SPECIAL RISK FACTORS” and “LITIGATION” for a discussion of certain factors that should be considered, in addition to the other matters set forth herein, in evaluating the investment quality of the Bonds. This cover page contains information for quick reference only. It is not a complete summary of the Bonds. Investors should read the entire Official Statement to obtain information essential to the making of an informed investment decision.

The Bonds will be offered when, as and if issued and received by the Underwriter, subject to the approval by Orrick, Herrington & Sutcliffe LLP, Bond Counsel. Certain legal matters will be passed upon for the Underwriter by its counsel, Nossaman, Guthner, Knox & Elliott LLP. Certain legal matters will be passed upon for the City by Orrick, Herrington & Sutcliffe LLP as Disclosure Counsel to the City and by the City Attorney. It is anticipated that the Bonds in definitive form will be available for delivery to DTC in New York, New York on or about October 27, 2004.

Citigroup

CITY OF DESERT HOT SPRINGS, CALIFORNIA

CITY COUNCIL

Matt Weyuker, *Mayor*
Mary Stephens, *Vice Mayor*
Gary Bosworth, *Council Member*
Hank Hohenstein, *Council Member*
Will Pieper, *Council Member*

CITY OFFICIALS

Jerry Hanson, *City Manager*
Rossie Stobbs, *City Clerk*
Linda Kelly, *Finance Manager*
Roy Hill, *Director of Public Safety*
Patricia A. Larson, *City Attorney*

SPECIAL SERVICES

Bond Counsel
Orrick, Herrington & Sutcliffe LLP
Los Angeles, California

Trustee
Wells Fargo Bank, National Association
San Francisco, California

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

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

The Underwriter has provided the following sentence for inclusion in this Official Statement. The Underwriter has reviewed the information in this Official Statement in accordance with, and as part of, its responsibilities to investors under the federal securities laws as applied to the facts and circumstances of this transaction, but the Underwriter does not guarantee the accuracy or completeness of such information. The information set forth herein has been obtained from the City and from other sources and is believed to be reliable but is not guaranteed as to accuracy or completeness. The information and expressions of opinions herein are subject to change without notice and neither the delivery of this Official Statement nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of the City since the date hereof. 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, unless authorized in writing by the City. All summaries of the documents and laws are made subject to the provisions thereof and do not purport to be complete statements of any or all such provisions.

OTHER THAN WITH RESPECT TO INFORMATION CONCERNING RADIAN ASSET ASSURANCE INC. CONTAINED UNDER THE CAPTION “MUNICIPAL BOND INSURANCE” HEREIN AND IN APPENDIX G – “FORM OF FINANCIAL GUARANTY INSURANCE POLICY” HERETO, NONE OF THE INFORMATION IN THIS OFFICIAL STATEMENT HAS BEEN SUPPLIED OR VERIFIED BY RADIAN ASSET ASSURANCE INC., AND RADIAN ASSET ASSURANCE INC. MAKES NO REPRESENTATION OR WARRANTY, EXPRESS OR IMPLIED, AS TO: (i) THE ACCURACY OR COMPLETENESS OF SUCH INFORMATION; (ii) THE VALIDITY OF THE BONDS; OR (iii) THE TAX STATUS OF THE INTEREST ON THE BONDS.

IN CONNECTION WITH THIS OFFERING, THE UNDERWRITER MAY OVERALLOT 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. THE UNDERWRITER MAY OFFER AND SELL THE BONDS TO CERTAIN DEALERS, INSTITUTIONAL INVESTORS AND OTHERS AT PRICES LOWER THAN THE PUBLIC OFFERING PRICES STATED ON THE COVER PAGE HEREOF AND SUCH PUBLIC OFFERING PRICES MAY BE CHANGED FROM TIME TO TIME BY THE UNDERWRITER.

TABLE OF CONTENTS

	Page
INTRODUCTION.....	1
General	1
Security and Sources of Payment.....	2
Municipal Bond Insurance	2
Bond Owners’ Risks.....	3
Continuing Disclosure.....	3
Other Information.....	3
THE BONDS.....	3
General	3
Transfer and Exchange of Bonds	5
Redemption Provisions	5
SECURITY AND SOURCES OF PAYMENT	8
Unconditional Obligation.....	8
Action on Default.....	9
Additional Financing.....	10
MUNICIPAL BOND INSURANCE.....	10
Financial Guaranty Insurance Policy	10
Radian Asset Assurance Inc	11
THE JUDGMENT AND THE PLAN OF FINANCE	13
Bankruptcy Claims; Silver Sage Judgment and Settlement Agreement	13
Plan of Finance.....	16
Satisfaction of Claims Under the Plan; Effective Date of the Plan	16
ESTIMATED SOURCES AND USES OF FUNDS	20
DEBT SERVICE SCHEDULE.....	21
THE CITY	22
Introduction	22
Government and Administration	23
Labor Relations	24
Services and Facilities.....	25
Financial and Accounting Information.....	25
CITY FINANCIAL INFORMATION	26
Economy	27
City General Fund Budget.....	27
Budgetary Process	28
City General Fund Revenues and Tax Receipts.....	28
Transient Occupancy Tax.....	29
Sales Taxes.....	32
Utility User’s Tax.....	33
Property Taxes and Assessed Valuations	34
Tax Levies, Collections and Delinquencies	37
County Teeter Plan.....	38
State Budget Acts.....	39
Summary Financial Statements	42
2002-03 Fiscal Year Summary.....	44
Fiscal Year 2003-04	45
Fiscal Year 2004-05	46

TABLE OF CONTENTS
(cont'd)

	Page
Financial Statements	47
General Fund Budgets.....	50
Pensions; Plan Descriptions	51
Property Insurance.....	54
Investment of Funds	54
Bonded and Other Indebtedness.....	55
Statement of Direct and Overlapping Debt	56
CONSTITUTIONAL AND STATUTORY LIMITATIONS ON TAXES AND	
APPROPRIATIONS	57
Article XIII A of the California Constitution	57
Legislation Implementing Article XIII A.....	58
Article XIII B of the California Constitution	59
Articles XIII C and XIII D of the California Constitution — Proposition 218.....	60
Proposition 62	61
Future Initiatives	62
SPECIAL RISK FACTORS	62
Bonds are a General Fund Obligation of the City	62
Cash Management	63
Limitations on Remedies.....	63
Ballot Initiatives and Legislative Measures	63
Loss of Tax Exemption	64
Changes in Law	64
Dependence of City on Tourism	64
Other Financial Matters.....	64
TAX EXEMPTION	64
VALIDATION PROCEEDING	66
CERTAIN LEGAL MATTERS	67
RATING	67
CONTINUING DISCLOSURE	67
LITIGATION	67
FINANCIAL INTEREST	68
UNDERWRITING	69
MISCELLANEOUS	70
APPENDIX A - CERTAIN INFORMATION REGARDING THE CITY OF DESERT HOT	
SPRINGS AND ECONOMIC AND DEMOGRAPHIC INFORMATION OF THE	
AREA	A-1
APPENDIX B - AUDITED FINANCIAL STATEMENTS OF THE CITY OF DESERT HOT	
SPRINGS FOR THE FISCAL YEAR ENDED JUNE 30, 2003	B-1
APPENDIX C - SUMMARY OF INDENTURE	C-1
APPENDIX D - PROPOSED FORM OF OPINION OF BOND COUNSEL	D-1
APPENDIX E - BOOK-ENTRY-ONLY SYSTEM	E-1
APPENDIX F - FORM OF CONTINUING DISCLOSURE AGREEMENT	F-1
APPENDIX G - FORM OF FINANCIAL GUARANTY INSURANCE POLICY FINANCIAL	
GUARANTY INSURANCE POLICY	G-1

OFFICIAL STATEMENT

\$9,725,000

CITY OF DESERT HOT SPRINGS JUDGMENT OBLIGATION BONDS

INTRODUCTION

This Official Statement (which includes the cover page and appendices hereto) (this “Official Statement”) provides certain information concerning the issuance and sale of City of Desert Hot Springs Judgment Obligation Bonds. 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 and the documents summarized or described herein. A full review should be made of the entire Official Statement. The issuance and sale of Bonds (as defined herein) to potential investors is made only by means of the entire Official Statement. All capitalized terms used in this Official Statement (unless otherwise defined herein) which are defined in the Indenture will have the same meanings assigned to such terms as set forth therein. See APPENDIX C – “SUMMARY OF INDENTURE – Definitions.”

General

The City of Desert Hot Springs Judgment Obligation Bonds (the “Bonds”) of \$9,725,000 aggregate principal amount are being issued by the City of Desert Hot Springs (the “City”) pursuant to the provisions of Articles 10 and 11 (commencing with Section 53570) of Chapter 3 of Division 2 of Title 5 of the California Government Code and all laws amendatory thereof or supplemental thereto (the “Act”) and under and pursuant to the provisions of the Indenture (the “Indenture”), dated as of October 1, 2004, by and between the City and Wells Fargo Bank, National Association, as Trustee (the “Trustee”). The Bonds will be dated as of their initial date of delivery and will mature on March 1 of each year and will bear interest (calculated on the basis of a 360-day year comprised of twelve 30-day months) at the rates per annum as set forth on the cover page hereof. Interest on the Bonds will be payable on March 1 and September 1 of each year, commencing March 1, 2005, so long as any Bonds remain Outstanding. See “THE BONDS” herein.

The Bonds are being issued to provide money for the payment of the City’s obligations to the Judgment Obligees (as defined herein) evidenced by the Silver Sage Judgment and the Settlement Agreement, as approved in the Confirmation Order (each as defined herein and collectively, the “Judgment”). Because the City could not previously satisfy its obligations to the Judgment Obligees, and certain other creditors, in December 2001, the City initiated a case under Chapter 9 of the United States Bankruptcy Code (the “Chapter 9 Case”) by filing a voluntary petition (the “Chapter 9 Petition”) with the United States Bankruptcy Court for the Central District of California, Riverside Division. The Bonds are to be issued in connection with and in satisfaction of the City’s Third Amended Plan for the Adjustment of Debts (the “Plan”), dated and filed in the Chapter 9 Case on or about April 28, 2004. SEE “THE JUDGMENT AND THE PLAN OF FINANCE.” In accordance with the Plan, the City is required to consummate a bond or private financing transaction that will produce a minimum of \$8.5 million in unrestricted net proceeds available to City for use in the payment of claims through the Plan and in the satisfaction of ongoing City obligations (the “Exit Financing”). The Bonds, an additional debt financing as described herein, and certain payments by the City to creditors in the Chapter 9 Case will constitute the City’s Exit Financing and the finalization of the pending Chapter 9 Case.

The net proceeds of the Bonds will be applied to payment of the Judgment Obligees in payment of claims aggregating approximately \$8.85 million due under the Silver Sage Judgment and Settlement

Agreement. Such payment will constitute payment of the Judgment and settlement of all claims involving Silver Sage. Total claims to be satisfied under the City's Plan in the Chapter 9 Case are approximately \$11.5 million. Remaining claims will be paid under the Plan from earmarked available funds of the City and proceeds of Certificates of Participation to be delivered concurrently with the Bonds. See "SECURITY AND SOURCES OF PAYMENT – Additional Financing."

The Bonds will be subject to optional redemption prior to maturity, as described herein. See "THE BONDS – Redemption Provisions."

The City is located in Riverside County, California, approximately 110 miles southeast of Los Angeles. The City is a small community, approximately 23.3 square miles in size, with a current population of approximately 17,700. The City is principally known as a unique city of spas and resorts located immediately to the north of Palm Springs and nestled in the foothills of Joshua Tree National Park. The City was incorporated in 1963 and has experienced relatively slow growth that, in recent years, has begun to accelerate somewhat. The City's General Fund budget for Fiscal Year 2004-05 projects revenues of approximately \$6.7 million, not including proceeds of the Bonds and other components of the Exit Financing. See "THE CITY," "CITY FINANCIAL INFORMATION" and APPENDIX A – "CERTAIN INFORMATION REGARDING THE CITY OF DESERT HOT SPRINGS AND ECONOMIC AND DEMOGRAPHIC INFORMATION OF THE AREA" herein.

Security and Sources of Payment

The Bonds are being issued for the purpose of satisfying the City's payment obligations under the Judgment. The Bonds are obligations imposed by law payable from funds to be appropriated by the City. The Bonds are unconditional obligations of the City, payable as to principal, premium (if any) and interest from all taxes, income, revenue, cash receipts and other legally available money of the City. Payment of principal of and interest on the Bonds is not limited to any special source of funds. The City has covenanted in the Indenture to include in its budget in each Fiscal Year a provision for funds in an amount sufficient to pay the principal of and interest on the Bonds coming due in such Fiscal Year.

The Bonds do not constitute an obligation of the City for which the City is obligated to levy or pledge any form of taxation or for which the City has levied or pledged any form of taxation, and neither the Bonds nor the obligation of the City to make payment of the interest on or the principal of the Bonds constitutes an indebtedness of the City or the State of California, or any of its political subdivisions, in contravention of any constitutional or statutory debt limitation or restriction. Reference is hereby made to the Act and to the Indenture for a description of the terms on which the Bonds are issued, for the rights of the Owners of the Bonds, for the security for payment of the Bonds, for the remedies upon default and limitations thereon and for the provisions for the amendment of the Indenture.

For more complete and detailed information, see "SECURITY AND SOURCES OF PAYMENT." For a discussion of certain risks associated with the City's ability to pay debt service on the Bonds, see "SPECIAL RISK FACTORS."

Municipal Bond Insurance

Payment of the principal of and interest on the Bonds will be insured in accordance with the terms of a financial guaranty insurance policy to be issued simultaneously with the delivery of the Bonds by RADIAN ASSET ASSURANCE INC. See "MUNICIPAL BOND INSURANCE" herein.

Bond Owners' Risks

Investment in the Bonds involves risks which may not be appropriate for some investors. Certain events could affect the ability of the City to pay debt service on the Bonds when due. See "SPECIAL RISK FACTORS" for a discussion of certain factors that should be considered, in addition to other matters set forth herein, in evaluating an investment in the Bonds.

Continuing Disclosure

The City has agreed to provide, or cause to be provided, to each nationally recognized municipal securities information repository and any public or private repository or entity designated by the State as a state repository for purposes of Rule 15c2-12(b)(5) adopted by the Securities and Exchange Commission certain annual financial information and operating data and, in a timely manner, notice of certain material events. These covenants have been made in order to assist the Underwriter in complying with SEC Rule 15c2-12(b)(5). See "CONTINUING DISCLOSURE" and APPENDIX F – "FORM OF CONTINUING DISCLOSURE AGREEMENT" herein for a description of the specific nature of the annual report and notices of material events and a summary description of the terms of the disclosure agreement pursuant to which such reports are to be made.

Other Information

For a more complete description of the Bonds and the basic documentation pursuant to which the Bonds are being sold and delivered, see "THE BONDS," "SECURITY AND SOURCES OF PAYMENT" and APPENDIX C – "SUMMARY OF INDENTURE." The summaries and descriptions in this Official Statement of the Indenture and other agreements relating to the Bonds are qualified in their entirety by the respective form thereof and the information with respect thereto included in such documents.

The information and expressions of opinion herein speak only as of their date and are subject to change without notice. Neither the delivery of this Official Statement nor any sale made hereunder nor any future use of this Official Statement shall, under any circumstances, create any implication that there has been no change in the affairs of the City since the date hereof. The presentation of information, including tables of receipt of revenues, is intended to show recent historical information and is not intended to indicate future or continuing trends in the financial position or other affairs of the City. No representation is made that past experience, as it might be shown by such financial and other information, will necessarily continue or be repeated in the future. The descriptions herein of the Indenture and any other agreements relating to the Bonds are qualified in their entirety by reference to such documents, and the descriptions herein of the Bonds are qualified in their entirety by the form thereof and the information with respect thereto included in the aforementioned documents. See APPENDIX C – "SUMMARY OF INDENTURE." Copies of the documents are on file and available for inspection at the office of the Trustee at Wells Fargo Bank, National Association, 707 Wilshire Boulevard, 17th Floor, Los Angeles, California 90017.

THE BONDS

General

The Bonds will be dated as of their initial date of delivery and will mature on March 1 of each year and will bear interest at the rates per annum as set forth on the cover page hereof. Interest on the Bonds will be payable on March 1 and September 1 of each year, commencing March 1, 2005, so long as any Bonds remain Outstanding. Interest on the Bonds will be computed on the basis of a 360-day year

consisting of twelve, 30-day months. The Bonds will be issued as fully registered Bonds without coupons in denominations of \$5,000 or any integral multiple thereof. The principal of and premium, if any, on the Bonds will be payable in lawful money of the United States of America upon presentation and surrender thereof upon maturity or earlier redemption at the Office of the Trustee.

The Bonds will be initially delivered only in book-entry form and will be registered in the name of Cede & Co., as nominee of The Depository Trust Company, New York, New York ("DTC"), which will act as securities depository for the Bonds. Individual purchases of the Bonds will be made in book-entry form only. Purchasers of Bonds will not receive certificates representing their ownership interests in the Bonds purchased. Rather, in accordance with the Book-Entry System, purchasers of Bonds will have beneficial ownership interests in the purchased Bonds through DTC Participants. For more information concerning the Book-Entry System, see APPENDIX E – "BOOK-ENTRY-ONLY SYSTEM" herein.

Interest on the Bonds will be payable from the Interest Payment Date next preceding the date of authentication thereof unless (i) a Bond is authenticated on or before an Interest Payment Date and after the close of business on the preceding Record Date, in which event it will bear interest from such Interest Payment Date; (ii) a Bond is authenticated on or before November 15, 2004, in which event interest thereon will be payable from the Closing Date; or (iii) interest on any Bond is in default as of the date of authentication thereof, in which event interest thereon will be payable from the date to which interest has been paid in full or made available for such payment, payable on each Interest Payment Date. Interest will be paid in lawful money of the United States on each Interest Payment Date to the Persons in whose names the ownership of the Bonds is registered on the Registration Books at the close of business on the immediately preceding Record Date, except as provided below. Interest will be paid by check of the Trustee mailed by first class mail, postage prepaid, on each Interest Payment Date to the Owners at their respective addresses shown on the Registration Books as of the close of business on the preceding Record Date, except that in the case of an Owner of \$1,000,000 or more in aggregate principal amount of Bonds, upon the written request of such Owner to the Trustee, received at least ten days prior to a Record Date, specifying the account or accounts to which such payment will be made, payment of interest will be made by wire transfer of immediately available funds on the following Interest Payment Date. Any such request will remain in effect until revoked or revised by such Owner by an instrument in writing delivered to the Trustee. Payments of principal of and interest on the Bonds are payable directly to DTC by the Trustee. Upon receipt of payments of principal and interest, DTC will in turn distribute such payments to the beneficial owners of the Bonds. See APPENDIX E – "BOOK-ENTRY-ONLY SYSTEM."

The Trustee and the City may treat DTC (or its nominee) as the sole and exclusive Owner of the Bonds registered in its name for the purposes of payment of the principal or Redemption Price of, or interest on the Bonds, selecting the Bonds or portions thereof to be redeemed, giving any notice permitted or required to be given to Owners of Bonds under the Indenture, registering the transfer of Bonds, obtaining any consent or other action to be taken by Owners of Bonds and for all other purposes whatsoever, and neither the Trustee nor the City will be affected by any notice to the contrary. Neither the Trustee nor the City will have any responsibility or obligation to any Participant, any person claiming a beneficial ownership interest in the Bonds under or through DTC or any Participant, or any other person which is not shown on the Registration Books as being an Owner, with respect to the accuracy of any records maintained by DTC or any Participant; the payment by DTC or any Participant of any amount in respect of the principal or Redemption Price of, or interest on the Bonds; any notice which is permitted or required to be given to Owners of Bonds under the Indenture; the selection by DTC or any Participant of any person to receive payment in the event of a partial redemption of the Bonds; or any consent given or other action taken by DTC as Owner of Bonds. While the Bonds are subject to the Book-Entry System, payments of principal or Redemption Price of, or interest on, the Bonds will be made by the Trustee to DTC, which in turn is obligated to remit such principal and interest to its DTC Participants for subsequent

disbursement to beneficial owners of the Bonds as described herein. See APPENDIX E – “BOOK-ENTRY-ONLY SYSTEM” herein.

Transfer and Exchange of Bonds

The following provisions regarding the exchange and transfer of the Bonds apply only during any period in which the Bonds are not subject to the Book-Entry System. While the Bonds are subject to the Book-Entry System, their exchange and transfer will be effected through DTC and the DTC Participants and will be subject to the procedures, rules and requirements established by DTC.

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, accompanied by delivery of a written instrument of transfer, duly executed in a form acceptable to the Trustee. Whenever any Bond or Bonds will be surrendered for transfer, the City will execute and the Trustee will authenticate and will deliver a new Bond or Bonds of the same maturity in a like aggregate principal amount, in any authorized denomination. The Trustee will require the Owner requesting such transfer to pay any tax or other governmental charge required to be paid with respect to such transfer.

The Bonds may be exchanged at the Office of the Trustee for a like aggregate principal amount of Bonds of the same maturity of other authorized denominations. The Trustee will require the payment by the Owner requesting such exchange of any tax or other governmental charge required to be paid with respect to such exchange.

The Trustee will not be obligated to make any transfer or exchange of Bonds during the period established by the Trustee for the selection of Bonds for redemption, or with respect to any Bonds selected for redemption.

Redemption Provisions

Optional Redemption. The Bonds maturing on or before March 1, 2014 are not subject to redemption prior to their stated maturity date. The Bonds maturing on and after March 1, 2015 shall be subject to optional redemption, in whole or in part, on any Interest Payment Date on or after March 1, 2014, from any source of available funds, at the principal amount thereof, plus accrued interest thereon to the date of redemption, without premium.

The City will give the Trustee written notice of its intention to cause the optional redemption of Bonds not less than 45 days prior to the applicable redemption date, unless such notice shall be waived by the Trustee.

Mandatory Sinking Fund Redemption. The Bonds maturing March 1, 2029 shall be subject to mandatory sinking fund redemption, in part, on March 1 in each year, commencing March 1, 2029, at a Redemption Price equal to the principal amount of the Bonds to be redeemed, without premium, plus accrued interest thereon to the date of redemption, in the aggregate respective principal amounts in the respective years as follows:

Sinking Fund Redemption Date (March 1)	Principal Amount to be Redeemed
2026	\$300,000
2027	315,000

2028	330,000
2029 (<i>maturity</i>)	345,000

If some but not all of the Bonds maturing on March 1, 2029 are redeemed at the option of the City as described above, the principal amount of Bonds maturing on March 1, 2029 to be redeemed from sinking fund payments on any subsequent March 1 shall be reduced, by \$5,000 or an integral multiple thereof, as designated by the City in writing filed with the Trustee; provided, however, that the aggregate amount of such reductions shall not exceed the aggregate amount of Bonds maturing on March 1, 2029 redeemed at the option of the City as described above.

The Bonds maturing March 1, 2034 shall be subject to mandatory sinking fund redemption, in part, on March 1 in each year, commencing March 1, 2034, at a Redemption Price equal to the principal amount of the Bonds to be redeemed, without premium, plus accrued interest thereon to the date of redemption, in the aggregate respective principal amounts in the respective years as follows:

Sinking Fund Redemption Date (March 1)	Principal Amount to be Redeemed
2030	\$360,000
2031	380,000
2032	395,000
2033	415,000
2034 (<i>maturity</i>)	435,000

If some but not all of the Bonds maturing on March 1, 2034 are redeemed at the option of the City as described above, the principal amount of Bonds maturing on March 1, 2034 to be redeemed from sinking fund payments on any subsequent March 1 shall be reduced, by \$5,000 or an integral multiple thereof, as designated by the City in writing filed with the Trustee; provided, however, that the aggregate amount of such reductions shall not exceed the aggregate amount of Bonds maturing on March 1, 2034 redeemed at the option of the City as described above.

The Bonds maturing March 1, 2044 shall be subject to mandatory sinking fund redemption, in part, on March 1 in each year, commencing March 1, 2044, at a Redemption Price equal to the principal amount of the Bonds to be redeemed, without premium, plus accrued interest thereon to the date of redemption, in the aggregate respective principal amounts in the respective years as follows:

Sinking Fund Redemption Date (March 1)	Principal Amount to be Redeemed
2035	\$455,000
2036	480,000
2037	500,000
2038	525,000
2039	555,000
2040	580,000
2041	610,000
2042	640,000
2043	675,000
2044 (<i>maturity</i>)	705,000

If some but not all of the Bonds maturing on March 1, 2044 are redeemed at the option of the City as described above, the principal amount of Bonds maturing on March 1, 2044 to be redeemed from sinking fund payments on any subsequent March 1 shall be reduced, by \$5,000 or an integral multiple thereof, as designated by the City in writing filed with the Trustee; provided, however, that the aggregate amount of such reductions shall not exceed the aggregate amount of Bonds maturing on March 1, 2044 redeemed at the option of the City as described above.

Selection of Bonds for Redemption. Whenever provision is made for the redemption of less than all of the Bonds, the Trustee will select the Bonds to be redeemed from all Bonds not previously called for redemption among maturities as directed in a Written Request of the City, and by lot among Bonds with the same maturity in such manner as will be determined by the Trustee. For purposes of such selection, all Bonds will be deemed to be comprised of separate \$5,000 denominations and such separate denominations will be treated as separate Bonds that may be separately redeemed.

Partial Redemption of Bonds. Upon surrender of any Bonds redeemed in part only, the City will execute and the Trustee will authenticate and deliver to the Owner thereof a new Bond or Bonds of the same maturity in authorized denominations, in aggregate principal equal to the unredeemed portion of the Bonds surrendered.

Notice of Redemption. The Trustee on behalf of the City will mail (by first class mail) notice of any redemption to the respective Owners of any Bonds designated for redemption at their respective addresses appearing on the Registration Books at least 30 but not more than 60 days prior to the redemption date. Such notice will state the date of the notice, the redemption date, the redemption place and the Redemption Price and will designate the CUSIP numbers, the Bond numbers (except in the event of redemption of all of the Bonds of a maturity or maturities in whole) and the maturity or maturities of the Bonds to be redeemed, and will 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. Neither the failure to receive any notice so mailed, nor any defect in such notice, will affect the sufficiency of the proceedings for the redemption of the Bonds or the cessation of accrual of interest thereon from and after the redemption date.

While the Bonds are subject to the Book-Entry System, the Trustee will be required to give notice of redemption only to DTC as provided in the Letter of Representations, and the Trustee will not be required to give any such notice of redemption to any other person or entity. DTC and the DTC Participants will have sole responsibility for providing any such notice of redemption to the beneficial owners of the Bonds to be redeemed. Any failure at DTC to notify any DTC Participant, or any failure of a DTC Participant to notify the beneficial owner of any Bonds to be redeemed, of a

notice of redemption or its content or effect will not affect the validity of the notice of redemption, or alter the effect of redemption described below under “Effect of Redemption.”

Effect of Redemption. When notice of redemption has been duly given as provided above and moneys for the redemption (including the interest to the applicable redemption date and including any applicable premium), having been deposited in the Redemption Account, the Bonds will become due and payable on said date, and, upon presentation and surrender thereof at the Office of the Trustee, said Bonds will be paid at the Redemption Price thereof, together with interest accrued and unpaid to said date.

If, on said redemption date, moneys for the redemption of all the Bonds to be redeemed, together with interest to said date, will be held by the Trustee so as to be available therefor on such date, and, if notice of redemption thereof will have been mailed as aforesaid and not canceled, then, from and after said date, interest on said Bonds will cease to accrue and become payable. All moneys held by or on behalf of the Trustee for the redemption of Bonds will be held in trust for the account of the Owners of the Bonds so to be redeemed.

All Bonds paid at maturity or redeemed prior to maturity pursuant to the provisions of the Indenture will be canceled upon surrender thereof and the Trustee will deliver a certificate of destruction to the City.

SECURITY AND SOURCES OF PAYMENT

Unconditional Obligation

The Indenture provides that the City is obligated to deposit or cause to be deposited with the Trustee the amount of the City’s obligations on the Bonds on October 27, 2004 and not later than July 31 of each Fiscal Year commencing July 31, 2005 to the maturity date or final redemption date of the Bonds, it will transfer to the. The City has covenanted in the Indenture to include in its budget in each Fiscal Year a provision for funds in an amount sufficient to pay the principal of and interest on the Bonds coming due in such Fiscal Year. Payment of the principal of and interest on the Bonds will be insured in accordance with the terms of a financial guaranty insurance policy to be issued simultaneously with the delivery of the Bonds by RADIAN ASSET ASSURANCE INC. See “MUNICIPAL BOND INSURANCE” herein.

The Bonds do not constitute an obligation of the City for which the City is obligated to levy or pledge any form of taxation or for which the City has levied or pledged any form of taxation. The obligation of the City to make payments with respect to the Bonds is an absolute and unconditional obligation of the City imposed upon the City and enforceable against the City pursuant to law. No assurance can be given as to the amount and source of money available to make the July 31 deposit in any year. See “CITY FINANCIAL INFORMATION” and APPENDIX B – “AUDITED FINANCIAL STATEMENTS OF THE CITY OF DESERT HOT SPRINGS FOR THE FISCAL YEAR ENDED JUNE 30, 2003.”

In accordance with the Indenture, the Trustee will establish, maintain and hold in trust a special fund designated the “Judgment Obligation Fund” and a special fund designated the “Bond Fund.” Not later than July 31 of each Fiscal Year commencing July 31, 2005, the City will transfer to the Trustee an amount which, together with the amount then on deposit in the Judgment Obligation Fund, will equal the amount of the principal of and interest on the Bonds becoming due in such Fiscal Year. The Trustee will, upon receipt, deposit such amount in the Judgment Obligation Fund.

On the last Business Day immediately preceding each Interest Payment Date, the Trustee will withdraw from the Judgment Obligation Fund and deposit in the Bond Fund in immediately available funds an amount which, together with the amount then on deposit in the Bond Fund, will equal the principal, if any, of and interest due on the Bonds on such Interest Payment Date.

On or before each Interest Payment Date, the Trustee will withdraw from the Bond Fund for payment to the Owners of the Bonds the principal, if any, of and interest then due and payable on the Bonds. If there are insufficient funds in the Bond Fund to pay the principal, if any, of and interest on the Bonds, the Trustee will apply the available funds first to the payment of interest on the Bonds, then to the payment of principal of the Bonds.

THE OBLIGATIONS OF THE CITY UNDER THE BONDS, INCLUDING THE OBLIGATION TO MAKE ALL PAYMENTS OF THE INTEREST ON AND THE PRINCIPAL OF THE BONDS WHEN DUE OR UPON PRIOR REDEMPTION, ARE OBLIGATIONS OF THE CITY IMPOSED BY LAW AND ARE ABSOLUTE AND UNCONDITIONAL, WITHOUT ANY RIGHT OF SET-OFF OR COUNTERCLAIM. THE BONDS DO NOT CONSTITUTE AN OBLIGATION OF THE CITY FOR WHICH THE CITY IS OBLIGATED TO LEVY OR PLEDGE ANY FORM OF TAXATION OR FOR WHICH THE CITY HAS LEVIED OR PLEDGED ANY FORM OF TAXATION, AND NEITHER THE BONDS NOR THE OBLIGATION OF THE CITY TO MAKE PAYMENT OF THE INTEREST ON OR THE PRINCIPAL OF THE BONDS CONSTITUTES AN INDEBTEDNESS OF THE CITY OR THE STATE, OR ANY OF ITS POLITICAL SUBDIVISIONS, IN CONTRAVENTION OF ANY CONSTITUTIONAL OR STATUTORY DEBT LIMITATION OR RESTRICTION.

If an Event of Default, as that term is defined in the Indenture, will occur, the principal of all Bonds may be declared due and payable upon the conditions, in the manner and with the effect provided in the Indenture; provided, that the Indenture provides that in certain events such declaration and its consequences may be rescinded under the circumstances as provided therein. See “Action on Default” below.

The Indenture and the rights and obligations of the City, the owners of the Bonds and the Trustee may be modified or amended from time to time and at any time in the manner, to the extent, and upon the terms provided in the Indenture; provided that no such modification or amendment will (a) extend the fixed maturity of any Bonds, or reduce the amount of principal thereof, or reduce the interest rate borne thereby, or extend or accelerate the time of payment thereof, or modify the redemption provisions applicable thereto, without the consent of the owner of each Bond so affected, or (b) reduce the percentage of Bonds the consent of the owners of which is required to effect any such amendment or modification, without the consent of the owners of all outstanding Bonds.

Action on Default

Should the City default under the Indenture, the Trustee may and, upon the written direction of the Owners of not less than 50% in aggregate principal amount of the Outstanding Bonds, shall, by written notice to the City, declare immediately due and payable the principal of all Outstanding Bonds and the accrued interest thereon, whereupon the same shall become immediately due and payable without any further action or notice; provided, however, that the indebtedness evidenced by the Bonds shall not be accelerated without the Insurer's prior written consent and the Insurer may, in its discretion, either direct the accelerated payment of the Bonds or continue to pay principal and interest on the originally scheduled due dates of the Bonds. See APPENDIX C – “SUMMARY OF INDENTURE – Events of Default and Remedies.” For specific with respect to the Insurer and the coverage provided by the Policy, see “MUNICIPAL BOND INSURANCE” herein and the Policy that has been reproduced in specimen form

in APPENDIX G – “FORM OF FINANCIAL GUARANTY INSURANCE POLICY” hereto. All money in the Judgment Obligation Fund and the Bond Fund upon the date of the declaration of acceleration by the Trustee and all amounts thereafter received by the Trustee under the Indenture will be applied by the Trustee to the payment of any expenses of the Trustee incurred in and about the performance of its powers and duties under the Indenture and thereafter to the payment of the principal of and interest then due on the Bonds as provided in the Indenture. For a description of the events of default and permitted remedies of the Trustee under the Indenture, see APPENDIX C – “SUMMARY OF INDENTURE – Events of Default and Remedies.”

Additional Financing

The City expects to enter into a Lease Agreement and related documents and to cause the execution and delivery, concurrently with the delivery of the Bonds, of certificates of participation to be captioned “City of Desert Hot Springs Certificates of Participation (Interim Cash Flow Financing)” in \$3,060,000 aggregate principal amount. Proceeds of the Certificates, together with other funds available to the City will be applied to pay the costs of the Exit Financing not being funded with proceeds of the Bonds. See also “THE JUDGMENT AND THE PLAN OF FINANCE” below.

MUNICIPAL BOND INSURANCE

The following information has been furnished by the Insurer for use in this Official Statement. No representation is made by the City or the Underwriter as to the accuracy or completeness of such information, or the absence of material adverse changes therein at any time subsequent to the date hereof. Reference is made to APPENDIX G for a specimen of the Insurer’s policy. The Insurer accepts no responsibility for the accuracy or completeness of this Official Statement or any other information or disclosure contained herein, or omitted herefrom, other than with respect to the accuracy of the information regarding the Insurer and its affiliates set forth under this heading. In addition, the Insurer makes no representation regarding the Bonds or the advisability of investing in the Bonds.

Financial Guaranty Insurance Policy

A financial guaranty insurance policy (the “Policy”) will be issued by Radian Asset Assurance Inc. (the “Insurer”) simultaneously with the issuance and delivery of the Bonds. The Policy is noncancelable during its term and provides for the prompt payment of principal of and interest on the Bonds to the extent that the Trustee, has not received sufficient funds from the City for payment of the Bonds on the “due date.” The Insurer is obligated to make the required payment on the later of the due date or the first business day after which the Insurer has received notice from The Bank of New York, as Insurance Trustee (the “Insurance Trustee”), that the City has failed to pay amounts due on the Bonds. Under the Policy, the “due date” of the Bonds, when referring to the payment of principal, means the stated maturity date thereof or the date on which payment of principal is due by reason of mandatory sinking fund payments and does not mean any earlier date on which payment is due by reason of any call for redemption, acceleration, or other advancement of maturity, other than in the discretion of the Insurer. With respect to interest on the Bonds, the “due date” means the stated date for payment of interest. The Policy guarantees reimbursement of any recovery of any such payment from a Holder or the Trustee pursuant to a final judgment by any court of competent jurisdiction holding that such payment constituted a voidable preference within the meaning of any applicable bankruptcy law.

Upon the occurrence and continuance of an Event of Default, the Insurer, may, in its discretion, direct the acceleration of the Bonds at a price equal to the principal amount thereof plus accrued interest, or the Insurer may elect to continue to pay principal and interest on the originally scheduled due dates of the Bonds. For specific information on the coverage provided, reference should be made to the Policy

that has been reproduced in specimen form in APPENDIX G – “FORM OF FINANCIAL GUARANTY INSURANCE POLICY” hereto. The Policy does not insure against nonpayment of principal or interest on the Bonds due to the insolvency, misconduct or negligence of the Trustee. The Policy does not insure the payment of any redemption premium.

Radian Asset Assurance Inc.

Radian Asset Assurance Inc. (the "Insurer") is a financial guaranty insurance company, regulated by the Insurance Department of the State of New York and licensed to do business in all 50 states and the District of Columbia. The Insurer was formerly known as “Asset Guaranty Insurance Company”. The Insurer changed its corporate name to Radian Asset Assurance Inc. The Insurer has received approval to use its new corporate name in all jurisdictions where it is licensed to do business. As of June 30, 2004, the Insurer had total shareholders' equity of approximately \$1,345,192,000 (unaudited) and total assets of approximately \$2,271,260,000 (unaudited). The financial information relating to the Insurer presented in this Official Statement was prepared internally by the Insurer, based on accounting principles generally accepted in the United States of America (“GAAP”), and has not been audited by independent auditors. The address of the Insurer's administrative office is 335 Madison Avenue, New York, New York 10017, and its telephone number is 212-983-5859.

The Insurer has filed the following information with entities designated as Nationally Recognized Municipal Securities Information Repositories (“NRMSIRs”) pursuant to Rule 15c2-12 of the Securities Exchange Act of 1934:

(i) the Insurer's consolidated financial statements as of December 31, 2003 and 2002 and for each of the three years in the period ended December 31, 2003 prepared in accordance with generally accepted accounting principles with the accompanying report of the Insurer's independent auditors, which expresses an unqualified opinion and includes an explanatory paragraph referring to a significant insurance loss recognized subsequent to the balance sheet date;

(ii) the Insurer's quarterly unaudited consolidated balance sheet as of March 31, 2004 and unaudited consolidated statement of operations for the three month period then ended, prepared in accordance with generally accepted accounting principles; and

(iii) the Insurer's quarterly unaudited consolidated balance sheet as of June 30, 2004 and unaudited consolidated statement of operations for the six month period then ended, prepared in accordance with generally accepted accounting principles.

The Insurer has an insurance financial strength rating of “AA” from Standard & Poor's Ratings Services, a division of The McGraw-Hill Companies, Inc. (“S&P”), “Aa3” from Moody's Investors Service, Inc. (“Moody's”) and “AA” by Fitch Ratings Services (“Fitch”). Such ratings reflect only the views of S&P, Moody's and Fitch, respectively, do not constitute a recommendation to buy, sell or hold securities and are subject to revision or withdrawal at any time by such rating agencies.

The Insurer is a wholly-owned indirect subsidiary of Radian Group Inc. (“Radian”), a publicly-owned corporation with its shares listed on the New York Stock Exchange (symbol “RDN”). Radian is a leading credit enhancement provider to the global financial and capital markets, headquartered in Philadelphia. Radian's subsidiaries provide products and services through three business lines: financial guaranty, mortgage insurance and financial services. None of Radian, Radian's other subsidiaries or any of Radian's investors is obligated to pay the debts of or claims against the Insurer. A complete copy of the audited consolidated financial statements and additional information of the Insurer as of December 31, 2003 and 2002, and for each of the three years in the period ended December 31, 2003, together with the

accompanying report of the Insurer's independent auditors, is available from the Insurer upon written request.

Additional information regarding the Insurer can be found in the following documents filed by Radian with the Securities and Exchange Commission: (a) in the Annual Report on Form 10-K of Radian for the year ended December 31, 2003 and the Quarterly Reports on Form 10-Q for the periods ended March 31, 2004 and June 30, 2004 under the headings (i) "Safe Harbor Statement under the Private Securities Limitation Reform Act of 1995" (but insofar as it relates to the financial guaranty insurance businesses); (ii) 10-K only, Item 1. Business: "*Financial Guaranty Business*" "Risk Management – *Financial Guaranty Business*" "*Ratings*" (but only insofar as it relates to the Insurer or Radian Reinsurance Inc.), "*Defaults and Claims*" (but only insofar as it relates to the financial guaranty business) and "Regulation – *Direct Regulation*" (but only insofar as it relates to the financial guaranty business); (iii) 10-K only, "Item 6 – Selected Financial Data –" "Selected Ratios – Financial Guaranty" and "Other Data – Financial Guaranty," and (iv) Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations "Financial Guaranty – Results of Operations, and "Liquidity and Capital Resources" (but only to the extent it relates to Radian Asset Assurance or Radian Reinsurance), and "Critical Accounting Policies;" and (b) the Reports on Form 8-K dated January 15, 2004, February 11, 2004, April 8, 2004, June 1, 2004, July 9, 2004 and July 22, 2004.

On January 14, 2004, Radian announced that the Insurer will add \$96.0 million to its loss reserves in anticipation of \$111.3 million in claims from a single manufactured housing transaction in which the Insurer reinsured from an affiliate. The Insurer held a \$15.0 million loss reserve for this transaction as of September 30, 2003 and the increased reserve totaling \$111.3 million, represents the Insurer's par exposure on the transaction. The Insurer expects losses to be paid out over the next several years. After Radian's announcement, S&P and Fitch affirmed their respective current "AA" insurance financial strength ratings of the Insurer, but S&P revised its outlook on the Insurer and Radian from "stable" to "negative." On May 25, 2004, Moody's assigned a financial strength rating of "Aa3" to the Insurer with an outlook of "stable". In January 2004, Radian contributed \$65.0 million in capital to the Insurer through an intermediary holding company from funds currently held at Radian to offset (on an after-tax basis) the effect of this loss on the Insurer.

Effective June 1, 2004, the financial guaranty reinsurance affiliate of the Insurer, Radian Reinsurance Inc. ("Radian Reinsurance") was merged with and into the Insurer. As a result of the Merger, the financial guaranty reinsurance business currently conducted by Radian Reinsurance and the direct financial guaranty business conducted by the Insurer will be conducted by the Insurer, and the Insurer has greater assets, liabilities and shareholder's equity than it currently has on a stand-alone basis.

The Insurer has filed with the NRMSIRs a table presenting selected unaudited balance sheet and income sheet data of the Insurer as of December 31, 2001 (with respect to non-balance sheet information only), 2002 and 2003 and March 31, 2004 on a proforma combined basis as if Radian Reinsurance were merged with the Insurer as of the dates indicated, in accordance with accounting principles generally accepted in the United States of America. Though unaudited, the information so filed was derived from the respective audited financial statements of the Insurer and Radian Reinsurance Inc. as of December 31, 2003 and 2002, and for each for the three years in the period ended December 31, 2003, together with the respective accompanying reports of the Insurer's independent auditors. For informational purposes, the Insurer has also filed the Radian Reinsurance Inc. audited financial statements with the NRMSIRs referred to above, as well as Radian Reinsurance Inc.'s quarterly unaudited consolidated balance sheet as of March 31, 2004 and unaudited consolidated statement of Income for the three month period then ended, prepared in accordance with generally accepted accounting principles.

Effective January 31, 2004, one primary insurer of Radian Reinsurance exercised its right to recapture the financial guaranty reinsurance business assumed by Radian Reinsurance. In connection with the recapture, Radian Reinsurance returned approximately \$16.4 billion of par in force and approximately \$96.4 million of statutory unearned premium with a carrying value of approximately \$71.5 million determined in accordance with accounting principles generally accepted in the United States of America. In addition, Radian Reinsurance was reimbursed for policy acquisition costs of approximately \$31.0 million with a carrying value of approximately \$21.3 million determined in accordance with accounting principles generally accepted in the United States of America. Radian Reinsurance has also reimbursed the primary insurer approximately \$7.5 million for case reserves, net of \$4.0 million salvage. The impact of the recapture resulted in a reduction of pre-tax income of \$15.9 million determined in accordance with accounting principles generally accepted in the United States of America. Such recapture also resulted in negative net premiums written for the quarter ended March 31, 2004.

Neither the Insurer nor any of its affiliates makes any representation regarding the Bonds or the advisability of purchasing the Bonds and makes no representation regarding this Official Statement other than as to the information supplied by the Insurer and presented under the heading “MUNICIPAL BOND INSURANCE” and as set forth in APPENDIX G – “FORM OF FINANCIAL GUARANTY INSURANCE POLICY” of this Official Statement. The Insurer's role is limited to providing the coverage set forth in the Policy. In accordance with applicable law, in the event the insurer becomes insolvent, any claims arising under this policy are excluded from coverage by the California Insurance Guaranty Association, established pursuant to Article 15.2 (commencing with Section 1063) of Chapter 1 of Part 2 of Division 1 of the California Insurance Code.

THE JUDGMENT AND THE PLAN OF FINANCE

Bankruptcy Claims; Silver Sage Judgment and Settlement Agreement

The City is currently a debtor in a case pending under Chapter 9 of the United States Bankruptcy Code in the Bankruptcy Court for the Central District of California, styled as *In re City of Desert Hot Springs*, Case No. RS01-30756-DN. That action, commenced by the City on December 19, 2001, resulted in large part from the City's inability to pay the Silver Sage Judgment, the accumulated post-judgment interest, and the substantial attorneys' fees for which the City would be held liable, as described below. Two principal creditor groups, one being the subject of the Silver Sage Judgment and Settlement Agreement, are creditors involved in the Chapter 9 Case. In summary, total claims to be satisfied under the City's Plan in the Chapter 9 Case are approximately \$11.5 million. The portion thereof to be financed and satisfied with proceeds of the Bonds is \$8,850,000. Remaining claims will be paid under the Plan from earmarked available funds of the City and proceeds of Certificates of Participation to be delivered concurrently with the Bonds. Proceeds of the Bonds and certain Certificates of Participation, together with other funds available to the City, will be used to pay the Judgment Obligees and applied to pay the costs of the Exit Financing required for settlement with creditors under the Chapter 9 Case and the City's exit from jurisdiction of the Bankruptcy Court. The principal creditors groups and claims before the Bankruptcy Court are as follows (capitalized terms not defined in this document and used in this section have the meanings given to them in the Plan):

First, an entity known as Silver Sage Partners Ltd. and its various principals and advisors (collectively referred to herein as “Silver Sage”) are creditors against the City under a judgment for damages resulting from an alleged violation of the federal Fair Housing Act. In 1991, an entity known as Silver Sage Partners Ltd. and associated individuals sued the City in the United States District Court for the Central District of California for damages arising out of an alleged violation of the federal Fair Housing Act (“FHA”), contending that the City improperly denied approval of a low income mobile home housing project within the City. A jury found the City liable under the FHA and assessed damages

against the City in the amount of \$3,040,439. The District Court subsequently reconsidered the damage award and ordered a new trial on damages, which resulted in a new damages award of \$1. Silver Sage subsequently appealed to the United States Court of Appeals for the Ninth Circuit, which in 2001 reversed the new trial order, directed that the original damage award be reinstated, and remanded the matter back to the District Court for a determination of an award of attorneys' fees in favor of Silver Sage, and directed the District Court to award attorneys' fees to the plaintiffs (collectively, the "Silver Sage Plaintiffs"). *Silver Sage Partners, Ltd. v. City of Desert Hot Springs*, 251 F.3d 814 (9th Cir. 2001). As part of the Plan, and pursuant to the order of the Bankruptcy Court confirming the Plan under section 943 of the Bankruptcy Code (the "Confirmation Order"), the City is obligated by law to pay the Silver Sage Plaintiffs, as Judgment Obligees as described herein, \$8,850,000 in satisfaction of the Silver Sage Judgment and monetary claims related to the Silver Sage case.

The Plan provides for the following with respect to Silver Sage:

In full satisfaction, release and discharge of the Silver Sage Monetary Claims, the City or its agent shall provide counsel for holders of the Silver Sage Claims, a cash payment on the Effective Date in the amount of \$8,850,000; and in full satisfaction, release and discharge of the Silver Sage Remedial Claims, on the Effective Date the City will consent to the entry of the Silver Sage Remedial Order by the District Court.

Pursuant to Bankruptcy Rule 9019 and in consideration for the distributions and other benefits provided under the Plan, the terms of the Plan are deemed to constitute a good faith compromise and settlement of all claims or controversies relating to the validity, enforceability, existence, extent, and amount of the Silver Sage Claims, as set forth in the Silver Sage Settlement Agreement. The entry of the Confirmation Order constitutes the approval by the Bankruptcy Court of such compromise and settlement and a determination that the Silver Sage Settlement Agreement and the compromises embodied therein are fair, reasonable, and in the best interests of the City and its creditors.

Second, holders of the City's \$1,415,000 original principal amount of Taxable Tax and Revenue Anticipation Notes (the "1998 TRANs"), stand as creditors under a settlement agreement that provided for the City to repay its obligations in twelve installment payments over the course of four years, commencing on January 31, 2001. In 1997, the City issued \$1,415,000 original principal amount of Taxable Tax and Revenue Anticipation Notes (the "1998 TRANs"), due to mature in June 1998. The 1998 TRANs were issued to provide funds to meet the City's repayment obligation under certain Taxable Tax and Revenue Anticipation Notes which matured in June 1997. Due to a budget shortfall at that maturity date of the 1998 TRANs, the City was unable to repay the 1998 TRANs, and defaulted on its obligations to holders. Following litigation, the City and holders of the 1998 TRANs entered into a Settlement Agreement and Mutual General Release, dated on or about April 2001, among the City, holders of the TRANs, and other parties (the "Settlement") that provided for the City to repay its obligations in twelve installment payments over the course of four years, commencing on January 31, 2001. Prior to the date of the City's Chapter 9 Petition, the City made the first three installment payments on its obligations under the settlement agreement.

The City's installment obligations under the 1998 TRANs settlement were made possible only because the City appealed to its residents for help, in the form of consent to an increased tax burden. In the general election held in March 2000, the City submitted to its voters Measure "F," which provided for a temporary five-year, 5% "Utility User's tax" measured on utility charges paid by City residents. The voters approved that tax with an advisory measure directing the City to apply forty percent (40%) of the tax revenues to reduce its debt (via payments with respect to the 1998 TRANs settlement), with the remainder to establish critical City reserves. The Utility User's tax was originally scheduled to expire on June 30, 2005. Residents of the City voted to extend the Utility User's tax by five years (through June 30,

2010), and to devote fifty percent of the revenues from the tax to resolution of the City's financial obligations under the Chapter 9 Petition.

The Plan provides for the following with respect to the 1998 TRANs:

As of the Effective Date, the TRANs claims shall be deemed to be Allowed Claims in the aggregate amount of \$1,356,450.70, plus an amount of \$303.87 accruing for each day after May 14, 2004, until the date on which the TRANs claims are paid pursuant to the Plan.

Pursuant to Bankruptcy Rule 9019 and in consideration for the distributions and other benefits provided under the Plan, the terms of the Plan are deemed to constitute a good faith compromise and compromise and settlement of the TRANs claims as evidenced by the Settlement and all controversies relating to the validity, enforceability, existence, extent, and amount of the TRANs claims. The entry of the Confirmation Order constitutes the approval by the Bankruptcy Court of such compromise and settlement and a determination that the compromise and settlement is fair, reasonable, and in the best interests of the City and its creditors.

Additional claims, subject to the Plan include:

1. A claim arising under or related to the Equipment Lease-Purchase Agreement, dated as of April 22, 1996 (the "LaSalle Agreement"), between the City and LaSalle National Bank, including without limitation the proof of claim filed by LaSalle National Bank in an amount of \$113,788.75 (the "LaSalle Claim"). As provided in the Plan, as of the Effective Date, the LaSalle Claim shall be deemed to be an Allowed Claim in the aggregate amount of \$84,000.00. The LaSalle Agreement shall be deemed modified and amended to provide that the City's seven remaining installment payments under the LaSalle Agreement shall be in amounts of \$12,000 and shall commence on the first Business Day of the first month following the Effective Date, with successive payments made on the first Business Day of the sixth month after the month of the last such payment. (For example, if the Effective Date occurs on June 15, 2004, the first payment will be made on July 1, 2004, the second payment will be made on January 1, 2005, the third payment will be made on July 1, 2005, and so on).

The City will assume and be bound by the LaSalle Agreement as so modified and amended, and all liens and security agreements provided by the LaSalle Agreement shall remain in place.

2. A claim for the payment of principal and interest due or to become due with respect to any of the Limited Obligation Improvement Bonds. The Limited Obligation Improvement Bonds claim relates to the following outstanding bonds: (a) the \$975,062 City of Desert Hot Springs Assessment District No. 92-1 (Arroyo Vista) Limited Obligation Improvement Bonds, dated as of November 23 or November 24, 1992; (b) the \$765,320 City of Desert Hot Springs Assessment District No. 93-2 (Arroyo Vista) Limited Obligation Improvement Bonds, dated as of October 19, 1993; and (c) the \$441,044.41 City of Desert Hot Springs Assessment District No. 91-1 (Two Bunch Palms Trail) Limited Obligation Improvement Bonds, dated as of May 5, 1994.

The Limited Obligation Bonds were issued under the following Fiscal Agent Agreements: (a) the Fiscal Agent Agreement approved and established by the City in connection with the City of Desert Hot Springs Assessment District No. 92-1 (Arroyo Vista) Limited Obligation Improvement Bonds between the City and U.S. Bank Trust National Association, dated as of November 24, 1992; (b) the Fiscal Agent Agreement approved and established by the City in connection with the City of Desert Hot Springs Assessment District No. 93-2 (Arroyo Vista) Limited Obligation Improvement Bonds between the City and U.S. Bank Trust National Association, dated as of October 19, 1993; and (c) the "Fiscal Agent Agreement" approved and established by the City in connection with the City of Desert Hot Springs

Assessment District No. 91-1 (Two Bunch Palms Trail) Limited Obligation Improvement Bonds between the City and U.S. Bank Trust National Association, dated as of May 5, 1994.

Under the plan, the City's payment obligations under the Limited Obligation Improvement Bonds claims shall be satisfied from the specific revenues pledged to secure such indebtedness in accordance with the operative documents (including without limitation the operative Fiscal Agent Agreement) that govern the Limited Obligation Improvement Bonds. See "CITY FINANCIAL INFORMATION – Bonded and Other Indebtedness – Non-obligatory Debt."

On the Effective Date, each holder of a Limited Obligation Improvement Bond claim shall have all legal, equitable, and contractual rights (including without limitation those provided under the applicable Fiscal Agent Agreement and the other operative documents that govern the Limited Obligation Improvement Bonds) to which such claim entitles such holder, and all liens and security interests provided in connection therewith shall remain in place.

3. An Unsecured Claim for the payment of principal and interest due or to become due in the amount of \$714,423.11 (the "Redevelopment Agency Claim") asserted against the City by the City of Desert Hot Springs Redevelopment Agency. As provided in the Plan, as of the Effective Date, the Redevelopment Agency Claim shall be deemed to be an Allowed Claim in the aggregate amount of \$714,423.11. The holder of the Redevelopment Agency Claim shall receive no distribution or any other consideration on account of such claim until such time as the City determines in its sole discretion that it has sufficient available funds to make all of the other distributions contemplated by the Plan.

Plan of Finance

The Bonds are being issued to provide money for the payment of the City's obligations to the Judgment Obligees, as evidenced by, respectively, the Silver Sage Judgment, the Confirmation Order, and the Settlement Agreement approved in the Confirmation Order. The proceeds from the sale of the Bonds will be used to (i) provide money for the payment of the City's obligations evidenced by the Silver Sage Judgment and Settlement Agreement and (ii) pay the costs incurred in connection with the authorization and issuance of the Bonds. See "ESTIMATED SOURCES AND USES OF FUNDS." The obligation to the Judgment Obligees evidenced by the Silver Sage Judgment, the Confirmation Order, and the Settlement Agreement approved in the Confirmation Order, is an obligation imposed by law. The Bonds, any refunding bonds, the Indenture and any and all contracts and agreements relating thereto, relate to and constitute the refunding of such obligation imposed by law and, accordingly, the City's obligation to pay the Silver Sage Plaintiffs, the Bonds, any refunding bonds, the Indenture and any and all contracts and agreements relating thereto, are exempt from the debt limitation of Article XVI, Section 18 of the California Constitution. On September 24, 2004, the Superior Court of California, County of Riverside, ordered to the effect, among other things, that the City has the authority under California law to issue the Bonds and that the Bonds and the Indenture are valid, legal and binding obligations of the City under California law. See "VALIDATION PROCEEDING."

Satisfaction of Claims Under the Plan; Effective Date of the Plan

The City's payment obligations under the Plan shall be satisfied from unrestricted funds available to the City on and after the Effective Date, including proceeds from the Exit Financing.

Except as otherwise specifically provided in the Plan, on the Effective Date any lien or security interest securing any Secured Claim shall be deemed released, and the entity holding such Secured Claim shall be authorized and directed to release any collateral or other property of the City (including without limitation any cash collateral) held by such entity and to take such actions as may be requested by the

City to evidence the release of such lien, including without limitation the execution, delivery and filing or recording of such releases.

In addition, the City has reserved the right to pursue or adopt against any other entity any claims alleged in any lawsuit in which the City is a defendant or an interested party.

Pursuant to section 944 of the Bankruptcy Code, upon the Effective Date, the City shall be discharged from all debts (as defined in the Bankruptcy Code) of the City and Claims against the City other than (a) any debt specifically and expressly excepted from discharge by the Plan or the Confirmation Order, or (b) any debt owed to an entity that, before the confirmation of the Plan, had neither notice nor actual knowledge of the Chapter 9 Case. This discharge shall not impair enforcement of the Silver Sage Remedial Order.

The rights afforded in the Plan and the treatment of all holders of claims shall be in exchange for and in complete satisfaction, discharge and release of all claims of any nature whatsoever arising on or before the Effective Date, known or unknown, including any interest accrued or expenses incurred thereon from and after the Petition Date, whether against the City or any of its properties, assets or interests in property. Except as otherwise provided herein, upon the Effective Date, all claims against the City shall be and shall be deemed to be satisfied, discharged and released in full.

Except as otherwise expressly provided in the Plan, all entities who have held, hold or may hold pre-Effective Date claims shall be permanently enjoined, from and after the Effective Date, from (a) commencing or continuing in any manner any action or other proceeding of any kind with respect to any such pre-Effective Date claim against the City or its property; (b) enforcing, attaching, collecting, or recovering by any manner or means any judgment, award, decree or order against the City or its property with respect to such pre-Effective Date claims; (c) creating, perfecting, or enforcing any lien or encumbrance of any kind against the City or its property; and (d) asserting any right of setoff, subrogation or recoupment of any kind against any obligation due to the City with respect to any such pre-Effective Date claim, except as otherwise permitted by section 553 of the Bankruptcy Code. This injunction shall not impair enforcement of the Silver Sage Remedial Order.

Following the Effective Date, the Bankruptcy Court shall retain and have exclusive jurisdiction over any matter (x) arising under the Bankruptcy Code and relating to the City, (y) arising in or related to the Chapter 9 Case or the Plan or the Plan Documents, and (z) otherwise for the following:

1. To resolve any matters related to the assumption, assumption and assignment, or rejection of any executory contract or unexpired lease to which the City is a party or with respect to which the City may be liable, and to hear, determine and, if necessary, liquidate, any claims arising therefrom, including those matters related to the amendment after the Effective Date of the Plan to add any executory contracts or unexpired leases to the Schedule of Rejected Agreements;
2. To enter such orders as may be necessary or appropriate to implement or consummate the provisions of the Plan, the Plan Documents, and all other contracts, instruments, releases, and other agreements or documents related to the Plan;
3. To determine any and all motions, adversary proceedings, applications and contested or litigated matters that may be pending on the Effective Date or that, pursuant to the Plan, may be instituted by the City after the Effective Date or that are instituted by any holder of a claim before or after the Effective Date concerning any matter based upon, arising out of, or

relating to the Chapter 9 Case, whether or not such action initially is filed in the Bankruptcy Court or any other court;

4. To ensure that distributions to holders of Allowed Claims are accomplished as provided herein;

5. To hear and determine any objections to claims or to proofs of claim filed, both before and after the Effective Date, including any objections to the classification of any claim, and to allow, disallow, determine, liquidate, classify, estimate or establish the priority of or secured or unsecured status of any claim, in whole or in part;

6. To enter and implement such orders as may be appropriate in the event the Confirmation Order is for any reason stayed, revoked, modified, reversed or vacated;

7. To issue such orders in aid of execution of the Plan, to the extent authorized by section 1142(b) of the Bankruptcy Code;

8. To consider any modifications of the Plan, to cure any defect or omission, or reconcile any inconsistency in any order of the Bankruptcy Court, including the Confirmation Order;

9. To hear and determine all applications for awards of compensation for services rendered and reimbursement of expenses incurred prior to the Effective Date;

10. To hear and determine all disputes or controversies arising in connection with or relating to the Plan or the Confirmation Order or the interpretation, implementation, or enforcement of the Plan or the Confirmation Order or the extent of any entity's obligations incurred in connection with or released under the Plan or the Confirmation Order;

11. To issue injunctions, enter and implement other orders or take such other actions as may be necessary or appropriate to restrain interference by any entity with consummation or enforcement of the Plan;

12. To determine any other matters that may arise in connection with or are related to the Plan, the Disclosure Statement, the Confirmation Order or any contract, instrument, release or other agreement or document related to the Plan or the Disclosure Statement (including the Plan Documents);

13. To hear any other matter or for any purpose specified in the Confirmation Order that is not inconsistent with the Bankruptcy Code;

14. To hear and determine any Rights of Action; and

15. To enter a final decree closing the Chapter 9 Case.

The "effective date of the plan," as used in section 1129 of the Bankruptcy Code, shall not occur, and the Plan shall be of no force and effect, until the Effective Date. The occurrence of the Effective Date is subject to the satisfaction, or waiver as provided therein, of the following conditions precedent:

1. Confirmation Order. The Confirmation Order shall be a Final Order and be in full force and effect. The term "Final Order" means a judgment, order, ruling, or other decree issued

and entered by the Bankruptcy Court or by any state or other federal court or other tribunal having jurisdiction over the subject matter thereof which judgment, order, ruling, or other decree has not been reversed, stayed, modified, or amended and as to which (a) the time to appeal or petition for review, rehearing or certiorari has expired and no appeal or petition for review, rehearing or certiorari is then pending; or (b) any appeal or petition for review, rehearing or certiorari has been finally decided and no further appeal or petition for review, rehearing or certiorari can be taken or granted.

2. Class 3 Maximum. The City determines that the maximum amount of Allowed Class 3 Claims, excluding the PERMA Claims, will not exceed \$2,000,000.

3. Exit Financing. The City shall have consummated the Exit Financing and thereby generated net proceeds available to the City in an amount of at least \$8,500,000.

4. Silver Sage Settlement Agreement. The Silver Sage Settlement Agreement shall be in full force and effect.

5. Timing. The Effective Date shall occur on the first Business Day after which the conditions set forth above are satisfied or waived; provided that, unless otherwise ordered by the Bankruptcy Court, the Effective Date must occur by no later than December 31, 2004.

The City, in its sole discretion, may waive, in whole or in part, any of the conditions to effectiveness of the Plan (provided, however, that the condition to the effect that the Effective Date have occurred by December 31, 2004, may be waived or modified only with the consent of counsel to the Committee and counsel to the Silver Sage Plaintiffs). Any such waiver of a condition may be effected at any time, without notice or leave or order of the Bankruptcy Court and without any formal action, other than the filing of a notice of such waiver with the Bankruptcy Court.

In the event that the conditions to effectiveness of the Plan have not been timely satisfied or waived, and upon notification submitted by the City to the Bankruptcy Court, (a) the Confirmation Order shall be vacated, (b) no distributions under the Plan shall be made, (c) the City and all holders of claims shall be restored to the status quo ante as of the day immediately preceding the Confirmation Date as though the Confirmation Date never occurred, and (d) all of the City's obligations with respect to the claims shall remain unchanged and nothing contained herein shall be deemed to constitute a waiver or release of any claims by or against the City or any other entity or to prejudice in any manner the rights of the City or any entity in any further proceedings involving the City.

ESTIMATED SOURCES AND USES OF FUNDS

The estimated sources and uses of funds with respect to the Bonds are shown below.

SOURCES

Principal Amount of Bonds	\$9,725,000.00
Less Original Issue Discount	(187,954.85)
Total Sources	<u>\$9,537,045.15</u>

USES

Refunding Fund	\$8,850,000.00
Costs of Issuance ⁽¹⁾	678,045.15
Total Uses	<u>\$9,537,045.15</u>

-
- (1) Includes legal, rating agency, bond insurance premium, printing costs, underwriter's discount and other miscellaneous costs of issuance.

DEBT SERVICE SCHEDULE

The table below sets forth the amount required in each Fiscal Year for the payment of principal of and interest on the Bonds. The Bonds mature on March 1 of each year as set forth below.

Debt Service Schedule

Fiscal Year Ending June 30,	Judgment Obligation Bonds		Total	Annual Lease Payments	Annual Debt Service
	Principal	Interest			
2005	--	--	\$164,041.67	\$ 90,685.00	\$254,726.67
2006	--	--	476,250.00	265,950.00	742,200.00
2007	--	--	476,250.00	267,350.00	743,600.00
2008	--	--	476,250.00	267,350.00	743,600.00
2009	--	--	476,250.00	267,150.00	743,400.00
2010	--	--	476,250.00	266,075.00	742,325.00
2011	--	--	476,250.00	265,300.00	741,550.00
2012	--	--	476,250.00	264,137.50	740,387.50
2013	--	--	476,250.00	267,387.50	743,637.50
2014	--	--	476,250.00	264,787.50	741,037.50
2015	--	--	476,250.00	266,950.00	743,200.00
2016	--	--	476,250.00	263,200.00	739,450.00
2017	--	--	476,250.00	264,200.00	740,450.00
2018	--	--	476,250.00	264,700.00	740,950.00
2019	--	--	476,250.00	264,200.00	740,450.00
2020	--	--	476,250.00	263,175.00	739,425.00
2021	--	--	476,250.00	266,625.00	742,875.00
2022	--	--	476,250.00	263,700.00	739,950.00
2023	\$165,000	\$476,250.00	641,250.00	100,225.00	741,475.00
2024	275,000	468,412.50	743,412.50	--	743,412.50
2025	285,000	455,350.00	740,350.00	--	740,350.00
2026	300,000	441,812.50	741,812.50	--	741,812.50
2027	315,000	427,562.50	742,562.50	--	742,562.50
2028	330,000	412,600.00	742,600.00	--	742,600.00
2029	345,000	396,925.00	741,925.00	--	741,925.00
2030	360,000	380,537.50	740,537.50	--	740,537.50
2031	380,000	363,437.50	743,437.50	--	743,437.50
2032	395,000	345,387.50	740,387.50	--	740,387.50
2033	415,000	326,625.00	741,625.00	--	741,625.00
2034	435,000	306,912.50	741,912.50	--	741,912.50
2035	455,000	286,250.00	741,250.00	--	741,250.00
2036	480,000	263,500.00	743,500.00	--	743,500.00
2037	500,000	239,500.00	739,500.00	--	739,500.00
2038	525,000	214,500.00	739,500.00	--	739,500.00
2039	555,000	188,250.00	743,250.00	--	743,250.00
2040	580,000	160,500.00	740,500.00	--	740,500.00
2041	610,000	131,500.00	741,500.00	--	741,500.00
2042	640,000	101,000.00	741,000.00	--	741,000.00
2043	675,000	69,000.00	744,000.00	--	744,000.00
2044	705,000	35,250.00	740,250.00	--	740,250.00

THE CITY

Introduction

The City is located in Riverside County, California, approximately 110 miles southeast of Los Angeles. Regionally recognized as part of the Palm Springs Desert Resorts, the City is located in the foothills of the San Bernardino Mountains, overlooking Palm Springs and the Coachella Valley.

The City is a small community with a current population of approximately 17,700, principally known as a unique city of spas and resorts just minutes north of Palm Springs, nestled in the foothills of Joshua Tree National Park. Built over one of the world's finest natural hot mineral water aquifers, the City also boasts award winning municipal drinking water, clean air and magnificent scenery. A principal feature of the City is crystal clear mineral waters flowing from the earth directly into the thermal wells of more than 40 hotel spas. The steaming, restorative waters have attracted visitors from around the globe. Hikers, campers, photographers, and other nature lovers also enjoy Desert Hot Springs as a gateway city to the spectacular Joshua Tree National Park.

The City was founded by a quirky settler named Cabot Yerxa, a Minnesota native who arrived in Southern California in 1913, settled in the desert and discovered the hot springs. Over time, the City has sought to capitalize on its natural resource. Today, thousands of visitors and "snowbirds" come to the City, taking advantage of the spas. There are on average more than 330 days of sunshine per year. With warm, sunny, clear and dry days, winter visitors find the area most attractive. The summer months are warm, but comfortable due to the low humidity and elevation above the rest of the valley. Mean elevation of the City is 1,185 feet.

The City was incorporated in 1963 and has experienced relatively slow growth which, in the past several years, has begun to accelerate somewhat. Long thought of as a retirement community and a tourist attraction for those seeking its natural hot mineral waters, the City is now attracting more families looking for affordable housing and a small town atmosphere. The valley was once considered a retirement community. In 1984, the median age was 64.7 years. In 1994 the median age had dropped to 31.5 years. The current median average age is 37.33 years old.

The City is approximately 23.3 square miles in size and currently includes within its boundaries four elementary schools, one middle school, one high school, six city parks, one recreational center and one branch of the Riverside County Public Library. Major health care facilities are located approximately 10 miles south in the City of Palm Springs. Palm Springs Unified School Districts serves the City, and its educational facilities include 15 elementary schools district-wide. Cabot's Museum is a Riverside County registered historic site. This museum was built by Cabot Yerxa over a 20 year period between 1940 and 1965.

Based on a 2002-03 report prepared by HDL, Coren & Cone the following types of property represent the asset value within the City's limits: Residential 62.3%, Unsecured 4.9%, Vacant land 12.1%, Commercial 15.6%, Institutional 1.6% and Other 2.6%. A total 10,048 parcels appeared on the secured tax roll and a total of 364 parcels appeared on the unsecured tax roll. The City is currently experiencing a period of growth in single family residential building throughout the City's limits. Currently 15 developments are in various stages of planning, building and completion for occupancy. A total of 10,126 new single family units is expected to be added to the City once these 15 developments are completed. With this growth it is anticipated that the City will build an additional elementary school, and a second fire station, and increase police, fire and medial emergency staffing to provide the services needed to support such growth.

Tourism, the City's main industry, benefits from three major resort hotels. In addition to these three hotels, there are 46 smaller spa-type resorts featuring hot mineral springs, providing a total of about 1,200 visitor rooms. Two 18-hole public golf courses are open near the City, each with a clubhouse, snack bar, proshop and retail store.

A wide range of activities are available to the Desert Hot Springs visitor. Hiking, golf, tennis, shuffleboard, sunning, shopping, sightseeing, bicycle riding, ballooning and horseback riding are all within easy reach of the Desert Hot Springs community. Museums, theatre, concerts and other cultural events are also available in the area.

Regional and international access to the City is convenient. The City is an approximately two hour drive either from Los Angeles via Interstate 10 or from San Diego via Interstates 15 and 10. The City is located on the direct route from Los Angeles to Phoenix. Palm Springs International Airport, offering connections to all parts of the world, is only twelve miles away. A larger regional airport, Ontario International Airport, is located approximately 70 miles west of the City and 35 miles east of downtown Los Angeles; an approximately one hour drive from the City. Bus travel is also readily available with Sunline Transit Agency buses providing service between the City and other Coachella Valley cities, and with local service supplemented by Greyhound and Desert Stage Lines.

See also, APPENDIX A – "CERTAIN INFORMATION REGARDING THE CITY OF DESERT HOT SPRINGS AND ECONOMIC AND DEMOGRAPHIC INFORMATION OF THE AREA" herein.

Government and Administration

The City is a charter city operating under the council-manager form of government. City Council members are elected at large for staggered four-year terms at elections held every two years. The Mayor is directly elected and serves a two-year term.

City Council	Date of First Election	Current Term Ends
Matthew Weyuker, <i>Mayor</i>	November 1999	November 2005
Mary Stephens, <i>Vice Mayor</i>	November 1999	November 2007
Gary Bosworth, <i>Council Member</i>	January 1995	November 2005
Hank Hohenstein, <i>Council Member</i>	November 2003	November 2007
Will Pieper, <i>Council Member</i>	November 2002	November 2005

The City is managed by a City Manager, who serves at the pleasure of the City Council, as does the City Attorney. Following is a biographical summary of the City's principal executive officers.

Jerry Hanson, *City Manager*. Mr. Hanson was appointed City Manager and Director of the City of Desert Hot Springs Redevelopment Agency in February 2003. Prior to this appointment, Mr. Hanson was employed by the City as a department head responsible for engineering, development review, building and safety, capital projects, intergovernmental liaison, parks, public works and maintenance. Mr. Hanson has over twelve years previous experience as a department head in charge of public works, building and development, parks and facilities, utilities, funding and financing, regulatory and environmental programs and major capital projects for county government, municipalities and agencies. Prior to entering governmental service, Mr. Hanson was President, Chairman or Director of five integrated corporations located in the San Francisco Bay area, providing funding for land development projects, equipment ownership or leasing programs, sureties for infrastructure construction projects, real estate development, design and management services, and marketing and management services. Previous experience included the management of construction, engineering and management services as Area Manager for the Morrison-Knudsen Corporation, serving customers such as General Motors, Firestone,

Phillip Morris, IBM, Xerox, Ford Motor Company and Schlitz Brewing. Mr. Hanson was awarded a Juris Doctorate (*Summa Cum Laude*) from Madison University, a Masters Degree (*with Honors*) from University of Hawaii, and a Bachelor of Science in Engineering from Montana State University. Mr. Hanson is a licensed professional engineer, architect, surveyor, a Seated National Construction Arbitrator and serves several State Boards as a professional expert.

Patricia A. Larson, *City Attorney*. Patricia “Corky” Larson was appointed City Attorney in 2004. Mrs. Larson received her Bachelor of Science degree from UCLA and her Juris Doctorate from Citrus Belt Law School. She is an active member of the California State Bar and as such she is permitted to argue cases in State of California courts and the United States District Court. She is also a member of the Desert Bar Association and the American Bar Association.

Mrs. Larson served two terms on the Palm Springs Board of Education, three terms as a member of the Riverside County Board of Supervisors, and served as Executive Director of the Coachella Valley Association of Governments for eight years. Over those years Mrs. Larson also served on numerous Joint Power Authorities and other local committees, serving as Chair of LAFCO, RCTC, SunLine Transit Agency, Salton Sea Authority, Riverside County School Boards Association and as a Director of the California School Boards Association. She served on the Hemet Federal Savings Board of Directors. Mrs. Larson has been a speaker for classes at Harvard Business School and Michigan State Business School. Mrs. Larson presently is a member of the Coachella Valley Water District Board of Directors. She also serves on the Board of Directors of the East Valley Tourism Development Authority.

Linda Kelly, *Finance Manager*. Ms. Kelly was appointed as designated Finance Manager in 2003. Ms. Kelly previously served the City as Administration Services Manager from January 1996 until her designation as Finance Manager. Each of these positions is under the administrative direction of the City Manager. Prior to public service, Ms. Kelly was employed with Ernst & Young as a Senior Accountant for over 24 years and worked directly with four managing partners in the Business Management Department of the firm’s Century City Office in Los Angeles, California.

The City has its own Police Department, but contracts for fire protection service from the County. Police protection was transferred from Riverside County Sheriff to the City, which formed its Police Department on July 1, 1997. Fire protection in the City is provided by Riverside County pursuant to a contract for services, and is supplemented by a local volunteer squad.

Labor Relations

The City has two collective bargaining units: the City of Desert Hot Springs Employees Union, and the City of Desert Hot Springs Police Officers Association. These units are the subject of existing three year collective bargaining arrangements which expire in June 2006 in the case of the Employees Union, and June 2006 in the case of the Police Officers Association. The City currently expects the Police Officers Association to re-open negotiations no later than June 1, 2005. All compensation is established by the City Council upon recommendation of the City Manager.

With budget year 2004-05 the City expects increased staffing levels in all departments: police, fire, administration, code enforcement and in the development department. The City recently recruited and hired a Deputy City Manager. Aggregate staffing increases are scheduled at 12 full time employees. The City has budgeted \$1,880,000 in reserves, with \$260,000 set aside as reserves for salary increases, including benefits and funding made available for management during bargaining with the two of its bargaining units. An additional \$500,000 has been set aside for increases expected to be required in connection with City pension and health benefits as required by the State of California Public Employees' Retirement System. See “CITY FINANCIAL INFORMATION - Pensions; Plan Descriptions.”

Services and Facilities

Residents of the City are supplied with water and sewer service by the Mission Springs Water District. Power is supplied by Southern California Edison and telephone service is provided by Verizon. Residential natural gas is supplied by Southern California Gas Company. Desert Valley Disposal provides solid waste disposal services within the City limits.

The Mission Springs Water District (formerly the Desert Hot Springs County Water District) (the “MSWD”) was formed in 1953 for the purpose of providing an adequate water supply for the City and its environs. The MSWD’s territory contains approximately 133 square miles, and includes the City and the communities of North Palm Springs, West Palm Springs, Desert Crest, West Garnet, Painted Hills, and Mission Lakes. The MSWD provides domestic water and sewage service to the same communities. The source of supply for the MSWD service area is derived 100% from groundwater. Their primary source of supply is the Mission Creek Subbasin.

A pattern of groundwater dependency by local residents began during the 1940s. With consumption increasing, it was discovered in the late 1950s that the local water table had dropped by as much as 70 feet in some areas. Concerned about future supply, voters formed the Desert Water Agency (the “DWA”) to qualify for participation in the California Water plan, and to avail themselves of water originating in the Feather River in northern California and released from Oroville Dam, and unregulated flows that have traveled through the San Francisco Bay/Sacramento-San Joaquin River Delta. This water is made available through participation in the State Water Project, which is owned by the State and operated by the State Department of Water Resources. This project transports such water south via the California Aqueduct to various delivery points along the approximately 444 mile length of the California Aqueduct. MSWD later joined Desert Water Agency’s taxing jurisdiction boundary to also qualify for the State Water Project. The DWA is responsible for management of the water supply within its service area, including artificial and natural recharge. The MSWD is totally within the DWA’s service area.

In 1962, the DWA entered into a water supply contract (the “State Water Contract”) with the State of California through the California Department of Water Resources. The State Water Contract will remain in force until at least 2029. At the expiration of the State Water Contract, the DWA has the option to continue State Water Project deliveries thereafter under substantially the same terms and conditions.

DWA has conducted an extensive hydrologic study of the Desert Hot Springs area and, in the past few years, has completed construction of a turnout on the Colorado River Aqueduct for purposes of recharging the Mission Creek Subbasin. Management of the availability of local groundwater supplies, and State Water Project supplies, through water marketing and groundwater banking is expected to play an important role in meeting California water needs.

Financial and Accounting Information

The accounts of the City are organized on the basis of funds and account groups, each of which is considered a separate 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 or expenses, as appropriate. Government 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 the spending activities are controlled. The various funds are grouped into fund and account categories as described below under the caption “CITY FINANCIAL INFORMATION” and in APPENDIX B – AUDITED FINANCIAL STATEMENTS OF THE CITY OF DESERT HOT SPRINGS FOR THE FISCAL YEAR ENDED JUNE 30, 2003” (see Note 1 therein).

CITY FINANCIAL INFORMATION

The following selected financial information provides a brief overview of the City's finances. This financial information has been extracted from the City's audited financial statements and, in some cases, from unaudited information provided by the City's Finance Department. The most recent audited financial statements of the City with an unqualified auditor's opinion is included as APPENDIX B – AUDITED FINANCIAL STATEMENTS OF THE CITY OF DESERT HOT SPRINGS FOR THE FISCAL YEAR ENDED JUNE 30, 2003” hereto.

In response to the Ninth Circuit's reinstatement of the original Silver Sage jury verdict together with attorney fees seven years after the trial and original jury verdict, as described above (which, with interest, was asserted in an amount of more than \$4.4 million), the City initiated the Chapter 9 Bankruptcy Proceedings by filing a voluntary petition under Chapter 9 of the Bankruptcy Code on December 19, 2001 in the United States Bankruptcy Judge for the Central District of California. The City's determination to initiate bankruptcy proceedings was compelled due to a variety of factors existing at that time, including low property values within the City, minimal retail and industry investment in the City, low per-capita income for the City's residents, and the revenue restrictions described herein. The City believed that it had no way of satisfying its obligations to Silver Sage absent relief under the Bankruptcy Code.

On or about April 30, 2004, the City filed with the Bankruptcy Court its Third Amended Plan for the Adjustment of Debts, dated April 28, 2004 (the “Plan”). On May 14, 2004, the Bankruptcy Court approved the City's Disclosure Statement with respect to the Plan and authorized the City to solicit the votes of creditors on the Plan. On July 26, 2004, the Bankruptcy Court considered confirmation of the Plan and confirmed the Third Amended Plan of Adjustment of Debts.

The Plan specifies the classification and treatment of the various pre-bankruptcy claims that have been asserted against the City. With certain exceptions, the Plan generally provides for a discharge of pre-bankruptcy claims in exchange for the treatment accorded such claims in the Plan. Among other things, the Plan provides for the payment of claims in respect of the 1998 TRANs Settlement in the compromised amount of \$1,356,450.70 plus interest of \$303.87 for each day after May 14, 2004, through the date of payment, with payment to be made on the Plan's Effective Date. The Plan also provides for the payment of all claims asserted by Silver Sage in respect of the Judgment in the compromised amount of \$8,850,000, with payment to be made on the Plan's Effective Date.

The City's installment obligations under the 1998 TRANs settlement were made possible only because the City appealed to its residents for help, in the form of consent to an increased tax burden. In the general election held in March 2000, the City submitted to its voters Measure “F,” which provided for a temporary five-year, 5% “Utility User's tax” measured on utility charges paid by City residents. The voters approved that tax with an advisory measure directing the City to apply forty percent (40%) of the tax revenues to reduce its debt (via payments with respect to the 1998 TRANs settlement), with the remainder to establish critical City reserves. The Utility User's tax was originally scheduled to expire on June 30, 2005. Residents of the City voted to extend the Utility User's tax by five years (through June 30, 2010), and to devote fifty percent of the revenues from the tax to resolution of the City's financial obligations under the Chapter 9 Petition.

The City had a deficit fund balance in the General Fund. The deficit fund balance was as a result of the ongoing legal expenses associated with the bankruptcy, protracted litigation with Silver Sage, and Loans from the City of Desert Hot Springs Redevelopment Agency to the General Fund. State budget cuts have also negatively affected City revenues. However, under strong and directed leadership, City revenues have increased dramatically by putting into place appropriate fees, participating in grant

programs, and obtaining a fair share of local agency funds. Although staff has grown slightly, the efficiency and work productivity is extremely high.

Economy

Following is a table which summarizes key economic indicators with respect to the City for the years 1999 through 2003:

Table 1
City of Desert Hot Springs Key Economic Indicators
Calendar Years 1999 through 2003

	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>
Population	16,400	16,582	16,750	16,950	17,300
Employment	6,200	6,470	6,760	7,100	7,300
Unemployment	370	400	390	480	490
Unemployment rate	5.7%	5.8%	5.5%	6.3%	6.3%

Sources: Data derived from California Department of Finance, Demographic Research Unit (Population); Employment Development Department, Labor Market Information Division (Employment, Unemployment).

City General Fund Budget

The City's General Fund revenues consist primarily of utility user's taxes, sales taxes, transient occupancy taxes, property taxes, and motor vehicle in-lieu taxes. Incorporated in 1963, the City did not levy a property tax prior to 1978, when Proposition 13 was adopted. Consequently, it receives a relatively low share of the county-wide 1% property tax under the statutory formula for distribution of those tax revenues to local agencies. Under legislation adopted in 1988, some relief has been granted to cities in similar circumstances, however property tax collections continue to be below what other cities collect. Currently, the City receives approximately \$0.163 of every property tax dollar paid by its residents. The City's increase in assessed value by 10.96% compared to other cities in the general area who's assessed value increased from 9.64% to 33.20%.

The City received \$976,746 in VLF in-lieu revenues in 2002-03, received approximately \$770,336 in 2003-04, and has budgeted to receive \$893,505 in 2004-05. As discussed below under "State Budget Acts," since June 30, 2003, the City has lost approximately \$196,215 due to the VLF related reductions and the failure of the State to make Backfill payments. However, as part of the City's 2003-04 annual budget, the City Council included a \$196,215 reduction in revenues projected to be received from the State in anticipation of the State's revenue shortfall and, therefore, should not be effected further in 2003-04 by the loss of the \$196,215. The 2004-05 State Budget includes funding for Backfill payments to cover the reduction in the VLF. However, the budget is subject to the legislative process and the final form and extent of such legislation, if adopted, cannot be predicted. See "State Budget Acts" below for additional information regarding the VLF and other fiscal impacts the 2003-04 and 2004-05 State Budgets may have on the City. See "State Budget Acts" below.

General Fund operating expenditures of the City tend to occur in level amounts throughout the Fiscal Year. Conversely, receipts have followed an uneven pattern primarily as a result of secured and unsecured property tax installment payment dates in December and April. As a result, the General Fund cash balance has typically been negative for a portion of each Fiscal Year and has been covered by temporary borrowings under the pooled investments program from restricted finds of the City which the City is obligated to pay back during the ensuing Fiscal Year.

Budgetary Process

The budget period for the City is for one year. It begins July 1 and ends June 30 one year later. On or before each February 28th, each department head must furnish to the City Manager an estimate of revenues and expenditures for the ensuing year. In preparing the proposed budget, the City Manager reviews the estimates, holds conferences thereon with the respective department heads, boards, or commissions as necessary and advises on revisions of the estimates. The budget process generally includes two or three meetings between the City Manager, the Finance Manager and a Budget Committee of the City Council, comprised of the Mayor and Vice Mayor.

At the first City Council meeting in June, prior to the beginning of the one-year budget period, the City Manager submits to the City Council the proposed budget. At the meeting, the City Council determines the time for the holding of budget hearings and copies of the proposed budget are made available for inspection by the public in the office of the City Clerk and Library. During the hearings, which are held with respect to the budget, all appropriations and revenues are subject to review. Since the budget must be in balance, any shortfall in estimated revenues requires a reduction in appropriation.

On or before each June 30, the City Council adopts an annual budget for the City. From the effective date of the budget, the amounts stated as proposed expenditures become appropriations to the various City departments, offices, and agencies for objects and purposes named, provided that the City Manager may transfer funds within prescribed guidelines established by the City Council. Any revisions that increase the total expenditures of any fund by \$1,000 must be approved by the City Council. At the conclusion of the hearings, the City Council further considers the proposed budget and makes any revisions thereof that it deems advisable and on or before June 30 it adopts the budget with revisions, if any by the affirmative vote of at least a majority of the total members of the council. The City Council and City Management now requires some level of reserve funding in the budget.

The City Council may amend the budget by motion any time during the one-year period. The City Manager may transfer funds from one major expenditure category to another within the same department and fund. Any revisions that alter the total expenditures of any fund must be approved by the City Council. Appropriations remaining at the end of the first year are carried forward to the second year. All appropriations lapse at the end of the one-year period to the extent that they have not been expended or lawfully encumbered.

The City Council employs an independent certified public accountant who, at such time or times as specified by the City Council, at least annually, and at such other times as the independent certified public accountant shall determine, examines the books, records, inventories, and reports of all officers and employees who receive, control, handle, or disburse public funds and all such other officers, employees, or departments as the City Council may direct. As soon as practicable after the end of the Fiscal Year, the final audit is submitted by such accountant to the City Council and a copy of the financial statement as of the close of the Fiscal Year is published. See APPENDIX B – “AUDITED FINANCIAL STATEMENTS OF THE CITY OF DESERT HOT SPRINGS FOR THE FISCAL YEAR ENDED JUNE 30, 2003.”

City General Fund Revenues and Tax Receipts

Taxes received by the City include utility user's taxes, sales taxes, property taxes, business license taxes, transient occupancy taxes, franchise taxes, parking facility taxes and other miscellaneous taxes. Of such taxes, Utility User's Taxes, Sales Taxes and Transient Occupancy Taxes constitute the major sources of revenues. The following table sets forth tax revenues received by the City, by source:

Table 2
City of Desert Hot Springs
City General Fund Revenues and Tax Receipts
Tax Revenues by Source
For Fiscal Years 1999-00 through 2003-04

Source	Fiscal Year Ended June 30,				
	2000	2001	2002	2003	2004
Utility User's Tax	\$ 876,018	\$ 940,179	\$ 1,063,244	\$ 1,066,885	\$ 1,155,992
Sales Taxes	668,017	686,917	752,874	763,699	813,316
Property Taxes ⁽¹⁾	404,142	405,762	421,012	592,230	480,115
Transient Occupancy Taxes	800,579	817,640	850,228	775,266	795,038
Business License Taxes	98,208	100,772	106,278	126,780	142,359
State In-Lieu Taxes ⁽²⁾	665,041	825,840	932,128	976,746	770,335
Real Property Transfer Tax	28,523	38,501	38,228	67,225	140,870
Franchise Taxes	321,768	334,886	385,958	423,115	451,824
Building Permits/Fees	92,257	89,952	232,117	749,661	4,631,472
Total	\$ 3,954,553	\$ 4,240,449	\$ 4,782,047	\$ 5,554,607	\$ 9,381,321

(1) Unaudited.

(2) Does not include tax increment received by redevelopment area.

(3) Motor Vehicle In-Lieu taxes.

Source: City of Desert Hot Springs.

A brief discussion of the City's transient occupancy tax, utility user's taxes, sales taxes and property taxes follows:

Transient Occupancy Tax

A transient occupancy tax ("TOT") is imposed on persons staying 28 days or less in a hotel, motel, inn, hostelry, tourist home, rooming house or other lodging place within the City. The current tax rate is of 10% of the rent charged by the operator or otherwise payable by the transient and has been in effect since July 1989. The TOT has been in effect since November 1963. Exemptions are granted to federal, State of California officials or employees on official business. Exemptions account for a very minor amount of the total TOT base. Payments are made to the City on a monthly basis and are then deposited to the City's General Fund. Receipts reflect in substantial part the seasonal basis of occupancy, which is weighted towards the winter months.

The City collects transient occupancy tax revenues from hotel operators for the privilege of occupancy in any hotel as a percentage of the rent charged by the operator. The tax constitutes a debt owed by the transient to the City which is extinguished only by payment to the operator or to the City. TOT revenues contributed approximately \$775,000 to General Fund revenues in the Fiscal Year ended June 30, 2003, equating to approximately 12% of total General Fund revenues for that Fiscal Year.

Such tax constitutes a debt owed by the transient to the City, which is extinguished only by payment to the operator of the hotel or to the City at the time the rent is paid. If the rent is paid in installments, a proportionate share of the tax shall be paid with each installment. The unpaid tax shall be due upon the transient's ceasing to occupy space in the hotel. If for any reason the tax due is not paid to the operator of the hotel, the Tax Administrator may require that such tax shall be paid directly to the Tax Administrator.

Each operator shall collect the tax imposed to the same extent and at the same time as the rent is collected from every transient. The amount of tax shall be separately stated from the amount of the rent charged, and each transient shall receive a receipt for payment from the operator. No operator of a hotel shall advertise or state in any manner, whether directly or indirectly, that the tax or any part thereof will be assumed or absorbed by the operator, or that it will not be added to the rent, or that, if added, any part will be refunded except in the manner hereinafter provided.

Any operator who fails to remit any tax imposed within the time required shall pay a penalty of 10% of the amount of the tax, in addition to the amount of the tax. Any operator who fails to remit any delinquent remittance on or before a period of 30 days following the date on which the remittance first became delinquent shall pay a second delinquency penalty of 10% of the amount of the tax in addition to the amount of the tax and the 10% penalty first imposed. In addition to the penalties imposed, any operator who fails to remit any tax shall pay interest at the rate of one-half of one percent per month or fraction thereof on the amount of the tax, exclusive of penalties, from the date on which the remittance became delinquent, until paid.

Whenever any operator fails to comply with any provision of applicable taxation provisions relating to occupancy tax or any rule or regulation of the Tax Administrator relating to occupancy tax prescribed and adopted, the Tax Administrator upon hearing, after giving the operator ten days' notice in writing specifying the time and place of hearing and requiring him or her to show cause why the permit or permits should not be revoked may suspend or revoke any one or more of the permits held by the operator. The Tax Administrator shall give to the operator written notice of the suspension or revocation of any of the permits. The notices herein required may be served, personally or by mail in the manner prescribed for service of notice of a deficiency determination.

If any amount required to be remitted or paid to the City as such taxes are not remitted or paid when due, the Tax Administrator may, within three years after the amount is due, file for record in the office of the Riverside County Recorder a certificate specifying the amount of tax, penalties and interest due, the name and address as it appears on the records of the Tax Administrator of the operator liable for the same and the fact that the Tax Administrator has complied with all relevant provisions in the determination of the amount required to be remitted and paid. From the time of the filing for record, the amount required to be remitted together with penalties and interest constitutes a lien upon all real property in the county owned by the operator or afterwards and before the lien expires acquired by him. The lien has the force, effect and priority of a judgment lien and shall continue for ten years from the time of filing of the certificate unless sooner released or otherwise discharged.

The amounts required to be remitted and/or paid by any operator as such taxes with penalties and interest shall be satisfied first in any of the following cases: (a) whenever the person is insolvent; (b) whenever the person makes a voluntary assignment of his or her assets; and (c) whenever the estate of the person in the hands of executors, administrators, or heirs is insufficient to pay all the debts due from the deceased.

At any time within three years after any operator is delinquent in the remittance or payment of any amount, the Tax Administrator may forthwith collect the amount in the following manner. The Tax Administrator shall seize any property, real or personal, of the operator and sell the property, or a sufficient part of it, at public auction to pay the amount due together with any penalties and interest imposed for the delinquency and any costs incurred on account of the seizure and sale. Any seizure made to collect occupancy taxes due shall be only of property of the operator not exempt from execution under the provisions of the California Civil Procedure Code.

Any operator or other person who fails or refuses to register as required by law, or to furnish any return to be made, or who fails or refuses to furnish a supplemental return or other data required by the City Manager, or who renders a false or fraudulent return or claim, is guilty of a misdemeanor.

As shown in Table 3, the transient occupancy tax revenues have generally been exhibiting a moderate upward trend since Fiscal Year 1993-94. The TOT revenues have grown by 70% between Fiscal Year 1993-94 and Fiscal Year 2002-03 (the last complete Fiscal Year recorded).

Table 3
City of Desert Hot Springs
Transient Occupancy Tax
Fiscal Years 1993-94 to 2003-04 ⁽¹⁾

Fiscal Year ⁽²⁾	Amount
1993-94	\$451,682.61
1994-95	492,587.24
1995-96	446,761.44
1996-97	533,757.77
1997-98	597,619.73
1998-99	641,786.10
1999-00	800,579.10
2000-01	817,639.73
2001-02	850,227.67
2002-03	775,265.56
2003-04 ⁽³⁾	790,538.27

(1) Fiscal Year refers to the twelve month period from July 1 of the previous year to June 30 of the referenced year.

(2) In the year ended June 30, 1994, the City began accounting for transient occupancy tax revenues on an accrued basis, rather than on a cash basis, as allowable under the National Council on Governmental Accounting (NCGA) Statement No. 1.

(3) Unaudited.

Source: City of Desert Hot Springs.

As shown in Table 4, the underlying room receipts, the amount recovered by the hotelier or innkeeper inclusive of taxes have likewise generally been exhibiting a moderate upward trend since Fiscal Year 1993-94.

Table 4
City of Desert Hot Springs
Underlying Room Receipts
Fiscal Years 1993-94 to 2003-04 ⁽¹⁾

Fiscal Year	Amount
1993-94	\$4,516,826
1994-95	4,925,872
1995-96	5,854,989
1996-97	5,337,578
1997-98	5,976,197
1998-99	6,417,861
1999-00	8,005,791
2000-01	8,176,397
2001-02	8,502,277
2002-03	7,752,656
2003-04 ⁽²⁾	7,905,383

(1) Fiscal Year refers to the twelve month period from July 1 of the previous year to June 30 of the referenced year.

(2) Unaudited.

Source: The City of Desert Hot Springs.

Table 5
City of Desert Hot Springs
Principal Taxpayers of Transient Occupancy Tax

Location
Miracle Springs – convention
Two Bunch Palms
Desert Hot Springs Hotel/Spa
Aqua Caliente
Hope Springs Resort
The Spring Resort & Spa
Lido Palms Spa Resort
Swiss Health Resort
Sagewater Spa
Sandpiper Inn

The top ten hotels/spas account for approximately 89% of Transient Occupancy Tax revenue.

Sales Taxes

The State collects a tax on retail transactions and the consumption of personal property within the City and rebates 1% to the County. The allocation is in addition to the half-cent sales tax allocated for public safety purposes pursuant to Proposition 172. The tax rate is established by the State Legislature. Sales Tax revenue collected by the State is directly deposited monthly to the City's General Fund.

Effective January 1, 2004, the statewide tax rate is 7.25%. An additional .50% is collected in the County for transportation purposes. Sales and use taxes contributed approximately \$736,700 to City General Fund revenues in the Fiscal Year ended June 30, 2003, equating to approximately 12% of total General Fund revenues for that Fiscal Year. The State collects and administers the tax, and makes distributions on taxes collected within the City as follows:

State General Fund	7.25%
Measure A Revenues	.50%
Total	7.75%

The following table illustrates historical taxable sales for calendar years 1995-2002 as well as computed annual growth rates for the same time period.

Table 6
City of Desert Hot Springs
Historical Taxable Sales
Calendar Years 1995-2002
(000s)

<u>Calendar Year</u>	<u>Taxable Sales</u>	<u>Growth Rate</u>
1995	\$50,033	--
1996	47,935	(4.2)%
1997	49,665	3.6
1998	52,998	6.7
1999	58,491	10.4
2000	63,475	8.5
2001	66,584	4.9
2002	65,974	(0.9)

Source: State of California Board of Equalization.

Among the information set forth in APPENDIX A – “CERTAIN INFORMATION REGARDING THE CITY OF DESERT HOT SPRINGS AND ECONOMIC AND DEMOGRAPHIC INFORMATION OF THE AREA” is a profile of total taxable sales within the County for the past five years on a calendar year basis, for which records are available, as reported by the State Board of Equalization.

Utility User’s Tax

One of the primary sources of General Fund revenue that the City can devote to repayment of creditor claims, and accordingly to the payment of the Bonds and the Lease Payments evidencing the Certificates of Participation to be issued, is the City’s temporary 5% “Utility User’s tax,” which is a tax on the charges for utility services such as gas, electricity, telephone, wireless communications, water and cable television. In March 2000, the City’s residents had voted to approve a temporary, five-year utility user’s tax with an advisory measure directing the City to apply forty percent (40%) of the tax revenues to reduce its debt (via payments with respect to the City’s settlement with holders of its defaulted 1998 TRANs), with the remainder of the revenues used to establish City reserves and fund City services. Initially, the City’s installment obligations under the 1998 TRANs settlement were made possible only because the City appealed to its residents for help in the general election held in March 2000, where the City submitted to its voters Measure “F,” which provided for a temporary five-year, 5% “Utility User’s tax” measured on utility charges paid by City residents. The voters approved that tax with an advisory

measure directing the City to apply forty percent (40%) of the tax revenues to reduce its debt (via payments with respect to the 1998 TRANs settlement), with the remainder to establish critical City reserves.

The Utility User's tax was set to expire on June 30, 2005. Thus, on March 4, 2003, the City Council adopted a resolution directing that a ballot measure be placed on the ballot at the next general election providing for City residents to consider a five-year extension of the Utility User's tax, at the existing rate of 5%, with provisions for fifty percent (50%) of the revenues from that tax to be allocated and devoted to resolution of the Chapter 9 Case and repayment of claims to the extent necessary to pay the City's creditors in full (with other fifty percent of tax revenues to be devoted to public safety services).

Because the ballot measure - known as "Measure C" - called for a specific use of the tax revenues, the tax was considered a "special tax" and, under applicable law, the affirmative vote of two-thirds of the voting electorate was required to win approval of the extension. An election on Measure C was held on June 3, 2003, and Measure C passed by a margin of 67.62% to 32.38%. The City currently projects that the extended Utility User's tax will generate greater than \$1,000,000 a year in revenue for the five year period from July 1, 2005, through June 30, 2010.

The Utility User's Tax is imposed on all users of natural gas, electricity, water, wastewater, video services and telephone services within the City's limits. The tax rate is 5.0% of all utility charges. This tax has been in effect since July 1993. As provided by the California Constitution, insurance companies are exempt from the Utility User's Tax. In addition, county, state, federal and foreign governments within the City are not subject to this tax, as the City has no authority to impose a tax on these entities. Exemptions account for a minor amount of the total Utility User's Tax base.

All utility companies, including the City's water and wastewater operations, collect and transmit the Utility User's Tax monthly to the City's Finance Department which then deposits the tax revenues into the General Fund.

Table 7
City of Desert Hot Springs
Utility User's Tax
Fiscal Years 1999-00 to 2003-04

<u>Calendar Year</u>	<u>Taxable Revenues</u>	<u>Growth Rate</u>
1999-00	\$ 876,018	--
2000-01	940,179	7.3%
2001-02	1,063,244	13.1
2002-03	1,066,886	.3
2003-04 ⁽¹⁾	1,155,992	8.3

(1) Unaudited.
Source: City of Desert Hot Springs.

Property Taxes and Assessed Valuations

The County collects property taxes against all property on the secured roll in two annual installments. Property taxes are derived on the basis of an *ad valorem* tax levied against the current assessed valuation of property in the County. Property taxes contributed approximately \$592,200 to

General Fund revenues in the Fiscal Year ended June 30, 2003, equating to approximately 9% of total General Fund revenues for that Fiscal Year.

Taxes are levied each Fiscal Year on taxable real and personal property which is situated in the City as of the preceding March 1. For assessment and collection purposes, property is classified either as “secured” or “unsecured” and is listed accordingly on separate parts of the assessment roll. The “secured roll” is that part of the assessment roll containing State-assessed public utilities property and property the taxes on which are a lien on real property sufficient, in the opinion of the County Assessor, to secure payment of the taxes. Other property is assessed on the “unsecured roll.”

The assessed valuation of property in the County is established by the County Assessor except for public utility property which is assessed by the State Board of Equalization. Assessed valuations are reported at 100% of the full value of the property as defined in Article XIII A of the California Constitution. See “CONSTITUTIONAL AND STATUTORY LIMITATIONS ON TAXES AND APPROPRIATIONS – Article XIII A of the California Constitution.”

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

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

Property taxes on the secured roll are due in two installments on November 1 and February 1 of each Fiscal Year and, if unpaid, become delinquent on December 10 and April 10 respectively. A penalty of 10% attaches immediately to all delinquent payments. Property on the secured roll with respect to which taxes are delinquent becomes tax defaulted on or about June 30 of the Fiscal Year. Such property may thereafter be redeemed by payment of a penalty of one and one-half percent per month to the time of redemption plus costs and a redemption fee. If taxes are unpaid for a period of five years or more, the property is subject to sale by the County Treasurer-Tax Collector.

Property taxes on the unsecured roll are due as of the January 1 lien date and become delinquent if unpaid on August 31. A 10% penalty attaches to delinquent unsecured taxes. If unsecured taxes are unpaid at 5:00 p.m. on October 31, an additional penalty of 1.5% attaches to them on the first day of each month until paid. The County has four ways of collecting delinquent unsecured personal property taxes: (1) bringing a civil action against the taxpayer; (2) filing a certificate in the office of the County Clerk specifying certain facts in order to obtain a lien on certain property of the taxpayer; (3) filing a certificate of delinquency for record in the County Recorder’s office in order to obtain a lien on certain property of

the taxpayer; and (4) seizing and selling personal property improvements or possessory interests belonging or assessed to the delinquent taxpayer.

The valuation of property in the City is established by the Riverside County Assessor, except for public utility property which is assessed by the State Board of Equalization. Assessed valuations are reported at 100% of the full value of the property, as defined in Article XIII A of the California Constitution. Prior to Fiscal Year 1981-82, assessed valuations were reported at 25% of the full value of the property. See "CONSTITUTIONAL AND STATUTORY LIMITATIONS ON TAXES AND APPROPRIATIONS" herein.

The California State Legislature adopted two types of State-reimbursed exemptions beginning in the tax year 1969-70. The first currently exempts 100% of the full value of business inventories from taxation. The second exemption currently provides a credit of \$7,000 of the full value of an owner-occupied dwelling for which application has been made to the Riverside County Assessor. Revenue estimated to be lost to local taxing agencies due to the above exemptions has in the past been reimbursed from State sources. Reimbursement is based upon total taxes due upon such exemption values and therefore is not reduced by any estimated amount of actual delinquencies.

Assessed valuation for revenue purposes increased by 10.96% in 2003-04 over 2002-03. Such assessed valuations include secured and unsecured properties assessed by the Riverside County Assessor, and secured utility properties assessed by the State Board of Equalization. Such assessed valuations exclude State-reimbursed homeowner's and business inventory exemptions and exclude veterans, religious, charitable, and other such nonrecoverable exemptions. In 1981-82, the assessed valuation became equivalent to the fair market valuation.

The tax roll for 2004-05 indicates a full market valuation of \$718,579,694 for the City. The table below shows the assessed values for the last twelve Fiscal Years. Net value is \$115,385,308 over net value for prior year of \$603,194,386. The 2004-05 assessment rolls were determined under the provisions of Proposition 13 and Proposition 8 approved by the voter in 1978, and under implementing legislation passed by the Legislature since 1978. Under Proposition 13, the base year value of individual properties changed only when there is a change in ownership or when new construction takes place. For properties that have not had any change in ownership or any new construction, additions or alterations, a 2% inflation factor has been added for 2003-04. The inflation factor reflects the percentage change in the California Consumer Price Index as provided by law. Under Proposition 8, the assessor has to recognize declines in value. For 2003-04 the assessor maintained reduced values on 49,499 properties. This resulted in a total decrease to the Assessment Rolls in excess of 1.9 billion dollars for Proposition 13 values. The 2% annual inflation cap does not apply to properties for which the assessed value was temporarily reduced during the economic downturn. Thus, some property values are increasing much more than 2%. It is important to note, however, that the reinstated value cannot exceed the factored base year value.

Table 8
City of Desert Hot Springs
Assessed Valuation

<u>Fiscal</u> <u>Year</u>	<u>Assessed</u> <u>Valuation</u>
1994	\$490,603,937
1995	485,299,315
1996	472,585,388
1997	476,645,045
1998	491,738,792
1999	486,995,066
2000	473,960,429
2001	500,543,214
2002	543,830,686
2003	579,064,258
2004	603,194,386
2005	718,579,694

Source: County of Riverside.

At the same special election approving the extension of the Utility User's Tax voters approved a municipal parcel tax - known as "Measure E" - which provides a parcel tax that would supply \$1.1 million per year for 10 years to maintain police, fire and other public-safety services in the City. Both passed by decisive majorities of 78 percent. See "CONSTITUTIONAL AND STATUTORY LIMITATIONS ON TAXES AND APPROPRIATIONS—Article XIII A of the California Constitution" herein for information on the effect, if any, of current litigation on assessed values in the City or the availability of revenue sources which may be provided by the State to replace lost property tax revenues.

The City uses the facilities and services of the County of Riverside (the "County") for the assessment and collection of taxes. City taxes are collected at the same time and on the same tax rolls as are the County, City and special district taxes. Assessed valuations are the same for both City and County taxing purposes.

Tax Levies, Collections and Delinquencies

The County levies and collects all property taxes for property falling within its taxing boundaries, including City boundaries. The County is a "Teeter Plan" county, which means that the City is made whole for any delinquencies in payment of property taxes by local property owners. See "County Teeter Plan" below. For a discussion of legal limitations on the ability of the District to raise revenues through local property taxes, see "CONSTITUTIONAL AND STATUTORY LIMITATIONS ON TAXES AND APPROPRIATIONS" below. The City's General Fund secured tax levy for Fiscal Years 1994-95 through 2002-03 are shown below:

Table 9
City of Desert Hot Springs
Secured Tax Levies
Fiscal Years 1994-95 through 2002-03

<u>Fiscal Year</u>	<u>Secured Tax Levy ⁽¹⁾</u>
1994-95	\$481,086,070
1995-96	490,758,129
1996-97	478,422,703
1997-98	481,590,043
1998-99	456,946,736
1999-00	453,805,898
2000-01	458,680,653
2001-02	528,210,392
2002-03	543,594,736
2003-04	577,920,404
2004-05	686,967,011

(1) The data presented represents the City's proportionate allocation of County-wide totals and is not based on the actual amount of taxes uncollected within the City.

Source: City of Desert Hot Springs (from data from County of Riverside Auditor-Controller).

The following table represents the ten largest taxpayers of local secured property taxes within the City:

Table 10
City of Desert Hot Springs
Largest Taxpayers 2003-04⁽¹⁾

<u>Property Owner</u>	<u>Primary Land Use</u>	<u>2003-04 Assessed Local Secured Valuation</u>	<u>% of Total¹</u>
1. Ironwood Country	Residential	\$ 7,095,528	1.10%
2. Inland 1 Delaware Trust	Commercial	6,781,189	1.05
3. Terracina Limited	Residential	5,905,395	0.91
4. Time Warner Entertainment	Unsecured	5,383,584	0.83
5. Verbena Crossing Apartments	Residential	5,064,256	0.78
6. Two Bunch Palms I	Commercial	4,602,869	0.71
7. Walgreen Company	Commercial	3,967,428	0.61
8. DHSL	Commercial	3,965,057	0.61
9. Vons Company, Inc.	Commercial	3,937,871	0.61
10. Highland Carlsbad Cablevision	Unsecured	3,767,871	0.58
Top Ten Totals		<u>\$50,440,883</u>	<u>7.81%</u>

(1) 2003-04 Local Secured Assessed Valuation: \$577,920,040.

Source: California Municipal Statistics, Inc. and HDL CAFR purchased by the City annually.

County Teeter Plan

The County has adopted the Alternative Method of Distribution of Tax Levies and Collections and of Tax Sale Proceeds (the "Teeter Plan"), as provided for in Section 4701 and following of the California Revenue and Taxation Code. Under the Teeter Plan, each participating local agency levying property taxes in the County, including the City, receives the amount of uncollected taxes credited to its fund, in the same manner as if the amount due from taxpayers had been collected. In return, the County

receives and retains delinquent payments, penalties and interest as collected, that would have been due the local agency.

The Teeter Plan is to remain in effect unless the County Board of Supervisors orders its discontinuance or unless, prior to the commencement of any fiscal year of the County (which commences on July 1), the Board of Supervisors receives a petition for its discontinuance from two-thirds of the participating revenue districts in the County. The Board of Supervisors may also, after holding a public hearing on the matter, discontinue the Teeter Plan with respect to any tax levying agency or assessment levying agency in the County if the rate of secured tax delinquency in that agency in any year exceeds three percent of the total of all taxes and assessments levied on the secured rolls in that agency

State Budget Acts

The following information concerning the State of California's budgets has been obtained from publicly available information which the City believes to be reliable; however, the City takes no responsibility as to the accuracy or completeness thereof and has not independently verified such information.

General. In accordance with the State Constitution, the Governor of the State is required to propose a budget to the State Legislature (the "Legislature") no later than January 10 of each year, and a final budget must be adopted by a 2/3 vote of each house of the Legislature no later than June 15, although this deadline is routinely breached. The budget becomes law upon the signature of the Governor, who may veto specific items of expenditure.

The 2003-04 Budget Act. The then Governor, Gray Davis signed the 2003-04 State Budget on August 2, 2003. At the time, the State faced a budget deficit estimated at \$10.67 billion. The estimate has been revised to \$8.563 billion, but may be further modified as more financial data is received. The 2003-04 State Budget authorized total spending of \$98.9 billion. Of this amount, \$70.8 billion was from the State's General Fund, \$20.5 billion was from special funds, and \$7.5 billion from bond funds. The 2003-04 State Budget addressed the General Fund shortfall through a combination of program savings, borrowing, new revenues, funding shifts, and deferrals, including the following: (i) significant reductions in K-12 and higher education, criminal justice Medi-Cal provider rates, employee compensation and through the suspension of cost-of-living adjustments (COLAs) for Supplemental Security Income/State Supplementary Program and California Work Opportunity and Responsibility to Kids grants; (ii) \$10.7 billion in deficit financing, whose proceeds will be used to eliminate the Fiscal Year 2002-03 deficit; (iii) \$2.2 billion in federal funds to cover state costs in Fiscal Years 2002-03 and 2003-04 combined; and (iv) an increase in revenues from an increase in the motor vehicle license fee ("VLF") and renegotiated gaming contracts. The 2003-04 State Budget nevertheless projected a Fiscal Year 2003-04 shortfall of approximately \$8 billion.

The 2003-04 State Budget assumed that the VLF would increase from the effective rate of 0.65 percent to 2 percent beginning October 1, 2003. From Fiscal Year 1998-99 to 2002-03, there had been a 67.5% reduction in the actual VLF charged to vehicle owners. Since VLF reductions were first enacted in 1998, the State had been obligated to compensate local governments for the revenue impact of the VLF rate reductions with State general fund revenues (the "Backfill"), and VLF allocations to counties and cities continued as if there were no VLF rate reductions. Such Backfill was meant to continue until the VLF was increased to the 2 percent rate. However in June 2003, the State Department of Finance made a determination that the State had insufficient moneys to provide any Backfill to local governments, and as a result of the determination, the Backfill ended. On July 1, 2003 the Governor implemented an automatic trigger mechanism (the "Automatic Trigger Mechanism"), which restores the funds not being backfilled by the State by increasing the VLF. However, the Automatic Trigger Mechanism did not apply

during the approximately three-month period between the end of the Backfill and October 2003. Thus, during the period from June 2003 to October 2003, local governments only received revenues based on the current 0.65 percent VLF rate, resulting in a loss in local governmental revenue of approximately \$1.3 billion.

On November 18, 2003, newly elected Governor Arnold Schwarzenegger signed an executive order reducing the VLF back to its 1998 level. On December 18, 2003, the Governor declared a public safety emergency and ordered the State Controller to make payments to local governments as a result of reduction of the VLF; however, the Governor did not declare that such payments would be permanent. In December 2003, the Governor proposed reductions totaling \$3.9 billion (\$2.3 billion in 2003-04 and \$1.6 billion in 2004-05), which are presently being considered by the Legislature. These proposals included reductions to Medi-Cal payments and the cancellation of a highway and transit improvement program adopted in calendar year 2000.

The 2004-05 Budget Act. The 2004-05 Governor's Budget, released on January 9, 2004, reported that, in the absence of corrective actions to change existing policies, operating deficits, estimated at \$13.9 billion for fiscal year 2004-05, would continue to be incurred. The 2004 Budget Act was adopted by the Legislature on July 29, 2004, along with a number of implementing measures, and signed by the Governor on July 31, 2004. The 2004 Budget Act largely reflects the budget proposals contained in the May Revision (released on May 13, 2004) to the original 2004-05 Governor's Budget (the "May Revision") proposed on January 9, 2004. The 2004 Budget Act addressed the projected \$13.9 billion budget shortfall through expenditure cuts (\$4.0 billion or 28.7 percent), cost avoidance (\$4.4 billion or 31.7 percent), fund shifts (\$1.6 billion or 11.2 percent), loans or borrowing (\$2.1 billion or 15.4 percent), and transfers and other revenue (\$1.8 billion or 13.0 percent).

Vehicle License Fees and the State-Local Agreement. Vehicle license fees historically were assessed in the amount of two percent of a vehicle's depreciated market value for the privilege of operating a vehicle on California's public highways. A program to offset (or reduce) a portion of the vehicle license fees ("VLF") paid by vehicle owners was established by Chapter 322, Statutes of 1998. Since 1999, various pieces of legislation have provided for increasing offsets of the VLF, resulting in the current effective rate of 0.65 percent. In connection with the offset of the VLF, the Legislature authorized appropriations from the State General Fund to "backfill" the offset so that local governments, which receive all of the vehicle license fee revenues, would not experience any loss of revenues. The legislation that established the VLF offset program also provided that if there were insufficient General Fund moneys to fully "backfill" the VLF offset, the percentage offset would be reduced proportionately (i.e., the license fee payable by drivers would be increased) to assure that local governments would not be disadvantaged. In June 2003, the Director of Finance under the Davis Administration ordered the suspension of VLF offsets due to a determination that insufficient General Fund moneys would be available for this purpose, and, beginning in October 2003, VLF paid by vehicle owners were restored to the 1998 level. However, the offset suspension was rescinded by Governor Schwarzenegger on November 17, 2003, and offset payments to local governments resumed. Local governments received "backfill" payments totaling \$3.80 billion in fiscal year 2002-03. "Backfill" payments totaling \$2.65 billion were expected to be paid to local governments in fiscal year 2003-04. However, approximately \$1.2 billion was not received by local governments during the time period between the suspension of the VLF offsets and the implementation of higher fees.

As part of the 2004 Budget Act negotiations, an agreement was made between the State and local governments officials (the "State-local agreement"). As part of the State-local agreement, VLF paid by vehicle owners will be permanently reduced from 2 percent to 0.65 percent of the value of the vehicle. The State-local agreement also provides for the repayment in August 2006 of the approximately \$1.2 billion that was not received by local governments during the time period between the suspension of the

VLF offsets and the implementation of higher fees. This repayment obligation will be codified if Senate Constitutional Amendment No. 4 (described below) is approved by voters at the November 2004 election. In order to protect local governments, the reduction in VLF revenue to cities and counties from this rate change will be replaced by an increase in the amount of property tax they receive. Under the State-local agreement, for fiscal years 2004-05 and 2005-06 only, the replacement property taxes that cities and counties receive would be reduced by \$700 million. Commencing in fiscal year 2006-07, local governments would receive their full share of replacement property taxes.

Senate Constitutional Amendment No. 4. Under current law, a number of the revenue sources on which the City relies can be reduced or eliminated by State legislative action, including, among others, sales and use taxes (12% of fiscal year 2003 General Fund Revenues), property taxes (9% of fiscal year 2003 General Fund Revenues), and VLF (16% of fiscal year 2003 General Fund Revenues). In addition, under current law, the City must continue to carry out state-mandated requirements, regardless of delays in State reimbursement. Under current law, there can be no assurance that the State will not adopt legislation to reduce or eliminate one or more of these revenue sources or impose additional mandates without appropriating reimbursement funds to the City.

However, as part of the State-local agreement, Senate Constitutional Amendment No. 4 has been enacted by the Legislature and placed on the November 2004 ballot as Proposition 1A for approval by the electorate. If approved by the voters, Senate Constitutional Amendment No. 4 would protect the VLF, property tax and sales tax revenues of cities, counties and special districts in future years. If approved, it would constitutionally guarantee VLF revenues at a rate of 0.65% and constitutionally require the state to “backfill” VLF revenues if the rate of collections is reduced. Additionally, after the \$1.3 billion shifts contemplated for each of fiscal years 2004-05 and 2005-06 have been carried out, it would make it more difficult for the State to shift property tax revenues to the Educational Revenue Augmentation Fund. The State could only change the allocation of property tax revenues among local entities within a county upon a two-thirds vote of both houses of the Legislature. In a fiscal emergency, the State could borrow up to eight percent of local property tax revenues, provided a number of conditions are met, and the amount borrowed would have to be paid back within three years. The State would be unable to restrict the authority of the local governments to impose or change the distribution of the statewide local sales tax, and the 0.25 percent portion of that tax that is currently being diverted to repayment of the State’s Economic Recovery Bonds would be required to be repaid while the Economic Recovery Bonds are outstanding and returned to local entities once the Economic Recovery Bonds are retired.

If approved by voters, Senate Constitutional Amendment No. 4 would also protect local governments by prohibiting the State from mandating activities on local governments, but deferring payment for these costs. If the State does not provide funding for the activity, the requirement on local governments would be suspended. In addition, the definition of what constitutes a mandate on local governments would be broadened to better reflect when added costs are imposed on local governments. Finally, the State would be required to repay amounts it owes local entities for unfunded mandates that are already in place.

Proposition 65, an initiative measure that also seeks to protect revenues for local governments, has qualified for the November 2004 ballot. Local officials have indicated they will drop all campaign efforts for this measure, and will campaign for Senate Constitutional Amendment No. 4. Senate Constitutional Amendment No. 4 provides that if Senate Constitutional Amendment No. 4 and Proposition 65 are both approved by the voters and Senate Constitutional Amendment No. 4 receives more affirmative votes, none of the provisions of Proposition 65 would take effect. Conversely, if Proposition 65 receives more votes than Senate Constitutional Amendment No. 4, the statutory portions of the State-local agreement, which are contained in Chapter 211, Statutes of 2004, will be suspended.

There can be no guarantee that Senate Constitutional Amendment No. 4 will be approved by voters at the November 2004 election or that, if approved, it will not be eliminated or modified by subsequent voter-approved constitutional amendments.

State Structural Deficit. In its May 17, 2004 “Overview of the 2004-05 May Revision,” the Legislative Analyst’s Office (“LAO”) projected that a \$6 billion operating shortfall would re-emerge in fiscal year 2005-06. Although the LAO expects that the shortfall could be substantially offset through accessing carryover reserves and issuing more Economic Recovery Bonds, the State budget would still be modestly out of balance. The LAO further projected that following fiscal year 2005-06, the State would again face major budget shortfalls, absent significant corrective actions. The LAO estimates that the fiscal year 2006-07 shortfall would approach \$8 billion, and that annual operating deficits above \$6.5 billion would persist for the forecast period (through fiscal year 2008-09). The LAO has not revised its May 17, 2004 forecast of revenues, expenditures and the State’s potential structural deficit since the adoption of the 2004 Budget Act. Although the LAO projects that, given current spending rates, there will be an operating deficit in fiscal year 2005-06, the State is required to adopt a balanced budget, as specified in the Constitution.

Whether or not Senate Constitutional Amendment No. 4 is approved, it cannot be predicted whether the State will enact further legislation with the effect of reducing the City’s tax revenues or imposing further unfunded mandates on the City. The City reports that general fund revenue has been reduced by \$196,215 or 1.4% of general fund revenues resulting from a loss of vehicle license fee (“VLF”) revenue for Fiscal Year 2003-04. However, the City has budgeted for this loss of funds for Fiscal Year 2004-05 and anticipates repayment of these funds by the State in Fiscal Year 2006-07.

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

Changes in State Budget. The final State Budget, which requires approval by a two-thirds vote of each house of the State Legislature, may differ substantially from the Governor’s original budget proposal. Accordingly, the City cannot predict the impact that the 2004-05 budget, or subsequent budgets, will have on its finances and operations. The State Budget will be affected by State and national economic conditions and other factors over which the City will have no control.

The City cannot predict what actions will be taken in the future by the State Legislature and the Governor to deal with changing State revenues and expenditures and the repercussions they may have on the current State budget and future State budgets. These developments at the State level may, in turn, affect local governments, including the City. The State’s revenue transfers to local governments, including VLF revenue backfill to the City, could be reduced. See “CITY FINANCIAL INFORMATION - State Budget Acts” herein.

Summary Financial Statements

The following unaudited summaries of the General Fund of the City have been prepared by the City’s Finance Department from audited financial statements, excluding those to be prepared for Fiscal Year 2003-04 and 2004-05. With respect to the 2002-03 audited financial statements, it is important to

note that the City's bankruptcy debt was reclassified by the auditors from long term debt accounts to current debts. As a result, such amount appears as deficit in fund balance for the last two years. Had the long term debt been excluded, the General Fund would have had a surplus balance in the year 2002 of \$2,273,762 and in year 2003 of \$2,071,000, with revenues over expenses for both years or \$1,032,593 and \$570,998 in 2002 and 2003, respectively. As a result of increased development within the City that has occurred over the last two years, the City is in a growth cycle, creating increased revenue in building and planning fees and development impact fees.

Table 11
City of Desert Hot Springs
Summary Budget - General Fund
Fiscal Years 2003-04 and 2004-05

	2003-04 Adopted <u>Budget⁽¹⁾</u>	2004-05 Adopted <u>Budget⁽²⁾</u>
Estimated Revenues		
Taxes		
Transient Occupancy Tax (TOT)	\$ 825,000	\$ 787,303
Sales and Use Tax	785,000	825,940
Utility Tax	1,050,000	1,200,058
Property Tax	460,000	548,731
Intergovernmental Revenues	1,577,000	428,159
Other Revenue – Building, Planning & Engineering Fees	<u>1,137,642</u>	<u>2,941,706</u>
Other Revenue – Exit Financing – Bankruptcy	--	9,500,000
Total Estimated Revenues	5,814,642	16,231,897
Transfers In – Contribution from Fund Balance	328,949	3,977,271
Total Available	6,143,591	20,209,168
Appropriations		
Salaries & Benefits	975,245	1,856,554
Supplies & Services	2,802,664	3,096,119
Other – Transfer to Other Funds	2,365,682	3,040,268
Bankruptcy Payments and Bond Payments	--	12,216,227
Total Appropriations	<u>\$6,143,591</u>	<u>\$20,209,168</u>

⁽¹⁾ Budget adopted on July 1, 2003.

⁽²⁾ Subject to adjustment and revision.

Source: City of Desert Hot Springs.

Table 12
City of Desert Hot Springs
Approved Budget and Estimated Actuals
Fiscal Year 2003-04

	Original 2003-04 Budget <u>Adoption</u> ⁽¹⁾	<u>2003-04</u> Estimated/Actual Results ⁽²⁾
Revenues:		
Property Taxes	\$ 507,896	\$ 480,115
Sales and Use Taxes	785,000	813,316
Other Taxes	2,085,000	2,757,661
Licenses and Permits	117,500	176,026
Intergovernmental Revenue	744,785	770,335
Charges for Services	1,171,642	3,467,530
Use of Money and Property	25,000	1,277,090
Other	378,169	119,873
Transfers In	<u>328,949</u>	<u>51,018</u>
Total Revenues and Transfers	\$6,143,941	\$9,913,054
Expenditures:		
Current:		
City Administration	\$2,272,620	\$2,273,526
Police Protection and Public Safety ⁽³⁾	1,682,505	2,179,755
Fire Protection	329,766	460,262
Engineering/Streets	737,312	553,229
Buildings	571,217	481,774
Community Development	169,000	164,040
Parks and Recreation	81,723	114,792
Non-Departmental	245,629	241,075
Transfers Out	<u>54,169</u>	<u>-0-</u>
Total Expenditures and Transfers	\$6,143,941	\$9,913,054

(1) Budget adopted on July 1, 2003. Subject to adjustment and revision.

(2) Unaudited; estimated/actuals. Subject to adjustment and revision.

(3) The City funds only a portion of the Community Safety Program from the General Fund. The total budget for Community Safety for 2003-04 was \$3,640,000 of which the General Fund transfer was budgeted at \$2,883,501. The four components of the restricted Community Safety Program are Police, Fire, Code Enforcement and Animal Control. A total of \$980,430 was budgeted in the restricted fund of Community Safety to be received from taxes collected for the Community Safety Tax the balance of funding comes from grant revenues, various license fees, code enforcement citations, etc. In the table above, Police, Code Enforcement and Animal Control as are presented as one.

Source: City of Desert Hot Springs.

2002-03 Fiscal Year Summary

As shown in the audited financial statements of the City included as APPENDIX B – AUDITED FINANCIAL STATEMENTS OF THE CITY OF DESERT HOT SPRINGS FOR THE FISCAL YEAR ENDED JUNE 30, 2003” hereto, the City ended Fiscal Year 2002-03 with deficit net assets of \$5,804,478 at the government-wide level. See Notes 2, 15, and 16 for information regarding the financial condition of the City’s General Fund as of the close of Fiscal Year 2002-03. In addition, as noted in the City’s

Audited Financial Statements, the following funds had expenditures in excess of the budget in the following amounts for the year ended June 30, 2003:

Community Safety Special Revenue Fund	\$	643,662
RDA Debt Service Fund		84,442
Non-major Governmental Funds:		
T.U.M.F. Special Revenue Fund	\$	224,762

With respect to the Community Safety Special Fund and Redevelopment Agency Debt Service Fund, the previous City Manager and previous Director of Finance did not prepare the appropriate budgetary adjustments during the year to increase the budgets to cover the additional expenses. The deficit within the TUMF Fund reflected insufficient collections in the building permit process. The TUMF Fund is a pass through account, with fees to be collected as part of the building permit process, and paid to the appropriate agency. Measures have been taken to correct the collection process and to increase staffing levels and training to address such prior insufficiencies.

Fiscal Year 2003-04

General. The City originally balanced its Fiscal Year 2003-04 General Fund budget by utilizing \$158,062 of fund balance. Originally, the Development Department revenues were budgeted at a total of 50 new units of residential homes and 250 in-fill lots. In the original budget the City was conservative in revenue budgeting - and fiscally responsible in budgeting the expenditures. The in-fill housing growth helps the City generate revenue yet incrementally does not dramatically increase service demands. The City anticipated a continuation of building growth for this fiscal year. The activity helped to offset some overhead an administrative expenses at the City.

The City was able to adjust the 2003-04 budget in August 2003 to decrease the revenue losses that were caused due to the state budget cuts totaling \$196,215 by eliminating (3) positions. The City was successful in fostering stable solid development in the City. During this budget year the City budgeted to coordinate and consolidate Master Plans for: Flood Control, Parks, Open Spaces, Trails, Multi-Species Habitat, Traffic Circulation, Zoning and the General Plan, Street & Drainage Reconstruction, and Preventative Maintenance Programs.

City Goals for 2003-04. The City has begun to form an active management style to analyze and reduce cost: Contract vs. Employee Service comparisons, Utility Consumption Management, Procurement Improvements, Productivity Analysis, Re-visit existing Contracts, and pursue Grants and to improve Grant Administration, Analyze Joint Agency Participation in common work arenas. Revise and update Policy and Personnel Manuals, revisit committee and commission purposes and procedures, create mechanisms for priority and goal setting with the City Council, and promote information flow for decision making, to the City Council.

City Accomplishments for 2003-04. Established more directed leadership at management level; reduced the number of Department Heads; defined and directed the legal issues of the bankruptcy and the City. Created a professional and service oriented Development Department; provide impetus to create a better financial management system; consolidated Public Safety under one department; instituted better department reporting for critical issues; created a realistic and workable Capital Improvement Plan. Maintained or improved working relationships with other agencies and implemented the seeds to create a holistic master planning process for the City.

Fiscal Year 2004-05

General. The Fiscal Year 2004-05 budget as passed is contingent on the successful placement of the Bonds and other components of the Exit Financing required to refund the bankruptcy debt. Debt service payments are expected to be funded from TOT proceeds and the extended utility user tax revenue streams. The City continues to research revenue enhancement opportunities to retire the debt early as well as provide for funding after the utility user tax expires in 2010. A restructuring of assessments on new development will be reviewed this coming fiscal year. Additionally, if directed by the City Council, a review of ballot measures to expand City revenues will be undertaken.

City staff has worked diligently to create a budget that meets the City's obligations including bankruptcy debt while creating reasonable flexibility to offset uncertainty or changes in assumed revenues. The budget committee met several times to review and provide budget direction. The budget was prepared by first projecting all City revenues. Then, all costs to fund administrative, financial, development and legal services for the coming year were analyzed and programmed. Public Safety costs were purposefully omitted until budget runs and analyses were completed for all other City functions. Included in the approved budget for 2004-05 were increases to Fire and Police services totaling \$614,782.

Full time employees increased from 72.5 to 82.5 in the 2004-05 budget. The adjustment in positions that shifts funding toward production and mid-level supervisory staffing and away from top management. New Positions are also offsetting contract service work. As organizational changes evolve, the work culture has dramatically changed, productivity has improved, and service to the public has been maintained at high and effective levels.

Development fees were conservatively based on 900 new single family units. The solid waste franchise and recycling contract was revised to improve services as well as add revenues to the City. The City has begun to build a strategically sound foundation to support a viable and vibrant future.

2004-05 Management Goals. Finalize the Bankruptcy plan; Fund the bankruptcy Exit Financing; Enhance "well planned and thought through" decision processes at the City; Continue to promote and foster good, stable, and solid development within the City; Develop and implement a usable and realistic Comprehensive Master Plan; advance staffing with the most qualified and dedicated employees to serve the City; Increase analysis efforts to reduce costs for contract vs. employee service comparisons, utility consumption management, procurement improvements, productivity analysis, re-visit existing contracts, pursue grants and improve grant administration, analyze joint agency participation in common work arenas.

Research and resolve City franchise issues, strategically review fire and emergency services, and provide for management continuity and corporate memory.

Additional Information. The City took into consideration the state budget cuts and reduced the property tax revenues and the sales tax revenue due to the triple flip (which suspended ¼ cent of the local sales tax - decreasing the overall property tax revenue by \$40,155 and the sales tax revenue by \$86,000. Motor vehicle fees were decreased this year due to the elimination of the backfill funding in the fiscal years budget as they applied. The City adjusted the 2003-04 budgets by \$196,215 due to the loss of Vehicle License Fees Backfill revenues. The California League of Cities and individual city government officials have worked on various "deal points" which will be brought forth as a Constitutional Amendment in November 2004. If Proposition 1A (SCA 4) is approved by the voters in November 2004, the State could not reduce local governments' share of the property tax below current levels. Proposition 1A would allow the State in a fiscal emergency to borrow up to 8% of local property tax revenues, provided the amount borrowed would be repaid within three years and a other conditions are satisfied.

Local sales taxes could not be reallocated by the State if Proposition 1A is passed. In addition, Proposition 1A would prohibit the State from mandating activities on local governments, but deferring payment for these costs. No assurances can be given that Proposition 1A will be approved by the voters in November 2004. Included in this amendment is VLF repayment to cities in 2006-07 of the 2003-04 VLF Backfill Loan.

Included in this budget cycle are re-payments in full to all bankruptcy claims, reserves have been established and will be increased in future budget cycles, capital improvement projects throughout the City limits have been budgeted to insure continuous growth and well as normal maintenance, Police, Fire and Administrative personnel have been increased, Redevelopment Agency projects in low or moderate income categories have been continued from last year as well as some small funding in the Capital Project areas and the City has programmed allowable expenditures in all restricted funds and grant funds.

This year the City has included increased costs associated with PERMA for general liability and workers compensation. The general liability insurance costs increased by \$35,833 over last year's costs and the workers compensation also increased by a total of \$138,692. Costs for on going liability claims have been budgeted in the amount of \$50,000 and the City has set up two reserves for workers compensation and general liability claims in the amount of \$30,000.

Increase in staffing levels have been accommodated to handle the increased work load being generated in the Building, Planning and Engineering Department. All user fees will be reviewed this year to ensure that the City is recouping all of the costs involved with future developments within the City's limits. New programs are being developed in the 2004-05 budget so that citizens can obtain information from the City's website and GIS Mapping services will soon be available for all developers to use at the counter. This department as with all other departments within the City are working hard to improve procedures and create programs that will decrease some of the staff's daily workload.

With respect to the coming Fiscal Year 2004-05, City management reports that there are increased staffing levels in all departments: police, fire, administration, code enforcement and in the development department, with total over all in staffing from prior year is a total of 12 full time employees. The City has also set a total of \$1,880,000 in reserves in the City's proposed budget and a portion of these reserves will address on going salary increases and benefits and funding made available for management during bargaining with the two unions. A total of \$260,000 has been set aside out of the \$1,880,000 in reserves for this purpose. Also set aside in reserve is approximately \$500,000 to address changes scheduled to be addressed this year in connection with City pension and health benefits as required by the State of California Public Employees' Retirement System. The last cost-of-living adjustment increase is 2% across the board (90) after the conclusion of the bankruptcy - this increase is already included in next year's fiscal budget.

Financial Statements

Selected portions of the Audited Financial Statements of the City for the Fiscal Year ended June 30, 2003, which have been audited by Vavrinek, Trine, Day & Co., LLP, Certified Public Accountants & Consultants, Rancho Cucamonga, California, are included in Appendix B hereto. The City anticipates that its Audited Financial Statements for the Fiscal Year ended June 30, 2004 will be filed pursuant to the Continuing Disclosure Agreement with each Nationally Recognized Municipal Securities Information Repository on or before April 1, 2005. The City has not requested, nor has Vavrinek, Trine, Day & Co., LLP given, consent to the inclusion in Appendix B of its report on such financial statements, nor have such accountants reviewed or performed any audit procedures in connection with the preparation of this Official Statement. At the time of the authorization and issuance of the Bonds, the City will certify that there has been no material adverse change in the City's financial position since June 30, 2003.

The Government Accounting Standards Board recently imposed significant new accounting standards on state and local governments pursuant to Statement No. 34 ("GASB 34"). GASB 34, Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments was issued in June 1999. The statement establishes a new financial reporting model for state and local governments and is the biggest change in the history of public-sector accounting. GASB developed the new requirements to make annual reports more comprehensive and easier to understand and use.

The new requirements include a narrative introductory overview and analysis called the Management Discussion and Analysis (MD&A); Government-wide financial statements prepared on the full accrual basis that are in addition to, not instead of, the traditional Fund-Based statements; and an expanded Budget Comparison that includes the adopted budget, final budget, and actual revenues and expenditures.

The following financial statements were generated from the Audited Financial Statements of the City and from the City's Finance Department. The financial and statistical information set forth herein does not purport to be a summary of the Audited Financial Statements of the City of Desert Hot Springs. The Audited Financial Statements of the City of Desert Hot Springs should be read in its entirety. The City's Audited Financial Statements for the Fiscal Year ended June 30, 2003 are attached to this Official Statement as Appendix B. The following statements are for information purposes only and do not constitute the complete financial statements of the City.

With respect to the 2002-03 audited financial statements, it is important to note that the City's bankruptcy debt was reclassified by the auditors from long term debt accounts to current debts. As a result, such amount appears as deficit in fund balance for the last two years. Had the long term debt been excluded, the General Fund would have had a surplus balance in the year 2002 of \$2270,541 and in year 2003 of \$2843,360, with revenues over expenses for both years or \$1,552,859 and \$3,214,974 in 2002 and 2003, respectively. As a result of increased development within the City that has occurred over the last two years, the City is in a growth cycle, creating increased revenue in building and planning fees and development impact fees.

Table 13
City of Desert Hot Springs
General Fund Statement of Actual Revenues, Expenditures
and Changes in Fund Balance
Years Ended June 30, 2002, 2003 and 2004⁽¹⁾

	2002 ⁽¹⁾	2003 ⁽¹⁾	2004 ⁽²⁾
REVENUES:			
Taxes	\$3,575,848	\$3,881,557	\$3,456,907
Permits and fees	437,908	1,279,962	3,467,530
Intergovernmental	950,050	996,110	770,335
Licenses	156,010	--	142,359
Interest	52,400	47,237	53,814
Miscellaneous	142,006	60,177	2,022,109
Total Revenues	<u>5,314,222</u>	<u>6,265,043</u>	<u>9,913,054</u>
EXPENDITURES:			
Current:			
General government	2,135,091	2,603,234	2,793,117
Public safety	--	--	--
Public works	154,903	446,835	--
Building, Engineering, Planning	--	--	1,034,913
Provision for liabilities subject to compromise:	--	--	--
Silver Sage Claims	6,000,000	--	--
TRANs Settlement Claims	1,261,689	--	--
Accounts payable	500,000	--	--
LaSalle Lease	113,789	--	--
Capital outlay	37,643	--	--
Debt Service:	--	--	--
Principal	9,090	--	--
Interest	2,940	--	256
Total Expenditures	<u>10,215,145</u>	<u>3,050,069</u>	<u>3,828,286</u>
REVENUES OVER (UNDER) EXPENDITURES	<u>(4,900,923)</u>	<u>3,214,974</u>	<u>6,084,768</u>
OTHER FINANCING SOURCES (USES)			
Operating transfers in	--	--	--
Operating transfers out	(1,950,163)	(2,643,975)	(2,640,017)
Total Other Financing Sources (Uses)	<u>(1,950,163)</u>	<u>(2,643,975)</u>	<u>(2,640,017)</u>
REVENUES AND OTHER FINANCING SOURCES OVER (UNDER) EXPENDITURES AND OTHER FINANCING USES	<u>(6,851,086)</u>	<u>570,999</u>	<u>3,444,751</u>
Fund Balance, Beginning of Year	703,426	(6,316,140)	(5,745,141)
Prior period adjustments	<u>(168,480)</u>	<u>570,999</u>	<u>--</u>
Fund Balance, End of Year	<u><u>\$(6,316,140)</u></u>	<u><u>\$(5,745,141)</u></u>	<u><u>\$(2,300,390)</u></u>

(1) This statement is a summary statement only. The Audited Financial Statements of the City, including the notes to the Audited Financial Statements, are an integral part of and necessary to a complete understanding of this statement.

(2) Unaudited; estimated/actuals. Subject to adjustment and revision.

Source: City of Desert Hot Springs, Finance Department.

(3) Includes one-time revenue received from sale of excess property of \$1,277,090

General Fund Budgets

Set forth in following table is a summary statement of the adopted General Fund budget for Fiscal Year 2001-02, 2002-03 and the adopted General Fund budget for Fiscal Year 2003-04.

Table 14
City of Desert Hot Springs
General Fund Budgets
Fiscal Years 2001-02, 2002-03 and 2003-04

	2001-02 Adopted <u>Budget</u>	2002-03 Adopted <u>Budget</u>	2002-03 <u>Actual</u>	2003-04 Adopted <u>Budget*</u>
REVENUES:				
Taxes	\$2,353,000	\$3,158,984	\$3,881,557	\$3,377,896
Permits and Fees	502,950	179,424	1,279,962	1,171,642
Intergovernmental	732,000	744,500	996,110	744,785
Licenses	99,000	130,938	--	117,500
Interest	13,500	3,030	47,237	50,000
Miscellaneous	79,600	127,482	60,177	353,169
Total Revenues	<u>3,780,050</u>	<u>4,344,358</u>	<u>6,265,043</u>	<u>5,814,992</u>
EXPENDITURES:				
Current:				
General government	2,093,928	2,396,228	2,603,234	3,942,546
Public safety	--	--	--	--
Public works	--	177,541	446,835	54,169
Economic Development	--	--	--	--
Provisions for liabilities subject to compromise:	--	--	--	--
Silver Sage Claims	--	--	6,000,000	--
TRANs Settlement Claims	--	--	1,261,689	--
Accounts Payable	--	--	500,000	--
LaSalle Lease/Redevelopment Agency Loan	--	--	714,424	--
Capital outlay	--	37,643	--	118,500
Debt service:	--	--	--	--
Principal	272,511	124,974	--	13,516
Interest	238,530	55,113	--	2,939
Total Expenditures	<u>2,604,969</u>	<u>2,791,499</u>	<u>11,526,182</u>	<u>4,131,670</u>
REVENUES OVER (UNDER)				
EXPENDITURES	1,175,081	1,522,859	(5,261,139)	1,683,322
OTHER FINANCING SOURCES:				
Reclassification of 1998 TRANs	--	--	--	--
Other	--	--	--	--
Operating transfers in	--	5,281	--	328,949
Operating transfers out	(1,175,081)	(1,805,741)	(2,643,975)	(2,012,271)
Total Other Financing Sources (Uses)	<u>(1,175,081)</u>	<u>(1,800,460)</u>	<u>(2,643,975)</u>	<u>(1,683,322)</u>
REVENUES AND OTHER FINANCING				
SOURCES OVER (UNDER) EXPENDITURES				
AND OTHER FINANCING USES	--	(247,601)	(7,905,114)	--
Fund Balance, Beginning of Year	--	--	2,159,973	(5,745,141)
Prior Period Adjustments	--	--	--	--
Fund balance (Deficit), End of Year	--	--	<u><u>\$(5,745,141)</u></u>	<u><u>(5,745,141)</u></u>

* Unaudited; subject to adjustment and revision.

Source: City of Desert Hot Springs, Finance Department.

Pensions; Plan Descriptions

General. The City contributes to the State of California Public Employees' Retirement System ("PERS"), an agent multiple-employer public employee 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. PERS is a contributory plan deriving funds from employee contributions as well as from employer contributions and earnings from investments. The staff actuaries at PERS prepare annually an actuarial valuation which covers a Fiscal Year ending approximately 15 months before the actuarial valuation is prepared (thus, the actuarial valuation delivered to the City in September 2003 covered the Fiscal Year ending June 30, 2002). The actuarial valuation expresses the City's required contribution rates in percentages of payroll, which percentages the City contributes in the Fiscal Year immediately following the Fiscal Year in which the actuarial valuation is prepared (thus, the contribution rates of the actuarial valuation as of June 30, 2002 are for the Fiscal Year 2004-05). PERS rules require the City to implement the actuary's recommended rates.

PERS maintains two pension plans for the City: a Safety Plan and a Miscellaneous Plan. In calculating the annual actuarially recommended rates of contribution, the PERS's actuary calculates on the basis of certain assumptions the actuarial present value of benefits that PERS will fund under the Miscellaneous Plan, which includes two components, the normal cost and the unfunded actuarial accrued liability (the "UAAL"). The normal cost represents the actuarial present value of benefits that PERS will fund under the Miscellaneous Plan that are attributed to the current year, and the UAAL represents the actuarial present value of benefits that PERS will fund that are attributed to past years. The UAAL differs from an amortized debt (such as a mortgage) in that the liability is not fixed or determinable like an amortized debt. Rather, the UAAL represents an estimate of the present value of the benefits that PERS will pay under the Miscellaneous Plan to retirees and active employees upon their retirement. The UAAL, thus, is based on several assumptions such as, among others, the rate of investment return, average life expectancy, average age of retirement, inflation, salary increases and occurrences of disabilities. If experience differs from these assumptions, then the actual amount that PERS would pay under the Miscellaneous Plan to retirees and active employees upon their retirement may be more or less than indicated by the UAAL, and possibly substantially so. In addition, the UAAL includes certain actuarial adjustments such as, among others, the actuarial practice of smoothing losses and gains over multiple years (which is described in more detail below). As a result, prospective investors are encouraged to consider the UAAL as an estimate of the unfunded actuarial present value of the benefits that PERS will fund under the Miscellaneous Plan to retirees and active employees upon their retirement and not as a fixed or hard expression the liability the City owes to PERS under the Miscellaneous Plan.

In calculating the UAAL in an actuarial valuation, the PERS actuary smoothes gains and losses over multiple years using a smoothing technique that generally only recognizes one third of the gain or loss realized in a given Fiscal Year. In each actuarial valuation, the PERS actuary calculates what was the expected actuarial value of the assets (the "Expected Value") of the Miscellaneous Plan at the end of the Fiscal Year (which assumes, among other things, that the real rate of return during that Fiscal Year equaled the assumed rate of return of 8.25%). However, PERS does not allow the Expected Value to be less than 90% or more than 110% of the Market Value.

The Miscellaneous Plan and the Safety Plan are a part of the Public Agency portion of the PERS system. A menu of benefit provisions as well as other requirements are established by State statutes within the Public Employees' Retirement Law. The City selects optional benefit provisions from the benefit menu by contract with PERS and adopts those benefits through local ordinance or resolution. PERS issues a separate comprehensive annual financial report. Copies of the PERS's annual financial report may be obtained from the PERS Executive Office – 400 P Street – Sacramento, California 95814.

PERS also provides death and disability benefits. These benefit provisions and all other requirements are established by state statute and City ordinance.

City Retirement Benefits and Expenses. All full-time City employees and part-time City employees who have worked over 1,000 hours during a fiscal year are eligible to participate in PERS, with benefits vesting after 5 years of service. Employees are designated as safety (police officers, firefighters and others designated as safety by law) or miscellaneous (all others).

Safety employees who retire at or after age 50 with 5 years of credited service are entitled to an annual retirement benefit, payable monthly for life, in an amount equal to a benefit factor multiplied by their final compensation which is the average monthly pay rate for the last consecutive 12 months of employment (or any 12-month period in which pay was higher). The benefit factor is an amount equal to between 2.4% and 3.0% multiplied by the number of years of credited employment. The percentage amount is based upon the age of the employee at retirement, increasing from age 50 to age 55.

Miscellaneous members who retire at age 50 with 5 years of credited service are entitled to an annual retirement benefit, payable monthly for life, in an amount equal to a benefit factor multiplied by their final compensation. Final compensation for miscellaneous members is the average monthly pay rate for the last consecutive 12 months (or any 12-month period in which pay was higher) of employment. The benefit factor is an amount equal to between 1.426% and 2.418% multiplied by the number of years of credited employment. The percentage amount is based upon the age of the employee at retirement, increasing from age 50 to age 63. The City recently approved a change to the existing plan for the Miscellaneous employees, increasing the current 2% at age 55 to a new plan of 2.7% at age 55.

The required employer contribution rate for Fiscal Year 2002-03 was 7.352% for Miscellaneous employees and 4.034% for Safety employees, and the required employer contribution rate for Fiscal Year 2003-04 was 10.364% percent for Miscellaneous employees and 4.298% percent for Safety employees. The estimated rate for Fiscal Year 2004-05 is expected to be 11.828% for Miscellaneous employees and 7.528% for Safety employees. Under proposed plan amendments, the estimated rate for Fiscal Year 2004-05 is projected to be 17.338% for Miscellaneous employees and 19.903% for Safety employees. The contribution requirements of the plan members are established by State statute and the employer contribution rate is established and may be amended by PERS.

In addition to making annual contributions to PERS in accordance with the applicable actuarial valuation, the City also has agreed pursuant to the collective bargaining arrangements with the City's employee unions to pay all of the employees' required contribution to PERS (these payments by the City are referred to herein as the "Employee Offsets"). The City has assumed the obligation of active plan members in the Miscellaneous Plan and the Safety Plan to contribute between 7 percent and 9 percent of their annual covered salary. The City's labor contracts require the City to pay all Miscellaneous Employee Plan PERS contributions and Safety Plan contributions that are required for the actuarially determined amounts necessary to fund the benefits for its members. The City is required to contribute the remaining amounts necessary to fund the benefits for its members using the actuarial basis recommended by the PERS actuaries and actuarial consultants and adopted by the PERS Board of Administration.

The City's payroll for employees covered by PERS for the year ended June 30, 2002 was \$2,333,508. Total payroll for the City for the year ended June 30, 2003 was \$2,998,782. As discussed above, payments to PERS are funded by contributions from the City for both the City's and member employees share. For Fiscal Year 2002-03, the City's annual pension cost was \$331,215 for both Miscellaneous and Safety members, and was equal to the City's required and actual contributions. The required contribution for Fiscal Year 2002-03 was determined using the entry age normal actuarial cost method with the contributions determined as a percent of pay. The actuarial assumptions included (a) 8.5

percent investment rate of return (net of administrative expenses); (b) projected salary increases that vary by duration of service ranging from 4.5 percent to 14.95 percent for Miscellaneous members and from 5.02 percent to 12.34 percent for Safety members, and (c) 0 percent cost-of-living adjustment. Both (a) and (b) include an inflation component of 4.5 percent.

The City's payroll for employees covered by PERS for the year ended June 30, 2004 is estimated to be \$3,180,859. The City's share of the City's annual pension cost is projected to be \$862,903 for Fiscal Year 2003-04, and it is projected that in Fiscal Year 2004-05 the City's and employees share will be \$789,701.

Funding Status. As of June 30, 2002, the date of the most recent actuarial valuation report, the actuarial value of assets in the Miscellaneous Plan was approximately \$1,077,319, and the actuarial accrued liability was approximately \$221,741. The Miscellaneous Plan was approximately 82.9% funded as of June 30, 2002. The UAAL was approximately \$221,741. In the actuarial valuation for the Miscellaneous Plan as of June 30, 2002, the actuary recommended an employer contribution rate of 11.828% to be implemented in Fiscal Year 2004-05, which the City anticipates will result in a contribution by the City to PERS of \$187,800 for that Fiscal Year. In addition, the City will pay to PERS approximately \$33,941 in Employee Offsets for Fiscal Year 2004-05, which results in a total amount of contribution that the City will make to PERS for Fiscal Year 2004-05 approximately \$789,701.00.

Increased funding requirements in recent years has been the result of a couple of factors. First, in the actuarial valuation as of June 30, 2000 (which was delivered to the City in September or October 2001 and which was used to determine the contribution rates to be applied in Fiscal Year 2002-03), the Miscellaneous Plan had an actuarial value of assets that exceeded the actuarial liability by approximately \$26,826. As a result, PERS consolidated the amount of that excess and then amortized that amount over 16 years. In each of those 16 years a portion of that amount is credited against the City's required contribution rate. This annual credit amount substantially offset the City's normal cost payments in Fiscal Years 2002-03 and 2003-04. Second, since June 30, 2000, as a result of lower-than-expected rates of returns, the actuarial losses have steadily increased. In the actuarial valuation as of June 30, 2001, which was used for the required contribution rates for Fiscal Year 2003-04, the full effect of these actuarial losses was not reflected in the City's required contribution rates because the actuarial gain that was being credited against the City's required contribution rates substantially offset the impact of the low investment return. But as of June 30, 2002, the actuarial loss had increased to such a level that the City must now pay the entire normal cost payment plus a portion of the UAAL that has resulted.

Prospects. The PERS actuary, in the June 30, 2002 actuarial valuation, projected that the City's contribution rate under the Miscellaneous Plan for the Fiscal Year 2005-06 will be 12.1%, which would result in an approximately 1.0% increase in the contribution rate from Fiscal Year 2004-05. Although there have been no projections completed beyond Fiscal Year 2005-06, the City believes that its contribution rate in Fiscal Year 2006-07 may again increase.

The projected increase in the City's contribution rate is principally the result of two causes. First, there currently exists a difference between the actuarial value and the market value of the assets in the Miscellaneous Plan. An actuarial valuation of assets differs from a market valuation of assets in that an actuarial valuation reflects so-called smoothing adjustments which smooth the impact of gains and losses over multiple years. As of June 30, 2002, the actuarial value of the assets in the Miscellaneous Plan was approximately 110% in excess of the market value. As a result, even if the real rate of return of the assets in the Miscellaneous Plan is above the actuarial assumed rate of 8.25% in future Fiscal Years, the actuarial practice of smoothing losses over several years may cause the investment rate of return for actuarial purposes to be less than the real rate of return. Therefore, the lower-than-expected investment

returns during Fiscal Years 2000-01 and 2001-02 have not been fully realized in the actuarial valuation as of June 30, 2002 and may continue to adversely impact the City's contribution rates in future Fiscal Years.

Second, the projected increase in the City's contribution rate in Fiscal Year 2005-06 will also be as a result of the real rate of return of the assets in the Miscellaneous Plan during Fiscal Year 2002-03. PERS has reported that the real rate of return of assets for all PERS plans was 4% (although PERS has indicated that such real rate of return may have actually been lower than that), which is substantially below the actuarially assumed rate of return of 8.25%. Since the real rate of return is lower than the assumed rate, the Miscellaneous Plan will realize a loss for actuarial purposes, but, ordinarily, this actuarial loss would be smoothed such that the Miscellaneous Plan would only be impacted by one third of that loss in one Fiscal Year. However, PERS has a policy that the difference between market value and actuarial value cannot exceed 110%. For a discussion of the smoothing policy of PERS, see "General" above. Since that 110% limit was reached in the actuarial valuation as of June 30, 2002, little, if any, of the loss that is realized during Fiscal Year 2002-03 will be smoothed. This will likely apply additional pressure on contribution rates, particularly for contribution rates to be used in Fiscal Year 2005-06.

PERS' investment returns for the most recent reporting year (2002-2003) were above actuarial assumptions, and the overall investment markets have improved dramatically from 2000-02. PERS has indicated that the real rate of return in Fiscal Year 2003-04, so far, is on track to exceed the actuarially assumed rate of return.

With respect to Fiscal Year 2004-05, the City has used the required contribution rate of 11.828% provided in the actuarial valuation as of June 30, 2002. With respect to Fiscal Year 2005-06, the City has assumed that the City's contribution rate under the Miscellaneous Plan will be 12.1%, since that is the projected contribution rate provided by the PERS actuary. In future Fiscal Years, the City assumed that the contribution rate will increase due to the increase in percentage being requested, including the rate increase from 2.5% to 2.7% for Miscellaneous employees group. The City will be meeting with the Public Safety group in the next month to discuss their requests.

Property Insurance

The City purchases property insurance and is currently insured according to a schedule of covered property. The City's current policy provides for a limit of \$9,128,450 for real and personal property and \$1,044,000 for scheduled autos. The "all risk" coverage are \$2,500 on licensed vehicles (except fire trucks which is \$10,000) \$2,500 on electronic data processing equipment and \$5,000 on all other property for all perils, except flood. The deductible for flood is \$25,000.

During the past three fiscal (policy) years, none of the above programs of protection have had settlements or judgments that exceeded pooled or insured coverage. There have been no significant reductions in pooled or insured coverage in the prior year.

Investment of Funds

The City Treasurer, in accordance with the California Government Code, is responsible for investing the unexpended cash of the City. The City is the only participant in the City investments; there are no other participants either voluntary or involuntary. The investment objectives of the City are preservation of capital, liquidity and return.

Oversight and Reporting Requirements. The City Treasurer (the "City Treasurer") provides an investment report on a monthly basis to the City Manager and the City Council and annually presents a

statement of investment policy (the “Investment Guidelines”) to the City Manager and the City Council. An independent audit is conducted annually by a public accounting firm.

The Treasurer prepares a series of monthly reports which include portfolio market valuation and is distributed to the Mayor, City Council, City Manager and other officials on a monthly basis.

Authorized Investments. The City’s treasury operations are governed by the California Government Code, Sections 53600 *et seq.* and the City Treasurer’s Investment Policy which sets forth permitted investment vehicles, liquidity parameters and maximum maturity of investments.

Investment Liquidity and Other Characteristics. The City investments are highly liquid. As of October 1, 2004, 100% of the City’s investments are invested with the State of California Local Agency Investment Fund or in checking and savings accounts with Guaranty Federal Bank. These investments have 24-hour liquidity at par and interest rates fluctuate on a daily basis. The composition and value of investments under management in the City investments will vary from time to time depending on cash flow needs of the City, maturity or sale of investments, purchase of new securities, and due to fluctuations in interest rates generally.

Bonded and Other Indebtedness

The City currently has no material long term obligations which are not otherwise the subject of its Judgment Obligation Bonds and its Certificates of Participation to be issued concurrently therewith. The following represent certain non-obligatory debt payable from sources other than the City’s general fund or special funds. For additional information, see APPENDIX B – “AUDITED FINANCIAL STATEMENTS OF THE CITY OF DESERT HOT SPRINGS FOR THE FISCAL YEAR ENDED JUNE 30, 2003.”

Heritage Hospital Certificates of Participation. On August 15, 1998, the Desert Hot Springs Public Financing Authority (the “Authority”), a joint powers authority organized and existing pursuant to that Joint Exercise of Powers Agreement dated September 25, 1990, by and between the City and the City of Desert Hot Springs Redevelopment Agency (the “Agency”) caused the execution and delivery of the Health Care Refunding and Improvement Certificates of Participation (the “Hospital Certificates”) for the Heritage Hospital Project. The Hospital Certificates were delivered in two series: Tax-Exempt Series A Certificates were executed and delivered evidencing principal in the aggregate amount of \$13,900,000 and Federally Taxable Series B were executed and delivered evidencing principal in the aggregate amount of \$8,430,000. As of June 30, 2004, the Hospital Certificates are in default for nonpayment. Bank of New York is serving as successor trustee.

The Hospital Certificates are payable solely from Installment Payments as and when paid by the operator of the Heritage Hospital Project, Heritage Rancho Healthcare, Inc., doing business as Heritage Hospital, and do not constitute general obligations of the Authority, the City, the State of California, or any political subdivision thereof.

Assessment Districts. In November 1992, the City issued \$975,062 of City of Desert Hot Springs Assessment District No. 92-1 (Arroyo Vista) Limited Obligation Improvement Bonds, dated on or about November 24, 1992, to provide financing for the acquisition of street, sewer, and water drainage utilities for the proposed residential subdivision known as Arroyo Vista. The bonds are subject to optional redemption prior to maturity at par plus accrued interest and a premium of 3 percent.

On September 1, 2000, Assessment District No. 92-1 defaulted on the scheduled principal and interest payments then due on the bonds due to a shortage of funds. Assessment District No. 92-1 does

not generate sufficient cash flow to meet the scheduled debt service payments. The bonds have remained in default. The outstanding balance at June 30, 2003, is \$705,000. The Chapter 9 Case included a claim for the Assessment District No. 92-1 Bonds in the amount of \$801,591.65

In October 1993, the City issued \$765,320 of City of Desert Hot Springs Assessment District No. 93-2 (Arroyo Vista) Limited Obligation Improvement Bonds, dated as of October 19, 1993, for the acquisition of street, sewer, water, drainage and dry utilities within, or adjacent to, the proposed Arroyo Vista development. The bonds are subject to optional redemption prior to maturity at par plus accrued interest and a premium of 3 percent.

On September 1, 2000, Assessment District No. 93-2 defaulted on the scheduled principal and interest payments then due on the bonds due to a shortage of funds. Assessment District No. 93-2 does not generate sufficient cash flow to meet the scheduled debt service payments. The bonds have remained in default. The outstanding balance at June 30, 2003, is \$550,000. The Chapter 9 Case included a claim for the Assessment District No. 93-2 Bonds in the amount of \$577,213.60.

In May 1994, the City issued \$441,044 of City of Desert Hot Springs Assessment District No. 91-1 (Two Bunch Palms Trail) Limited Obligation Improvement Bonds, dated as of May 5, 1994, for the acquisition and construction of certain street improvements for Two Bunch Palms Trail. The bonds are subject to optional redemption prior to maturity at par plus accrued interest and a premium of 3 percent.

A separate Fiscal Agent Agreement was executed by the City in connection with each of the above-referenced Limited Obligation Improvement Bonds. The payment obligations under the Limited Obligation Improvement Bonds are limited to the specific revenues pledged to secure such indebtedness in accordance with the operative documents (including without limitation the operative Fiscal Agent Agreement) that govern the Limited Obligation Improvement Bonds. The City is acting only in an agent capacity for collection of principal and interest payments by the property owners and remittance of such monies to the bondholders. As provided under the Plan, each holder of a Limited Obligation Improvement Bond claim shall have all legal, equitable, and contractual rights (including without limitation those provided under the applicable Fiscal Agent Agreement and the other operative documents that govern the Limited Obligation Improvement Bonds) to which such claim entitles such holder, and all liens and security interests provided in connection therewith shall remain in place. The City has no obligation or duty to pay any delinquency out of any available funds of the City. For the above noted Assessment Districts, neither the full faith and credit nor the taxing power of the City, the State of California or any political subdivision thereof is pledged to the payment of the above noted bonds.

Statement of Direct and Overlapping Debt

Contained within the City are numerous overlapping local agencies providing public services. These local agencies have outstanding bonds issued in the form of general obligation, lease revenue and special assessment bonds. Set forth below is a statement of direct and overlapping debt as of September 1, 2004 (the "Debt Statement") prepared by California Municipal Statistics, Inc.

The Debt Statement generally includes long term obligations sold in the public credit markets by public agencies other than the City whose boundaries overlap the boundaries of the City in whole or in part. Such long term obligations generally are not payable from revenues of the City (except as indicated) nor are they necessarily obligations secured by land within the City. In many cases long term obligations issued by a public agency are payable only from the general fund or other revenues of such public agency. Self-supporting revenue bonds, tax allocation bonds and non-bonded capital lease obligations are excluded from the debt statement.

Table 15
City of Desert Hot Springs
Direct and Overlapping Debt
As of September 1, 2004

2003-04 Assessed Valuation: \$619,680,290
 Redevelopment Incremental Valuation: 182,473,368
 Adjusted Assessed Valuation: \$437,206,922

<u>DIRECT AND OVERLAPPING TAX AND ASSESSMENT DEBT:</u>	<u>% Applicable</u>	<u>Debt 9/1/04</u>
Riverside County Flood Control District, Zone No. 6	6.465%	\$ 21,011
Banning Unified School District	0.096	7,526
Palm Springs Unified School District	4.974	5,889,216
City of Desert Hot Springs	100.0	0 ⁽¹⁾
City of Desert Hot Springs 1915 Act Bonds (Estimate)	100.0	1,435,000
Mission Springs Water District 1915 Act Bonds	100.0	<u>235,000</u>
TOTAL DIRECT AND OVERLAPPING TAX AND ASSESSMENT DEBT		\$7,587,753
 <u>OVERLAPPING GENERAL FUND OBLIGATION DEBT:</u>		
Riverside County General Fund Obligations	0.486%	\$3,125,666
Riverside County Board of Education Certificates of Participation	0.486	63,958
Mt. San Jacinto Community College District General Fund Obligations	0.003	<u>234</u>
TOTAL GROSS OVERLAPPING GENERAL FUND OBLIGATION DEBT		\$3,189,858
Less: Riverside County self-supporting obligations		<u>104,048</u>
TOTAL NET OVERLAPPING GENERAL FUND OBLIGATION DEBT		\$3,085,810
 GROSS COMBINED TOTAL DEBT		\$10,777,611 ⁽²⁾
NET COMBINED TOTAL DEBT		\$10,673,563

(1) Excludes issue to be sold.

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

Ratios to 2003-04 Assessed Valuation:

Direct Debt	0.00%
Total Direct and Overlapping Tax and Assessment Debt	1.22%

Ratios to Adjusted Assessed Valuation:

Gross Combined Total Debt	2.47%
Net Combined Total Debt	2.44%

STATE SCHOOL BUILDING AID REPAYABLE AS OF 6/30/04: \$0

Source: California Municipal Statistics, Inc.

**CONSTITUTIONAL AND STATUTORY LIMITATIONS ON
 TAXES AND APPROPRIATIONS**

Article XIII A of the California Constitution

On June 6, 1978, California voters approved Proposition 13 ("Proposition 13"), which added Article XIII A to the State Constitution ("Article XIII A"). Article XIII A, as amended, limits the amount of any *ad valorem* tax on real property to one percent of the full cash value thereof, except that additional

ad valorem taxes may be levied to pay debt service on (i) indebtedness approved by the voters prior to July 1, 1978, (ii) (as a result of an amendment to Article XIII A approved by State voters on June 3, 1986) on bonded indebtedness for the acquisition or improvement of real property which has been approved on or after July 1, 1978 by two-third of the voters on such indebtedness, and (iii) bonded indebtedness incurred by a school district or community college district for the construction, reconstruction, rehabilitation or replacement of school facilities or the acquisition or lease of real property for school facilities, approved by 55% of the voters of the district, but only if certain accountability measures are included in the proposition. Article XIII A defines full cash value to mean “the county assessor’s valuation of real property as shown on the 1975-76 tax bill under “full cash value,” or thereafter, the appraised value of real property when purchased, newly constructed, or a change in ownership has occurred after the 1975 assessment.” This full cash value may be increased at a rate not to exceed two percent per year to account for inflation.

Article XIII A has subsequently been amended to permit reduction of the “full cash value” base in the event of declining property values caused by damage, destruction or other factors, to provide that there would be no increase in the “full cash value” base in the event of reconstruction of property damaged or destroyed in a disaster, and in other minor or technical ways.

On December 27, 2001, the Orange County Superior Court held in the case of *County of Orange v. Orange County Assessment Appeals Board No. 3*, case no. 00CC03385, that where a home’s taxable value did not increase for two years, due to a flat real estate market, the Orange County assessor violated the two percent inflation adjustment provision of Article XIII A, when the assessor tried to “recapture” the tax value of the property by increasing its assessed value by 4% in a single year. The assessors in all California counties use a similar methodology in raising the taxable values of property beyond 2% in a single year. The State Board of Equalization has approved this methodology for increasing assessed values. On December 12, 2002, the Orange County Superior Court ruled in favor of a motion to restate the complaint as a class action. Following arguments on appeal, on March 26, 2004, the California District Court of Appeals, 4th Appellate District, unanimously overruled the ruling of the Orange County Superior Court, concluding that the intent of the drafters of Proposition 13, as it was amended in 1978 within six months of its passage by Proposition 8, was that the inflation factor is calculated against the original purchase price of the property and not against the intervening previous years reassessed value. On July 21, 2004, the California Supreme Court denied plaintiff/petitioner’s review of the Court of Appeal ruling, which means that the Superior Court will have to comply with the Court of Appeal’s ruling that annual inflation adjustments under Article XIII A are to be calculated based on the original purchase price of property, and not applied against any intervening previous year’s reassessed value. The City cannot state with certainty whether appeal to the United States Supreme Court of this matter might be requested or available.

Legislation Implementing Article XIII A

Legislation has been enacted and amended a number of times since 1978 to implement Article XIII A. Under current law, local agencies are no longer permitted to levy directly any property tax (except to pay voter-approved indebtedness). The one percent property tax is automatically levied by the County and distributed according to a formula among taxing agencies. The formula apportions the tax roughly in proportion to the relative shares of taxes levied prior to 1989.

Increases of assessed valuation resulting from reappraisals of property due to new construction, change in ownership or from the two percent annual adjustment are allocated among the various jurisdictions in the “taxing area” based upon their respective “situs.” Any such allocation made to a local agency continues as part of its allocation in future years.

Beginning in the 1981-82 fiscal year, assessors in the State no longer record property values on tax rolls at the assessed value of 25% of market value which was expressed as \$4 per \$100 assessed value. All taxable property is now shown at full market value on the tax rolls. Consequently, the tax rate is expressed as \$1 per \$100 of taxable value. All taxable property value included in this Official Statement is shown at 100% of market value (unless noted differently) and all tax rates reflect the \$1 per \$100 of taxable value.

Article XIII B of the California Constitution

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

Appropriations subject to Article XIII B include generally any authorization to expend during the fiscal year the proceeds of taxes levied by the State or other entity of local government, exclusive of certain State subventions, refunds of taxes, benefit payments from retirement, unemployment insurance and disability insurance funds. Appropriations subject to limitation pursuant to Article XIII B do not include debt service on indebtedness existing or legally authorized as of January 1, 1979, or bonded indebtedness thereafter approved according to law by a vote of the electors of the issuing entity voting in an election for such purpose, appropriations required to comply with mandates of courts or the federal government, appropriations for qualified outlay projects, and appropriations by the State of revenues derived from any increase in gasoline taxes and motor vehicle weight fees above January 1, 1990 levels. “Proceeds of taxes” include, but are not limited to, all tax revenues and the proceeds to any entity of government from (i) regulatory licenses, user charges, and user fees to the extent such proceeds exceed the cost of providing the service or regulation, (ii) the investment of tax revenues and (iii) certain State subventions received by local governments. Article XIII B includes a requirement that if an entity’s revenues in any year exceed the amount permitted to be spent, the excess would have to be returned by revising tax rates or fee schedules over the subsequent two fiscal years.

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

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

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

The City's appropriations limit for the 2004-05 fiscal year is \$13,609,219 and the amount shown in its budget for that year as the appropriations subject to limitation is \$12,957,867. The calculation does not include proceeds of the Bonds, described herein, nor the Certificates of Participation proposed to be executed and delivered, nor the Order of the Bankruptcy Court confirming the plan of adjustment of debts. The City does not anticipate any difficulty in holding appropriations below the allowed limit for the fiscal year ending June 30, 2004.

Articles XIII C and XIII D of the California Constitution — Proposition 218

On November 5, 1996, the voters of the State approved Proposition 218, known as the "Right to Vote on Taxes Act." Proposition 218 added Articles XIII C and XIII D to the California Constitution, which contain a number of provisions affecting the ability of the City to levy and collect both existing and future taxes, assessments, fees and charges.

Article XIII C requires that all new local taxes be submitted to the electorate before they become effective. Taxes for general governmental purposes of the City require a majority vote and taxes for specific purposes, even if deposited in the City's General Fund, require a two-thirds vote. The voter approval requirements of Proposition 218 reduce the flexibility of the City Council to raise revenues for the General Fund, and no assurance can be given that the City will be able to impose, extend or increase such taxes in the future to meet increased expenditure requirements. In addition, Article XIII D contains new provisions relating to how local agencies may levy and maintain "assessments" for municipal services and programs. "Assessment" is defined to mean any levy or charge upon real property for a special benefit conferred upon the real property. This definition applies to landscape and maintenance assessments for open space areas, street medians, street lights and parks.

Article XIII D also contains several new provisions affecting "fees" and "charges," defined for purposes of Article XIII D to mean "any levy other than an *ad valorem* tax, a special tax, or an assessment, imposed by a [local government] upon a parcel or upon a person as an incident of property ownership, including a user fee or charge for a property related service." All new and existing property related fees and charges must conform to requirements prohibiting, among other things, fees and charges which (i) generate revenues exceeding the funds required to provide the property related service, (ii) are used for any purpose other than those for which the fees and charges are imposed, (iii) are for a service not actually used by, or immediately available to, the owner of the property in question, or (iv) are used for general governmental services, including police, fire or library services, where the service is available to the public at large in substantially the same manner as it is to property owners. Further, before any property related fee or charge may be imposed or increased, written notice must be given to the record owner of each parcel of land affected by such fee or charge. The City must then hold a hearing upon the proposed imposition or increase, and if written protests against the proposal are presented by a majority of the owners of the identified parcels, the City may not impose or increase the fee or charge. Moreover, except for fees or charges for sewer, water and refuse collection services, or fees for electrical and gas service, which are not treated as "property related" for purposes of Article XIII D, no property related fee or charge may be imposed or increased without majority approval by the property owners subject to the fee or charge or, at the option of the local agency, two-thirds voter approval by the electorate residing in the affected area.

In addition to the provisions described above, Article XIII C removes many of the limitations on the initiative power in matters of reducing or repealing any local tax, assessment, fee or charge. No

assurance can be given that the voters of the City will not, in the future, approve an initiative or initiatives which reduce or repeal local taxes, assessments, fees or charges currently comprising a substantial part of the City's General Fund. "Assessment," "fee" and "charge" are not defined in Article XIIC, and it is not clear whether the definitions of these terms in Article XIID (which are generally property related as described above) would be applied to Article XIIC. If the Article XIID definitions are not held to apply to Article XIIC, the initiative power could potentially apply to revenue sources which currently constitute a substantial portion of general fund revenues. No assurance can be given that the voters of the City will not, in the future, approve initiatives which repeal, reduce or prohibit the future imposition or increase of local taxes, assessments, fees or charges.

The City does not currently levy any property related "fees" or "charges" which it considers subject to challenge under Proposition 218.

Proposition 62

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

On September 28, 1995, the California Supreme Court, in *Santa Clara County Local Transportation Authority v. Guardino*, 11 Cal. 4th 220 (1995) (the "Santa Clara Case"), upheld the constitutionality of the portion of Proposition 62 requiring a two-thirds vote in order for a local government or district to impose a special tax, and, by implication, upheld a parallel provision requiring a majority vote in order for a local government or district to impose any general tax. The decision in the Santa Clara Case did not address the question of whether it should be applied retroactively. On June 4, 2001, the California Supreme Court released *Howard Jarvis Taxpayers Association v. City of La Habra, et al.* ("La Habra"). In this decision, the court held that a public agency's continued imposition and collection of a tax is an ongoing violation, upon which the statute of limitations period begins anew with each collection. The court also held that, unless another statute or constitutional rule provided differently, the statute of limitations for challenges to taxes subject to Proposition 62 is three years. Accordingly, a challenge to a tax subject to Proposition 62 may only be made for those taxes received within three years of the date the action is brought. Proposition 62 applies to the imposition of any taxes or the effecting of any tax increases after its enactment in 1986, but the requirements of Proposition 62 are subsumed by the requirements of Proposition 218 for the imposition of any taxes or the effecting of any tax increases after November 5, 1996. See "—Articles XIIC and XIID of the California Constitution — Proposition 218" above.

The City has effected certain tax increases after the enactment of Proposition 62 in 1986. In December 1993 the City Council approved a 3% Utility Users Tax. The Utility Users Tax was later upheld in a special election and subsequently increased to 5% in July 1, 2000. Of the proceeds, 2% was to be used to reduce the City's debt. This Utility User's Tax was scheduled to expire in July, 2005.

However, in June 2003 the Utility Tax was extended to 2010, with half of the revenue generated to go to debt retirement and half to be used for public safety. Similarly, a Public Safety Tax measure was placed before the voters and approved in June 2000. Since the implementation of this tax, more than \$3.5 million has been collected and used for public safety.

The City is of the opinion that Proposition 62 will not materially impact any existing or future taxes, fees and assessments collected by the City. No revenues collected by the City have been challenged under Proposition 62.

Future Initiatives

Article XIII A, Article XIII B, Article XIII C and Article XIII D were each adopted as measures that qualified for the ballot pursuant to the State's initiative process. From time to time, other initiative measures could be adopted, which may place further limitations on the ability of the State, the City or local districts to increase revenues or to increase appropriations which may affect the City's revenues or its ability to expend its revenues.

SPECIAL RISK FACTORS

The following factors, along with the other information in this Official Statement, should be considered by potential investors in evaluating the purchase of the Bonds. However, they do not purport to be an exhaustive listing of risks and other considerations which may be relevant to an investment in the Bonds. In addition, the order in which the following factors are presented is not intended to reflect the relative importance of any such risks.

Bonds are a General Fund Obligation of the City

The obligation of the City to make debt service payments on the Bonds does not constitute an obligation of the City for which the City is obligated to levy or pledge any form of taxation or for which the City has levied or pledged any form of taxation.

The Indenture does not create a pledge, lien or encumbrance upon the funds of the City. Pursuant to law, the Bonds are payable from any available funds of the City. The City covenants in the Indenture to punctually pay the interest on and principal of every Bond in strict conformity with the terms thereof and of the Indenture. The City is liable and may become liable on other obligations payable from general revenues, some of which may have a priority over payments of the principal of, premium, if any, and interest on, the Bonds, or which the City, in its discretion, may determine to pay prior to the principal of, premium, if any, and interest on, the Bonds.

The City has the capacity to enter into other obligations payable from the City's General Fund without the consent of or prior notice to the Owners of the Bonds, and has expressly reserved the right to issue or incur other obligations for any of its corporate purposes. To the extent that additional obligations are incurred by the City, the funds available to make payments of the principal of, premium, if any, and interest on, the Bonds may be decreased. In the event the City's revenue sources are less than its total obligations, the City could choose to fund other activities before making payment of the principal of, premium, if any, and interest on, the Bonds. The same result could occur if State constitutional expenditure limitations were to prohibit the City from appropriating and spending all of its otherwise available revenues.

Cash Management

The City has numerous internal or external means to manage its cash flow, including but not limited to interfund borrowing, intrafund borrowing and tax and revenue anticipation notes which may be employed to the extent the City Council is required to make budget adjustments in order to maintain a balanced budget. If the City does not take required actions and the budget remains out of balance, the cash requirements of the City may exceed available cash flow. The ability of the City to borrow on an interim basis to meet any cash shortfalls also may be limited if the budget remains out of balance for a sustained period of time. The City has the legal authority to issue “warrants” in place of cash to meet various types of expenditures or appropriations as an additional means to manage its cash flow. See “CITY FINANCIAL INFORMATION.”

Limitations on Remedies

Remedies available to the Bondowners may be limited by a variety of factors and may be inadequate to assure the timely payment of principal of and interest on the Bonds or to preserve the tax exempt status of the Bonds.

Bond Counsel has limited its opinion as to the enforceability of the Bonds and of the Indenture to the extent that enforceability may be limited by bankruptcy, insolvency, reorganization, fraudulent conveyance or transfer, moratorium, or other similar laws affecting generally the enforcement of creditor’s rights, by equitable principles and by the exercise of judicial discretion. Additionally, the Bonds are not subject to acceleration in the event of the breach of any covenant or duty under the Indenture. The lack of availability of certain remedies or the limitation of remedies may entail risks of delay, limitation or modification of the rights of the Bondowners.

Enforceability of the rights and remedies of the Owners of the Bonds, and the obligations incurred by the City, may become subject to the federal bankruptcy code and applicable bankruptcy, insolvency, reorganization, moratorium, or similar laws relating to or affecting the enforcement of creditor’s rights generally, now or hereafter in effect, equity principles which may limit the specific enforcement under State law of certain remedies, the exercise by the United States of America of the powers delegated to it by the Constitution, the reasonable and necessary exercise, in certain exceptional situations, of the police powers inherent in the sovereignty of the State and its governmental bodies in the interest of serving a significant and legitimate public purpose and the limitations on remedies against municipal corporations and charter cities in the State. Bankruptcy proceedings, or the exercise of powers by the federal or State government, if initiated, could subject the owners of the Bonds to judicial discretion and interpretation of their rights in bankruptcy or otherwise, and consequently may entail risks of delay, limitation, or modification of their rights.

Ballot Initiatives and Legislative Measures

The Initiative was adopted pursuant to a measure qualified for the ballot pursuant to California’s constitutional initiative process; and the State Legislature has in the past enacted legislation which has altered the spending limitations or established minimum funding provision for particular activities. From time to time, other initiative measures could be adopted by California voters or legislation enacted by the Legislature. The adoption of any such initiative or legislation might place limitations on the ability of the State, the City or other local districts to increase revenues or to increase appropriations.

Loss of Tax Exemption

As discussed under the heading “TAX EXEMPTION,” certain acts or omissions of the City in violation of its covenants in the Indenture could result in the interest on the Bonds being deemed included in gross income for purposes of federal income taxation retroactive to the date of delivery of the Bonds. Should such an event of taxability occur, the Bonds would not be subject to a special redemption and would remain Outstanding until maturity or until redeemed under the optional redemption provisions contained in the Indenture.

Changes in Law

There can be no assurance that the State Legislature will not at some future time enact legislation that will amend or create laws resulting in a reduction of moneys available to pay debt service on the Bonds. Similarly, the California electorate could adopt initiatives or the State Legislature could adopt legislation with the approval of the electorate amending the State Constitution which could have the effect of reducing moneys available to pay debt service on the Bonds.

Dependence of City on Tourism

The City’s economy is dependent in large part on the tourism and the hospitality industry, which sector generated \$7,752,656 and provided 20% of all employment in the City in Fiscal Year 2002-03. Tourism and the hospitality industry, with corresponding residential development, is the major economic base of the entire desert resort community. Many factors can influence the overall health of the tourism industry, including gasoline prices, and ecological and natural conditions and events.

On September 11, 2001, terrorist attacks occurred in New York City and Washington, D.C. and resulted in significant damage and casualties. The City is unable to determine the effects similar events, if any, on, among other things, the demand for the City’s services or an impact upon the allocation of City resources. In addition, the City will likely experience a decrease with respect to certain tourism-related revenues because of changes in economic circumstances indirectly related to these events. See “— Other Financial Matters” below.

Other Financial Matters

Due to recent economic changes in the State and the United States and the consequences of terrorist attacks, military movements, and responses thereto, it is possible that the general revenues of the City will decline, particularly those based on tourism. Such a reduction in revenues may include, but may not be limited to, a decline in transient occupancy tax and sales tax revenues, and the loss of vehicle license fee revenue. Such financial matters may have a detrimental impact on the City’s General Fund. See “CITY FINANCIAL INFORMATION - Transient Occupancy Tax” herein for information on transient occupancy tax revenues of the City, see “CITY FINANCIAL INFORMATION – State Budget Acts” herein for information on the loss of vehicle license fee revenue by the City.

TAX EXEMPTION

In the opinion of Orrick, Herrington & Sutcliffe LLP (“Bond Counsel”), based upon an analysis of existing laws, regulations, rulings and court decisions, and assuming, among other matters, the accuracy of certain representations and compliance with certain covenants, interest on the Bonds is excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986 (the “Code”) and is exempt from State of California personal income taxes. Bond Counsel is of the further opinion that interest on the Bonds is not a specific preference item for purposes of the

federal individual or corporate alternative minimum taxes, although Bond Counsel observes that such interest is included in adjusted current earnings when calculating corporate alternative minimum taxable income. A complete copy of the proposed form of opinion of Bond Counsel is set forth in Appendix D hereto.

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

Bonds purchased, whether at original issuance or otherwise, for an amount higher than their principal amount payable at maturity (or, in some cases, at their earlier call date) (“Premium Bonds”) will be treated as having amortizable bond premium. No deduction is allowable for the amortizable bond premium in the case of bonds, like the Premium Bonds, the interest on which is excluded from gross income for federal income tax purposes. However, the amount of tax-exempt interest received, and a Beneficial Owner’s basis in a Premium Bond, will be reduced by the amount of amortizable bond premium properly allocable to such Beneficial Owner. Beneficial Owners of Premium Bonds should consult their own tax advisors with respect to the proper treatment of amortizable bond premium in their particular circumstances.

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

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

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

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

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

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

VALIDATION PROCEEDING

On July 16, 2004, the City filed a complaint in the Superior Court of the State of California for the County of Riverside seeking judicial confirmation of the validity of the transactions relating to the authorization of the issuance of Bonds and the issuance thereof with respect to certain obligations of the City arising under the Silver Sage Judgment and Settlement Agreement, and the Indenture. The action was brought against all interested persons pursuant to the provisions of Sections 860 *et seq.* of the California Code of Civil Procedure. After a hearing held on September 24, 2004, the court entered a judgment in the City's favor on September 24, 2004 to the effect, among other things, that the City has the authority under California law to issue the Bonds and that the Bonds and the Indenture are valid, legal and binding obligations of the City under California law. Pursuant to Section 870 of the California Code of Civil Procedure and Rule 2(a) of the California Rules of Court, the period during which a notice of appeal to this judgment could be timely filed expired on October 25, 2004 and the judgment is binding and conclusive in accordance with California law.

CERTAIN LEGAL MATTERS

Certain legal matters are subject to the approving opinion of Orrick, Herrington & Sutcliffe LLP, Los Angeles, California, Bond Counsel. A complete copy of the proposed form of Bond Counsel opinion is contained in Appendix D. Bond Counsel undertakes no responsibility for the accuracy, completeness or fairness of this Official Statement. Orrick, Herrington & Sutcliffe LLP, as Disclosure Counsel, will provide certain other legal services for the City. Payment of the fees and expenses of Bond Counsel is contingent upon the issuance and sale of the Bonds. Certain legal matters will be passed upon for the Underwriter by its counsel, Nossaman, Guthner, Knox & Elliott LLP. Certain legal matters will be passed upon for the City by the City Attorney.

RATING

Standard & Poor's, a division of The McGraw-Hill Companies ("S&P") has assigned its municipal bond rating of "AA" to the Bonds with the understanding that, upon delivery of the Bonds, the Policy will be issued by Radian Asset Assurance Inc. This rating reflects S&P's view of the creditworthiness of the Insurer. Such rating reflects only the view of such organization, and an explanation of the significance of the rating may be obtained by contacting Standard & Poor's, 55 Water Street, New York, NY, United States, 10041, Telephone: (212) 438-1000 or (212) 438-2000 (for Index Services). Such rating is not a recommendation to buy, sell or hold the Bonds. There is no assurance that such rating will continue for any given period of time or that they will not be revised downward or withdrawn entirely by the rating agency, if, in the judgment of such agency, circumstances so warrant. Any such downward revision or withdrawal of such rating may have an adverse effect on the market price of the Bonds.

CONTINUING DISCLOSURE

The City has agreed to provide, or cause to be provided, to each nationally recognized municipal securities information repository and any public or private repository or entity designated by the State as a state repository for purposes of Rule 15c2-12(b)(5) adopted by the Securities and Exchange Commission certain annual financial information and operating data and, in a timely manner, notice of certain material events. For a complete listing of items of information which will be provided in the Annual Report, see APPENDIX F – "FORM OF CONTINUING DISCLOSURE AGREEMENT." Such information is to be provided by the City not later than nine (9) months after the end of the City's fiscal year (which currently would be April 1), commencing with the report for the 2003-04 fiscal year. The Annual Report will be filed by the Trustee, acting as Dissemination Agent, on behalf of the City with each Nationally Recognized Municipal Securities Information Repository and with each State Repository, if any. These covenants have been made in order to assist the Underwriter in complying with S.E.C. Rule 15c2-12(b)(5). 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.

LITIGATION

The City has no knowledge of any action, suit or proceeding known to be pending or threatened either restraining or enjoining the execution or delivery of the Bonds or the Indenture, or in any way contesting or affecting the validity of the foregoing or any proceedings of the City taken with respect to the foregoing. In the opinion of the City and the City Attorney, there are no lawsuits or claims pending against the City which will materially affect the City's finances so as to impair its ability pay debt service on the Bonds as and when due.

A number of claims and suits are pending against the City for alleged damages to persons and/or property and for other alleged liabilities arising out of matters usually incident to the operation of a city. Although the aggregate amount asserted for such lawsuits and claims is significant, in the opinion of the City Attorney and the City management, the City has strong defenses against such claims, and thus the exposure under these claims and suits, if any, not covered by insurance, will not materially affect the financial position of the City.

Prior to the date of the Chapter 9 Petition, Edward Moore and Albert Pimentel, represented by the same counsel who represents the plaintiffs in the *Silver Sage* case, filed a purported class-action complaint against the City and other defendants for alleged employment discrimination and retaliation, deprivation of due process, and police brutality. *Moore, et al. v. City of Desert Hot Springs, et al.*, Case No. ED CV98-137 RT (C.D. Cal.). The plaintiffs filed the following proofs of claim in the Chapter 9 Case in respect of that action: (a) a claim of \$1,550,000 plus (including \$1,000,000 in punitive damages), representing alleged liability to Edward Moore; (b) a claim of \$350,000 plus, representing alleged liability to Albert Pimentel; and (c) a claim of \$11,625,000 (including \$7,500,000 in punitive damages), representing alleged liability to the purported class of similarly-situated plaintiffs.

The City disputes the claims asserted by Moore, Pimentel, and the purported class in all regards. The Moore/Pimentel Claims are not impaired nor resolved by the Plan, and holders of such claims were not entitled to vote their claims to accept or reject the Plan. Each holder of a Moore/Pimentel Claim shall have all legal, equitable, and contractual rights to which such claim entitles such holder to proceed before the District Court, meaning that the City will pay whatever amounts, if any, it ultimately is determined by final order to be liable for in respect of such claims.

After the City filed its bankruptcy case, two claimants filed proofs of claim for alleged tort and related liability of the City. Stephen O'Connor filed a proof of claim in the amount of \$1,000,000 alleging damages (including punitive damages) for wrongful termination and related causes of action. The Bankruptcy Court disallowed that claim, and O'Connor has taken an appeal of the Bankruptcy Court's order of disallowance. Donnie Dennis filed a proof of claim in the amount of \$500,000 alleging damages relating to an automobile accident within the City. The Bankruptcy Court disallowed that claim, and no appeal was taken of the order of disallowance.

At the time of delivery of the Bonds, the City will certify that there is no action, suit, proceeding, inquiry or investigation, at law or in equity, before or by any court or governmental or public entity pending or, to the best knowledge of the City, threatened against the City (i) which affects or seeks to prohibit, restrain or enjoin the authentication or issuance of the Bonds or the execution or delivery of the Indenture, the Bonds, the Continuing Disclosure Agreement or the Bond Purchase Agreement, (ii) contesting the validity of the Bond Purchase Agreement, the Indenture or the Continuing Disclosure Agreement, the powers of the City to enter into or perform its obligations under the Bond Purchase Agreement, the Indenture, the Continuing Disclosure Agreement or the Bond Purchase Agreement, or the existence or powers of the City, or (iii) which, if determined adversely to the City, would materially impair the City's ability to meet its obligations under the Indenture or materially and adversely affect the City's financial condition.

FINANCIAL INTEREST

The fees of Bond Counsel and Underwriter's Counsel are contingent upon the authorization and issuance of the Bonds. From time to time, Orrick, Herrington & Sutcliffe LLP represents Citigroup Global Markets Inc. on matters unrelated to the Bonds.

UNDERWRITING

The Bonds are to be purchased by Citigroup Global Markets Inc. (the “Underwriter”). The Underwriter has agreed to purchase the Bonds at a price of \$9,419,380.98 (reflecting an underwriter’s discount of \$117,664.17 from the public offering prices shown on the cover of this Official Statement less original issue discount of \$187,954.85). The Bond Purchase Agreement related to the Bonds provides that the Underwriter will purchase all the Bonds if any are purchased, the obligation to make such purchase being subject to certain terms and conditions set forth in the Bond Purchase Agreement, including the approval of certain legal matters by Bond Counsel and certain other conditions. The Bonds may be offered and sold to certain dealers (including dealers depositing said Bonds into investment trusts) and others at prices lower than the initial public offering prices, and the public offering prices may be changed from time to time by the Underwriter.

MISCELLANEOUS

References are made herein to certain documents and reports which are brief summaries thereof 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. Copies of the documents are on file and available for inspection at the office of the Trustee at Wells Fargo Bank, National Association, 707 Wilshire Boulevard, 17th Floor, Los Angeles, California 90017.

Any statements 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 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 City.

CITY OF DESERT HOT SPRINGS, CALIFORNIA

By _____ /s/ Jerry Hanson
City Manager

APPENDIX A

CERTAIN INFORMATION REGARDING THE CITY OF DESERT HOT SPRINGS AND ECONOMIC AND DEMOGRAPHIC INFORMATION OF THE AREA

The information and expressions of opinion set forth herein have been obtained from sources believed to be reliable, but such information is not guaranteed as to accuracy or completeness. Statements contained herein which involve estimates, forecasts, or matters of opinion, whether or not expressly so described herein, are intended solely as such and are not to be construed as representations of facts. Data contained under this caption is intended to portray economic, demographic, and business trends within the City. While not constituting direct revenue sources as such, these trends help explain changes in revenue sources such as property taxes, sales taxes, and transient occupancy taxes, which could be impacted by economic conditions. The information and expressions of opinion herein are subject to change without notice, and neither delivery of this Official Statement nor any sale of the Bonds made thereafter shall under any circumstances create any implication that there has been no change in the affairs of the City or in any other information contained herein since the date of the Official Statement.

THE CITY OF DESERT HOT SPRINGS

Population

Between 1990 and 2004 the City's population increased 51.6 percent, compared to a 14.5 percent increase for the State of California for the same period. As of January 1, 2004, the City's population was approximately 17,700. A summary of the City's population and the State's population for the past 12 years is shown below:

**Table A-1
City of Desert Hot Springs
Population 1993-2004**

<u>Year</u> <u>(as of January 1)</u>	<u>City</u>	<u>State</u>
1993	14,200	31,577,000
1994	14,550	31,728,200
1995	15,100	31,957,300
1996	15,500	32,362,300
1997	15,900	32,609,000
1998	16,200	32,657,000
1999	16,400	33,140,000
2000	16,582	33,873,086
2001	16,742	34,431,000
2002	16,900	35,049,000
2003	17,300	35,612,000
2004	17,700	36,144,000

Source: State of California and City of Desert Hot Springs.

Economy

Following is a table which summarizes key economic indicators with respect to the City for the years 1999 through 2003:

Table A-2
City of Desert Hot Springs Key Economic Indicators
Calendar Years 1999 through 2003

	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>
Employment	6,200	6,470	6,760	7,100	7,300
Unemployment	370	400	390	480	490
Unemployment rate	5.7%	5.8%	5.5%	6.3%	6.3%

Sources: Data derived from California Department of Finance, Demographic Research Unit (Population); Employment Development Department, Labor Market Information Division (Employment, Unemployment).

Employment

Civilian labor force in the City increased from approximately 6,570 in 1999 to approximately 7,790 in 2003, an increase of 18%. The following table summarizes the labor force, employment and unemployment figures over the past five years for the City, the County, the State of California and the nation as a whole.

Table A-3
County of Riverside
Labor Force, Employment and Unemployment
Yearly Average for Calendar Years 1999 through 2003

<u>Year and Area</u>	<u>Civilian Labor Force</u>	<u>Employment</u>	<u>Unemployment</u>	<u>Rate</u>
1999				
City of Desert Hot Springs	6,570	6,200	370	5.7%
Riverside County	689,400	652,000	37,400	5.4
California	16,375,600	15,522,300	853,300	5.2
United States	139,638,000	133,488,000	5,880,000	4.2
2000				
City of Desert Hot Springs	6,870	6,470	400	5.8
Riverside County	720,700	680,900	39,800	5.5
California	16,892,000	16,056,500	835,500	4.9
United States	142,583,000	136,891,000	5,692,000	4.0
2001				
City of Desert Hot Springs	7,150	6,760	390	5.5
Riverside County	750,000	710,700	39,300	5.2
California	17,171,600	16,249,100	922,500	5.4
United States	143,734,000	136,933,000	6,801,000	4.7
2002				
City of Desert Hot Springs	7,580	7,100	480	6.3
Riverside County	794,500	746,200	48,300	6.1
California	17,375,800	16,214,900	1,160,900	6.7
United States	144,863,000	136,485,000	8,378,900	5.8
2003				
City of Desert Hot Springs	7,790	7,300	490	6.3
Riverside County	817,600	768,100	49,500	6.1
California	17,460,000	16,282,700	1,177,300	6.7
United States	146,510,000	137,736,000	8,774,000	6.0

Source: California Employment Development Department; U.S. Department of Labor Bureau of Labor Statistics.

The table below lists the principal property taxpayers within the City.

Table A-4
City of Desert Hot Springs
Major Property Taxpayers
Fiscal Year 2003-04

<u>Taxpayer</u>	<u>Assessed Valuation</u>
Time Warner Entertainment	\$5,190,850
DHS Investments	5,509,675
Von's Companies	3,583,626
Duane C Enochs Trust	3,588,560
Desert Hot Springs Real Properties	3,181,165
Chevron USA	2,570,953
Hacienda Palm Thrifty Payless Inc.	2,516,940
Casa Del Sol	2,764,472
Desert Hot Springs Associates	2,728,547
Thomas Wilhelm	2,864,474
Jameslane Associates Limited Partnership	1,858,432
Mineral Springs Resort Inc.	1,665,723
Angel View Crippled Children's Foundation	2,942,987
Rite Aid Corporation	941,598
Atlantic Richfield Corporation	1,303,286
Casa West Limited	1,275,789
Byron Schiers	880,000
Inland Delaware Business Trust	6,648,226

Source: County of Riverside Assessor's Roll.

Income

Personal income information is not available for the City. The following table summarizes the total effective buying income and the median household effective buying income for the County, the State and the nation over the most recent 5 year period for which complete records are available.

Table A-5
County of Riverside
Personal Income
Calendar Years 1998 through 2002

Year and Area	Total Effective Buying Income (000's Omitted)	Median Household Effective Buying Income
1998		
Riverside County	\$ 20,543,675	\$33,089
California	551,999,317	37,091
United States	4,621,491,738	35,377
1999		
Riverside County	22,453,426	35,145
California	590,376,663	39,492
United States	4,877,786,658	37,233
2000		
Riverside County	25,144,120	39,293
California	652,190,282	44,464
United States	5,230,824,904	39,129
2001		
Riverside County	23,617,301	37,480
California	650,521,407	45,532
United States	5,303,481,498	38,365
2002		
Riverside County	25,180,040	38,691
California	647,879,427	42,484
United States	5,340,682,818	38,035

Source: Sales & Marketing Management Survey of Buying Power.

Effective Buying Income

Table A-6 shows the per capita Effective Buying Income (EBI) for the County, the State, and the United States for calendar years 1998 through 2002. EBI statistics are not maintained for the City. The estimates for each calendar year are published in the September issue of the following calendar year (i.e., data for 2003 will be published in the September 2004 issue). The purpose of this table is to show the EBI within the County as compared to other locations.

Table A-6
County of Riverside
Per Capita Effective Buying Income
Calendar Years 1998 through 2002

Calendar Year	County of Riverside	State of California	United States
1998	\$13,708	\$16,299	\$16,895
1999	14,453	17,245	17,691
2000	15,980	19,081	18,426
2001	14,753	18,652	18,491
2002	15,041	18,236	18,375

Source: Sales & Marketing Management Survey of Buying Power.

Retail Sales

According to the California State Board of Equalization, taxable transactions at retail and other outlets in the City during calendar year 2002 totaled approximately \$65,974,000, up 24% from 1998. Table A-7 provides annual sales information for the period 1998 through 2002.

Table A-7
City of Desert Hot Springs
Taxable Transactions by Type of Business
Calendar Year
(000's)

	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>
Retail Stores	46,872	52,180	57,571	61,510	60,517
Total Outlets	52,998	58,491	63,475	66,584	65,974

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

Tourism

Table A-8 below sets forth a summary statement of total visitor spending in the City for calendar year 1996 to 2003. 2002.

Table A-8
City of Desert Hot Springs
Total Visitor Spending
Calendar Year

Calendar Year	Amount
1996	\$5,855,000
1997	5,537,000
1998	6,065,000
1999	7,181,000
2000	8,170,000
2001	8,468,000
2002	8,011,000
2003	7,755,000

Source: City of Desert Hot Springs.

As shown in Table A-9, the underlying room receipts, the amount recovered by the hotelier or inkeeper inclusive of taxes have likewise generally been exhibiting a moderate upward trend since Fiscal Year 1993-94.

Table A-9
City of Desert Hot Springs
Underlying Room Receipts
Fiscal Years 1993-94 to 2003-04 ⁽¹⁾

Fiscal Year ⁽²⁾	Amount
1993-94	\$4,516,826
1994-95	4,925,872
1995-96	5,854,989
1996-97	5,337,578
1997-98	5,976,197
1998-99	6,417,861
1999-00	8,005,791
2000-01	8,176,397
2001-02	8,502,276
2002-03	7,752,655
2003-04 ⁽³⁾	7,905,383

(1) Fiscal Year refers to the twelve month period from July 1 of the previous year to June 30 of the referenced year.

(2) In the year ended June 30, 1994, the City began accounting for transient occupancy tax revenues on an accrued basis, rather than on a cash basis, as allowable under the National Council on Governmental Accounting (NCGA) Statement No. 1.

(3) Unaudited.

Source: City of Desert Hot Springs.

Table A-10 below demonstrates a comparison of underlying room receipts and room tax collections for calendar year 2003.

Table A-10
City of Desert Hot Springs
Comparison of Underlying Room Receipts and Room Tax Collections
Calendar Year 2003 ⁽¹⁾

	Hotels ⁽¹⁾	Hotel Rooms	% TOT ⁽²⁾	TOT Collections	Gross Hotel Room Sales
Cathedral City	8	658	10%	\$ 1,214,336	\$ 12,143,364
Desert Hot Springs	36	907	10	754,697	7,546,972
Indian Wells	5	1,467	9.25	4,019,691	43,456,119
Indio	20	1,069	10	1,051,260	10,512,604
La Quinta	3	854	10 or 11	4,008,067	36,827,119
Palm Desert	17	2,244	9	7,229,840	80,881,558
Palm Springs	138	5,993	13.5 or 11.5	12,177,717	101,454,735
Rancho Mirage	6	1,505	10	5,104,461	51,044,607
Riverside County Area	3	194	10	N/A	N/A
Totals	236	14,891		\$35,560,069	\$343,317,078

(1) May include timeshares and other rental properties.

(2) Two-tiered funding formula in some cities.

Source: Palm Springs Desert Resorts Convention and Visitors Authority Member Cities Finance Departments.

Construction Activity

Building permit activity for the years 1999 through 2003 is summarized below.

Table A-11
City of Desert Hot Springs
Building Permit Valuation

	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>
Valuation					
Residential	\$ 632,498	\$2,563,447	\$4,923,868	\$21,387,317	\$67,772,673
Nonresidential	<u>2,030,853</u>	<u>1,271,908</u>	<u>3,171,716</u>	<u>1,593,735</u>	<u>3,548,709</u>
Total	\$2,663,351	\$3,835,355	\$8,095,584	\$22,981,052	\$71,321,382
New Housing Units					
Single Family	3	24	46	187	543
Multiple Family	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>4</u>
Total	3	24	46	187	547

Source: Construction Industry Research Board.

Education

Public school education is available through the Palm Springs Unified School District. Total public school enrollment in the 2002-03 school year was approximately 5,565 students.

Table A-12
City of Desert Hot Springs
Public School Enrollment
For Fiscal Years 1998-99 through 2002-03

	<u>1998-99</u>	<u>1999-00</u>	<u>2000-01</u>	<u>2001-02</u>	<u>2002-03</u>
K – 8	3,548	3,702	3,903	4,076	4,215
9 – 12	0	693	927	1,203	1,332
Special Classes	<u>19</u>	<u>20</u>	<u>18</u>	<u>19</u>	<u>18</u>
Total	3,567	4,415	4,848	5,298	5,565

Source: California Department of Education, Educational Demographic Unit.

AREA CITIES

Included around the City are eight desert cities located in an area called the Coachella Valley lining the base of the Santa Rosa, San Jacinto and San Bernardino mountains with each city having their own history. Palm Springs, Palm Desert, Rancho Mirage, Indian Wells, La Quinta, Cathedral City, Indio and Desert Hot Springs are each communities where one can choose to raise a family, retire, seasonal vacation, and week-end get-a-way in this destination resort community. The Coachella Valley is less than a two-hour drive to Los Angeles, Newport Beach, San Diego and Mexico.

The desert has a permanent population of 290,000 with an additional 100,000 seasonal residents. The permanent population is estimated to double within the next ten years. Tourism and the hospitality industry with corresponding residential development is the major economic base of the eight desert city resort community. The valley was once considered a retirement community.

Palm Springs

More than 140 hotels and the impressive Palm Springs Convention Center surround a downtown village which combines new retail developments, an Indian casino, and beautifully preserved historical sites. Special events attractions include The Nortel Palms Springs International Film Festival, VillageFest, the Palm Springs Aerial Tramway, Palm Springs Desert Museum, Palm Springs Air Museum and the Indian Canyons (owned and operated by the Agua Caliente Band of Cahuilla Indians) which showcase the continent's largest natural palm oasis.

Palm Desert

Palm Desert is a perfect place to relax, golf, shop, play or bask in the sunshine. Shopping enthusiasts can explore an exciting array of shops, boutiques and plazas including the desert's largest mall. Outdoor activities are a particular attraction in Palm Desert, especially golf with 22 public and private courses. Palm Desert's latest gem along the fairways, Desert Willow Golf Resort, can test professionals, yet be forgiving for amateur players. Art galleries, the McCallum Theatre, The Living Desert Wildlife and Botanical Park, and Civic Center Park provide cultural and recreational opportunities to residents and visitors alike.

Rancho Mirage

Dubbed the "Playground of Presidents," Rancho Mirage is the perfect setting for exclusive country clubs, luxurious resort hotels, and street names such as "Bob Hope," "Dinah Shore," and "Frank

Sinatra,” The city’s “Restaurant Row” attracts diners from around the valley, and the annual Nabisco Dinah Shore championship golf tournament is legendary as a magnet for LPGA golfers. Also making a rare appearance: regal bighorn sheep, which are occasionally spotted munching poolside flowers at the five-star Ritz-Carlton Mountainside resort.

Indian Wells

Since President Eisenhower’s golf vacations drew national attention to the city, Indian Wells has been synonymous with internationally recognized sporting and cultural events, world-class resorts and restaurants and championship golf courses and tennis courts. The birthplace of the Bob Hope Chrysler Classic, Indian Wells now hosts over 500 golf and tennis tournaments each year including the California State Open, the Newsweek Champions Cup and State Farm Everett Cup. Indian Wells is also home to the nation’s only international jazz festival held on New Year’s Day, and for thought-provoking dialogue, the renowned Desert Town Hall lecture series features some of the most fascinating speakers of our time, from Lady Margaret Thatcher to general Colin Powell.

La Quinta

Nestled amid the stunning foothills of the Santa Rosa Mountains, La Quinta offers an allure dating back to the Golden Age of Hollywood when stars like Ginger Rogers, Frank Capra, and Clark Gable found respite at the desert’s first resort (which still today welcomes VIPs and dignitaries from around the world). With the nationally-televised Skins Game golf tournament, now hosted by Rancho La Quinta Country Club, and PGA West within the city’s borders, La Quinta has earned an international reputation for fine golf.

Cathedral City

Cathedral City is one of the valley’s youngest and fastest-growing cities. A new IMAX theater and entertainment complex which serves as the valleywide Visitor Information Center, joins Camelot Park Family Entertainment Center which boasts miniature golf, bumper carts, game pavilion and video arcade. Big League Dreams Sports Park featuring softball baseball fields, four sand volleyball courts, arena for in-line hockey, basketball, soccer, restaurants and other amenities.

Indio

Indio’s heritage - the longest in the valley - is rich with traditions reflecting a strong local culture. Indio is host city to the annual Tamale Festival, the southwest Arts Festival, the National Date Festival and Riverside County Fair. Indio is also home to an equestrian center, world-famous polo fields, two Indian gaming centers, and a multitude of date gardens which supply 95 percent of the country’s dates.

Education

The cities have developed a strong educational environment to attract families. Palm Desert has become the educational center with such facilities as College of the Desert (“COD”) with 10,000 plus students seeking Associate Degrees, California State University, which offers bachelor’s, master’s and teaching credentials, and University of California, Riverside for students seeking graduate degrees. A number of new public and private schools and high schools have been added in recent years.

APPENDIX B

**AUDITED FINANCIAL STATEMENTS OF THE CITY OF DESERT HOT SPRINGS
FOR THE FISCAL YEAR ENDED JUNE 30, 2003**

(THIS PAGE INTENTIONALLY LEFT BLANK)

**CITY OF DESERT HOT SPRINGS,
CALIFORNIA**

**BASIC
FINANCIAL STATEMENTS**

JUNE 30, 2003

(THIS PAGE INTENTIONALLY LEFT BLANK)

CITY OF DESERT HOT SPRINGS, CALIFORNIA

BASIC FINANCIAL STATEMENTS

JUNE 30, 2003

TABLE OF CONTENTS

INDEPENDENT AUDITOR'S REPORT	1
BASIC FINANCIAL STATEMENTS	
Government-Wide Financial Statements	
Statement of Net Assets	3
Statement of Activities	4
Fund Financial Statements	
Governmental Funds	
Balance Sheet	5
Reconciliation of the Balance Sheet of Governmental Funds to the Statement of Net Assets	7
Statement of Revenues, Expenditures, and Changes in Fund Balances	8
Reconciliation of the Statement of Revenues, Expenditures, and Changes in Fund Balances to the Statement of Activities	10
Fiduciary Funds	
Statement of Fiduciary Net Assets	11
Notes to the Financial Statements	12
REQUIRED SUPPLEMENTARY INFORMATION	
General Fund	
Statement of Revenues, Expenditures, and Changes in Fund Balance - Budget and Actual	39
Capital Improvement Deposits Special Revenue Fund	
Statement of Revenues, Expenditures, and Change in Fund Balance - Budget and Actual	40
Community Safety Special Revenue Fund	
Statement of Revenues, Expenditures, and Change in Fund Balance - Budget and Actual	41
SUPPLEMENTARY SCHEDULES	
Major Fund Budgetary Comparison Schedules	
Schedule of Revenues, Expenditures, and Changes in Fund Balances - Budget and Actual	
RDA Debt Service Fund	43

CITY OF DESERT HOT SPRINGS, CALIFORNIA

BASIC FINANCIAL STATEMENTS

JUNE 30, 2003

TABLE OF CONTENTS (Continued)

Non-Major Governmental Funds	
Combining Balance Sheet	48
Combining Statement of Revenues, Expenditures, and Changes in Fund Balances	54
Schedule of Revenues, Expenditures, and Changes in Fund Balances - Budget and Actual	
Special Revenue Funds	
Housing and Community Development	60
Traffic Safety Fund	61
Source Reduction Recycling Fund	62
Special Gas Tax Fund	63
T.U.M.F. Fund	64
Municipal Lighting District Fund	65
Measure A Fund	66
Air Quality Control Fund	67
Safe Routes to School Grant	68
State Transportation Improvement Grant	69
Law Enforcement Service Fund	70
Abandoned Vehicle Replacement Fund	71
Local Law Enforcement Block Grant Fund	72
State Bicycle/Pedestrian Grants	73
County Service Area Fund	74
RDA Low Income Housing Fund	75
Federal Cops Grant Fund	76
CMAQ ISTEA Fund	77
Parks Recreation Grant	78
Citizens Option Program CLEEP	79
Traffic Congestion Relief	80
Capital Projects Funds	
Assessment District 93-2 Fund	81
Assessment District 91-1 Fund	82
RDA Capital Projects Fund	83
Agency Funds	
Combining Statement of Net Assets	85
Combining Statement of Changes in Assets and Liabilities	87

FINANCIAL SECTION

(THIS PAGE INTENTIONALLY LEFT BLANK)



INDEPENDENT AUDITOR'S REPORT

The Honorable Mayor and Members of City
Council
The City of Desert Hot Springs, California

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the City of Desert Hot Springs, as of and for the year ended June 30, 2003, which collectively comprise the City of Desert Hot Springs' basic financial statements as listed in the table of contents. These financial statements are the responsibility of the City of Desert Hot Springs' management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America, 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 financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and 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 opinion.

As discussed in Notes #2 and #16, the City of Desert Hot Springs filed a voluntary petition for relief under Chapter 9 of the United States Bankruptcy Code on December 19, 2001. The basic financial statements reflect the bankruptcy filing by segregating the City's pre-petition date liabilities that are subject to compromise in the bankruptcy case as "liabilities subject to compromise". The basic financial statements do not include any adjustments that might be necessary if the City is unable to continue to operate as a going concern.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the governmental activities, each major fund, and the aggregate remaining fund information of the City of Desert Hot Springs, California, as of June 30, 2003, and the respective changes in financial positions, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The City has not presented management's discussion and analysis that accounting principles generally accepted in the United States of America has determined is necessary to supplement, although not required to be part of, the basic financial statements.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 12, 2004, 2003, on our consideration of the City's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. 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.

As discussed in the Notes to the basic financial statements, the accompanying financial statements reflect certain changes required as a result of the implementation of Governmental Accounting Standards Board (GASB) Statements No. 34, 37, 38, and 41 for the year ended June 30, 2003. This results in a change to the format and content of the basic financial statements.

The required supplementary information, such as the budgetary comparison schedules noted in the table of contents are not a required part of the basic financial statements, but is supplementary information required by the GASB. 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 City's basic financial statements. The other supplementary information listed in the table of contents, including combining schedules and additional budgetary comparison schedules, are presented for purposes of additional analysis and are not a required part of the basic financial statements. These schedules have not been subjected to the auditing procedures applied in the audit of the basic financial statements and accordingly, we express no opinion on them.

Vavonek, Tanne, Day & Co., LLP

Rancho Cucamonga, California
March 12, 2004

BASIC FINANCIAL STATEMENTS

(THIS PAGE INTENTIONALLY LEFT BLANK)

GOVERNMENT-WIDE FINANCIAL STATEMENTS

(THIS PAGE INTENTIONALLY LEFT BLANK)

CITY OF DESERT HOT SPRINGS

STATEMENT OF NET ASSETS

JUNE 30, 2003

	Governmental Activities
ASSETS	
Cash and investments	\$ 8,852,967
Cash with fiscal agent	1,603,158
Accounts receivable	1,017,572
Notes receivable	185,282
Special assessments receivable	21,896
Due from agency fund	3,709
Deposits	15,625
Prepaid costs	1,401
Capital assets, net of accumulated depreciation	2,958,328
Total Assets	<u>14,659,938</u>
LIABILITIES	
Accounts payable	1,049,480
Accrued liabilities	186,537
Interest payable	178,590
Deposits payable	94,003
Deferred revenue	157,180
Notes and bonds payable	17,826
Insurance claims payable	648,261
Liabilities subject to compromise	7,875,478
Noncurrent liabilities:	
Due within one year	559,785
Due in more than one year	9,149,348
Total Liabilities	<u>19,916,488</u>
NET ASSETS	
Invested in capital assets, net of related debt	(6,256,672)
Restricted	
Community development	1,335,570
Public safety	62,897
Public works	903,163
Debt service	3,004,612
Unrestricted	(4,306,120)
Total Net Assets	<u>\$ (5,256,550)</u>

The accompanying notes are an integral part of these financial statements.

CITY OF DESERT HOT SPRINGS

**STATEMENT OF ACTIVITIES
YEAR ENDED JUNE 30, 2003**

	Expenses	Program Revenues			Net Governmental Activities
		Charges for Services	Operating Contributions and Grants	Capital Contributions and Grants	
Governmental Activities:					
General government	\$ 3,034,684	\$ 238,809	\$ 15,613		\$ (2,780,262)
Public safety	3,809,153	134,553	1,316,013	\$ 134,852	(2,223,735)
Public works	1,394,963	1,498,252	831,337	250,540	1,185,166
Parks and recreation	51,570		1,797		(49,773)
Economic development	619,033	1,053,319	62,144		496,430
Interest on long-term debt	532,066				(532,066)
Total Governmental Activities	<u>\$ 9,441,469</u>	<u>\$ 2,924,933</u>	<u>\$ 2,226,904</u>	<u>\$ 385,392</u>	<u>\$ (3,904,240)</u>

General Revenues:

Taxes:

Property tax, levied for general purpose	592,229
Property tax, Redevelopment Agency tax increment	1,456,075
Transient occupancy tax	775,266
Franchise tax	423,115
Sales tax	830,056
Motor vehicle in lieu tax	976,922
Utility user tax	1,066,886
Other taxes	67,225
Investment income	128,648
Other	9,189
Total General Revenues	<u>6,325,611</u>
Change in Net Assets	2,421,371
Net Assets at Beginning of Year	<u>(7,677,921)</u>
Net Assets at End of Year	<u>\$ (5,256,550)</u>

The accompanying notes are an integral part of these financial statements.

FUND FINANCIAL STATEMENTS

CITY OF DESERT HOT SPRINGS

GOVERNMENTAL FUNDS

BALANCE SHEET

JUNE 30, 2003

		Special Revenue		Debt Service
		Capital		
	General	Improvement	Community	RDA
		Deposits	Safety	
ASSETS				
Cash and investments	\$ 2,836,481	\$ 1,893,746	\$ 248,244	\$ 1,831,680
Cash with fiscal agent				1,066,887
Accounts receivable	813,063	4,923	56,084	13,084
Loan to General Fund				464,704
Deposits	15,625			
Prepaid items	1,401			
Due from other funds	468,326			
Total Assets	<u>\$ 4,134,896</u>	<u>\$ 1,898,669</u>	<u>\$ 304,328</u>	<u>\$ 3,376,355</u>
LIABILITIES AND FUND BALANCES				
LIABILITIES				
Accounts payable	422,601	45,709	181,659	331,685
Accrued liabilities	38,666		92,772	40,058
Liabilities subject to compromise (Notes 2,15):				
Silver Sage claims	6,000,000			
TRANS settlement claims	1,261,689			
Redevelopment Agency claim	714,424			
Accounts payable/legal claims	500,000			
LaSalle lease	113,789			
Deposits payable	17,904			
Due to other funds				
Deferred revenue	144,877			
Notes and bonds payable	17,826			
Insurance claims payable	648,261			
Total Liabilities	<u>9,880,037</u>	<u>45,709</u>	<u>274,431</u>	<u>371,743</u>
FUND BALANCES				
Reserved for:				
Encumbrances				
Prepaid items	1,401			
Loan to General Fund				464,704
Debt service				2,539,908
Fund Balances				
Unreserved and reported in:				
General fund	(5,746,542)			
Special revenue funds		1,852,960	29,897	
Capital projects funds				
Total Fund Balances	<u>(5,745,141)</u>	<u>1,852,960</u>	<u>29,897</u>	<u>3,004,612</u>
Total Liabilities and Fund Balances	<u>\$ 4,134,896</u>	<u>\$ 1,898,669</u>	<u>\$ 304,328</u>	<u>\$ 3,376,355</u>

The accompanying notes are an integral part of these financial statements.

Non-Major Funds	Total Governmental Funds
\$ 2,042,816	\$ 8,852,967
536,271	1,603,158
130,418	1,017,572
249,720	714,424
	15,625
	1,401
3,933	472,259
<u>\$ 2,963,158</u>	<u>\$ 12,677,406</u>

67,826	1,049,480
15,041	186,537
	6,000,000
	1,261,689
	714,424
	500,000
	113,789
76,099	94,003
468,550	468,550
12,303	157,180
	17,826
	648,261
<u>639,819</u>	<u>11,211,739</u>

21,803	21,803
	1,401
249,720	714,424
	2,539,908

	(5,746,542)
2,149,036	4,031,893
(97,220)	(97,220)
<u>2,323,339</u>	<u>1,465,667</u>
<u>\$ 2,963,158</u>	<u>\$ 12,677,406</u>

(THIS PAGE INTENTIONALLY LEFT BLANK)

CITY OF DESERT HOT SPRINGS

GOVERNMENTAL FUNDS

**RECONCILIATION OF THE BALANCE SHEET OF GOVERNMENTAL FUNDS
TO THE STATEMENT OF NET ASSETS**

JUNE 30, 2003

Fund Balances of Governmental Funds	\$ 1,465,667
Amounts reported for governmental activities in the statement of net assets are different because:	
Capital assets of governmental activities are not financial resources and, therefore, are not reported in the governmental funds.	2,958,328
Long-term notes and assessments receivable are not current available resources, and therefore are not reported in the governmental funds.	207,178
Interest expenditures are recognized when due, and therefore, interest payable is not recorded in the governmental funds.	(178,590)
Long-term liabilities are not due and payable in the current period and, therefore, are not reported in the governmental funds.	<u>(9,709,133)</u>
Net Assets of Governmental Activities	<u>\$ (5,256,550)</u>

The accompanying notes are an integral part of these financial statements.

CITY OF DESERT HOT SPRINGS

**GOVERNMENTAL FUNDS
STATEMENT OF REVENUES, EXPENDITURES AND
CHANGES IN FUND BALANCES
YEAR ENDED JUNE 30, 2003**

		Special Revenue		Debt Service
		Capital		
		Improvement	Community	
	General	Deposits	Safety	RDA
REVENUES				
Taxes	\$ 3,881,557		\$ 875,884	\$ 1,164,862
Permits and fees	1,279,962	\$ 1,073,478	86,089	
Intergovernmental	996,110		115,797	
Interest	47,237	3,065		29,477
Miscellaneous	60,177		30,457	
Total Revenues	6,265,043	1,076,543	1,108,227	1,194,339
EXPENDITURES				
Current:				
General government	2,603,234			
Public safety			3,586,368	
Public works	446,835			
Parks and recreation				
Economic development				69,951
Capital outlay		73,022	50,503	
Debt service:				
Principal				325,000
Interest				532,040
Total Expenditures	3,050,069	73,022	3,636,871	926,991
REVENUES OVER (UNDER) EXPENDITURES	3,214,974	1,003,521	(2,528,644)	267,348
OTHER FINANCING SOURCES (USES)				
Transfers in			2,558,541	159,000
Transfers out	(2,643,975)	(89,554)		(32,812)
Total Other Financing Sources (Uses)	(2,643,975)	(89,554)	2,558,541	126,188
Net Change in Fund Balances	570,999	913,967	29,897	393,536
Fund Balances, Beginning of Year	(6,316,140)	938,993	-	2,611,076
Fund Balances, End of Year	\$ (5,745,141)	\$ 1,852,960	\$ 29,897	\$ 3,004,612

The accompanying notes are an integral part of these financial statements.

Non-Major Funds	Total Governmental Funds
\$ 670,932	\$ 6,593,235
21,516	2,461,045
1,442,390	2,554,297
56,892	136,671
26,958	117,592
<u>2,218,688</u>	<u>11,862,840</u>
165,802	2,769,036
132,535	3,718,903
1,206,904	1,653,739
1,252	1,252
648,809	718,760
525,190	648,715
2,601	327,601
1,940	533,980
<u>2,685,033</u>	<u>10,371,986</u>
<u>(466,345)</u>	<u>1,490,854</u>
230,704	2,948,245
<u>(181,904)</u>	<u>(2,948,245)</u>
48,800	-
(417,545)	1,490,854
<u>2,740,884</u>	<u>(25,187)</u>
<u>\$2,323,339</u>	<u>\$ 1,465,667</u>

CITY OF DESERT HOT SPRINGS

**RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES AND
CHANGES IN FUND BALANCES OF GOVERNMENTAL FUNDS
TO THE STATEMENT OF ACTIVITIES
YEAR ENDED JUNE 30, 2003**

Net Change in Fund Balances - Total Governmental Funds \$ 1,490,854

Amounts reported for governmental activities in the Statement of Activities differs from the amounts reported in the Statement of Revenues, Expenditures, and Changes in Fund Balances because:

Governmental funds report capital outlays as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives as depreciation expense or are allocated to the appropriate functional expense when the cost is below the capitalization threshold. This activity is reconciled as follows:

Cost of assets capitalized less disposals	945,557
Depreciation expense	(260,276)

Increases in long-term notes and assessments receivable use current financial resources and are included in the expenditures of governmental funds. Repayments of long-term receivables provide current financial resources and are included in the revenues of governmental funds. These changes in notes receivable are not reflected in the revenues or expenses of the Statement of Activities. The changes in long-term receivables are reconciled as follows:

New receivables funded	113,676
Repayments received	(13,949)

Interest expenditures are recognized when paid in the governmental funds. Interest expense is recognized when incurred in the government-wide Statement of Activities. This amount represents the difference between interest paid and interest incurred.

1,914

Repayments of long-term liabilities requires the use of current financial resources of governmental funds. This expense is not recognized in the government-wide financial statements. Repayments are summarized as follows:

Bonds payable repayments	325,000
Capital lease obligation repayments	2,601

Increases in compensated absences payable does not result in the use of current financial resources of governmental funds. The expense is recognized in the government-wide financial statements. This amount represents the net increase in compenstated absences payable.

(184,006)

Change in Net Assets of Governmental Activities

\$ 2,421,371

The accompanying notes are an integral part of these financial statements.

CITY OF DESERT HOT SPRINGS

FIDUCIARY FUNDS

STATEMENT OF FIDUCIARY NET ASSETS

JUNE 30, 2003

	<u>Agency Funds</u>
ASSETS	
Cash and investments	\$ 645,655
Cash with fiscal agent	133,983
Receivables	<u>10,110</u>
 Total Assets	 <u><u>\$ 789,748</u></u>
 LIABILITIES	
Accounts payable	\$ 15,783
Due to other funds	3,709
Deposits payable	34,559
Pension payable	473,476
Due to bondholders	<u>262,221</u>
 Total Liabilities	 <u><u>\$ 789,748</u></u>

(THIS PAGE INTENTIONALLY LEFT BLANK)

NOTES TO FINANCIAL STATEMENTS

(THIS PAGE INTENTIONALLY LEFT BLANK)

CITY OF DESERT HOT SPRINGS

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2003

NOTE #1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies of the City of Desert Hot Springs (the City) conform to accounting principles generally accepted in the United States of America (GAAP) as applicable to governments. The Governmental Accounting Standards Board (GASB) is the accepted standard setting body for governmental accounting and financial reporting principles. The City has implemented GASB Statements No. 34, 37, 38, and 41 and these statements are presented according to those requirements. The following is a summary of the significant policies.

A. Reporting Entity:

The City was incorporated September 24, 1963 under the general laws of the State of California and enjoys all the rights and privileges pertaining to such "General Law" cities.

The inclusion of an organization within the scope of the reporting entity of the City is dependent upon City Council's exercise of oversight responsibility over that organization. The following criteria were considered in determining the extent to which City Council exercised oversight responsibility: selection of governing authority, designation of management, ability to significantly influence operations, approval of budgets, accountability for fiscal matters, and financial interdependency.

Although a legally separate entity the Redevelopment Agency of the City of Desert Hot Springs (the RDA) is included within the scope of the reporting entity of the city because it met all of the above-mentioned criteria. For presentation within the annual financial report of the governmental reporting entity, the transactions between this organization and the City are reported as interfund transactions. Certain reclassifications of prior year data have been made in order to conform to this presentation. The Redevelopment Agency audit report can be obtained at the City of Desert Hot Springs City Hall.

B. Accounting and Reporting Policies:

The City has conformed to the pronouncements of the GASB, which are the primary authoritative statements of accounting principles generally accepted in the United States of America applicable to state and local governments. In accordance with GASB Statement No. 20, the City applies all applicable Financial Accounting Standards Board (FASB) pronouncements, as well as those of its predecessors, issued on or before November 30, 1989, unless any such pronouncements contradict GASB pronouncements.

GASB Statements No. 34 and 37 - In June 1999 and June 2001, the GASB issued Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis - for State and Local Governments*, and Statement No. 37, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments - an amendment of GASB Statement No. 34*. The City has adopted these statements for its 2003 financial statements. Some of the significant changes in the statement include the following:

- A change in the fund financial statements to focus on the major funds
- For the first time the financial statements include:

CITY OF DESERT HOT SPRINGS

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2003

NOTE #1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

- A Management Discussion and Analysis (MD&A) section providing an analysis of the City's overall financial position and results of operations. The City has decided not to include this in the June 30, 2003 basic financial statements.
- Financial statements prepared using full accrual accounting for all of the City's activities, including infrastructure (roads, traffic signals, etc.) and long-term debt.

GASB Statement No. 38 - In June 2001, the GASB issued Statement No. 38, *Certain Financial Statement Note Disclosures*. This statement modifies various note disclosure requirements concurrently with the implementation of Statement No. 34. While this statement does not affect amounts reported in the financial statements of the City, certain note disclosures have been modified for capital assets, debt service obligations, interfund transfers and balances and short-term obligations.

GASB Statement No. 41 - In May 2003, the GASB issued Statement No. 41, *Budgetary Comparison Schedules - Perspective Differences, an amendment of GASB 34*. This statement establishes guidance for governments with significant budgetary perspective differences to report budgetary comparison schedules within the GASB No. 34 reporting model. This statement does not have a significant impact on the financial statements of the City.

These and other changes are reflected in the accompanying financial statements (including notes to financial statements).

C. Description of Funds:

The accounts of the City 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. The following are types of funds used:

Governmental Fund Types:

- *General Fund* – Used to account for all financial resources except those required to be accounted for in another fund.
- *Special Revenue Funds* – Used to account for the proceeds of specific revenue sources that are restricted by law or administrative action for specified purposes.

CITY OF DESERT HOT SPRINGS

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2003

NOTE #1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

- *Debt Service Funds* – The debt service funds of the RDA are used to account for property tax increment revenue and related interest income. Disbursements from this fund consist mainly of principal and interest on RDA indebtedness.
- *Capital Projects Funds* – Used to account for financial resources used for the construction of specific capital projects.

D. Basis of Accounting/Measurement Focus

Government – Wide Financial Statements

The City's Government-Wide Financial Statements include a Statement of Net Assets and a Statement of Activities (including changes in net assets). These statements present summaries of Governmental Activities for the City.

These statements are presented on an "economic resources" measurement focus and the accrual basis of accounting. Accordingly, all of the City's assets and liabilities, including capital assets and long-term debt, 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 Statement of Activities demonstrates the degree to which the direct expenses of a given function are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function. The types of transactions reported as program revenues for the City are reported in three categories: 1) charges for services, 2) operating grants and contributions, and 3) capital grants and contributions. Charges for services include revenues from customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function. Operating grants and contributions include revenues restricted to meeting the requirements of a particular operating function and may include state shared revenues and grants. Capital grants and contributions include revenues restricted to meeting the requirements of a particular capital function and may include grants and developer fees. Taxes and other items not properly included among program revenues are reported instead as general revenues.

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 government-wide statements have been eliminated.

Governmental Fund Financial Statements

Governmental fund financial statements include a Balance Sheet and Statement of Revenue, Expenditures, and Changes in Fund Balances for all major governmental funds and aggregated non-major funds. An accompanying schedule is presented to reconcile and explain the differences in fund balances as presented in these statements to the net assets presented in the Government-Wide Financial Statements. The City has presented all major funds that met qualifications of GASB Statement No. 34.

CITY OF DESERT HOT SPRINGS

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2003

NOTE #1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (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 present increases (revenues and other financing sources) and decreases (expenditures and other financing uses) in fund balances. Revenues are recognized in the accounting period in which they become susceptible to accrual, that is, when they become both measurable and available to finance expenditures of the current period. “Measurable” means that the amount of the transaction can be determined, and “available” means collectible within the current period or soon enough thereafter to be used to pay liabilities of the current period. Accrued revenues include property taxes received within 60 days after year-end (see Note #7), taxpayer assessed taxes such as sales taxes, and earnings on investments. Grant funds earned but not received are recorded as a receivable, and grant funds received before the revenue recognition criteria have been met are reported as deferred revenues. Expenditures are recorded when the fund liability is incurred, if measurable, except for interest on long-term debt, which is recognized when due.

The City reports the following major governmental funds:

The General Fund is the City’s primary operating fund. It accounts for all financial resources of the City, except those required to be accounted for on another fund.

The Capital Improvement Deposits Special Revenue Fund is used to account for accumulated resources to be used to purchase the protection equipment and facilities, traffic signals, and parks. Financing is provided through a development fee on all new commercial and residential construction.

The Community Safety Special Revenue Fund is used to account for community safety expenditures funded by a special tax.

The RDA Debt Service Fund is used to account for the accumulation of resources for the payment of principal and interest of long-term debt of the Redevelopment Agency.

Fiduciary Fund Financial Statements

Fiduciary Fund Financial Statements include a Statement of Net Assets. The fiduciary funds are used to report assets held in a trustee or agency capacity for others and therefore are not available to support City programs. Since these assets are being held for the benefit of a third party, these funds are not incorporated into the government-wide statements.

The City’s only fiduciary funds are agency funds, which use the accrual basis of accounting to account for amounts held on behalf of other parties. The Agency funds are custodial in nature (assets equal liabilities) and therefore do not involve measurement of results of operations.

CITY OF DESERT HOT SPRINGS

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2003

NOTE #1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

E. Budgetary Data

The City adopts an annual budget prepared on the modified accrual basis for all of its governmental funds, except the Assessment District 92-1 Capital Projects Fund. Under Section 2-16(g) of the Desert Hot Springs Municipal Code, the City Manager is required to prepare and submit to the City Council the annual budget of the City and administers it after adoption. The City Manager is authorized to transfer budgeted amounts between the accounts of any department; however, any revisions that alter the total appropriations of any department must be approved by City Council. For each fund, total expenditures may not legally exceed total appropriations.

F. Encumbrances

Encumbrance accounting, under which purchase orders, contracts, and other commitments for the expenditure of funds are recorded in order to reserve that portion of the fund balance, is employed in the governmental funds. Encumbrances are reported as reservations of fund balances since they do not constitute expenditures or liabilities.

G. Cash Equivalents

The City considers all highly liquid debt instruments with an original maturity of three months or less to be cash equivalents.

H. Claims and Judgments

The City records a liability for litigation, judgments, and claims when it is probable that an asset has been impaired or a liability has been incurred prior to year-end and the probable amount of loss (net of any insurance coverage) can be reasonably estimated. This liability is recorded as a long-term liability on the Government-wide Statement of Net Assets.

As discussed in Note # 2, claims and judgments relating to the pre-petition periods through December 19, 2001, have been segregated as "liabilities subject to compromise" and therefore do not appear in the "Claims and Judgments" line item.

CITY OF DESERT HOT SPRINGS

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2003

NOTE #1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

I. Capital Assets and Depreciation

Capital assets, which include land, machinery and equipment (vehicles, computers, etc.), buildings and improvements, and infrastructure assets (street systems, storm drains park improvements, etc.), are reported in the Governmental Activities column of the Government-Wide Financial Statements. Capital assets are defined by the City as all land and buildings; vehicles, computers and equipment with an initial individual cost of more than \$5,000; and improvements and infrastructure assets with costs of more than \$100,000. Such assets are recorded at historical cost or estimated historical cost. Donated or annexed capital assets are recorded at estimated market value at the date of donation or annexation.

The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend assets lives are not capitalized. Depreciation is recorded in the Government-Wide Financial Statements on a straight-line basis over the useful life of the assets as follows:

Buildings and improvements	25 to 50 years
Vehicles, computers, and equipment	3 to 10 years
Infrastructure	20 to 30 years

GASB Statement No. 34 requires the City to report and depreciate new infrastructure assets effective with the beginning of the current year. Infrastructure assets include roads, bridges, sidewalks, park improvements, traffic signals, etc. Neither their historical cost nor related depreciation has historically been reported in the financial statements. The retroactive reporting of infrastructure (assets acquired prior to July 1, 2002) is subject to an extended implementation period and is first effective for fiscal years ending in 2006. **The City has elected to defer the retroactive reporting of infrastructure and plans to report these assets within the timeline provided by GASB Statement No. 34.**

Prior to the 2002-03 fiscal year the City did not maintain adequate records in order to report capital asset balances. During the fiscal year the City performed an inventory and analysis of the capital assets to determine the cost or estimated cost of assets in use as of the beginning of the fiscal year. As noted above, **generally accepted accounting principles (GAAP) require that capital assets be recorded at historical cost or estimated historical cost (when the actual cost is not readily determinable).** During the course of review of City owned land it was necessary to make certain estimations regarding the historical cost. Based on known costs and/or sales prices of certain properties, the City estimated land costs as follows:

<u>Acquisition Period</u>	<u>Estimated Historical Cost</u>
Prior to 1980	\$0.09/square foot
1980-1989	\$0.25/square foot
1990-1999	\$0.50/square foot

CITY OF DESERT HOT SPRINGS

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2003

NOTE #1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

J. Employee Leave Benefits

Permanent City employees earn from 12 to 21 days per year of vacation time depending upon their length of employment. Additionally, employees earn 12 days sick time per full year of employment. Employees can carry forward up to 30 days of unused sick leave days and 30 days of unused vacation days.

Upon termination or retirement, permanent employees are entitled to receive compensation at their current base salary for all unused vacation leave. To encourage attendance at work, an employee with continuous employment of 5 years or more may receive a payment from 25 percent to 50 percent of the value of unused sick time, depending upon length of employment, when they resign or retire. This compensation is paid in cash at straight time salary rates.

A current liability is accrued in the governmental funds for material leave benefits due on demand to governmental fund employees that have terminated prior to year end or are expected to terminate within a current period. All other amounts are recorded as long-term liabilities in the Government-wide Statement of Net Assets. These non-current amounts will be recorded as fund expenditures in the year in which they are paid or become due on demand to terminated employees.

The non-vested sick leave benefits (those that are not payable in the event of employee termination) are considered contingent liabilities and are not reflected in the accompanying financial statements. The City does not provide health care benefits for retired employees.

K. Deferred Compensation

In October 1997, GASB Statement No. 32, "Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans", was issued. This Statement establishes accounting and financial reporting standards for Internal Revenue Code (IRC) section 457 deferred compensation plans of state and local governments. Deferred compensation funds are not subject to the claims of the City's general creditors. Under the provisions of this Statement, it is no longer considered appropriate to report the Section 457 deferred compensation plan in the City's financial statements.

CITY OF DESERT HOT SPRINGS

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2003

NOTE #1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

L. Bankruptcy Reporting

Due to its bankruptcy filing, the City has prepared its financial statements as of June 30, 2003 using Statement of Position 90-7 (SOP 90-7), *Financial Reporting by Entities in Reorganization Under the Bankruptcy Code*, issued by the American Institute of Certified Public Accountants as a guideline. All of the City's pre-petition liabilities that are subject to compromise in the bankruptcy case through a plan of adjustment of debts are segregated in the City's financial statements as "liabilities subject to compromise". These liabilities are recorded at the amounts expected to be allowed as claims in the bankruptcy case, as estimated by management, rather than at the amounts for which they have been asserted in the bankruptcy case or the amounts of the distributions that may be made in respect of such claims through a plan of adjustment.

M. Use of Restricted Resources

When both restricted and unrestricted resources are available for use, it is the City's policy to use restricted resources first, and then unrestricted resources as they are needed. Restricted resources are defined as resources received from outside agencies dedicated for specific projects or purposes (grants for example).

N. Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that effect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates. The most significant of these estimates include the carrying balances of "liabilities subject to compromise" and the estimate of historical cost of the City's capital assets.

CITY OF DESERT HOT SPRINGS

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2003

NOTE #2 – REORGANIZATION UNDER THE BANKRUPTCY CODE

The City of Desert Hot Springs filed a voluntary petition for relief under Chapter 9 of the United States Bankruptcy Code on December 19, 2001. The City has continued operations since the petition date, and expects to continue its operations during and after the bankruptcy proceedings.

Using SOP 90-7 as a guideline, a significant portion of the City's outstanding debt, related accrued interest, and pre-petition accounts payable is classified as "liabilities subject to compromise." The liabilities which are subject to compromise as estimated by management, are summarized as follows (in thousands):

Silver Sage Claims	\$ 6,000
TRANS Settlement Claims	1,262
Redevelopment Agency Claim*	714
Accounts Payable/Legal Claims	500
LaSalle Lease	113
Total	<u>\$ 8,589</u>

- * Because the Redevelopment Agency claim is an interfund balance, the liability and related loan receivable are eliminated on the Government-wide Statement of Net Assets in accordance with the provisions of GASB Statement No. 34.

These amounts represent the City's estimate of the amounts that will be allowed in respect of known pre-petition claims. Various claimants have filed proofs of claim in amounts significantly in excess of these estimated amounts.

- Silver Sage Claims — reflect the claims asserted in respect of the Silver Sage litigation. See Note #15.
- TRANS Settlement Claims — reflect the claims asserted in the settlement with respect to the 1998 \$1,415,000 Taxable Tax and Revenue Anticipation Notes issued by the City.
- Redevelopment Agency Claim — reflects the claim asserted by the Desert Hot Springs Redevelopment Agency in respect of a loan made to the City.
- Accounts Payable/Legal Claims — reflects claims asserted in respect of general accounts payable as of the bankruptcy petition date and other claims discussed in Note #15.
- LaSalle Lease — reflects the claim asserted by LaSalle National Bank (LaSalle) in respect of an Equipment Lease-Purchase Agreement, dated April 22, 1996, between the City and LaSalle.

CITY OF DESERT HOT SPRINGS

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2003

NOTE #3 – CASH AND INVESTMENTS

The City maintains a cash and investments pool, which is available for use by all funds. Each fund's portion of the pool is displayed on the combined balance sheet as "Cash and Investments".

Cash and investments at June 30, 2003, consisted of the following:

Cash on hand	\$ 1,616
Pooled deposits:	
Demand deposits	638,031
Pooled investments:	
Local Agency Investment Fund	8,385,499
Subtotal: Pooled Deposits	<u>9,025,146</u>
Restricted investments/cash with fiscal agent:	
First American Treasury Money Market Fund	1,595,737
Federated Treasury Fund	141,404
Pension Funds	473,476
Subtotal: Restricted investments/cash with fiscal agent	<u>2,210,617</u>
Total Cash and Investments	<u>\$ 11,235,763</u>

Interest income earned on pooled cash and investments is allocated monthly to the funds based on average monthly cash and investment balances. Interest income from deferred compensation is credited directly to the related fund.

Authorized Investments

Under provision of the City's Investment Policy, and in accordance with Section 53601 of the California Government Code, the City may invest in the following:

- Obligations/Securities of the U.S. Government, or its agencies and instrumentality's
- All time deposits with banks and savings and loan associations
- Prime bank acceptances
- Negotiable certificates of deposit
- Repurchase Agreements
- Local Agency Investment Fund (State pool)
- Money market funds

CITY OF DESERT HOT SPRINGS

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2003

NOTE #3 – CASH AND INVESTMENTS (Continued)

Pooled Deposits/Credit Risk

The California Government Code requires California banks and savings and loan associations to secure a City's deposits by pledging government securities as collateral. The market value of pledged securities must equal at least 110 percent of a City's deposits. California law also allows financial institutions to secure city deposits by pledging first trust deed mortgage notes having a value of 150 percent of a city's total deposits.

The City may waive collateral requirements for deposits, which are fully insured by federal depository insurance.

In accordance with GASB Statement No. 3, deposits are classified as to credit risk by three categories as follows:

Category 1: Insured or collateralized with securities held by the City or by its agent in the City's name.

Category 2: Collateralized with securities held by the pledging financial institution's trust department or agent in the City's name.

Category 3: Uncollateralized. This includes any bank balance that is collateralized with securities held by the pledging financial institution, or by its trust department or agent, but not in the City's name.

Credit Risk, Carrying Amount, and Market Value of Pooled Investments:

Investments, which are represented by specific identifiable investment securities, are classified as to credit risk by three categories as follows:

Category 1: Insured or registered or securities held by the City or its agent in the City's name.

Category 2: Uninsured and unregistered with securities held by the pledging financial institutions' or counterparty's trust department or agent in the City's name.

Category 3: Uninsured and unregistered with securities held by the counterparty or by its trust department or agent, but not in the City's name.

Deposits at June 30, 2003, by risk category are as follows:

	BANK BALANCE - CATEGORY			TOTAL	CARRYING AMOUNT
	1	2	3		
Categorized					
Demand deposits	\$ 100,000		\$ 630,372	\$ 730,372	\$ 638,031
Cash on hand				-	1,616
Total	<u>\$ 100,000</u>	<u>\$ -</u>	<u>\$ 630,372</u>	<u>\$ 730,372</u>	<u>\$ 639,647</u>

CITY OF DESERT HOT SPRINGS

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2003

NOTE #3 – CASH AND INVESTMENTS (Continued)

Investments consisted of the following at June 30, 2003:

	<u>FAIR VALUE</u>
Uncategorized	
LAIF State of California (1)	\$ 8,385,499
First American Treasury Money Market Fund	1,595,737
Federated Treasury Money Market Fund	141,404
Pension Fund	473,476
Total	<u>\$10,596,116</u>

- (1) The management of the State of California Pooled Money Investment Account (generally referred to as LAIF) has indicated to the City that as of June 30, 2003, the carrying amount of the pool was \$55,422,506,109 and the estimated market value of the pool (including accrued interest) was \$55,709,492,881. Included in LAIF's investment portfolio are certain derivative securities or similar products in the form of structured notes, totaling \$304,000,000 and asset-backed securities totaling \$985,676,000. LAIF's (and the City's) exposure to risk (credit, market, or legal) is not currently available.

Fair Value of Investments

Accounting pronouncement GASB Statement 31 generally applies to investments in external investment pools, investments purchased with maturities greater than one year, mutual funds, and certain investment agreements. Generally, governmental entities need to report the "fair value" changes for these investments at year-end and records these gains or losses on their income statement.

Methods and assumptions used to estimate fair value: The City maintains investment accounting records on amortized cost and adjusts those records to "fair value" on an annual basis. The City's investment custodian provides market values on each investment instrument on a monthly basis. The investments held by the City are widely traded in the financial markets and trading values are readily available from numerous published sources. The City has elected to report its money market investments (those investments with maturities of less than one year) at amortized cost adjusted to fair value on a monthly basis. Unrealized gains and losses are recorded on an annual basis and the carrying value of its investments is considered "fair value".

State of California State Treasurer's Local Agency Investment Fund ("LAIF"): The City holds an investment in LAIF that is subject to being adjusted to "fair value". The City is required to disclose its methods and assumptions used to estimate the fair value of its holdings in LAIF. The City relied upon information provided by the State Treasurer in estimating the City's fair value position of its holdings in LAIF. The City had contractual withdrawal value of \$8,385,499 whose pro-rata share of fair value was estimated by the State Treasurer to be \$8,409,366. The fair value change in this investment for the year came to an amount that was not material for presentation in the financial statements.

CITY OF DESERT HOT SPRINGS

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2003

NOTE #3 – CASH AND INVESTMENTS (Continued)

The LAIF is a governmental investment pool managed and directed by the California State Treasurer and is not registered with the Securities and Exchange Commission. An oversight committee, comprised of California State officials and various participants, provide oversight to the management of the fund. It is the City's understanding that the values of share in the LAIF fall under the auspices of the State Treasurer's office. It is the City's understanding that the values of share in the LAIF pool reflect "fair value". The City is a voluntary participant in the investment pool.

NOTE #4 – CAPITAL ASSETS

In accordance with GASB Statement No. 34, the City has reported all capital assets including infrastructure in the Government-Wide Statement of Net Assets (except the retroactive reporting of infrastructure as discussed in Note #1). The City elected to use the basic approach as defined by GASB Statement No. 34 for all infrastructure reporting, whereby depreciation expense and accumulated depreciation have been recorded. The following table presents the capital assets and depreciation activity for the year ended June 30, 2003.

	Beginning Balance	Increases	Decreases	Ending Balance
Governmental Activities				
Capital Assets Not Being Depreciated:				
Land	\$ 586,472			\$ 586,472
Construction in progress	20,000	\$ 162,172	\$ (20,000)	162,172
Total Capital Assets Not Being Depreciated	606,472	162,172	(20,000)	748,644
Capital Assets, Being Depreciated:				
Buildings and improvements	2,956,504	123,100		3,079,604
Machinery and equipment	545,671	20,185		565,856
Vehicles	967,870	135,222		1,103,092
Infrastructure		524,878		524,878
Total Capital Assets Being Depreciated	4,470,045	803,385	-	5,273,430
Less Accumulated Depreciation For:				
Buildings and improvements	(1,631,628)	(97,241)		(1,728,869)
Machinery and equipment	(355,608)	(65,116)		(420,724)
Vehicles	(816,234)	(90,948)		(907,182)
Infrastructure		(6,971)		(6,971)
Total Accumulated Depreciation	(2,803,470)	(260,276)	-	(3,063,746)
Total Capital Assets, Being Depreciated, Net	1,666,575	543,109	-	2,209,684
Governmental Activities Capital Assets, Net	\$ 2,273,047	\$ 705,281	\$ (20,000)	\$ 2,958,328

CITY OF DESERT HOT SPRINGS

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2003**

NOTE #4 – CAPITAL ASSETS (Continued)

Depreciation expense was charged to functions/programs of the primary government as follows:

General government	\$ 81,642
Public safety	90,250
Municipal services	38,066
Recreation and community services	50,318
Total Depreciation Expense - Governmental Activities	<u>\$ 260,276</u>

NOTE #5 – LONG-TERM LIABILITIES

The following is a summary of changes in long-term liabilities for the year ended June 30, 2003:

	Balance June 30, 2002	Additions	Retirements	Balance June 30, 2003	Amount Due Within One Year
Governmental Activities					
Long-Term Bonds and Leases					
<u>City of Desert Hot Springs:</u>					
Capital leases	\$ 7,938		\$ (2,601)	\$ 5,337	\$ 2,838
<u>Desert Hot Springs Redevelopment Agency:</u>					
1993 Project #1 Series A Tax Allocation Bonds	7,170,000		(125,000)	7,045,000	135,000
1993 Project #1 Series B Tax Allocation Bonds	1,080,000		(140,000)	940,000	150,000
1993 Project #2 Tax Allocation Bonds	1,290,000		(60,000)	1,230,000	40,000
Total Long-Term Bonds and Leases	9,547,938		(327,601)	9,220,337	327,838
Other Long-Term Liabilities					
<u>City of Desert Hot Springs:</u>					
Compensated absences	304,790	\$ 197,627	(13,621)	488,796	231,947
Total Long-Term Liabilities	<u>\$ 9,852,728</u>	<u>\$ 197,627</u>	<u>\$ (341,222)</u>	<u>\$ 9,709,133</u>	<u>\$ 559,785</u>

CITY OF DESERT HOT SPRINGS

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2003

NOTE #5 – LONG-TERM LIABILITIES (Continued)

A. Capital Leases

At June 30, 2003, minimum annual lease payments under capital lease obligations for the next two years ending June 30 are as follows:

Year Ending June 30,	
2004	\$ 3,125
2005	2,604
Total	5,729
Less: Amount Representing Interest	(392)
Present Value of Minimum Lease Payments	<u>\$ 5,337</u>

B. Compensated Absences

The City accrued compensated absences of \$488,796 as of June 30, 2003. The General Fund is expected to incur the majority of expenditures required to liquidate this balance.

C. Redevelopment Project No. 1 - 1993 Tax Allocation Bonds Series A and B

On August 1, 1993, the Redevelopment Agency of the City of Desert Hot Springs issued \$9,200,000 of Tax Allocation Parity Bonds (Series-1993A) and \$1,900,000 of taxable Tax Allocation Parity Bonds (Series-1993B). The bonds were issued in part to refund the Agency's previously issued Redevelopment Project No. 1 - 1985 Tax Allocation Refunding Bonds, the Redevelopment Project No. 1 - 1987 Tax Allocation (Series-1987A) and 1987 Refunding Parity Bonds (Series-1987B), and to fund certain activities within Redevelopment Project Area No. 1 pursuant to the California Community Redevelopment Law.

The Series 1993A bonds maturing on or after September 1, 2004 are subject to optional redemption at par plus accrued interest and a premium ranging up to 2 percent. The Series 1993B bonds maturing on or after September 1, 2003 are subject to optional redemption at par plus accrued interest. No call premium is imposed on the Series 1993B bonds.

CITY OF DESERT HOT SPRINGS

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2003**

NOTE #5 – LONG-TERM LIABILITIES (Continued)

The debt service maturity schedule for the 1993 Series A and B is as follows:

Year Ended June 30	Series A			Series B		
	Principal	Interest	Total	Principal	Interest	Total
2004	\$ 135,000	\$ 278,136	\$ 413,136	\$ 150,000	\$ 58,820	\$ 208,820
2005	140,000	367,049	507,049	160,000	48,280	208,280
2006	145,000	359,670	504,670	170,000	37,060	207,060
2007	150,000	351,779	501,779	185,000	24,990	209,990
2008	160,000	343,486	503,486	195,000	12,070	207,070
2009-2013	2,035,000	1,282,868	3,317,868	80,000	2,720	82,720
2014-2018	2,750,000	798,469	3,548,469			
2019-2022	1,530,000	108,046	1,638,046			
Total	\$ 7,045,000	\$ 3,889,503	\$10,934,503	\$ 940,000	\$ 183,940	\$1,123,940

D. Redevelopment Project No. 2 - 1993 Tax Allocation Bonds

In June 1993, the Agency issued Redevelopment Project Area No. 2 - 1993 Tax Allocation Bonds in the amount of \$2,515,000 for purposes of funding capital projects within Project Area No. 2 pursuant to the California Community Redevelopment Law. The bonds are subject to optional redemption beginning September 1, 2003, at par plus accrued interest and a premium ranging up to 2 percent.

The debt service maturity schedule for the 1993 Area #2 Bonds is as follows:

Year Ended June 30	Principal	Interest	Total
2004	\$ 40,000	\$ 82,482	\$ 122,482
2005	70,000	76,519	146,519
2006	70,000	71,881	141,881
2007	70,000	67,244	137,244
2008	70,000	62,607	132,607
2009-2013	350,000	217,964	567,964
2014-2018	350,000	127,532	477,532
2019-2022	210,000	20,870	230,870
Total	\$ 1,230,000	\$ 727,099	\$ 1,957,099

CITY OF DESERT HOT SPRINGS

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2003

NOTE #6 – DEFINED CONTRIBUTION PLAN

The City has a money purchase defined contribution plan for all eligible employees. In a defined contribution plan, benefits depend solely on amounts contributed to the plan plus investment earnings. ICMA Retirement Corporation serves as the plan administrator and plan amendments must be authorized by the City Council. Eligibility begins for full-time employees with 6 months or more service. Employees earn a vesting in the benefits at a rate of 10 percent-20 percent per year with 100 percent vesting after 7 years service. The City contributed 12 percent of annual wages for all covered employees for the year ended June 30, 2003. For the 2002-03 fiscal year required and actual contributions were \$12,256. At June 30, 2003, the plan net assets available were \$473,476, all of which was vested.

NOTE #7 – PROPERTY TAXES/SPECIAL PARCEL TAXES

Riverside County assesses, bills, collects, and distributes property taxes/special parcel tax and any related interest and penalties to the City. Under California law, property taxes are assessed and collected by the counties up to 1 percent of assessed value, plus other increases approved by the voters. Accordingly, the City of Desert Hot Springs accrues only those taxes, which are received from the County within sixty days after the year-end.

Lien Date	March 1
Levy Date	June 30
Due Dates	November 1 and February 1
Collection Dates	December 10 and April 10

NOTE #8 – SPECIAL ASSESSMENT AND NOTES RECEIVABLE

During the fiscal year ended June 30, 1987 the Capital Projects Fund of the Redevelopment Agency financed construction of certain public improvements pursuant to the Municipal Act of 1913 and provisions of the Streets and Highway Code of the State of California. At June 30, 2003 the Agency has a receivable for unpaid assessments from the property holders in the amount of \$21,896. The receivables bear interest at a rate not exceeding 12 percent. A total of \$5,866 was collected during the fiscal year ended June 30, 2003.

Notes receivable of \$185,282 represent collateral deposits for various types of loan programs including the first time home buyer program, owner occupied rehabilitation loans, and commercial rehabilitation loans made by the Redevelopment Agency. The notes are for generally thirty years and bear interest at 7 percent. The housing rehabilitation and first time home buyer loans are secured by a deed of trust and are normally repaid when the home changes ownership. Since the notes are not current available resources the balance is reported only in the Government-wide Statement of Net Assets. During the fiscal year ended June 30, 2003, \$13,949 of loans were collected and \$113,676 of new loans were funded.

CITY OF DESERT HOT SPRINGS

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2003

NOTE #9 – RISK MANAGEMENT

The City of Desert Hot Springs has managed its risk using several different types of insurance for general liability, workers' compensation, property, and earthquake coverage. Each are described below summarizing the coverage maintained by the City of Desert Hot Springs.

A. Workers' Compensation Coverage

The City of Desert Hot Springs is self-insured for the first \$250,000 of each accident. The City uses a third party claims administrator to process all claims. For coverage above the \$250,000 level, the City participates in the Public Entity Risk Management Authority (PERMA). PERMA provides coverage for the costs incurred in the \$250,001 to \$750,000 layer through a risk sharing pool, and costs are shared between thirteen participating members within this pool based upon deposit premium contributions. For costs above \$750,001, excess insurance is purchased by PERMA with a limit of \$25,000,000.

B. General Liability

The City of Desert Hot Springs is self-insured for the first \$10,000 of each occurrence. For coverage above the \$10,000 level, the City participates in the PERMA. PERMA provides coverage for the costs incurred above the \$10,000 level up to \$1,000,000 through risk sharing pools, and costs are shared between the participating members within each pool based upon deposit premium contribution. For costs above \$1,000,001, excess insurance is purchased with a limit of \$25,000,000. The City uses PERMA to process all claims.

C. Employment Practices Liability Coverage

The City of Desert Hot Springs is self-insured for the first \$25,000 of each occurrence. As a member of PERMA, the City participates in the Employment Risk Management Authority (ERMA) for employment practices liability coverage. The limit of coverage is \$4,000,000 and provided through a combination of pooling and reinsurance. Risk sharing pools provide the coverage above the City's \$25,000 self-insured retention up to \$1,000,000. Reinsurance is purchased for coverage above \$1,000,001 up to \$4,000,000.

D. Earthquake Insurance

The City of Desert Hot Springs purchases earthquake insurance on a portion of its property. The City currently has a policy with a \$2,500,000 loss limit. There is a deductible of 10 percent of the values at risk per location subject to a per occurrence minimum of \$50,000.

CITY OF DESERT HOT SPRINGS

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2003

NOTE #9 – RISK MANAGEMENT (Continued)

E. Property Insurance

The City purchases property insurance and is currently insured according to a schedule of covered property. The City's current policy provides for a limit of \$9,128,450 for real and personal property and \$1,044,000 for scheduled autos. The "all risk" coverage are \$2,500 on licensed vehicles (except fire trucks which is \$10,000) \$2,500 on electronic data processing equipment and \$5,000 on all other property for all perils, except flood. The deductible for flood is \$25,000.

F. Fidelity Bonds

The City of Desert Hot Springs purchases fidelity bond coverage in the amount of \$500,000 per loss with a deductible of \$2,500. Coverage includes employee theft, faithful performance of duty, forgery, alteration, and computer fraud.

G. Adequacy of Protection

During the past three fiscal (policy) years, none of the above programs of protection have had settlements or judgements that exceeded pooled or insured coverage. There have been no significant reductions in pooled or insured coverage in the prior year.

Complete financial statements may be obtained from the Public Entity Risk Management Authority at 77-670 Springfield Lane, Suite 1A, Palm Desert, CA 92211.

NOTE #10 – PUBLIC EMPLOYEES RETIREMENT SYSTEM (PERS)

Plan Description

The City of Desert Hot Springs' defined benefit pension plans, the Miscellaneous Plan and the Safety Plan, provide retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries. The Miscellaneous Plan and the Safety Plan are a part of the Public Agency portion of the California Public Employees Retirement System (CalPERS), an agent multiple-employer plan administered by CalPERS, which acts as a common investment and administrative agent for participating public employers within the State of California. A menu of benefit provisions as well as other requirements are established by State statutes within the Public Employees' Retirement Law. The City of Desert Hot Springs selects optional benefit provisions from the benefit menu by contract with CalPERS and adopts those benefits through local ordinance or resolution. CalPERS issues a separate comprehensive annual financial report. Copies of the CalPERS's annual financial report may be obtained from the CalPERS Executive Office – 400 P Street – Sacramento, California, 95814.

CITY OF DESERT HOT SPRINGS

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2003

NOTE #10 – PUBLIC EMPLOYEES RETIREMENT SYSTEM (PERS) (Continued)

Funding Policy

Active plan members in the Miscellaneous Plan and the Safety Plan are required to contribute between 7 percent and 9 percent of their annual covered salary. The City of Desert Hot Springs' labor contract requires the City to pay all Miscellaneous Employee Plan PERS contributions and Safety Plan contributions that are required for the actuarially determined amounts necessary to fund the benefits for its members. The actuarial methods and assumptions used are those adopted by the CalPERS Board of Administration. The required employer contribution rate for Fiscal Year 2002-2003 was 7.352 percent for Miscellaneous employees and 4.034 percent for Safety employees. The contribution requirements of the plan members are established by State statute and the employer contribution rate is established and may be amended by CalPERS.

Annual Pension Cost

For fiscal year 2002-2003, the City's annual pension cost was \$331,215 for both Miscellaneous and Safety members, and was equal to the City's required and actual contributions. The required contribution for fiscal year 2002-2003 was determined using the entry age normal actuarial cost method with the contributions determined as a percent of pay. The actuarial assumptions included (a) 8.5 percent investment rate of return (net of administrative expenses); (b) projected salary increases that vary by duration of service ranging from 4.5 percent to 14.95 percent for Miscellaneous members and from 5.02 percent to 12.34 percent for Safety members, and (c) 0 percent cost-of-living adjustment. Both (a) and (b) include an inflation component of 4.5 percent. The actuarial value of the Miscellaneous Plan's and the Safety Plan's assets were determined using a technique that smoothes the effect of short-term volatility in the market value of investments over a two to five year period depending on the size of investment gains and/or losses. The Miscellaneous Plan's and the Safety Plan's unfunded actuarial accrued liability (or excess assets) is being amortized as a level percentage of projected payroll on a closed basis.

Three-Year Trend Information for the Miscellaneous and Safety Plan

<u>Fiscal Year Ending</u>	<u>Annual Pension Cost (APC)</u>	<u>Percentage of APC Contributed</u>	<u>Net Pension Obligation</u>
6/30/2001	\$186,764	100%	\$0
6/30/2002	\$285,603	100%	\$0
6/30/2003	\$331,215	100%	\$0

CITY OF DESERT HOT SPRINGS

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2003**

NOTE #10 – PUBLIC EMPLOYEES RETIREMENT SYSTEM (PERS) (Continued)

Funded Status of the Miscellaneous Plan

Valuation Date	Entry Age Normal Accrued Liability	Actuarial Value of Assets	Unfunded (Overfunded) Liability	Funded Ratio	Annual Covered Payroll	UAAL As a % of Payroll
6/30/2000	\$ 768,293	\$ 794,984	\$ (26,691)	103.5%	\$ 553,519	(4.8%)
6/30/2001	\$ 974,643	\$ 937,280	\$ 37,363	96.2%	\$ 775,809	4.8%
6/30/2002	\$ 1,299,060	\$ 1,077,319	\$ 221,741	82.9%	\$ 1,421,785	15.6%

Funded Status of the Safety Plan

Valuation Date	Entry Age Normal Accrued Liability	Actuarial Value of Assets	Unfunded (Overfunded) Liability	Funded Ratio	Annual Covered Payroll	UAAL As a % of Payroll
6/30/2000	\$ 1,345,367	\$ 1,734,630	\$ (389,263)	128.9%	\$ 632,631	(61.5%)
6/30/2001	\$ 1,543,875	\$ 1,927,118	\$ (383,243)	124.8%	\$ 680,362	(56.3%)
6/30/2002	\$ 1,747,211	\$ 1,955,270	\$ (208,059)	111.9%	\$ 785,629	(26.5%)

NOTE #11 – INTERFUND TRANSACTIONS

The advances payable balances and the loan to General Fund at June 30, 2003 are as follows:

	Loan to General Fund	Advances Payable
General Fund		\$ 714,424
RDA Debt Service Fund	\$ 464,704	
RDA Capital Project Fund	249,720	
Total	\$ 714,424	\$ 714,424

CITY OF DESERT HOT SPRINGS

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2003

NOTE #11 – INTERFUND TRANSACTIONS (Continued)

The advance payable is composed of an interfund loan between the General Fund and the funds noted above. The loans were advanced based upon two loan agreements. The first loan agreement dated July 1, 1998, advanced the general fund \$760,000 and bears interest at the average quarterly LAIF rate. The second advance for \$120,000 was dated April 19, 1999 and bears interest at 5.19 percent. Neither loan has a specific term.

During the fiscal year ended June 30, 2003, the General Fund made no loan repayments. These amounts are classified as “liabilities subject to compromise” as described in Note #2.

The other interfund balances at June 30, 2003, are as follows:

Receivable	Payable	Amount
General Fund	Non-major Governmental Funds	\$ 464,617
General Fund	Community Programs Agency Fund	3,709
Non-major Governmental Funds	Non-major Governmental Funds	3,933
Total		<u>\$ 472,259</u>

These balances resulted from one fund advancing money to another fund to cover operating costs. These balances are expected to be repaid during the 2003-04 fiscal year.

With Council approval, resources may be transferred from one City fund to another. Transfers are used to move revenue from the fund that statute or budget requires to collect them to the fund that statute or budget requires to expend them. Interfund transfers for the year ended June 30, 2003, consisted of the following:

Transfer In	Transfer Out	Amount
Community Safety Special Revenue Fund	General Fund	\$ 2,558,541
Non-major Governmental Funds	General Fund	85,434
Non-major Governmental Funds	Capital Improvement Deposits Special Revenue Fund	89,554
RDA Debt Service Fund	Non-major Governmental Funds	159,000
Non-major Governmental Funds	RDA Debt Service Fund	32,812
Non-major Governmental Funds	Non-major Governmental Funds	22,904
Total		<u>\$ 2,948,245</u>

CITY OF DESERT HOT SPRINGS

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2003

NOTE #12 – REDEVELOPMENT AGENCY

The Redevelopment Agency's governing body approved the proposal to merge Redevelopment Project Areas #1 and #2. The merger would allow the Redevelopment area to expand and thereby generate more tax increment monies. The date of the merger was December 16, 1997.

NOTE #13 – NON-OBLIGATORY DEBT

The Desert Hot Springs Public Financing Authority issued the "Health Care Refunding and Improvement Certificates of Participation" (the Certificates) for the Heritage Hospital Project on August 15, 1998. The Certificates were issued in two series: Series A was issued for \$13,900,000 and were tax exempt and Series B was issued for \$8,430,000 and were taxable. The Certificates do not constitute general obligations of the Authority, the City, the State of California, or any political subdivision thereof. The Certificates do not constitute a debt or liability of the State of California or any political subdivision thereof within the meaning of any constitutional or statutory debt limitation. As of June 30, 2003, the Certificates in default and have been transferred to the Bank of New York as the successor indenture trustee. The City is not aware of the outstanding balance of the Certificates as of June 30, 2003.

NOTE # 14 – ASSESSMENT DISTRICTS

In November 1992, the City issued \$975,062 of municipal limited improvement bonds (Assessment District 92-1) to provide financing for the acquisition of street, sewer, and water drainage utilities for the proposed residential subdivision known as Arroyo Vista. The bonds are subject to optional redemption prior to maturity at par plus accrued interest and a premium of 3 percent. The outstanding balance at June 30, 2003, is \$705,000. The 92-1 Assessment District was in default as of June 30, 2003, (see Note #17).

In October 1993, the City issued \$765,320 of municipal limited improvement bonds (Assessment District 93-2) for the acquisition of street, sewer, water, drainage and dry utilities within, or adjacent to, the proposed Arroyo Vista development. The bonds are subject to optional redemption prior to maturity at par plus accrued interest and a premium of 3 percent. The outstanding balance at June 30, 2003, is \$550,000.

In May 1994, the City issued \$441,044 of municipal limited improvement bonds (Assessment District 91-1) for the acquisition and construction of certain street improvements for Two Bunch Palms Trail. The bonds are subject to optional redemption prior to maturity at par plus accrued interest and a premium of 3 percent. The outstanding balance at June 30, 2003, is \$325,000.

The City is acting only in an agent capacity for collection of principal and interest payments by the property owners and remittance of such monies to the bondholders. The City has no obligation or duty to pay any delinquency out of any available funds of the City. For the above noted Assessment Districts, neither the full faith and credit nor the taxing power of the City, the County, the State of California or any political subdivision thereof is pledged to the payment of the above noted bonds.

CITY OF DESERT HOT SPRINGS

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2003

NOTE #15 – LITIGATION

- Silver Sage

In 1991, an entity known as Silver Sage Partners Ltd. and various principals and advisors to Silver Sage (collectively referred to as “Silver Sage”) sued the City for damages resulting from an alleged violation of the federal Fair Housing Act, contending that the City improperly had denied Silver Sage the necessary approvals for a trailer-park housing project within the City.

After trial in the United States District Court before the Honorable Consuelo B. Marshall, in July 1994, a jury found for Silver Sage by a general verdict and awarded damages of \$3,040,439. The City subsequently filed a motion for judgment as a matter of law or, in the alternative for a new trial. Ultimately, Chief Judge Marshall denied the motion for judgment as a matter of law and for a new trial on liability. Chief Judge Marshall, however, determined the jury’s damage award to be “grossly excessive,” and therefore entered an order denying the City’s motion for a new trial on damages, conditional on Silver Sage’s acceptance of a remittitur to \$388,146.

Silver Sage rejected the remittitur, and the Court held a second trial on damages. After that second trial in 1999, the jury awarded nominal damages of \$1. Silver Sage subsequently filed a motion to amend the damage award or, alternatively, for a new trial as to damages. Silver Sage also filed a motion for imposition of “remedial measures.” The District Court denied both motions, but did award Silver Sage \$57,000 in attorneys’ fees (out of more than a requested \$2.5 million in fees and costs).

Silver Sage appealed to the United States Court of Appeals for the Ninth Circuit. On June 1, 2001, seven years after Chief Judge Marshall’s remittitur, the Ninth Circuit filed an opinion reversing the District Court. *Silver Sage Partners, Ltd. v. City of Desert Hot Springs*, 251 F.3d 814 (9th Cir. 2001). The Ninth Circuit ordered that the first jury’s original damage award be reinstated, and that the District Court reconsider the amount of the award for attorneys’ fees and Silver Sage’s motion for an injunction. The Ninth Circuit subsequently denied the City’s petition for rehearing, and the mandate was spread on November 8, 2001.

After the City commenced its bankruptcy case, the plaintiffs in the *Silver Sage* case filed the following five proofs of claim: (a) a claim of \$4,473,851, representing the *Silver Sage* judgment, alleged post-judgment interest through the bankruptcy petition date, and costs related to the appeal to the Ninth Circuit; (b) a claim for \$744,238 for alleged prejudgment interest; (c) a claim for \$4,241,871 for attorneys’ fees that the plaintiffs claim in connection with the litigation; (d) a claim for \$324,214 for attorneys’ fees that the plaintiffs claim in connection with their appeal to the Ninth Circuit; and (e) a claim for \$3,000,000 plus for an alleged entitlement to an “injunction and remedial relief” in connection with the litigation.

CITY OF DESERT HOT SPRINGS

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2003

NOTE #15 – LITIGATION (Continued)

The City acknowledges that Silver Sage has a claim in respect of its judgment in the amount of \$3,040,439. The City also acknowledges that the Ninth Circuit has ordered that Silver Sage is entitled to recover reasonable attorneys' fees. The City, however, disputes the amount of attorneys' fees claimed by Silver Sage, as well as Silver Sage's claimed entitlement to pre-judgment interest and "remedial relief". The City has consented to a modification of the automatic stay to enable litigation regarding the entitlement to and amounts, if any, of such claims to proceed before the District Court. On October 15, 2002, the District Court entered an order denying Silver Sage's request for prejudgment interest. The remainder of the litigation regarding the amount of Silver Sage's claims remains pending.

- Moore/Pimentel

Prior to the bankruptcy petition date, Edward Moore and Albert Pimentel, represented by the same counsel who represents the plaintiffs in the *Silver Sage* case, filed a purported class-action complaint against the City and other defendants for alleged employment discrimination and retaliation, deprivation of due process, and police brutality. *Moore, et al. v. City of Desert Hot Springs, et al.*, Case No. ED CV-98-137 RT (C.D. Cal.). As of the petition date, that litigation (including a motion for class certification) remained pending. After the petition date, the plaintiffs filed the following proofs of claim in respect of that action: (a) a claim of \$1,550,000 plus (including \$1,000,000 in punitive damages), representing alleged liability to Edward Moore; (b) a claim of \$350,000 plus, representing alleged liability to Albert Pimentel; and (c) a claim of \$11,625,000 (including \$7,500,000 in punitive damages), representing alleged liability to the purported class of similarly-situated plaintiffs.

The City disputes the claims asserted by Moore, Pimentel, and the purported class in all regards. With the City's consent, the Bankruptcy Court has modified the automatic stay to enable litigation regarding the City's alleged liability and the amounts, if any, of such claims to proceed before the District Court.

- Other Tort Claims

After the City filed its bankruptcy case, two claimants filed proofs of claim for alleged tort and related liability of the City. Stephen O'Connor filed a proof of claim in the amount of \$1,000,000 alleging damages (including punitive damages) for wrongful termination and related causes of action. Donnie Dennis filed a proof of claim in the amount of \$500,000 alleging damages relating to an automobile accident within the City. The City disputes both such claims in their entirety. The bankruptcy court has disallowed both claims. The bankruptcy court denied Mr. O'Connor's motion seeking reconsideration of the order of disallowance and the matter is on appeal.

NOTE #16 – FINANCIAL CONDITION/GOING CONCERN/DEFICIT FUND BALANCE

The City filed a voluntary petition for relief under chapter 9 of the United States Bankruptcy Code on December 19, 2001. Due to the bankruptcy, the City's General Fund ended the year with a deficit balance of \$5,745,141. The basic financial statements do not include any adjustments that might be necessary if the City is unable to continue to operate as a going concern.

CITY OF DESERT HOT SPRINGS

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2003

NOTE #17 – ASSESSMENT DISTRICT DEFAULT

On September 1, 2000, Assessment District No. 92-1 defaulted on the scheduled principal and interest payments then due on the bonds due to a shortage of funds. The Assessment District does not generate sufficient cash flow to meet the scheduled debt service payments. The bonds have remained in default.

NOTE #18 – COMMITMENTS AND CONTINGENCIES

In June 2003, the City entered into a contract for the construction of a skate park in the amount of approximately \$266,000. As of June 30, 2003, approximately \$221,000 was remaining on the contract which is expected to be paid during fiscal year 2003-04.

The City is involved in various litigation, in addition to the litigation described in Note #15. In the opinion of management and legal counsel, the disposition of such other litigation will not have a material effect on the City's financial statements.

The City participates in several federal and state programs. These programs are subject to examination by the grantors and the amount, if any, of expenditures, which may be disallowed by the granting agencies, cannot be determined at this time. The City expects such amounts, if any, to be immaterial. The City is not aware, nor has it been contacted, by granting agencies of any such audit.

NOTE #19 – OTHER FUND DISCLOSURES

The City ended the 2002-2003 fiscal year with deficit net assets of \$5,256,550 at the government-wide level. In addition, the following funds ended the 2002-03 fiscal year with deficit fund balances in the following amounts:

General Fund (1)	\$ 5,745,141
Non-Major Governmental Funds (2):	
Special Revenue Fund:	
State Transportation Improvement Grant	\$ 3,933

- (1) See Notes # 2, 15, and 16 for information regarding the financial condition of the City's General Fund.
- (2) The deficits in the Transportation Improvement Grant Fund is expected to be funded through future revenues of the funds.

CITY OF DESERT HOT SPRINGS

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2003

NOTE #19 – OTHER FUND DISCLOSURES (Continued)

The following funds had expenditures in excess of the budget in the following amounts for the year ended June 30, 2003:

Community Safety Special Revenue Fund	\$	643,662
RDA Debt Service Fund	\$	84,442
Non-major Governmental Funds:		
T.U.M.F. Special Revenue Fund	\$	224,762

Community Safety Special Fund and Redevelopment Agency Debt Service Fund – The previous City Manager and Director of Finance did not prepare the appropriate budgetary adjustments during the year to increase the budgets to cover the additional expenses.

T.U.M.F. Fund – This is a pass through account – these fees are collected as part of the building permit process – the revenues increase at the same rate as the expenses – the fees collected are paid to the appropriate agency.

(THIS PAGE INTENTIONALLY LEFT BLANK)

REQUIRED SUPPLEMENTARY INFORMATION

(THIS PAGE INTENTIONALLY LEFT BLANK)

CITY OF DESERT HOT SPRINGS

**SCHEDULE OF REVENUES, EXPENDITURES AND
CHANGES IN FUND BALANCE - BUDGET AND ACTUAL
GENERAL FUND
FOR THE YEAR ENDED JUNE 30, 2003**

	Budgeted Amounts		Actual	Variance with Final Budget - Positive (Negative)
	Original	Final	Amounts	
REVENUES				
Taxes	\$ 3,604,000	\$ 3,604,000	\$ 3,881,557	\$ 277,557
Permits and fees	288,250	288,250	1,279,962	991,712
Intergovernmental	930,000	930,000	996,110	66,110
Interest	20,000	20,000	47,237	27,237
Miscellaneous	15,000	15,000	60,177	45,177
Total Revenues	4,857,250	4,857,250	6,265,043	1,407,793
EXPENDITURES				
Current:				
General government	2,301,310	2,178,651	2,603,234	(424,583)
Public works	314,482	405,908	446,835	(40,927)
Debt service:				
Principal	68,589	456,236		456,236
Interest		93,649		93,649
Total Expenditures	2,684,381	3,134,444	3,050,069	84,375
REVENUES OVER EXPENDITURES	2,172,869	1,722,806	3,214,974	1,492,168
OTHER FINANCING USES				
Transfers out	(2,465,164)	(1,815,797)	(2,643,975)	(828,178)
Total Other Financing Uses	(2,465,164)	(1,815,797)	(2,643,975)	(828,178)
Net Change in Fund Balance	(292,295)	(92,991)	570,999	663,990
Fund Deficit, Beginning of Year	(6,316,140)	(6,316,140)	(6,316,140)	-
Fund Deficit, End of Year	\$ (6,608,435)	\$ (6,409,131)	\$ (5,745,141)	\$ 663,990

CITY OF DESERT HOT SPRINGS

**SCHEDULE OF REVENUES, EXPENDITURES AND
CHANGES IN FUND BALANCE - BUDGET AND ACTUAL
CAPITAL IMPROVEMENT DEPOSITS SPECIAL REVENUE FUND
FOR THE YEAR ENDED JUNE 30, 2003**

	Budgeted Amounts		Actual	Variance with Final Budget - Positive (Negative)
	Original	Final	Amounts	
REVENUES				
Permits and fees	\$ 587,798	\$ 587,798	\$ 1,073,478	\$ 485,680
Interest	8,500	8,500	3,065	(5,435)
Total Revenues	596,298	596,298	1,076,543	480,245
EXPENDITURES				
Capital outlay	543,000	543,000	73,022	469,978
Total Expenditures	543,000	543,000	73,022	469,978
REVENUES UNDER EXPENDITURES	53,298	53,298	1,003,521	950,223
OTHER FINANCING SOURCES (USES)				
Transfers out	(227,535)	(227,535)	(89,554)	(137,981)
Net Change in Fund Balance	(174,237)	(174,237)	913,967	1,088,204
Fund Balance, Beginning of Year	938,993	938,993	938,993	-
Fund Balance, End of Year	\$ 764,756	\$ 764,756	\$ 1,852,960	\$ 1,088,204

CITY OF DESERT HOT SPRINGS

**SCHEDULE OF REVENUES, EXPENDITURES AND
CHANGES IN FUND BALANCE - BUDGET AND ACTUAL
COMMUNITY SAFETY SPECIAL REVENUE FUND
FOR THE YEAR ENDED JUNE 30, 2003**

	Budgeted Amounts		Actual	Variance with Final Budget - Positive (Negative)
	Original	Final	Amounts	
REVENUES				
Taxes	\$ 904,280	\$ 904,280	\$ 875,884	\$ (28,396)
Permits and fees	89,775	89,775	86,089	(3,686)
Intergovernmental	115,833	115,833	115,797	(36)
Interest	3,117	3,117		(3,117)
Miscellaneous	108,061	108,061	30,457	(77,604)
Total Revenues	1,221,066	1,221,066	1,108,227	(112,839)
EXPENDITURES				
Current:				
Public safety	2,945,888	2,945,888	3,586,368	(640,480)
Capital outlay	97,824	97,824	50,503	47,321
Total Expenditures	3,043,712	3,043,712	3,636,871	(643,662)
REVENUES UNDER EXPENDITURES	(1,822,646)	(1,822,646)	(2,528,644)	(756,501)
OTHER FINANCING SOURCES				
Transfers in	1,730,363	1,730,363	2,558,541	828,178
Net Change in Fund Balance	(92,283)	(92,283)	29,897	71,677
Fund Balance, Beginning of Year	-	-	-	-
Fund Balance, End of Year	\$ (92,283)	\$ (92,283)	\$ 29,897	\$ 71,677

(THIS PAGE INTENTIONALLY LEFT BLANK)

SUPPLEMENTARY SCHEDULES

CITY OF DESERT HOT SPRINGS

JUNE 30, 2003

MAJOR FUND BUDGETARY COMPARISON SCHEDULES

Budgetary comparison schedules are presented as part of the basic financial statements for the General Fund and all Major Special Revenue Funds as provided for by GASB Statement No. 34. The budgetary comparison schedule for the RDA Debt Service Fund is presented to aid in additional analysis and is not a required part of the basic financial statements.

CITY OF DESERT HOT SPRINGS

**SCHEDULE OF REVENUES, EXPENDITURES AND
CHANGES IN FUND BALANCE - BUDGET AND ACTUAL
RDA DEBT SERVICE FUND
FOR THE YEAR ENDED JUNE 30, 2003**

	Budgeted Amounts		Actual	Variance with Final Budget - Positive (Negative)
	Original	Final	Amounts	
REVENUES				
Taxes	\$ 795,000	\$ 795,000	\$1,164,862	\$ 369,862
Interest	61,505	61,505	29,477	(32,028)
Total Revenues	856,505	856,505	1,194,339	337,834
EXPENDITURES				
Current:				
Economic development	53,500	53,500	69,951	(16,451)
Debt service:				
Principal	325,000	325,000	325,000	
Interest	464,049	464,049	532,040	(67,991)
Total Expenditures	842,549	842,549	926,991	(84,442)
REVENUES OVER EXPENDITURES	13,956	13,956	267,348	253,392
OTHER FINANCING SOURCES (USES)				
Transfers in	159,000	159,000	159,000	
Transfers out			(32,812)	(32,812)
Total Other Financing Sources (Uses)	159,000	159,000	126,188	(32,812)
Net Change in Fund Balance	172,956	172,956	393,536	220,580
Fund Balance, Beginning of Year	2,611,076	2,611,076	2,611,076	-
Fund Balance, End of Year	\$ 2,784,032	\$2,784,032	\$3,004,612	\$ 220,580

CITY OF DESERT HOT SPRINGS

JUNE 30, 2003

NON-MAJOR GOVERNMENTAL FUNDS

Special Revenues Fund Descriptions

Housing and Community Development Fund

The Housing and Community Development Fund is used to account for Federal grants for Basics. Financing is provided for by a grant under the Emergency Jobs Act, and Federal Community Development Entitlements. Current year expenditures were made for park improvements.

Traffic Safety Fund

The Traffic Safety Fund is used to account for resources specifically designated for traffic safety. Financing is provided by vehicle code fines. Expenditures are for traffic safety purposes.

Source Reduction Recycling Fund

The Source Reduction Recycling Fund is used to account for disposal fees collected to be used for programs related to recycling mandated program AB-939.

Special Gas Tax Fund

The Special Gas Tax Fund is used to account for street maintenance activity funded by gas taxes. The financing source is the state gasoline tax and sales tax on gasoline. Expenditures are restricted to construction, improvement and maintenance of public streets.

T.U.M.F. Fund

The T.U.M.F. (Transportation Uniform Mitigation Fees) Fund is used to account for street improvements funded through a development fee. Funding is received based upon the City's need for street improvements. Expenditures are restricted to those cities in the Coachella Valley with arterial streets.

Municipal Lighting District Fund

The Municipal Lighting District Fund is used to account for street lighting activity. Financing is provided by an assessment against all parcels of real property within the City. Expenditures are for the costs of providing street and palm tree lights.

CITY OF DESERT HOT SPRINGS

JUNE 30, 2003

NON-MAJOR GOVERNMENTAL FUNDS (Continued)

Special Revenues Fund Descriptions (Continued)

Measure A Fund

The Measure A Fund is used to account for resources designated for street projects. Financing is provided by sales tax. Air Quality Control Fund

Air Quality Control

The Air Quality Control Fund is used to account for resources designated by South Coast Air Quality Management District.

Safe Routes to School Grant Fund

The Safety Routes to School Grant Fund is used to account for grants received, which are to be used to establish and administer a (SR2S) construction program and to use federal transportation funds for the construction of bicycle and pedestrian safety and traffic calming projects. The work is to be completed on West Drive.

State Transportation Improvement Grant Fund

The State Transportation Improvement Grant Fund is used to account for grants received, which are used for street improvements, unpaved and shoulder improvements. The City must provide a match when the grant funding is received by 11.47 percent of total grant. Match will come from Measure A Funds.

Law Enforcement Service Fund

The Supplemental Law Enforcement Service Fund is used to account for funds received in connection with the Citizens Option for Public Safety Program (COPS), which supplement expenditures for "front line municipal police services".

Abandoned Vehicle Reimbursement Fund

The City receives a portion of DMV registration fees from the Riverside County Abandoned Vehicle Abatement Service Authority as reimbursement to the City for costs it incurs for the administration, removal and abatement of nuisance vehicles within city limits.

Local Law Enforcement Block Grant Fund

The Local Law Enforcement Block Grant Fund is used to account for grants received, which are to be used to reduce crime and improve public safety.

CITY OF DESERT HOT SPRINGS

JUNE 30, 2003

NON-MAJOR GOVERNMENTAL FUNDS (Continued)

Special Revenues Fund Descriptions (Continued)

State Bicycle/Pedestrian Grants Fund

The State Bicycle/Pedestrian Grants Fund is used to account for grants received, which are used to complete sidewalks on Palm Drive near Skys Haven Mobile Home Park.

County Service Area

This fund receives money from property tax on parcels through County Assessment District #152 to meet EPA requirements for storm water monitoring.

Redevelopment Agency Low Income Housing Fund

The Redevelopment Agency Low Income Housing Fund is used to account for redevelopment funds set aside for development and improvement of low and moderate income housing. Twenty percent of the property tax increment from the redevelopment area is set aside for these funds. Expenditures are restricted to those that benefit the targeted areas.

Federal COPS Grant

To account for the transactions relating to the Federal COPS grant.

CMAQ ISTEA

To account for restricted funds for the ISTEA program.

Park and Recreation Grant

This fund is used to account for transactions related parks and recreation grant funding.

Citizens Option Program CLEEP

This fund was established to account for a new grant.

Traffic Congestion Relief

This fund was established to account for a new grant.

CITY OF DESERT HOT SPRINGS

JUNE 30, 2003

NON-MAJOR GOVERNMENTAL FUNDS (Continued)

Capital Project Funds

Assessment District 92-1

The Assessment District 92-1 Capital Project Fund is used to account for improvements to Assessment District 92-1 and is financed from bond proceeds. Liabilities will be paid from tax revenues.

Assessment District 93-2

The Assessment District 93-2 Capital Project Fund is used to account for improvements to Assessment District 93-2 and is financed from bond proceeds. Liabilities will be paid from tax revenues.

Assessment District 91-1 - Two Bunch Palms Trail

The Assessment District 91-1 Capital Project Fund is used to account for improvements to Assessment District 91-1 and is financed from bond proceeds. Liabilities will be paid from tax revenues.

Redevelopment Agency

The Redevelopment Agency Capital Project Fund is used to account for community improvements financed from bond proceeds. Liabilities will be paid from tax increment revenues.

CITY OF DESERT HOT SPRINGS

**NON-MAJOR GOVERNMENTAL FUNDS
COMBINING BALANCE SHEET
JUNE 30, 2003**

	Special Revenue Funds				
	Housing and Community Development	Traffic Safety	Source Reduction Recycling	Special Gas Tax	T.U.M.F.
ASSETS					
Cash and investments		\$ 13,304	\$ 5,963	\$ 107,964	\$ 39,845
Cash with fiscal agent					
Accounts receivable		3,561		35,049	794
Loan to General Fund					
Due from other funds					
Total Assets	\$ -	\$ 16,865	\$ 5,963	\$ 143,013	\$ 40,639
LIABILITIES AND FUND BALANCES					
LIABILITIES					
Accounts payable			245	6,595	12,717
Accrued liabilities				1,167	
Deposits payable					
Due to other funds					
Deferred revenue					
Total Liabilities	-	-	245	7,762	12,717
FUND BALANCES					
Reserved for:					
Encumbrances					
Loan to General Fund					
Special revenue funds		16,865	5,718	135,251	27,922
Capital projects funds					
Total Fund Balances	-	16,865	5,718	135,251	27,922
Total Liabilities					
and Fund Balances	\$ -	\$ 16,865	\$ 5,963	\$ 143,013	\$ 40,639

Special Revenue Funds						
Municipal Lighting District	Measure A	Air Quality Control	Safe Routes to School Grant	State Transportation Improvement Grant	Law Enforcement Service	Abandoned Vehicle Replacement
\$ 143,612	\$ 515,219	\$ 52,751			\$ 79,874	\$ 277
21,838		3,340				39,806
	3,933					
<u>\$ 165,450</u>	<u>\$ 519,152</u>	<u>\$ 56,091</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 79,874</u>	<u>\$ 40,083</u>
23,713	11,943	1,113			794	2,464
1,765	4,763					2,465
				\$ 3,933	76,099	22,000
<u>25,478</u>	<u>16,706</u>	<u>1,113</u>	<u>-</u>	<u>3,933</u>	<u>76,893</u>	<u>26,929</u>
						328
139,972	502,446	54,978		(3,933)	2,981	12,826
<u>139,972</u>	<u>502,446</u>	<u>54,978</u>	<u>-</u>	<u>(3,933)</u>	<u>2,981</u>	<u>13,154</u>
<u>\$ 165,450</u>	<u>\$ 519,152</u>	<u>\$ 56,091</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 79,874</u>	<u>\$ 40,083</u>

CITY OF DESERT HOT SPRINGS

**NON-MAJOR GOVERNMENTAL FUNDS
COMBINING BALANCE SHEET
JUNE 30, 2003**

	Special Revenue Funds			
	Local Law Enforcement Block Grant	State Bicycle/Pedestrian Grants	County Service Area	RDA Low Income Housing
ASSETS				
Cash and investments			\$ 206	\$ 939,986
Cash with fiscal agent				286,868
Accounts receivable				4,765
Loan to general fund				
Due from other funds				
Total Assets	\$ -	\$ -	\$ 206	\$ 1,231,619
LIABILITIES AND FUND BALANCES				
LIABILITIES				
Accounts payable				2,619
Accrued liabilities				
Deposits payable				
Due to other funds				
Deferred revenue				
Total Liabilities	-	-	-	2,619
FUND BALANCES				
Reserved for:				
Encumbrances				
Loan to General Fund				
Special revenue funds			206	1,229,000
Capital projects funds				
Total Fund Balances	-	-	206	1,229,000
Total Liabilities and Fund Balances	\$ -	\$ -	\$ 206	\$ 1,231,619

Special Revenue Funds					
Federal COPS Grant	CMAQ ISTEA	Parks and Recreation Grant	Citizens Option Program CLEEP	Traffic Congestion Relief	Sub-Total
	\$ 443	\$ 12,848		\$ 33,672	\$ 1,945,964
					286,868
				11,657	120,810
					3,933
<u>\$ -</u>	<u>\$ 443</u>	<u>\$ 12,848</u>	<u>\$ -</u>	<u>\$ 45,329</u>	<u>\$ 2,357,575</u>
	38				62,241
					10,160
					76,099
					25,933
		12,303			12,303
<u>-</u>	<u>38</u>	<u>12,303</u>	<u>-</u>	<u>-</u>	<u>186,736</u>
				21,475	21,803
	405	545		23,854	2,149,036
<u>-</u>	<u>405</u>	<u>545</u>	<u>-</u>	<u>45,329</u>	<u>2,170,839</u>
<u>\$ -</u>	<u>\$ 443</u>	<u>\$ 12,848</u>	<u>\$ -</u>	<u>\$ 45,329</u>	<u>\$ 2,357,575</u>

CITY OF DESERT HOT SPRINGS

**NON-MAJOR GOVERNMENTAL FUNDS
COMBINING BALANCE SHEET
JUNE 30, 2003**

	Capital Projects Funds		
	Assessment	Assessment	Assessment
	District	District	District
	92-1	93-2	91-1
ASSETS			
Cash and investments	\$ 8	\$ 4,119	\$ 89,551
Cash with fiscal agent	2	6,679	741
Accounts receivable			
Loan to general fund			
Due from other funds			
Total Assets	<u>\$ 10</u>	<u>\$ 10,798</u>	<u>\$ 90,292</u>
LIABILITIES AND FUND BALANCES			
LIABILITIES			
Accounts payable			
Accrued liabilities			
Deposits payable			
Due to other funds			
Deferred revenue			
Total Liabilities	<u>-</u>	<u>-</u>	<u>-</u>
FUND BALANCES			
Reserved for:			
Encumbrances			
Loan to General Fund			
Special revenue funds			
Capital projects funds	10	10,798	90,292
Total Fund Balances	<u>10</u>	<u>10,798</u>	<u>90,292</u>
Total Liabilities			
and Fund Balances	<u>\$ 10</u>	<u>\$ 10,798</u>	<u>\$ 90,292</u>

Capital Projects Funds		Total Non-Major Governmental Funds
RDA	Sub-Total	
\$ 3,174	\$ 96,852	\$ 2,042,816
241,981	249,403	536,271
9,608	9,608	130,418
249,720	249,720	249,720
		3,933
<u>\$ 504,483</u>	<u>\$ 605,583</u>	<u>\$ 2,963,158</u>

5,585	5,585	67,826
4,881	4,881	15,041
		76,099
442,617	442,617	468,550
		12,303
<u>453,083</u>	<u>453,083</u>	<u>639,819</u>

		21,803
249,720	249,720	249,720
		2,149,036
(198,320)	(97,220)	(97,220)
51,400	152,500	2,323,339
<u>\$ 504,483</u>	<u>\$ 605,583</u>	<u>\$ 2,963,158</u>

CITY OF DESERT HOT SPRINGS

**NON-MAJOR GOVERNMENTAL FUNDS
COMBINING STATEMENT OF REVENUES, EXPENDITURES AND
CHANGES IN FUND BALANCES
FOR THE YEAR ENDED JUNE 30, 2003**

	Special Revenue Funds				
	Housing and Community Development	Traffic Safety	Source Reduction Recycling	Special Gas Tax	T.U.M.F.
REVENUES					
Taxes					
Permits and fees		\$ 21,216			
Intergovernmental	\$ 34,907		\$ 9,512	\$ 359,908	\$ 278,731
Interest		515	76	1,687	800
Miscellaneous				4,673	
Total Revenues	34,907	21,731	9,588	366,268	279,531
EXPENDITURES					
Current:					
General government			8,396		
Public safety		15,132			
Public works				280,510	279,762
Parks and recreation					
Economic development	34,907				
Capital outlay				113,007	
Debt service:					
Principal				2,601	
Interest				1,940	
Total Expenditures	34,907	15,132	8,396	398,058	279,762
REVENUES OVER (UNDER) EXPENDITURES		6,599	1,192	(31,790)	(231)
OTHER FINANCING SOURCES (USES)					
Transfers in				108,338	
Transfers out		(22,904)			
Total Other Financing Sources (Uses)	-	(22,904)	-	108,338	-
REVENUES AND OTHER FINANCING SOURCES OVER (UNDER) EXPENDITURES					
Net Change in Fund Balances		(16,305)	1,192	76,548	(231)
Fund Balances (Deficit), Beginning of Year	-	33,170	4,526	58,703	28,153
Fund Balances (Deficit), End of Year	\$ -	\$ 16,865	\$ 5,718	\$ 135,251	\$ 27,922

Special Revenue Funds						
Municipal Lighting District	Measure A	Air Quality Control	Safe Routes to School Grant	State Transportation Improvement Grant	Law Enforcement Service	Abandoned Vehicle Replacement
\$ 379,717						
	\$ 241,374	\$ 17,758	\$ 134,240		\$ 89,999	\$ 300
2,046	9,166	782	612		1,189	89,462
4,583						281
						560
386,346	250,540	18,540	134,852	-	91,188	90,603
		6,004	11,462		90,864	138,440
425,880	182,758			\$ 3,933		
	211,274		123,515			
425,880	394,032	6,004	134,977	3,933	90,864	138,440
(39,534)	(143,492)	12,536	(125)	(3,933)	324	(47,837)
	89,554					
-	89,554	-	-	-	-	-
(39,534)	(53,938)	12,536	(125)	(3,933)	324	(47,837)
179,506	556,384	42,442	125	-	2,657	60,991
\$ 139,972	\$ 502,446	\$ 54,978	\$ -	\$ (3,933)	\$ 2,981	\$ 13,154

CITY OF DESERT HOT SPRINGS

**NON-MAJOR GOVERNMENTAL FUNDS
COMBINING STATEMENT OF REVENUES, EXPENDITURES AND
CHANGES IN FUND BALANCES
FOR THE YEAR ENDED JUNE 30, 2003**

	Special Revenue Funds			
	Local Law Enforcement Block Grant	State Bicycle/Pedestrian Grants	County Service Area	RDA Low Income Housing
REVENUES				
Taxes				\$ 291,215
Permits and fees				
Intergovernmental	\$ 62,194		\$ 1,500	
Interest	121			24,862
Miscellaneous				5,839
Total Revenues	62,315	-	1,500	321,916
EXPENDITURES				
Current:				
General government			1,500	
Public safety	26,539			
Public works				
Parks and recreation				
Economic development				57,691
Capital outlay	35,776			
Debt service:				
Principal				
Interest				
Total Expenditures	62,315	-	1,500	57,691
REVENUES OVER (UNDER) EXPENDITURES				264,225
OTHER FINANCING SOURCES (USES)				
Transfers in				
Transfers out				(159,000)
Total Other Financing Sources (Uses)	-	-	-	(159,000)
REVENUES AND OTHER FINANCING SOURCES OVER (UNDER) EXPENDITURES				
Net Change in Fund Balances				105,225
Fund Balances (Deficit), Beginning of Year	-	-	206	1,123,775
Fund Balances (Deficit), End of Year	\$ -	\$ -	\$ 206	\$ 1,229,000

Special Revenue Funds					
Federal COPS Grant	CMAQ ISTEA	Parks and Recreation Grant	Citizens Option Program CLEEP	Traffic Congestion Relief	Sub-Total
					\$ 670,932
					21,516
		\$ 1,797	\$ 44,771	\$ 76,237	1,442,390
	\$ 7				42,144
	2,479				18,134
-	2,486	1,797	44,771	76,237	2,195,116
					165,802
					132,535
			23,350	10,711	1,206,904
		1,252			1,252
					92,598
			21,421	20,197	525,190
					2,601
					1,940
-	-	1,252	44,771	30,908	2,128,822
	2,486	545		45,329	66,294
					197,892
					(181,904)
-	-	-	-	-	15,988
	2,486	545		45,329	82,282
-	(2,081)	-	-	-	2,088,557
\$ -	\$ 405	\$ 545	\$ -	\$ 45,329	\$ 2,170,839

CITY OF DESERT HOT SPRINGS

**NON-MAJOR GOVERNMENTAL FUNDS
COMBINING STATEMENT OF REVENUES, EXPENDITURES AND
CHANGES IN FUND BALANCES
FOR THE YEAR ENDED JUNE 30, 2003**

	Capital Project Funds		
	Assessment District 92-1	Assessment District 93-2	Assessment District 91-1
REVENUES			
Taxes			
Permits and fees			
Intergovernmental			
Interest		\$ 161	\$ 2,014
Miscellaneous			
Total Revenues	-	161	2,014
EXPENDITURES			
Current:			
General government			
Public safety			
Public works			
Parks and recreation			
Economic development			
Capital outlay			
Debt service:			
Principal			
Interest			
Total Expenditures	-	-	-
REVENUES OVER (UNDER) EXPENDITURES		161	2,014
OTHER FINANCING SOURCES (USES)			
Transfers in			
Transfers out			
Total Other Financing Sources (Uses)	-	-	-
REVENUES AND OTHER FINANCING SOURCES OVER (UNDER) EXPENDITURES			
Net Change in Fund Balances		161	2,014
Fund Balances (Deficit), Beginning of Year	\$ 10	10,637	88,278
Fund Balances (Deficit), End of Year	\$ 10	\$ 10,798	\$ 90,292

Capital Project Funds		Total Non-Major Governmental Funds
RDA	Sub-Total	
		\$ 670,932
		21,516
		1,442,390
\$ 12,573	\$ 14,748	56,892
8,824	8,824	26,958
21,397	23,572	2,218,688
		165,802
		132,535
		1,206,904
		1,252
556,211	556,211	648,809
		525,190
		2,601
		1,940
556,211	556,211	2,685,033
(534,814)	(532,639)	(466,345)
32,812	32,812	230,704
		(181,904)
32,812	32,812	48,800
(502,002)	(499,827)	(417,545)
553,402	652,327	2,740,884
\$ 51,400	\$ 152,500	\$ 2,323,339

CITY OF DESERT HOT SPRINGS

**SCHEDULE OF REVENUES, EXPENDITURES AND
CHANGES IN FUND BALANCE - BUDGET AND ACTUAL
HOUSING AND COMMUNITY DEVELOPMENT SPECIAL REVENUE FUND
FOR THE YEAR ENDED JUNE 30, 2003**

	Budgeted Amounts		Actual	Variance with Final Budget - Positive (Negative)
	Original	Final	Amounts	
REVENUES				
Intergovernmental	\$ 323,870	\$ 323,870	\$ 34,907	\$ (288,963)
Total Revenues	323,870	323,870	34,907	(288,963)
EXPENDITURES				
Capital outlay	226,870	226,870		226,870
Debt service:				
Economic development	97,000	97,000	34,907	62,093
Total Expenditures	323,870	323,870	34,907	288,963
Net Change in Fund Balance	-	-	-	-
Fund Balance, Beginning of Year	-	-	-	-
Fund Balance, End of Year	\$ -	\$ -	\$ -	\$ -

CITY OF DESERT HOT SPRINGS

**SCHEDULE OF REVENUES, EXPENDITURES AND
CHANGES IN FUND BALANCE - BUDGET AND ACTUAL
TRAFFIC SAFETY SPECIAL REVENUE FUND
FOR THE YEAR ENDED JUNE 30, 2003**

	Budgeted Amounts		Actual	Variance with Final Budget - Positive (Negative)
	Original	Final	Amounts	
REVENUES				
Permits and fees	\$ 12,000	\$ 12,000	\$ 21,216	\$ 9,216
Interest	1,400	1,400	515	(885)
Total Revenues	13,400	13,400	21,731	8,331
EXPENDITURES				
Current:				
Public safety	17,277	17,457	15,132	2,325
Capital outlay		7,354		7,354
Total Expenditures	17,277	24,811	15,132	9,679
REVENUES OVER (UNDER) EXPENDITURES	(3,877)	(11,411)	6,599	18,010
OTHER FINANCING SOURCES (USES)				
Transfers out	(22,904)	(22,904)	(22,904)	
Total Other Financing Uses	(22,904)	(22,904)	(22,904)	-
Net Change in Fund Balance	(26,781)	(34,315)	(16,305)	18,010
Fund Balance, Beginning of Year	33,170	33,170	33,170	-
Fund Balance, End of Year	\$ 6,389	\$ (1,145)	\$ 16,865	\$ 18,010

CITY OF DESERT HOT SPRINGS

**SCHEDULE OF REVENUES, EXPENDITURES AND
CHANGES IN FUND BALANCE - BUDGET AND ACTUAL
SOURCE REDUCTION RECYCLING SPECIAL REVENUE FUND
FOR THE YEAR ENDED JUNE 30, 2003**

	Budgeted Amounts		Actual	Variance with Final Budget - Positive (Negative)
	Original	Final	Amounts	
REVENUES				
Intergovernmental	\$ 10,000	\$ 10,000	\$ 9,512	\$ (488)
Interest	325	325	76	(249)
Total Revenues	10,325	10,325	9,588	(737)
EXPENDITURES				
Current:				
General government	6,900	8,396	8,396	-
Total Expenditures	6,900	8,396	8,396	-
Net Change in Fund Balance	3,425	1,929	1,192	(737)
Fund Balance, Beginning of Year	4,526	4,526	4,526	-
Fund Balance, End of Year	\$ 7,951	\$ 6,455	\$ 5,718	\$ (737)

CITY OF DESERT HOT SPRINGS

**SCHEDULE OF REVENUES, EXPENDITURES AND
CHANGES IN FUND BALANCE - BUDGET AND ACTUAL
SPECIAL GAS TAX SPECIAL REVENUE FUND
FOR THE YEAR ENDED JUNE 30, 2003**

	Budgeted Amounts		Actual	Variance with Final Budget - Positive (Negative)
	Original	Final	Amounts	
REVENUES				
Intergovernmental	\$ 318,155	\$ 318,155	\$ 359,908	\$ 41,753
Interest	4,500	4,500	1,687	(2,813)
Miscellaneous	8,500	8,500	4,673	(3,827)
Total Revenues	331,155	331,155	366,268	35,113
EXPENDITURES				
Current:				
Public works	300,164	326,101	280,510	45,591
Capital outlay	128,338	111,338	113,007	(1,669)
Debt service:				
Principal	11,000	11,000	2,601	8,399
Interest	5,700	6,450	1,940	4,510
Total Expenditures	445,202	454,889	398,058	56,831
REVENUES OVER EXPENDITURES	(114,047)	(123,734)	(31,790)	91,944
OTHER FINANCING USES				
Transfers in	108,338	108,338	108,338	-
Total Other Financing Uses	108,338	108,338	108,338	-
Net Change in Fund Balance	(5,709)	(15,396)	76,548	91,944
Fund Balance, Beginning of Year	58,703	58,703	58,703	-
Fund Balance, End of Year	\$ 52,994	\$ 43,307	\$ 135,251	\$ 91,944

CITY OF DESERT HOT SPRINGS

**SCHEDULE OF REVENUES, EXPENDITURES AND
CHANGES IN FUND BALANCE - BUDGET AND ACTUAL
TUMF SPECIAL REVENUE FUND
FOR THE YEAR ENDED JUNE 30, 2003**

	Budgeted Amounts		Actual	Variance with Final Budget - Positive (Negative)
	Original	Final	Amounts	
REVENUES				
Intergovernmental	\$ 55,000	\$ 55,000	\$ 278,731	\$ 223,731
Interest	2,200	2,200	800	(1,400)
Total Revenues	57,200	57,200	279,531	222,331
EXPENDITURES				
Current:				
Public works	55,000	55,000	279,762	(224,762)
Total Expenditures	55,000	55,000	279,762	(224,762)
Net Change in Fund Balance	2,200	2,200	(231)	(2,431)
Fund Balance, Beginning of Year	28,153	28,153	28,153	-
Fund Balance, End of Year	\$ 30,353	\$ 30,353	\$ 27,922	\$ (2,431)

CITY OF DESERT HOT SPRINGS

**SCHEDULE OF REVENUES, EXPENDITURES AND
CHANGES IN FUND BALANCE - BUDGET AND ACTUAL
MUNICIPAL LIGHTING DISTRICT SPECIAL REVENUE FUND
FOR THE YEAR ENDED JUNE 30, 2003**

	Budgeted Amounts		Actual	Variance with Final Budget - Positive (Negative)
	Original	Final	Amounts	
REVENUES				
Taxes	\$ 410,000	\$ 410,000	\$ 379,717	\$ (30,283)
Interest	2,565	2,565	2,046	(519)
Miscellaneous	6,500	6,500	4,583	(1,917)
Total Revenues	419,065	419,065	386,346	(32,719)
EXPENDITURES				
Current:				
Public works	436,057	435,465	425,880	9,585
Total Expenditures	436,057	435,465	425,880	9,585
Net Change in Fund Balance	(16,992)	(16,400)	(39,534)	(23,134)
Fund Balance, Beginning of Year	179,506	179,506	179,506	-
Fund Balance, End of Year	\$ 162,514	\$ 163,106	\$ 139,972	\$ (23,134)

CITY OF DESERT HOT SPRINGS

**SCHEDULE OF REVENUES, EXPENDITURES AND
CHANGES IN FUND BALANCE - BUDGET AND ACTUAL
MEASURE A SPECIAL REVENUE FUND
FOR THE YEAR ENDED JUNE 30, 2003**

	Budgeted Amounts		Actual	Variance with Final Budget - Positive (Negative)
	Original	Final	Amounts	
REVENUES				
Intergovernmental	\$ 228,000	\$ 228,000	\$ 241,374	\$ 13,374
Interest	18,000	18,000	9,166	(8,834)
Total Revenues	246,000	246,000	250,540	4,540
EXPENDITURES				
Current:				
Public works	154,851	185,211	182,758	2,453
Capital outlay	530,371	484,736	211,274	273,462
Total Expenditures	685,222	669,947	394,032	275,915
REVENUES OVER (UNDER) EXPENDITURES	(439,222)	(423,947)	(143,492)	280,455
OTHER FINANCING SOURCES (USES)				
Transfers in	17,920	89,554	89,554	-
Transfers out	(228,755)	(228,755)		228,755
Total Other Financing Sources (Uses)	(210,835)	(139,201)	89,554	228,755
Net Change in Fund Balance	(650,057)	(563,148)	(53,938)	509,210
Fund Balance, Beginning of Year	556,384	556,384	556,384	-
Fund Balance, End of Year	\$ (93,673)	\$ (6,764)	\$ 502,446	\$ 509,210

CITY OF DESERT HOT SPRINGS

**SCHEDULE OF REVENUES, EXPENDITURES AND
CHANGES IN FUND BALANCE - BUDGET AND ACTUAL
AIR QUALITY CONTROL SPECIAL REVENUE FUND
FOR THE YEAR ENDED JUNE 30, 2003**

	Budgeted Amounts		Actual	Variance with
	Original	Final	Amounts	Final Budget - Positive (Negative)
REVENUES				
Intergovernmental	\$ 17,400	\$ 17,400	\$ 17,758	\$ 358
Interest	900	900	782	(118)
Total Revenues	18,300	18,300	18,540	240
EXPENDITURES				
Current:				
General government	6,500	6,500	6,004	496
Total Expenditures	6,500	6,500	6,004	496
Net Change in Fund Balance	11,800	11,800	12,536	736
Fund Balance, Beginning of Year	42,442	42,442	42,442	-
Fund Balance, End of Year	\$ 54,242	\$ 54,242	\$ 54,978	\$ 736

CITY OF DESERT HOT SPRINGS

**SCHEDULE OF REVENUES, EXPENDITURES AND
CHANGES IN FUND BALANCE - BUDGET AND ACTUAL
SAFE ROUTES TO SCHOOL GRANT SPECIAL REVENUE FUND
FOR THE YEAR ENDED JUNE 30, 2003**

	Budgeted Amounts		Actual	Variance with
	Original	Final	Amounts	Final Budget - Positive (Negative)
REVENUES				
Intergovernmental	\$ 32,021	\$ 32,021	\$ 134,240	\$ 102,219
Interest			612	612
Total Revenues	32,021	32,021	134,852	102,831
EXPENDITURES				
Current:				
General government	2,279	54,895	11,462	43,433
Capital outlay	29,742	217,043	123,515	93,528
Total Expenditures	32,021	271,938	134,977	136,961
Net Change in Fund Balance	-	(239,917)	(125)	239,792
Fund Balance, Beginning of Year	125	125	125	-
Fund Balance, End of Year	\$ 125	\$ (239,792)	\$ -	\$ 239,792

CITY OF DESERT HOT SPRINGS

**SCHEDULE OF REVENUES, EXPENDITURES AND
CHANGES IN FUND BALANCE - BUDGET AND ACTUAL
STATE TRANSPORTATION IMPROVEMENT GRANT SPECIAL REVENUE FUND
FOR THE YEAR ENDED JUNE 30, 2003**

	Budgeted Amounts		Actual Amounts	Variance with Final Budget - Positive (Negative)
	Original	Final		
REVENUES				
Intergovernmental	\$ 637,500	\$ 637,500		\$ (637,500)
Total Revenues	637,500	637,500	-	(637,500)
EXPENDITURES				
Current:				
Public works	149,721	149,721	\$ 3,933	145,788
Capital outlay	656,625	656,625		656,625
Total Expenditures	806,346	806,346	3,933	802,413
REVENUES UNDER EXPENDITURES	(168,846)	(168,846)	(3,933)	164,913
OTHER FINANCING SOURCES				
Transfers in	201,748	201,748		(201,748)
Total Other Financing Sources	201,748	201,748	-	(201,748)
Net Change in Fund Balance	32,902	32,902	(3,933)	(36,835)
Fund Balance, Beginning of Year	-	-	-	-
Fund Balance, End of Year	\$ 32,902	\$ 32,902	\$ (3,933)	\$ (36,835)

CITY OF DESERT HOT SPRINGS

**SCHEDULE OF REVENUES, EXPENDITURES AND
CHANGES IN FUND BALANCE - BUDGET AND ACTUAL
LAW ENFORCEMENT SERVICE SPECIAL REVENUE FUND
FOR THE YEAR ENDED JUNE 30, 2003**

	Budgeted Amounts		Actual	Variance with Final Budget - Positive (Negative)
	Original	Final	Amounts	
REVENUES				
Intergovernmental	\$ 45,000	\$ 45,000	\$ 89,999	\$ 44,999
Interest	20,000	20,000	1,189	(18,811)
Total Revenues	65,000	65,000	91,188	26,188
EXPENDITURES				
Current:				
Public safety	273,519	174,176	90,864	83,312
Total Expenditures	273,519	174,176	90,864	83,312
Net Change in Fund Balance	(208,519)	(109,176)	324	109,500
Fund Balance, Beginning of Year	2,657	2,657	2,657	-
Fund Balance, End of Year	\$ (205,862)	\$ (106,519)	\$ 2,981	\$ 109,500

CITY OF DESERT HOT SPRINGS

**SCHEDULE OF REVENUES, EXPENDITURES AND
CHANGES IN FUND BALANCE - BUDGET AND ACTUAL
ABANDONED VEHICLE REPLACEMENT SPECIAL REVENUE FUND
FOR THE YEAR ENDED JUNE 30, 2003**

	Budgeted Amounts		Actual	Variance with Final Budget - Positive (Negative)
	Original	Final	Amounts	
REVENUES				
Permits and fees			\$ 300	\$ 300
Intergovernmental	\$ 65,000	\$ 65,000	89,462	24,462
Interest	2,600	2,600	281	(2,319)
Miscellaneous			560	560
Total Revenues	67,600	67,600	90,603	23,003
EXPENDITURES				
Current:				
General government	151,948	141,514	138,440	3,074
Total Expenditures	151,948	141,514	138,440	3,074
Net Change in Fund Balance	(84,348)	(73,914)	(47,837)	26,077
Fund Balance, Beginning of Year	60,991	60,991	60,991	-
Fund Balance, End of Year	<u>\$ (23,357)</u>	<u>\$ (12,923)</u>	<u>\$ 13,154</u>	<u>\$ 26,077</u>

CITY OF DESERT HOT SPRINGS

**SCHEDULE OF REVENUES, EXPENDITURES AND
CHANGES IN FUND BALANCE - BUDGET AND ACTUAL
LOCAL LAW ENFORCEMENT BLOCK GRANT SPECIAL REVENUE FUND
FOR THE YEAR ENDED JUNE 30, 2003**

	Budgeted Amounts		Actual	Variance with Final Budget - Positive (Negative)
	Original	Final	Amounts	
REVENUES				
Intergovernmental	\$ 76,000	\$ 76,000	\$ 62,194	\$ (13,806)
Interest	4,500	4,500	121	(4,379)
Total Revenues	80,500	80,500	62,315	(18,185)
EXPENDITURES				
Current:				
Public safety	39,792	39,792	26,539	13,253
Capital outlay	68,708	68,708	35,776	32,932
Total Expenditures	108,500	108,500	62,315	46,185
Net Change in Fund Balance	(28,000)	(28,000)		28,000
Fund Balance, Beginning of Year	-	-	-	-
Fund Balance, End of Year	\$ (28,000)	\$ (28,000)	\$ -	\$ 28,000

CITY OF DESERT HOT SPRINGS

**SCHEDULE OF REVENUES, EXPENDITURES AND
CHANGES IN FUND BALANCE - BUDGET AND ACTUAL
STATE BICYCLE/PEDESTRIAN GRANTS SPECIAL REVENUE FUND
FOR THE YEAR ENDED JUNE 30, 2003**

	Budgeted Amounts		Actual	Variance with
	Original	Final	Amounts	Final Budget - Positive (Negative)
REVENUES				
Intergovernmental	\$ 32,542	\$ 32,542		\$ (32,542)
Total Revenues	32,542	32,542	-	(32,542)
EXPENDITURES				
Current:				
General government	5,650	5,650		5,650
Capital outlay	26,892	26,892		26,892
Total Expenditures	32,542	32,542	-	32,542
Net Change in Fund Balance				
Fund Balance, Beginning of Year	-	-	-	-
Fund Deficit, End of Year	\$ -	\$ -	\$ -	\$ -

CITY OF DESERT HOT SPRINGS

**SCHEDULE OF REVENUES, EXPENDITURES AND
CHANGES IN FUND BALANCE - BUDGET AND ACTUAL
COUNTY SERVICE AREA SPECIAL REVENUE FUND
FOR THE YEAR ENDED JUNE 30, 2003**

	Budgeted Amounts		Actual	Variance with
	Original	Final	Amounts	Final Budget - Positive (Negative)
REVENUES				
Intergovernmental	\$ 11,000	\$ 11,000	\$ 1,500	\$ (9,500)
Total Revenues	11,000	11,000	1,500	(9,500)
EXPENDITURES				
Current:				
General government	2,050	3,100	1,500	1,600
Total Expenditures	2,050	3,100	1,500	1,600
Net Change in Fund Balance	8,950	7,900		(7,900)
Fund Balance, Beginning of Year	206	206	206	-
Fund Balance, End of Year	\$ 9,156	\$ 8,106	\$ 206	\$ (7,900)

CITY OF DESERT HOT SPRINGS

**SCHEDULE OF REVENUES, EXPENDITURES AND
CHANGES IN FUND BALANCE - BUDGET AND ACTUAL
RDA LOW INCOME HOUSING SPECIAL REVENUE FUND
FOR THE YEAR ENDED JUNE 30, 2003**

	Budgeted Amounts		Actual	Variance with Final Budget - Positive (Negative)
	Original	Final	Amounts	
REVENUES				
Taxes	\$ 203,000	\$ 203,000	\$ 291,215	\$ 88,215
Interest	46,300	46,300	24,862	(21,438)
Miscellaneous			5,839	5,839
Total Revenues	249,300	249,300	321,916	72,616
EXPENDITURES				
Current:				
Economic development	581,599	581,725	57,691	524,034
Total Expenditures	581,599	581,725	57,691	524,034
REVENUES OVER (UNDER) EXPENDITURES	(332,299)	(332,425)	264,225	596,650
OTHER FINANCING USES				
Transfers out	(159,000)	(159,000)	(159,000)	-
Total Other Financing Uses	(159,000)	(159,000)	(159,000)	-
Net Change in Fund Balance	(491,299)	(491,425)	105,225	596,650
Fund Balance, Beginning of Year	1,123,775	1,123,775	1,123,775	-
Fund Balance, End of Year	\$ 632,476	\$ 632,350	\$ 1,229,000	\$ 596,650

CITY OF DESERT HOT SPRINGS

**SCHEDULE OF REVENUES, EXPENDITURES AND
CHANGES IN FUND BALANCE - BUDGET AND ACTUAL
FEDERAL COPS GRANT SPECIAL REVENUE FUND
FOR THE YEAR ENDED JUNE 30, 2003**

	Budgeted Amounts		Actual	Variance with
	Original	Final	Amounts	Final Budget - Positive (Negative)
REVENUES				
Intergovernmental	\$ 19,371	\$ 19,371		\$ (19,371)
Total Revenues	19,371	19,371	-	(19,371)
EXPENDITURES				
Current:				
General government	19,371	19,371		19,371
Total Expenditures	19,371	19,371	-	19,371
Net Change in Fund Balance	-	-	-	-
Fund Balance, Beginning of Year	-	-	-	-
Fund Balance, End of Year	\$ -	\$ -	\$ -	\$ -

CITY OF DESERT HOT SPRINGS

**SCHEDULE OF REVENUES, EXPENDITURES AND
CHANGES IN FUND BALANCE - BUDGET AND ACTUAL
CMAQ ISTE A SPECIAL REVENUE FUND
FOR THE YEAR ENDED JUNE 30, 2003**

	Budgeted Amounts		Actual	Variance with Final Budget - Positive (Negative)
	Original	Final	Amounts	
REVENUES				
Intergovernmental	\$ 320,354	\$ 335,402		\$ (335,402)
Interest	11,617	11,617	\$ 7	(11,610)
Miscellaneous			2,479	2,479
Total Revenues	331,971	347,019	2,486	(344,533)
EXPENDITURES				
Current:				
General government	370,890	335,402		335,402
Total Expenditures	370,890	335,402	-	335,402
REVENUES OVER EXPENDITURES	(38,919)	11,617	2,486	(9,131)
OTHER FINANCING SOURCES				
Transfers in	38,919	38,919		(38,919)
Total Other Financing Sources	38,919	38,919	-	(38,919)
Net Change in Fund Balance		50,536	2,486	(48,050)
Fund Deficit, Beginning of Year	(2,081)	(2,081)	(2,081)	-
Fund Balance, End of Year	\$ (2,081)	\$ 48,455	\$ 405	\$ (48,050)

CITY OF DESERT HOT SPRINGS

**SCHEDULE OF REVENUES, EXPENDITURES AND
CHANGES IN FUND BALANCE - BUDGET AND ACTUAL
PARKS AND RECREATION GRANT SPECIAL REVENUE FUND
FOR THE YEAR ENDED JUNE 30, 2003**

	Budgeted Amounts		Actual	Variance with Final Budget - Positive (Negative)
	Original	Final	Amounts	
REVENUES				
Intergovernmental	\$ 141,000	\$ 141,000	\$ 1,797	\$ (139,203)
Total Revenues	141,000	141,000	1,797	(139,203)
EXPENDITURES				
Current:				
Parks and recreation	10,000	10,000	1,252	8,748
Capital outlay	146,000	146,000		146,000
Total Expenditures	156,000	156,000	1,252	154,748
REVENUES UNDER EXPENDITURES	(15,000)	(15,000)	545	15,545
Net Change in Fund Balance	(15,000)	(15,000)	545	15,545
Beginning of Year	-	-	-	-
Fund Balance, End of Year	\$ (15,000)	\$ (15,000)	\$ 545	\$ 15,545

CITY OF DESERT HOT SPRINGS

**SCHEDULE OF REVENUES, EXPENDITURES AND
CHANGES IN FUND BALANCE - BUDGET AND ACTUAL
CITIZENS OPTION PROGRAM CLEEP SPECIAL REVENUE FUND
FOR THE YEAR ENDED JUNE 30, 2003**

	Budgeted Amounts		Actual	Variance with Final Budget - Positive (Negative)
	Original	Final	Amounts	
REVENUES				
Intergovernmental	\$ 35,000	\$ 35,000	\$ 44,771	\$ 9,771
Interest	3,500	3,500		(3,500)
Total Revenues	38,500	38,500	44,771	6,271
EXPENDITURES				
Current:				
Public works	22,000	23,402	23,350	52
Capital outlay	13,000	22,644	21,421	1,223
Total Expenditures	35,000	46,046	44,771	1,275
Net Change in Fund Balance	3,500	(7,546)	-	7,546
Fund Balance, Beginning of Year	-	-	-	-
Fund Balance, End of Year	\$ 3,500	\$ (7,546)	\$ -	\$ 7,546

CITY OF DESERT HOT SPRINGS

**SCHEDULE OF REVENUES, EXPENDITURES AND
CHANGES IN FUND BALANCE - BUDGET AND ACTUAL
TRAFFIC CONGESTION RELIEF SPECIAL REVENUE FUND
FOR THE YEAR ENDED JUNE 30, 2003**

	Budgeted Amounts		Actual	Variance with Final Budget - Positive (Negative)
	Original	Final	Amounts	
REVENUES				
Intergovernmental	\$ 60,000	\$ 60,000	\$ 76,237	\$ 16,237
Interest	2,000	2,000		(2,000)
Total Revenues	62,000	62,000	76,237	14,237
EXPENDITURES				
Current:				
Public works		15,000	10,711	4,289
Capital outlay	116,000	101,000	20,197	80,803
Total Expenditures	116,000	116,000	30,908	85,092
Net Change in Fund Balance	(54,000)	(54,000)	45,329	99,329
Fund Balance, Beginning of Year	-	-	-	-
Fund Deficit, End of Year	\$ (54,000)	\$ (54,000)	\$ 45,329	\$ 99,329

CITY OF DESERT HOT SPRINGS

**SCHEDULE OF REVENUES, EXPENDITURES AND
CHANGES IN FUND BALANCE - BUDGET AND ACTUAL
ASSESSMENT DISTRICT 93-2 CAPITAL PROJECT FUND
FOR THE YEAR ENDED JUNE 30, 2003**

	Budgeted Amounts		Actual	Variance with Final Budget - Positive (Negative)
	Original	Final	Amounts	
REVENUES				
Interest	\$ 335	\$ 335	\$ 161	\$ (174)
Total Revenues	335	335	161	(174)
Net Change in Fund Balance	335	335	161	(174)
Fund Balance, Beginning of Year	10,637	10,637	10,637	-
Fund Balance, End of Year	<u>\$ 10,972</u>	<u>\$ 10,972</u>	<u>\$ 10,798</u>	<u>\$ (174)</u>

CITY OF DESERT HOT SPRINGS

**SCHEDULE OF REVENUES, EXPENDITURES AND
CHANGES IN FUND BALANCES - BUDGET AND ACTUAL
ASSESSMENT DISTRICT 91-1 CAPITAL PROJECT FUND
FOR THE YEAR ENDED JUNE 30, 2003**

	Budgeted Amounts		Actual	Variance with Final Budget - Positive (Negative)
	Original	Final	Amounts	
REVENUES				
Interest	\$ 3,000	\$ 3,000	\$ 2,014	\$ (986)
Total Revenues	3,000	3,000	2,014	(986)
Net Change in Fund Balance	3,000	3,000	2,014	(986)
Fund Balance, Beginning of Year	88,278	88,278	88,278	-
Fund Balance, End of Year	<u>\$ 91,278</u>	<u>\$ 91,278</u>	<u>\$ 90,292</u>	<u>\$ (986)</u>

CITY OF DESERT HOT SPRINGS

**SCHEDULE OF REVENUES, EXPENDITURES AND
CHANGES IN FUND BALANCES - BUDGET AND ACTUAL
RDA CAPITAL PROJECTS FUND
FOR THE YEAR ENDED JUNE 30, 2003**

	Budgeted Amounts		Actual	Variance with Final Budget - Positive (Negative)
	Original	Final	Amounts	
REVENUES				
Intergovernmental	\$ 75,000	\$ 75,000		\$ (75,000)
Interest	67,000	67,000	\$ 12,573	(54,427)
Miscellaneous			8,824	8,824
Total Revenues	142,000	142,000	21,397	(120,603)
EXPENDITURES				
Debt service:				
Economic development	574,644	527,747	556,211	(28,464)
Total Expenditures	574,644	527,747	556,211	(28,464)
REVENUES UNDER EXPENDITURES	(432,644)	(385,747)	(534,814)	(149,067)
OTHER FINANCING USES				
Transfers in		10,000	32,812	22,812
Total Other Financing Uses	-	10,000	32,812	22,812
Net Change in Fund Balance	(432,644)	(375,747)	(502,002)	(126,255)
Fund Balance, Beginning of Year	553,402	553,402	553,402	-
Fund Balance, End of Year	\$ 120,758	\$ 177,655	\$ 51,400	\$ (126,255)

CITY OF DESERT HOT SPRINGS

AGENCY FUNDS - FIDUCIARY FUNDS DESCRIPTION

JUNE 30, 2003

Employee Pension Plan Fund

The Employee Pension Plan Fund is used to account for the accumulation of resources for employee retirement payments. The retirement system is a defined contribution plan. City contributions to the plan are established by the Council; employee contributions are optional. Administrative costs of the plan are borne by the General Fund.

Community Services

The Community Services Fund is used to account for donations received for various community programs. The monies are held in a bank account until used for the designated purpose. The Community Services Fund is also used to account for collections made at Cabot Museum.

Assessment District 91-1 - Two Bunch Palms Trail

The Assessment District 91-1 Debt Service Fund is used to account for payments of principal and interest for Assessment District 91-1 municipal bonds.

Assessment District 92-1

The Assessment District 92-1 Debt Service Fund is used to account for payments of principal and interest for Assessment District municipal bonds.

Assessment District 93-2

The Assessment District 93-2 Debt Service Fund is used to account for payments of principal and interest for Assessment District municipal bonds.

(THIS PAGE INTENTIONALLY LEFT BLANK)

CITY OF DESERT HOT SPRINGS

AGENCY FUNDS

COMBINING STATEMENT OF NET ASSETS

JUNE 30, 2003

	Employee Pension Plan	Community Services	Assessment District 91-1	Assessment District 92-1
ASSETS				
Cash and investments	\$ 473,476	\$ 38,942	\$ 41,117	\$ 40,243
Cash with fiscal agent			35,182	15,640
Receivables		495	3,014	2,867
Total Assets	<u>\$ 473,476</u>	<u>\$ 39,437</u>	<u>\$ 79,313</u>	<u>\$ 58,750</u>
LIABILITIES				
Accounts payable		1,169	33	9,376
Due to other funds		3,709		
Deposits payable		34,559		
Pension payable	473,476			
Due to bondholders			79,280	49,374
Total Liabilities	<u>\$ 473,476</u>	<u>\$ 39,437</u>	<u>\$ 79,313</u>	<u>\$ 58,750</u>

Assessment District 93-2	Total Agency Funds
\$ 51,877	\$ 645,655
83,161	133,983
3,734	10,110
<u>\$ 138,772</u>	<u>\$ 789,748</u>

5,205	15,783
	3,709
	34,559
	473,476
<u>133,567</u>	<u>262,221</u>
<u>\$ 138,772</u>	<u>\$ 789,748</u>

CITY OF DESERT HOT SPRINGS

**COMBINING STATEMENT OF CHANGES IN ASSETS AND LIABILITIES
AGENCY FUNDS
FOR THE YEAR ENDED JUNE 30, 2003**

	Balance June 30, 2002	Net Additions	Net Deletions	Balance June 30, 2003
<u>PENSION PLAN</u>				
ASSETS				
Investments	\$ 471,000	\$ 2,476	\$ -	\$ 473,476
LIABILITIES				
Pension payable	\$ 471,000	\$ 2,476	\$ -	\$ 473,476
<u>COMMUNITY SERVICES</u>				
ASSETS				
Cash and investments	\$ 65,885		\$ 26,943	\$ 38,942
Receivables	950		455	495
Total Assets	\$ 66,835	\$ -	\$ 27,398	\$ 39,437
LIABILITIES				
Accounts payable	\$ 11,625		\$ 10,456	\$ 1,169
Due to other funds	3,709			3,709
Accrued liabilities	1,821		1,821	
Deposits payable	49,680		15,121	34,559
Total Liabilities	\$ 66,835	\$ -	\$ 27,398	\$ 39,437
<u>ASSESSMENT DISTRICT 91-1</u>				
ASSETS				
Cash and investments	\$ 37,693	\$ 3,424		\$ 41,117
Cash with fiscal agent	35,143	39		35,182
Receivables	3,121		\$ 107	3,014
Total Assets	\$ 75,957	\$ 3,463	\$ 107	\$ 79,313
LIABILITIES				
Accounts payable	\$ 790		\$ 757	\$ 33
Due to bondholders	75,167	\$ 4,113		79,280
Total Liabilities	\$ 75,957	\$ 4,113	\$ 757	\$ 79,313
<u>ASSESSMENT DISTRICT 92-1</u>				
ASSETS				
Cash and investments	\$ 35,584	\$ 4,659		\$ 40,243
Cash with fiscal agent	15,463	177		15,640
Receivables	39,914		\$ 37,047	2,867
Total Assets	\$ 90,961	\$ 4,836	\$ 37,047	\$ 58,750
LIABILITIES				
Accounts payable	\$ 805	\$ 8,571		\$ 9,376
Due to bondholders	90,156		\$ 40,782	49,374
Total Liabilities	\$ 90,961	\$ 8,571	\$ 40,782	\$ 58,750

CITY OF DESERT HOT SPRINGS

COMBINING STATEMENT OF CHANGES IN ASSETS AND LIABILITIES (Continued)
AGENCY FUNDS
FOR THE YEAR ENDED JUNE 30, 2003

	Balance June 30, 2002	Net Additions	Net Deletions	Balance June 30, 2003
<u>ASSESSMENT DISTRICT 93-2</u>				
ASSETS				
Cash and investments	\$ 32,951	\$ 18,926		\$ 51,877
Cash with fiscal agent	82,681	480		83,161
Receivables	7,289		\$ 3,555	3,734
Total Assets	<u>\$ 122,921</u>	<u>\$ 19,406</u>	<u>\$ 3,555</u>	<u>\$ 138,772</u>
LIABILITIES				
Accounts payable	\$ 670	\$ 4,535		\$ 5,205
Due to bondholders	122,251	11,316		133,567
Total Liabilities	<u>\$ 122,921</u>	<u>\$ 15,851</u>	<u>\$ -</u>	<u>\$ 138,772</u>
<u>TOTAL ALL AGENCIES</u>				
ASSETS				
Cash and investments	\$ 643,113	\$ 29,485	\$ 26,943	\$ 645,655
Cash with fiscal agent	133,287	696		133,983
Receivables	51,274		41,164	10,110
Total Assets	<u>\$ 827,674</u>	<u>\$ 30,181</u>	<u>\$ 68,107</u>	<u>\$ 789,748</u>
LIABILITIES				
Accounts payable	\$ 13,890	\$ 13,106	\$ 11,213	\$ 15,783
Due to other funds	3,709			3,709
Pension payable	471,000	2,476		473,476
Deposits	49,680		15,121	34,559
Accrued liabilities	1,821		1,821	
Due to bondholders	287,574	15,429	42,603	262,221
Total Liabilities	<u>\$ 827,674</u>	<u>\$ 31,011</u>	<u>\$ 70,758</u>	<u>\$ 789,748</u>

(THIS PAGE INTENTIONALLY LEFT BLANK)

APPENDIX C

SUMMARY OF INDENTURE

The following is a brief summary of certain provisions of the Indenture and not otherwise summarized in the text of this Official Statement under the headings “THE BONDS” and “SECURITY AND SOURCES OF PAYMENT FOR THE BONDS.” This summary does not purport to be comprehensive or definitive and is subject to all of the terms and provisions of the Indenture in its entirety, to which reference is made for the detailed provisions thereof.

DEFINITIONS

Unless the context otherwise requires, the terms defined in this section shall for all purposes of the Indenture and of any certificate, opinion or other document mentioned in such document or in the Indenture, have the meanings specified in the Indenture.

“Act” means Articles 10 and 11 (commencing with Section 53570) of Chapter 3 of Division 2 of Title 5 of the California Government Code.

“Authorized Representative” means, with respect to the City, the City Manager of the City, the Treasurer of the City, and any other Person designated as an Authorized Representative in a Written Certificate of the City filed with the Trustee.

“Available Amount” has the meaning ascribed thereto in Treasury Regulations Section 1.148-6(d)(3)(iii) and, for any Fiscal Year, generally means all amounts (excluding unspent proceeds of the Bonds) that, as of July 1 of such Fiscal Year (a) are available for appropriation by the City or any related person for working capital or normal operating expenditures of the City, and (b) are not subject to a legislative, judicial or contractual requirement that the amount expended be reimbursed to the fund or account of the City from which it was withdrawn, which legislative, judicial or contractual requirements shall have been adopted or entered into for bona fide governmental purposes and without any view towards increasing the amounts that could be borrowed on a tax-exempt basis or treated as unavailable by or on behalf of the City or any related person.

“Bankruptcy Court” means the United States Bankruptcy Court for the Central District of California or any other court with jurisdiction over the Chapter 9 Case.

“Bond Counsel” means a firm of nationally recognized bond counsel selected by the City and acceptable to the Trustee.

“Bond Fund” means the fund by that name established and held by the Trustee pursuant to the Indenture.

“Bonds” means the City of Desert Hot Springs Judgment Obligation Bonds issued under the Indenture.

“Book-Entry Bonds” means the Bonds registered in the name of the nominee of DTC, or any successor securities depository for the Bonds, as the registered owner thereof pursuant to the terms and provisions of the Indenture.

“Business Day” means a day other than (a) Saturday or Sunday, (b) a day on which banking institutions in the city or cities in which the principal corporate trust office of the Trustee is located are authorized or required by law to be closed, or (c) a day on which the New York Stock Exchange is closed.

“Cede & Co.” means Cede & Co., the nominee of DTC, and any successor nominee of DTC with respect to the Bonds.

“Chapter 9 Case” means the case under Chapter 9 of the United States Bankruptcy Code commenced by the City on December 19, 2001, and designated as In re City of Desert Hot Springs, California, Case No. 01-30756-DN, pending before the Bankruptcy Court.

“Closing Date” means October 27, 2004.

“Code” means the Internal Revenue Code of 1986.

“Continuing Disclosure Agreement” means the Continuing Disclosure Agreement, dated as of the date of the Indenture, by and between the City and the Trustee, as originally executed and as it may from time to time be amended in accordance with the provisions thereof.

“Costs of Issuance” means all items of expense directly or indirectly payable by or reimbursable to the City 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, initial fees, expenses and charges of the Trustee and its counsel (including the Trustee’s first annual administrative fee), 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.

“Costs of Issuance Fund” means the fund by that name established and held by the Trustee pursuant to the Indenture.

“City” means the City of Desert Hot Springs, a charter city organized and existing under and by virtue of the laws of the State of California organized and existing under and by virtue of the laws of the State of California.

“DTC” means The Depository Trust Company, a limited-purpose trust company organized under the laws of the State of New York, and its successors as securities depository for the Bonds, including any such successor appointed pursuant to the Indenture.

“Event of Bankruptcy” means the filing of a petition in bankruptcy or the commencement of a proceeding under the United States Bankruptcy Code or any other applicable law concerning insolvency, reorganization or bankruptcy by or against the City, but excludes the Chapter 9 Case or any proceeding relating to the Chapter 9 Case (including without limitation any petition to reopen the Chapter 9 Case following the closure of the Chapter 9 Case).

“Event of Default” means an event described as such in the Indenture.

“Federal Securities” means (a) direct general 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), and (b) obligations of any agency, department or instrumentality of the United States of America the timely payment of principal of and interest on which are fully guaranteed by the United States of America.

“Fiscal Year” means the period beginning on July 1 of each year and ending on the next succeeding June 30, or any other annual accounting period hereafter designated by the City as its Fiscal Year in accordance with applicable law.

“Indenture” means the Indenture, dated as of October 1, 2004, by and between the City and the Trustee, as originally executed or as it may from time to time be amended or supplemented by any Supplemental Indenture.

“Insurance Trustee” shall mean The Bank of New York.

“Insurer” shall mean Radian Asset Assurance Inc., a corporation organized under the laws of the State of New York or any successor thereto.

“Interest Payment Date” means March 1 and September 1 of each year, commencing, March 1, 2005, so long as any Bonds remain Outstanding.

“Judgment” means the judgment entered on the jury’s verdict in *Silver Sage Partners, Ltd., et al. v. City of Desert Hot Springs, et al.*, United States District Court for the Central District of California, Case No. CV 91-6804.

“Judgment Obligation Fund” means the fund by that name established and held by the Trustee pursuant to the Indenture.

“Judgment Obligees” means the Persons to whom the City is obligated to make payments pursuant to the terms of the Judgment and Settlement Agreement.

“Moody’s” means Moody’s Investors Service, a corporation organized and existing under the laws of the State of Delaware, its successors and assigns except that if such entity shall no longer perform the functions of a securities rating agency for any reason, the term “Moody’s” shall be deemed to refer to any other nationally recognized securities rating agency selected by the City and specified to the Trustee in writing.

“Office of the Trustee” means the principal corporate trust office of the Trustee in St. Paul, Minnesota, or such other office as may be specified to the City by the Trustee in writing.

“Original Purchaser” means the underwriter named in the contract of purchase for the Bonds, as original purchaser of such Bonds.

“Other Replacement Proceeds” means, for any Fiscal Year, the remainder of (a) the Available Amount for such Fiscal Year, less (b) the Working Capital Reserve for such Fiscal Year, less (c) the amount, if any, expected to be necessary to reduce the operating deficit of the City in such Fiscal Year, calculated pursuant to Treasury Regulations Section 1.148-6(d)(3).

“Outstanding,” when used as of any particular time with reference to Bonds, means (subject to the provisions of the Indenture) all Bonds except (a) Bonds theretofore canceled and destroyed by the Trustee or surrendered to the Trustee for cancellation and destruction, (b) Bonds paid or deemed to have been paid within the meaning of the Indenture, and (c) Bonds in lieu of or in substitution for which other Bonds shall have been executed by the City and authenticated and delivered by the Trustee pursuant to the terms of the Indenture.

“Owner” means, with respect to a Bond, the Person in whose name such Bond is registered on the Registration Books.

“Participant” means any entity which is recognized as a participant by DTC in the book-entry system of maintaining records with respect to Book-Entry Bonds.

“Participating Underwriter” has the meaning ascribed thereto in the Continuing Disclosure Agreement.

“Permitted Investments” means any of the following to the extent then permitted by the general laws of the State of California and any investment policies of the City:

(1) (a) Direct obligations (other than an obligation subject to variation in principal repayment) of the United States of America (“United States Treasury Obligations”), (b) obligations fully and unconditionally guaranteed as to timely payment of principal and interest by the United States of America, (c) obligations fully and unconditionally guaranteed as to timely payment of principal and interest by any agency or instrumentality of the United States of America when such obligations are backed by the full faith and credit of the United States of America, or (d) evidences of ownership of proportionate interests in future interest and principal payments on obligations described above held by a bank or trust company as custodian, under which the owner of the investment is the real party in interest and has the right to proceed directly and individually against the obligor and the underlying government obligations are not available to any person claiming through the custodian or to whom the custodian may be obligated (collectively “United States Obligations”). These include, but are not necessarily limited to:

- U.S. Treasury obligations
All direct or fully guaranteed obligations

- Farmers Home Administration
Certificates of beneficial ownership
- General Services Administration
Participation certificates
- U.S. Maritime Administration
Guaranteed Title XI financing
- Small Business Administration
Guaranteed participation certificates
Guaranteed pool certificates
- Government National Mortgage Association (GNMA)
GNMA-guaranteed mortgage-backed securities
GNMA-guaranteed participation certificates
- U.S. Department of Housing & Urban Development
Local authority bonds
- Washington Metropolitan Area Transit Authority
Guaranteed transit bonds

(2) Federal Housing Administration debentures.

(3) The listed obligations of government-sponsored agencies which are not backed by the full faith and credit of the United States of America:

- Federal Home Loan Mortgage Corporation (FHLMC)
Participation certificates (excluded are stripped mortgage securities which are purchased at prices exceeding their principal amounts)
Senior debt obligations
- Farm Credit Banks (formerly: Federal Land Banks, Federal Intermediate Credit Banks and Banks for Cooperatives)
Consolidated systemwide bonds and notes
- Federal Home Loan Banks (FHL Banks)
Consolidated debt obligations
- Federal National Mortgage Association (FNMA)
Senior debt obligations
Mortgage-backed securities (excluded are stripped mortgages securities which are purchased at prices exceeding their principal amounts)
- Student Loan Marketing Association (SLMA)
Senior debt obligations (excluded are securities that do not have a fixed par value and/or whose terms do not promise a fixed dollar amount at maturity or call date)
- Financing Corporation (FICO)
Debt obligations
- Resolution Funding Corporation (REFCORP)
Debt obligations

(4) Unsecured certificates of deposit, time deposits, and bankers' acceptances (having maturities of not more than 180 days) of any bank, including the Trustee and its affiliates, the short-term obligations of which are rated "A-1+" or better by S&P and "P-1" or better by Moody's.

(5) Deposits the aggregate amount of which are fully insured by the Federal Deposit Insurance Corporation (FDIC), in banks, including the Trustee and its affiliates, which have capital and surplus of at least \$5 million.

(6) Commercial paper (having original maturities of not more than 270 days) rated “A-1+” by S&P and “Prime-1” by Moody’s.

(7) Money market funds rated “AAm” or “AAm-G” or better by S&P and “AA” or better by Moody’s, including funds for which the Trustee, its parent holding company, if any, or any affiliates or subsidiaries of the Trustee provide investment advisory or other management services, and, subject to the prior written consent of the Insurer, S&P and Moody’s, the investment pool maintained by the County of Riverside, so long as such pool is rated in one of the two highest rating categories by S&P and Moody’s.

(8) Repurchase agreements:

(a) With any domestic bank the long term debt of which is rated “AA” or better by S&P and Moody’s (so long as an opinion is rendered that the repurchase agreement is a “repurchase agreement” as defined in the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (“FIRREA”) and that such bank is subject to FIRREA), or any foreign bank rated at least “AA” by S&P and “Aaa” by Moody’s or “AAA” by S & P and at least “Aa” by Moody’s; provided the term of such repurchase agreement is for one year or less.

(b) With (i) any broker-dealer with “retail customers” which has, or the parent company of which has, long-term debt rated at least “AA” by S&P and “Aa” by Moody’s, which broker-dealer falls under the jurisdiction of the Securities Investors Protection Corp. (SIPC); provided that:

- A. The market value of the collateral is maintained for United States Treasury Obligations, at the levels shown below under “Collateral Levels for United States Treasury Obligations”;
- B. Failure to maintain the requisite collateral percentage will require the City or the Trustee to liquidate the collateral;
- C. The Trustee, the City or a third party acting solely as agent therefor (the “Holder of the Collateral”) has possession of the collateral or the collateral has been transferred to the Holder of the Collateral in accordance with applicable state and federal laws (other than by means of entries on the transferor’s books);
- D. The repurchase agreement states, and an opinion of counsel is rendered to the effect, that the Trustee 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);
- E. The transferor represents that the collateral is free and clear of any third-party liens or claims;
- F. An opinion is rendered that the repurchase agreement is a “repurchase agreement” as defined in the United States Bankruptcy Code;
- G. There is or will be a written agreement governing every repurchase transaction;
- H. Each of the City and the Trustee represents that it has no knowledge of any fraud involved in the repurchase transaction; and

- I. The City and the Trustee receive an opinion of counsel (which opinion shall be addressed to the City and the Trustee) that such repurchase agreement is legal, valid and binding and enforceable against the provider in accordance with its terms.

(9) State Obligations

(a) Direct general obligations of any state of the United States or any subdivision or agency thereof to which is pledged the full faith and credit of a state the unsecured general obligation debt of which is rated "A" by Moody's and "A" by S&P, or better, or any obligation fully and unconditionally guaranteed by any state, subdivision or agency whose unsecured general obligation debt is so rated.

(b) Direct, general short-term obligations of any state agency or subdivision described in (a) above and rated "A-1+" by S&P and "Prime-1" by Moody's.

(c) Special Revenue Bonds (as defined in the United States Bankruptcy Code) of any state, state agency or subdivision described in (a) above and rated "AA" or better by S&P and "Aa" or better by Moody's.

(10) Investment agreements with a domestic or foreign bank or corporation (other than a life or property casualty insurance company) the long-term debt of which, or, in the case of a guaranteed corporation the long-term debt of the guarantor, or in the case of a monoline financial guaranty insurance company the claims paying ability of the guarantor, is rated at least "AA" by S&P and "Aa" by Moody's; provided, that prior written notice of an investment in the investment agreement is provided to S&P and, provided, further, 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 (or, if the investment agreement is for the construction fund, construction draws) on the Bonds;

(b) the invested funds are available for withdrawal without penalty or premium, at any time for purposes identified in the Indenture other than acquisition of alternative investment property upon not more than seven days prior notice (which notice may be amended or withdrawn at any time prior to the specified withdrawal date); provided that the Indenture specifically requires the Trustee or the City to give 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 obligation of, the provider thereof;

(d) a fixed guaranteed rate of interest is to be paid on invested funds and all future deposits, if any, required to be made to restore the amount of such funds to the level specified under the Indenture;

(e) the Trustee and the City receive the opinion of domestic counsel (which opinion shall be addressed to the City) that such investment agreement is legal, valid and binding and enforceable against the provider in accordance with its terms and of foreign counsel (if applicable);

(f) the investment agreement shall provide that if during its term (A) the provider's or the guarantor's rating by either Moody's or S&P is withdrawn or suspended or falls below "AA" or "Aa", respectively, or, with respect to a foreign bank, below the ratings of such provider at the delivery date of the investment agreement, the provider must, at the direction of the City or the Trustee within 10 days of receipt of such direction, either (1) 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 Trustee, the City or a Holder of the Collateral, United States Treasury Obligations which are free and clear of any third-party liens or claims at the Collateral Levels set forth below; or (2) repay the principal of and accrued but unpaid interest on the investment (the choice of (1) or (2) above shall be that of the City or Trustee, as appropriate), and (B) the provider's or the guarantor's rating by either Moody's or S&P is withdrawn or suspended or falls below "A", or, with respect to a foreign bank, below "AA" or "Aa" by S&P or Moody's, as appropriate, the provider must, at the direction of the City 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 City or Trustee;

(g) the investment agreement shall state, and an opinion of counsel shall be rendered to the effect, that the Trustee 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 Trustee is in possession); and

(h) the investment agreement must provide that if during its term (A) the provider shall default in its payment obligations, the provider's obligation under the investment agreement shall, at the direction of the City or the Trustee, be accelerated and amounts invested and accrued but unpaid interest thereon shall be repaid to the City or Trustee, as appropriate, and (B) 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 City or Trustee, as appropriate.

(11) The Local Agency Investment Fund of the State of California.

(12) Pre-refunded municipal obligations rated "AAA" by S&P and "Aaa" by Moody's meeting the following requirements:

(a) the municipal obligations are (i) not subject to redemption prior to maturity or (ii) the trustee for the municipal obligations has been given irrevocable instructions concerning their call and redemption and the issuer of the municipal obligations has covenanted not to redeem such municipal obligations other than as set forth in such instructions;

(b) the municipal obligations are secured by cash or United States Treasury Obligations which may be applied only to payment of the principal of, interest and premium on such municipal obligations;

(c) the principal of and interest on the United States Treasury Obligations (plus any cash in the escrow) has been verified by the report of independent certified public accountants to be sufficient to pay in full all principal of, interest, and premium, if any, due and to become due on the municipal obligations ("Verification");

(d) the cash or United States Treasury Obligations serving as security for the municipal obligations are held by an escrow agent or trustee in trust for owners of the municipal obligations; and

(e) no substitution of a United States Treasury Obligation shall be permitted except with another United States Treasury Obligation and upon delivery of a new Verification; and

(f) the cash or the United States Treasury Obligations are not available to satisfy any other claims, including those by or against the trustee or escrow agent.

Further Requirements: (a) On each valuation date the City, the Trustee, or the custodian who shall confirm to the City and the Trustee, shall value the market value (exclusive of accrued interest) of the

collateral, which market value will be an amount equal to the requisite collateral percentage times the principal amount of the investment (including unpaid accrued interest thereon) that is being secured, (b) in the event the collateral level is below its collateral percentage on a valuation date, such percentage shall be restored within the following restoration periods: one Business Day for daily valuations, two Business Days for weekly and monthly valuations, and one month for quarterly valuations (the use of different restoration periods affect the requisite collateral percentage), (c) the City or the Trustee shall terminate the repurchase agreement or the investment agreement, as the case may be, upon a failure to maintain the requisite collateral percentage after the restoration period and, if not paid by the counterparty in federal funds against transfer of the collateral, liquidate the collateral.

“Person” means an individual, corporation, firm, association, partnership, limited liability company, trust, or other legal entity or group of entities, including a governmental entity or any agency or political subdivision thereof.

“Plan” means the Third Amended Plan for the Adjustment of Debts of the City of Desert Hot Springs, dated April 28, 2004, as confirmed by an order of the Bankruptcy Court entered on July 26, 2004.

“Policy” shall mean the financial guaranty insurance policy issued by Insurer insuring the payment when due of the principal of and interest on the Bonds as provided therein.

“Rebate Fund” means the fund by that name established and held by the Trustee pursuant to the Indenture.

“Rebate Requirement” has the meaning ascribed thereto in the Tax Certificate.

“Record Date” means the 15th calendar day of the month preceding each Interest Payment Date, whether or not such day is a Business Day.

“Redemption Account” means the account within the Bond Fund by that name established and held by the Trustee pursuant to the Indenture.

“Redemption Price” means the aggregate amount of principal of the Bonds upon the redemption thereof pursuant to the terms of the Indenture.

“Refunding Fund” means the fund by that name established and held by the Trustee pursuant to the Indenture.

“Registration Books” means the records maintained by the Trustee for the registration of ownership and registration of transfer of the Bonds pursuant to the Indenture.

“Representation Letter” means the Letter of Representations from the City to DTC, or any successor securities depository for the Bonds, in which the City makes certain representations with respect to issues of its securities for deposit by DTC or such successor depository.

“Settlement” means the court approved settlement agreement in *Silver Sage Partners, Ltd., et al. v. City of Desert Hot Springs, et al.*, United States District Court for the Central District of California, Case No. CV 91-6804.

“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 assigns except that if such entity shall no longer perform the functions of a securities rating agency for any reason, the term “S&P” shall be deemed to refer to any other nationally recognized securities rating agency selected by the City and specified to the Trustee in writing.

“State” means the State of California.

“Supplemental Indenture” means any supplemental indenture amendatory of or supplemental to the Indenture, but only if and to the extent that such Supplemental Indenture is specifically authorized under the Indenture.

“Tax Certificate” means the Tax Certificate executed by the City at the time of issuance of the Bonds relating to the requirements of Section 148 of the Code, as originally executed and as it may from time to time be amended in accordance with the provisions thereof.

“Tax-Exempt Obligations” means obligations the interest on which is not includable in gross income under Section 103 of Code and obligations which are not specified private activity bonds (as defined in Section 57(a)(5)(C) of the Code).

“Trustee” means Wells Fargo Bank, National Association, a national banking association organized and existing under the laws of the United States of America with a corporate trust office in Los Angeles, California, or any successor thereto as Trustee under the Indenture, appointed as provided in the Indenture.

“Working Capital Reserve” means, for any Fiscal Year, an amount equal to 5% of the actual working capital expenditures paid with current revenues of the City during the immediately preceding Fiscal Year.

“Written Certificate” and “Written Request” of the City mean, respectively, a written certificate or written request signed in the name of the City by its Authorized Representative. Any such certificate or request 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 BONDS

Authorization of Bonds; Bonds Constitute Obligations Imposed by Law. The City has authorized under the Indenture the issuance of the Bonds under and subject to the terms of the Indenture, the Act and other applicable laws of the State of California for the purpose of satisfying the City’s payment obligations under the Judgment.

The obligations of the City under the Bonds, including the obligation to make all payments of the interest on and the principal of the Bonds when due or upon prior redemption, are obligations of the City imposed by law and are absolute and unconditional, without any right of set-off or counterclaim. The Bonds do not constitute an obligation of the City for which the City is obligated to levy or pledge any form of taxation or for which the City has levied or pledged any form of taxation, and neither the Bonds nor the obligation of the City to make payment of the interest on or the principal of the Bonds constitutes an indebtedness of the City or the State, or any of its political subdivisions, in contravention of any constitutional or statutory debt limitation or restriction.

Interest on the Bonds shall be payable from the Interest Payment Date next preceding the date of authentication thereof unless (i) a Bond is authenticated on or before an Interest Payment Date and after the close of business on the preceding Record Date, in which event it shall bear interest from such Interest Payment Date; (ii) a Bond is authenticated on or before the first Record Date, in which event interest thereon shall be payable from the Closing Date; or (iii) interest on any Bond is in default as of the date of authentication thereof, in which event interest thereon shall be payable from the date to which interest has been paid in full or made available for such payment, payable on each Interest Payment Date. Interest shall be paid in lawful money of the United States on each Interest Payment Date to the Persons in whose names the ownership of the Bonds is registered on the Registration Books at the close of business on the immediately preceding Record Date, except as provided below. Interest shall be paid by check of the Trustee mailed by first class mail, postage prepaid, on each Interest Payment Date to the Owners at their respective addresses shown on the Registration Books as of the close of business on the preceding Record Date, except that in the case of an Owner of \$1,000,000 or more in aggregate principal amount of Bonds, upon the written request of such Owner to the Trustee, received at least ten days prior to a Record Date, specifying the account or accounts to which such payment shall be made, payment of interest shall be made by wire transfer of immediately available funds on the following Interest Payment Date. Any such request shall remain in effect until revoked or revised by such Owner by an instrument in writing delivered to the Trustee.

The principal of and premium, if any, on the Bonds shall be payable in lawful money of the United States of America upon presentation and surrender thereof upon maturity or earlier redemption at the Office of the Trustee. Payment of principal of and premium, if any, on any Bond shall be made only upon presentation and surrender of such Bond at the Office of the Trustee.

Transfer and Exchange of Bonds. 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, accompanied by delivery of a written instrument of transfer, duly executed in a form acceptable to the Trustee. Whenever any Bond or Bonds shall be surrendered for transfer, the City shall execute and the Trustee shall authenticate and shall deliver a new Bond or Bonds of the same maturity in a like aggregate principal amount, in any authorized denomination. The Trustee shall require the Owner requesting such transfer to pay any tax or other governmental charge required to be paid with respect to such transfer.

The Bonds may be exchanged at the Office of the Trustee for a like aggregate principal amount of Bonds of the same maturity of other authorized denominations. The Trustee shall require the payment by the Owner requesting such exchange of any tax or other governmental charge required to be paid with respect to such exchange.

The Trustee shall not be obligated to make any transfer or exchange of Bonds pursuant to this section during the period established by the Trustee for the selection of Bonds for redemption, or with respect to any Bonds selected for redemption.

Registration Books. The Trustee will keep or cause to be kept, at the Office of the Trustee, sufficient records for the registration and transfer of ownership of the Bonds, which shall be open to inspection during regular business hours and upon reasonable notice by the City; and, upon presentation for such purpose, the Trustee shall, under such reasonable regulations as it may prescribe, register or transfer or cause to be registered or transferred, on such records, the ownership of the Bonds as hereinbefore provided.

Temporary Bonds. The Bonds may be issued in temporary form exchangeable for definitive Bonds when ready for delivery. Any temporary Bonds may be printed, lithographed or typewritten, shall be of such authorized denominations as may be determined by the City, shall be in fully registered form without coupons and may contain such reference to any of the provisions of the Indenture as may be appropriate. Every temporary Bond shall be executed by the City and authenticated by the Trustee upon the same conditions and in substantially the same manner as the definitive Bonds. If the City issues temporary Bonds it shall execute and deliver definitive Bonds as promptly thereafter as practicable, and thereupon the temporary Bonds may be surrendered, for cancellation, at the Office of the Trustee and the Trustee shall authenticate and deliver in exchange for such temporary Bonds a like aggregate principal amount of definitive Bonds of the same maturity in authorized denominations. Until so exchanged, the temporary Bonds shall be entitled to the same benefits under the Indenture as definitive Bonds authenticated and delivered under the Indenture.

Bonds Mutilated, Lost, Destroyed or Stolen. If any Bond shall become mutilated, the City, at the expense of the Owner of said Bond, shall execute, and the Trustee shall thereupon authenticate and deliver, a new Bond of like tenor in exchange and substitution for the Bond so mutilated, but only upon surrender to the Trustee of the Bond so mutilated. Every mutilated Bond so surrendered to the Trustee shall be destroyed by it. If any Bond shall be lost, destroyed or stolen, evidence of such loss, destruction or theft may be submitted to the Trustee and, if such evidence and indemnity satisfactory to the Trustee shall be given, the City, at the expense of the Owner, shall execute, and the Trustee shall thereupon authenticate and deliver, a new Bond of like tenor in lieu of and in replacement for the Bond so lost, destroyed or stolen (or if any such Bond shall have matured or shall have been selected for redemption, instead of issuing a replacement Bond, the Trustee may pay the same without surrender thereof). The City may require payment by the Owner of a sum not exceeding the actual cost of preparing each replacement Bond issued under this section and of the expenses which may be incurred by the City and the Trustee. Any Bond issued under the provisions of this section in lieu of any Bond alleged to be lost, destroyed or stolen shall constitute an original additional contractual obligation on the part of the City whether or not the Bond so alleged to be lost, destroyed or stolen be at any time enforceable by anyone, and shall be entitled to the benefits of the Indenture with all other Bonds secured by the Indenture.

Book-Entry Bonds. (1) Except as provided in subsection (c) immediately above, the registered Owner of all of the Bonds shall be DTC and the Bonds shall be registered in the name of Cede & Co., as nominee for DTC. Notwithstanding anything to the contrary contained in the Indenture, payment of interest with respect to any Bond registered as of each Record Date in the name of Cede & Co. shall be made by wire transfer of same-day funds to the account of Cede & Co. on the payment date for the Bonds at the address indicated on the Record Date for Cede & Co. in the Registration Books or as otherwise provided in the Representation Letter.

(2) The Bonds shall be initially issued in the form of separate single fully registered Bonds in the amount of each separate stated maturity of the Bonds. Upon initial issuance, the ownership of such Bonds shall be registered in the Registration Books in the name of Cede & Co., as nominee of DTC. The Trustee and the City may treat DTC (or its nominee) as the sole and exclusive Owner of the Bonds registered in its name for the purposes of payment of the principal, Redemption Price or interest with respect to the Bonds, selecting the Bonds or portions thereof to be redeemed, giving any notice permitted or required to be given to Owners of Bonds under the Indenture, registering the transfer of Bonds, obtaining any consent or other action to be taken by Owners of Bonds and for all other purposes whatsoever, and neither the Trustee nor the City shall be affected by any notice to the contrary. Neither the Trustee nor the City shall have any responsibility or obligation to any Participant, any person claiming a beneficial ownership interest in the Bonds under or through DTC or any Participant, or any other person which is not shown on the Registration Books as being an Owner, with respect to the accuracy of any records maintained by DTC or any Participant; the payment by DTC or any Participant of any amount in respect of the principal, Redemption Price or interest with respect to the Bonds; any notice which is permitted or required to be given to Owners of Bonds under the Indenture; the selection by DTC or any Participant of any person to receive payment in the event of a partial redemption of the Bonds; or any consent given or other action taken by DTC as Owner of Bonds. The Trustee shall pay all principal, premium, if any, and interest with respect to the Bonds, only to DTC, and all such payments shall be valid and effective to fully satisfy and discharge the City's obligations with respect to the principal, premium, if any, and interest with respect to the Bonds to the extent of the sum or sums so paid. Except under the conditions of (c) below, no person other than DTC shall receive an executed Bond for each separate stated maturity. Upon delivery by DTC to the Trustee of written notice to the effect that DTC has determined to substitute a new nominee in place of Cede & Co., and subject to the provisions in the Indenture with respect to record dates, the term "Cede & Co." in the Indenture shall refer to such new nominee of DTC.

(3) In the event (i) DTC, including any successor as securities depository for the Bonds, determines not to continue to act as securities depository for the Bonds; or (ii) the City determines that the incumbent securities depository shall no longer so act, and delivers a written certificate to the Trustee to that effect, then the City will discontinue the book-entry system with the incumbent securities depository for the Bonds. If the City determines to replace the incumbent securities depository for the Bonds with another qualified securities depository, the City shall prepare or direct the preparation of a new single, separate fully registered Bond for the aggregate outstanding principal amount of Bonds of each maturity, registered in the name of such successor or substitute qualified securities depository, or its nominee, or make such other arrangement acceptable to the City, the Trustee and the successor securities depository for the Bonds as are not inconsistent with the terms of the Indenture. If the City fails to identify another qualified successor securities depository of the Bonds to replace the incumbent securities depository, then the Bonds shall no longer be restricted to being registered in the Registration Books in the name of the incumbent securities depository or its nominee, but shall be registered in whatever name or names the incumbent securities depository for the Bonds, or its nominee, shall designate. In such event the Trustee shall authenticate and deliver a sufficient quantity of Bonds as to carry out the transfers and exchanges provided in the Indenture. All such Bonds shall be in fully registered form in denominations authorized by the Indenture.

(4) Notwithstanding any other provision of the Indenture to the contrary, so long as any Bond is registered in the name of DTC, or its nominee, all payments with respect to the principal, premium, if any, and interest with respect to such Bond and all notices with respect to such Bond shall be made and given, respectively, as provided in the Representation Letter.

(5) In connection with any notice or other communication to be provided to Owners of Book-Entry Bonds pursuant to the Indenture by the City or the Trustee with respect to any consent or other action to be taken by Owners, the City or the Trustee, as the case may be, shall establish a record date for such consent or other action and give DTC notice of such record date not less than 15 calendar days in advance of such record date to the extent possible.

Equal Security. In consideration of the acceptance of the Bonds by the Owners thereof, the Indenture shall be deemed to be and shall constitute a contract among the City, the Trustee and the Owners from time to time of all Bonds authorized, executed, issued and delivered under the Indenture and then Outstanding to secure the full and final payment of the principal of, premium, if any, and interest on all Bonds which may from time to time be authorized, executed, issued and delivered under the Indenture, subject to the agreements, conditions, covenants and provisions contained in the Indenture; and all agreements and covenants set forth in the Indenture to be performed by or on behalf of the City shall be for the equal and proportionate benefit, protection and security of all Owners of the Bonds without distinction, preference or priority as to security or otherwise of any Bonds over any other Bonds by reason of the number or date thereof or the time of authorization, sale, execution, issuance or delivery thereof or for any cause whatsoever, except as expressly provided in such document or in the Indenture.

SECURITY FOR BONDS; FLOW OF FUNDS; INVESTMENTS

Pledge. Subject only to the provisions of the Indenture permitting the application thereof for the purposes and on the terms and conditions set forth in the Indenture, all of the amounts held in the Judgment Obligation Fund and the Bond Fund are pledged by the City to secure the payment of the principal of and interest on the Bonds in accordance with their terms, the provisions of the Indenture and the Act. Said pledge shall constitute a first lien on such assets.

Judgment Obligation Fund. The Trustee shall establish, maintain and hold in trust a special fund designated the "Judgment Obligation Fund." The City agrees and covenants that on October 27, 2004 and not later than July 31 of each Fiscal Year commencing July 31, 2005 to the maturity date or final redemption date of the Bonds, it will transfer to the Trustee an amount which, together with the amount then on deposit in the Judgment Obligation Fund, will equal the amount of the principal of and interest on the Bonds becoming due in such Fiscal Year either as a result of the maturity thereof or mandatory sinking fund redemptions required to be made with respect thereto. The Trustee shall, upon receipt, deposit such amount in the Judgment Obligation Fund.

On the last Business Day immediately preceding each Interest Payment Date, the Trustee shall withdraw from the Judgment Obligation Fund and deposit in the Bond Fund in immediately available funds an amount which, together with the amount then on deposit in the Bond Fund, will equal the principal of the Bonds due and payable at their maturity dates or upon earlier mandatory sinking fund redemption, if any, and interest due on the Bonds on such Interest Payment Date.

Bond Fund. The Trustee shall establish, maintain and hold in trust a special fund designated the "Bond Fund." The Trustee shall deposit in the Bond Fund the amounts required to be deposited therein pursuant to the Indenture.

On or before each Interest Payment Date, the Trustee shall withdraw from the Bond Fund for payment to the Owners of the Bonds the principal, if any, of and interest then due and payable on the Bonds. If there are insufficient funds in the Bond Fund to pay the principal, if any, of and interest on the Bonds, the Trustee shall apply the available funds first to the payment of interest on the Bonds, then to the payment of principal of the Bonds.

Redemption Account. The Trustee shall establish and maintain a special account within the Bond Fund designated the "Redemption Account." The Trustee shall deposit in the Redemption Account funds received from the City in connection with the City's exercise of its rights to redeem Bonds pursuant to the Indenture.

Amounts in the Redemption Account shall be disbursed therefrom for the payment of the Redemption Price of Bonds redeemed pursuant to the Indenture.

Rebate Fund. The Trustee shall establish and maintain a special fund designated the "Rebate Fund." There shall be deposited in the Rebate Fund such amounts as are required to be deposited therein pursuant to the Tax Certificate, as specified in a Written Request of the City. All money at any time deposited in the Rebate Fund shall be held by the Trustee in trust, to the extent required to satisfy the Rebate Requirement, for payment to the United States of America. Notwithstanding defeasance of the Bonds in accordance with the Indenture or anything to the contrary contained in the Indenture, all amounts required to be deposited into or on deposit in the Rebate Fund shall

be governed exclusively by this section and by the Tax Certificate (which is incorporated in the Indenture by reference). The Trustee shall be deemed conclusively to have complied with such provisions if it follows the written directions of the City, and shall have no liability or responsibility to enforce compliance by the City with the terms of the Tax Certificate.

Any funds remaining in the Rebate Fund after payment in full of all of the Bonds and after payment of any amounts described in this section, shall be withdrawn by the Trustee and shall be transferred to the City to be expended for any lawful purpose of the City.

Investment of Moneys. Except as otherwise provided in the Indenture, all moneys in any of the funds or accounts established pursuant to the Indenture shall be invested by the Trustee solely in Permitted Investments, as directed in a Written Request of the City received no later than two Business Days prior to the making of such investment. Moneys in all funds and accounts shall be invested in Permitted Investments maturing not later than the date on which the City estimates that such moneys will be required for the purposes specified in the Indenture. Absent timely written direction from the City, the Trustee shall invest any funds held by it in Permitted Investments described in clause (7) of the definition thereof.

Subject to the provisions set forth herein under the caption "COVENANTS - Tax Covenants," all interest, profits and other income received from the investment of moneys in any fund or account established pursuant to the Indenture shall be retained therein.

Permitted Investments acquired as an investment of moneys in any fund established under the Indenture shall be credited to such fund. All investments of amounts deposited in any fund or account created by or pursuant to the Indenture shall be acquired, disposed of, and valued at fair market value.

The Trustee or an affiliate thereof may act as principal or agent in the making or disposing of any investment and shall be entitled to its reasonable and customary fee therefor. Upon the Written Request of the City, the Trustee shall sell or present for redemption any Permitted Investments so purchased whenever it shall be necessary to provide moneys to meet any required payment, transfer, withdrawal or disbursement from the fund to which such Permitted Investments is credited, and the Trustee shall not be liable or responsible for any loss resulting from any investment made or sold pursuant to this section. For purposes of investment, the Trustee may commingle moneys in any of the funds and accounts established under the Indenture.

City Budgets. The City shall in each Fiscal Year include in its budget a provision to provide funds in an amount sufficient to pay the principal of and interest on the Bonds coming due in such Fiscal Year.

COVENANTS

Punctual Payment and Performance. The City will punctually pay the interest on and principal of every Bond issued under the Indenture in strict conformity with the terms of the Indenture and of the Bonds, and will faithfully observe and perform all the agreements and covenants required to be observed or performed by the City contained in the Indenture and in the Bonds.

Extension of Payment of Bonds. The City 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 Event of Default under the Indenture, to the benefits of the Indenture, except subject to the prior payment in full of the principal of all of the Bonds then Outstanding and of all claims for interest thereon which shall not have been so extended; provided, that nothing in this section shall be deemed to limit the right of the City to issue Bonds for the purpose of refunding any Outstanding Bonds, and such issuance shall not be deemed to constitute an extension of maturity of the Bonds.

Additional Obligations. At any time during which the S&P credit rating of the City shall be below S&P's lowest investment grade rating, and so long as the Insurer is not in default in its payment obligations under the

Policy, the City agrees, to the extent permitted by law, not to issue or incur any multi-year obligation in excess of \$250,000 per year or agree to incur any debt obligation in excess of \$1,000,000 alone or in the aggregate, without the prior written consent of the Insurer; it being expressly acknowledged that the City will enter into a lease agreement and related documents and cause the execution and delivery, concurrently with the delivery of the Bonds, of certificates of participation to be captioned "City of Desert Hot Springs Certificates of Participation (Interim Cash Flow Financing)" in \$3,060,000 aggregate principal amount.

Power to Issue Bonds. The City is duly authorized to issue the Bonds and to enter into the Indenture. The Bonds and the provisions of the Indenture are and will be the legal, valid and binding obligations of the City in accordance with their terms. The Bonds constitute obligations imposed by law.

Prosecution and Defense of Suits. The City will defend against every suit, action or proceeding at any time brought against the City upon any claim to the extent involving the failure of the City to fulfill its obligations under the Indenture; provided, that the Trustee or any Owner at its election may appear in and defend any such suit, action or proceeding.

Tax Covenants. The City shall not take any action, or fail to take any action, if such action or failure to take such action would adversely affect the exclusion from gross income of interest on the Bonds under Section 103 of the Code. Without limiting the generality of the foregoing, the City shall comply with the requirements set forth below under the caption "Other Replacement Proceeds" and the requirements of the Tax Certificate, which is incorporated in the Indenture as if fully set forth in the Indenture. This covenant shall survive payment in full or defeasance of the Bonds.

In the event that at any time the City is of the opinion that for purposes of this section it is necessary or helpful to restrict or limit the yield on the investment of any moneys held by the Trustee in any of the funds or accounts established under the Indenture, the City shall so instruct the Trustee in writing, and the Trustee shall act in accordance with such instructions.

Notwithstanding any provisions of this section, if the City shall provide to the Trustee an opinion of Bond Counsel to the effect that any specified action required under this section or the requirements set forth below under the caption "Other Replacement Proceeds" is no longer required or that some further or different action is required to maintain the exclusion from federal income tax of interest on the Bonds, the Trustee may conclusively rely on such opinion in complying with the requirements of this section, the requirements set forth below under the caption "Other Replacement Proceeds" and the requirements of the Tax Certificate, and the covenants under the Indenture shall be deemed to be modified to that extent.

So long as the Insurer is not in default in its payment obligations under the Policy, the City agrees, that there shall be no mandatory redemption of the Bonds upon an event or determination of taxability of the Bonds or otherwise.

Other Replacement Proceeds. The City shall, no later than August 1 of each year, calculate and determine the amount, if any, of Other Replacement Proceeds for such Fiscal Year. If Other Replacement Proceeds exist for a Fiscal Year, such Other Replacement Proceeds shall be invested in Tax-Exempt Obligations until such Other Replacement Proceeds are spent.

Continuing Disclosure. The City and the Trustee will each comply with and carry out their respective obligations under the provisions of the Continuing Disclosure Agreement. Notwithstanding any other provision of the Indenture, failure of the City or the Trustee to comply with the Continuing Disclosure Agreement shall not be considered an Event of Default; provided, however, that the Trustee may (and, at the written direction of any Participating Underwriter or the holders of at least 25% of the aggregate principal amount of Outstanding Bonds, shall upon receipt of indemnification for its costs and fees reasonably acceptable to it) or any holder or beneficial owner of the Bonds may, take such actions as may be necessary and appropriate to compel performance, including seeking mandate or specific performance by court order.

Further Assurances. Whenever and so often as reasonably requested to do so by the Trustee or any Owner, the City will promptly execute and deliver or cause to be executed and delivered all such other and further assurances, documents or instruments, and promptly do or cause to be done all such other and further things as may be necessary or reasonably required in order to further and more fully vest in the Trustee and the Owners all rights, interests, powers, benefits, privileges and advantages conferred or intended to be conferred upon them under the Indenture.

THE TRUSTEE

(a) Duties and Liabilities of Trustee. (1) *Duties of Trustee Generally.* The Trustee shall, prior to an Event of Default, and after the curing of all Events of Default which may have occurred, perform such duties and only such duties as are expressly and specifically set forth in the Indenture. The Trustee shall, during the existence of any Event of Default which has not been cured, exercise such of the rights and powers vested in it by the Indenture, and use the same degree of care and skill in their exercise, as a prudent person would exercise or use under the circumstances in the conduct of his or her own affairs.

(2) *Removal of Trustee.* The City may upon 30 days' prior written notice remove the Trustee at any time unless an Event of Default shall have occurred and then be continuing, and the City shall remove the Trustee if at any time requested to do so by the Insurer (so long as the Insurer is not in default in its payment obligations under the Insurance Policy) or by an instrument or concurrent instruments in writing signed by the Owners of not less than a majority in aggregate principal amount of the Bonds then Outstanding (or their attorneys duly authorized in writing) or if at any time the Trustee shall cease to be eligible in accordance with subsection (e) of this section, or shall become incapable of acting, or shall be adjudged a bankrupt or insolvent, or a receiver of the Trustee or its property shall be appointed, or any public officer shall take control or charge of the Trustee or of its property or affairs for the purpose of rehabilitation, conservation or liquidation, in each case by giving written notice of such removal to the Trustee and thereupon shall appoint a successor Trustee by an instrument in writing.

(3) *Resignation of Trustee.* The Trustee may at any time resign by giving written notice of such resignation by first class mail, postage prepaid, to the City, and to the Owners at the respective addresses shown on the Registration Books. Upon receiving such notice of resignation, the City shall promptly appoint a successor Trustee by an instrument in writing. The Trustee shall not be relieved of its duties until such successor Trustee has accepted appointment.

(4) *Appointment of Successor Trustee.* Any removal or resignation of the Trustee and appointment of a successor Trustee shall become effective upon acceptance of appointment by the successor Trustee; provided, however, that under any circumstances the successor Trustee shall be qualified as provided in subsection (e) of this section. If no qualified successor Trustee shall have been appointed and have accepted appointment within 45 days following giving notice of removal or notice of resignation as aforesaid, the resigning Trustee or any Owner (on behalf of himself and all other Owners) may petition any court of competent jurisdiction for the appointment of a successor Trustee, and such court may thereupon, after such notice, if any, as it may deem proper, appoint such successor Trustee. Any successor Trustee appointed under the Indenture shall signify its acceptance of such appointment by executing and delivering to the City and to its predecessor Trustee a written acceptance thereof, and such successor Trustee, without any further act, deed or conveyance, shall become vested with all the moneys, estates, properties, rights, powers, trusts, duties and obligations of such predecessor Trustee, with like effect as if originally named Trustee in the Indenture; but, nevertheless at the Written Request of the City or the request of the successor Trustee, such predecessor Trustee shall execute and deliver any and all instruments of conveyance or further assurance and do such other things as may reasonably be required for more fully and certainly vesting in and confirming to such successor Trustee all the right, title and interest of such predecessor Trustee in and to any property held by it under the Indenture and shall pay over, transfer, assign and deliver to the successor Trustee any money or other property subject to the trusts and conditions specified in the Indenture. Upon request of the successor Trustee, the City shall execute and deliver any and all instruments as may be reasonably required for more fully and certainly vesting in and confirming to such successor Trustee all such moneys, estates, properties, rights, powers, trusts, duties and obligations. Upon acceptance of appointment by a successor Trustee as provided in this subsection, the City shall mail or cause the successor Trustee to mail, by first class mail postage prepaid, a notice of the succession of such Trustee to the trusts under the Indenture to the Owners at the addresses shown on the

Registration Books. If the City fails to mail such notice within 15 days after acceptance of appointment by the successor Trustee, the successor Trustee shall cause such notice to be mailed at the expense of the City.

(5) *Qualifications of Trustee.* The Trustee shall be a trust company or bank having the powers of a trust company, having (or if such bank or trust company is a member of a bank holding company system, its parent bank holding company shall have) a combined capital and surplus of at least \$75,000,000, and subject to supervision or examination by federal or state agency. If such bank or trust company publishes a report of condition at least annually, pursuant to law or to the requirements of any supervising or examining agency above referred to, then for the purpose of this subsection the combined capital and surplus of such bank or trust company shall be deemed to be its combined capital and surplus as set forth in its most recent report of condition so published.

In case at any time the Trustee shall cease to be eligible in accordance with the provisions of this subsection (e), the Trustee shall resign immediately in the manner and with the effect specified in this section.

(b) **Merger or Consolidation.** Any bank or trust company into which the Trustee may be merged or converted or with which it may be consolidated or any bank or trust company resulting from any merger, conversion or consolidation to which it shall be a party or any bank or trust company to which the Trustee may sell or transfer all or substantially all of its corporate trust business, provided such bank or trust company shall be eligible under subsection (e) of this section shall be the successor to such Trustee, without the execution or filing of any paper or any further act, anything to the contrary in the Indenture notwithstanding.

(c) **Liability of Trustee.** (1) The recitals of facts in the Indenture and in the Bonds contained shall be taken as statements of the City, and the Trustee shall not assume responsibility for the correctness of the same, or make any representations as to the validity or sufficiency of the Indenture or of the security for the Bonds or shall incur any responsibility in respect thereof, other than as expressly stated in the Indenture in connection with the respective duties or obligations in the Indenture or in the Bonds assigned to or imposed upon it. The Trustee shall, however, be responsible for its representations contained in its certificate of authentication on the Bonds. The Trustee makes no representations as to the validity or sufficiency of the Indenture or of any Bonds, or in respect of the security afforded by the Indenture and the Trustee shall incur no responsibility in respect thereof. The Trustee shall be under no responsibility or duty with respect to (i) the issuance of the Bonds for value, (ii) the application of the proceeds thereof except to the extent that such proceeds are received by it in its capacity as Trustee, or (iii) the application of any moneys paid to the City or others in accordance with the Indenture except as the application of any moneys paid to it in its capacity as Trustee. The Trustee shall not be liable in connection with the performance of its duties under the Indenture, except for its own negligence or willful misconduct. The Trustee shall not be liable for any action taken or omitted by it in good faith and believed by it to be authorized or within the discretion or rights or powers conferred upon it by the Indenture. The Trustee and its officers and employees may become the Owner of Bonds with the same rights it would have if it were not Trustee, and, to the extent permitted by law, may act as depository for and permit any of its officers or directors to act as a member of, or in any other capacity with respect to, any committee formed to protect the rights of Bond Owners, whether or not such committee shall represent the Owners of a majority in aggregate principal amount of the Bonds then Outstanding.

(2) The Trustee shall not be liable for any error of judgment made in good faith by a responsible officer, unless it shall be proved that the Trustee was negligent in ascertaining the pertinent facts.

(3) The Trustee shall not be liable with respect to any action taken or omitted to be taken by it in good faith in accordance with the direction of the Owners of not less than a majority in aggregate principal amount of the Bonds at the time Outstanding relating to the time, method and place of conducting any proceeding for any remedy available to the Trustee, or exercising any trust or power conferred upon the Trustee under the Indenture.

(d) **Right to Rely on Documents.** The Trustee shall be protected in acting upon any notice, resolution, request, consent, order, certificate, report, opinion, bonds or other paper or document believed by it to be genuine and to have been signed or presented by the proper party or parties. The Trustee may consult with counsel, who may be counsel to the City, with regard to legal questions, and the opinion of such counsel shall be full and complete authorization and protection in respect of any action taken or suffered by it under the Indenture in good faith and in accordance therewith.

Whenever in the administration of the trusts imposed upon it by the Indenture the Trustee shall deem it necessary or desirable that a matter be proved or established prior to taking or suffering any action under the Indenture, such matter (unless other evidence in respect thereof is otherwise specifically prescribed in the Indenture) may be deemed to be conclusively proved and established by a Written Certificate of the City, and such Written Certificate shall be full warrant to the Trustee for any action taken or suffered in good faith under the provisions of the Indenture in reliance upon such Written Certificate, but in its discretion the Trustee may, in lieu thereof, accept other evidence of such matter or may require such additional evidence as it may deem reasonable.

(e) Accounting Records and Reports; Preservation and Inspection of Documents. The Trustee will keep or cause to be kept proper books of record and accounts in which complete and correct entries shall be made of all transactions relating to the receipts, disbursements, allocation and application of all money on deposit in the accounts and funds established under the Indenture, which such books shall be available for inspection by the City at reasonable hours and under reasonable conditions.

All documents received by the Trustee under the provisions of the Indenture shall be retained in its possession and shall be subject during business hours and upon 24 hours' notice to the inspection of the City, the Owners and their agents and representatives duly authorized in writing.

(f) Compensation and Indemnification. The City shall pay to the Trustee from time to time all reasonable compensation for all services rendered under the Indenture, and also all reasonable expenses, charges, legal and consulting fees and other disbursements and those of its attorneys, agents and employees, incurred in and about the performance of their powers and duties under the Indenture. The City further agrees, to the extent permitted by law, to indemnify, defend and save the Trustee harmless against any liabilities which it may incur in the exercise and performance of its powers and duties under the Indenture and under any related documents, including the enforcement of any remedies and the defense of any suit, and which are not due to its negligence or its willful misconduct. The duty of the City to indemnify and compensate the Trustee shall survive the termination and discharge of the Indenture and the resignation or removal of the Trustee.

The Trustee shall not be required to expend or risk its own funds or otherwise incur any financial liability in the performance of its rights or powers under the Indenture if the Trustee shall have reasonable grounds for believing that repayment of such funds or adequate indemnity against such risk or liability is not reasonably assured to it. The Trustee shall be under no obligation to exercise any of the rights or powers vested in it by the Indenture at the request or direction of any of the Owners pursuant to the Indenture, unless such Owners shall have offered to the Trustee security or indemnity, reasonably satisfactory to the Trustee in its judgment, against the reasonable costs, expenses and liabilities which might be incurred by it in compliance with such request or direction. The right of the Trustee to take any action under the Indenture shall not be construed as a duty. The Trustee shall not be required to take any action under the Indenture if the Trustee shall have reasonably determined, or shall have been advised by counsel, that such action is likely to result in liability on the part of the Trustee or is contrary to the terms of the Indenture or is otherwise contrary to law.

SUPPLEMENTAL INDENTURES

Modifications and Amendments Permitted. The Indenture and the rights and obligations of the City, the Owners of the Bonds and the Trustee may be modified or amended from time to time and at any time by a Supplemental Indenture, which the City and the Trustee may enter into with the prior written consent of the Insurer and the written consent of the Owners of a majority in aggregate principal amount of all Bonds then Outstanding, which shall have been filed with the Trustee. No such modification or amendment shall (i) extend the fixed maturity of any Bonds, or reduce the amount of principal thereof, or reduce the interest rate borne thereby, or extend or accelerate the time of payment thereof, or modify the redemption provisions applicable thereto, without the consent of the Owner of each Bond so affected, or (ii) reduce the aforesaid percentage of Bonds the consent of the Owners of which is required to effect any such modification or amendment, without the consent of the Owners of all of the Bonds then Outstanding. It shall not be necessary for the consent of the Owners to approve the particular form of any Supplemental Indenture, but it shall be sufficient if such consent shall approve the substance thereof.

The Indenture and the rights and obligations of the City, the Trustee and the Owners of the Bonds may also be modified or amended from time to time and at any time, with the prior written consent of the Insurer, by a

Supplemental Indenture, which the City and the Trustee may enter into without the consent of any Bond Owners for any one or more of the following purposes:

- (a) to add to the covenants and agreements of the City in the Indenture contained, other covenants and agreements thereafter to be observed, to pledge or assign additional security for the Bonds (or any portion thereof), or to surrender any right or power reserved to or conferred upon the City under the Indenture;
- (b) to make such provisions for the purpose of curing any ambiguity, inconsistency or omission, or of curing or correcting any defective provision contained in the Indenture;
- (c) to modify, amend or supplement the Indenture in such manner as to permit the qualification of the Indenture under the Trust Indenture Act of 1939, as amended, or any similar federal statute hereafter in effect, and to add such other terms, conditions and provisions as may be permitted by said act or similar federal statute;
- (d) to modify, amend or supplement the Indenture in such manner as to cause interest on the Bonds to be excludable from gross income for purposes of federal income taxation by the United States of America; and
- (e) in any other respect whatsoever as the City may deem necessary or desirable, provided that such modification or amendment does not materially adversely affect the interests of the Owners under the Indenture.

Any rating agency rating the Bonds must receive notice of each amendment to the Indenture and a copy thereof at least fifteen (15) Business Days in advance of its execution or adoption. The Insurer shall be provided with a full transcript of all proceedings relating to the execution of any such amendment.

Promptly after the execution by the City and the Trustee of any Supplemental Indenture, the Trustee shall mail a notice (the form of which shall be furnished to the Trustee by the City), by first class mail postage prepaid, setting forth in general terms the substance of such Supplemental Indenture, to the Owners of the Bonds at the respective addresses shown on the Registration Books. Any failure to give such notice, or any defect therein, shall not, however, in any way impair or affect the validity of any such Supplemental Indenture.

Effect of Supplemental Indenture. Upon the execution and delivery of any Supplemental Indenture in accordance with the Indenture, the Indenture shall be deemed to be modified and amended in accordance therewith, and the respective rights, duties and obligations under the Indenture of the City, the Trustee and all Owners of Bonds Outstanding shall thereafter be determined, exercised and enforced under the Indenture subject in all respects to such modification and amendment, and all the terms and conditions of any such Supplemental Indenture shall be deemed to be part of the terms and conditions of the Indenture for any and all purposes.

Endorsement of Bonds; Preparation of New Bonds. Bonds delivered after the execution of any Supplemental Indenture pursuant to the Indenture may, and if the City so determines shall, bear a notation by endorsement or otherwise in form approved by the City and the Trustee as to any modification or amendment provided for in such Supplemental Indenture, and, in that case, upon demand of the Owner of any Bonds Outstanding at the time of such execution and presentation of his Bonds for the purpose at the Office of the Trustee a suitable notation shall be made on such Bonds. If the Supplemental Indenture shall so provide, new Bonds so modified as to conform, in the opinion of the City and the Trustee, to any modification or amendment contained in such Supplemental Indenture, shall be prepared and executed by the City and authenticated by the Trustee, and upon demand of the Owners of any Bonds then Outstanding shall be exchanged at the Office of the Trustee, without cost to any Bond Owner, for Bonds then Outstanding, upon surrender for cancellation of such Bonds, in equal aggregate principal amount of the same interest rate and maturity.

Amendment of Particular Bonds. The provisions of this section shall not prevent any Bond Owner from accepting any amendment as to the particular Bonds held by such Owner.

Opinion of Counsel as to Supplemental Indenture. Prior to entering into any Supplemental Indenture, the Trustee shall be entitled to receive an Opinion of Counsel, upon which it may conclusively rely, stating to the effect that (1) such Supplemental Indenture is authorized or permitted by the Indenture, and, if applicable, (2) the execution and delivery of such Supplemental Indenture will not adversely affect the exclusion from gross income for Federal income tax purposes of the Bonds.

EVENTS OF DEFAULT AND REMEDIES OF HOLDERS

Events of Default. If any of the following events occur, they shall constitute Events of Default under the Indenture, namely:

- (1) If default shall be made by the City in the due and punctual payment of the interest on any Bond when and as the same shall become due and payable;
- (2) If default shall be made by the City in the due and punctual payment of the principal of any Bond when and as the same shall become due and payable at maturity or on prior redemption;
- (3) If default shall be made by the City in the performance of any of the other agreements or covenants required in the Indenture to be performed by the City, and such default shall have continued for a period of 30 after the City shall have been given notice in writing of such default by the Trustee, the Insurer or the Owners of not less than 50% in aggregate principal amount of the Outstanding Bonds with the prior consent of the Insurer...provided, however, if in the reasonable opinion of the City the failure stated in the notice can be corrected, but not within such 30 day period, such failure shall not constitute an Event of Default if, with the prior written consent of the Insurer, corrective action is instituted by the City within such 30 day period and the City shall thereafter diligently and in good faith cure such failure in a reasonable period of time; or
- (4) If an Event of Bankruptcy shall occur, 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 City or of the whole or any substantial part of its property.

Remedies for Events of Default. If an Event of Default occurs and is continuing, the Trustee may and, upon the written direction of the Owners of not less than 50% in aggregate principal amount of the Outstanding Bonds, shall, by written notice to the City, declare immediately due and payable the principal of all Outstanding Bonds and the accrued interest thereon, whereupon the same shall become immediately due and payable without any further action or notice; provided, however, that the indebtedness evidenced by the Bonds shall not be accelerated without the Insurer's prior written consent and the Insurer may, in its discretion, either direct the accelerated payment of the Bonds or continue to pay principal and interest on the originally scheduled due dates of the Bonds, and; provided further that if at any time after such acceleration and before any judgment or decree for the payment of money with respect thereto has been entered all amounts payable to the Trustee under the Indenture on the Bonds subject to acceleration under this paragraph (except interest on or principal of the Bonds which are due solely by reason of such acceleration) shall have been paid or provided for by deposit with the Trustee and all existing Events of Default shall have been cured or waived, then the Owners of not less than 25% in aggregate principal amount of the Outstanding Bonds may annul such acceleration and its consequences by written notice to the City and the Trustee, which annulment shall be binding upon the City, the Trustee and all of the Owners, but no such annulment shall extend to or affect any subsequent Event of Default or impair any right or remedy consequent thereon.

Application of Funds Upon Acceleration. All money in the Judgment Obligation Fund and the Bond Fund upon the date of the declaration of acceleration by the Trustee as provided in the Indenture and all amounts thereafter received by the Trustee under the Indenture shall be applied by the Trustee in the following order--

- (1) To the payment of any expenses necessary in the opinion of the Trustee to protect the interests of the Owners and 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;

(2) To the payment of the principal of and interest then due with respect to the Bonds (upon presentation of the Bonds to be paid, and stamping thereon of the payment if only partially paid, or surrender thereof if fully paid) subject to the provisions of the Indenture, as follows:

First: To the payment to the Persons entitled thereto of all installments of interest then due in the order of the maturity of such installments and, if the amount available shall not be sufficient to pay in full any installment or installments maturing on the same date, then to the payment thereof ratably, according to the amounts due thereon, to the Persons entitled thereto, without any discrimination or preference; and

Second: To the payment to the Persons entitled thereto of the unpaid principal of any Bonds which shall have become due, whether at maturity or by call for redemption, with interest on the overdue principal at the rate borne by the respective Bonds on the date of maturity or redemption, and, if the amount available shall not be sufficient to pay in full all the Bonds, together with such interest, then to the payment thereof ratably, according to the amounts of principal due on such date to the Persons entitled thereto, without any discrimination or preference.

(3) Any remaining funds shall be transferred by the Trustee to the Judgment Obligation Fund.

Power of Trustee to Enforce. All rights of action under the Indenture or the Bonds or otherwise may be prosecuted and enforced by the Trustee without the possession of any of the Bonds or the production thereof in any proceeding relating thereto, and any such suit, action or proceeding instituted by the Trustee shall be brought in the name of the Trustee for the benefit and protection of the Owners of such Bonds, subject to the provisions of the Indenture.

Bond Owners Direction of Proceedings. Anything in the Indenture to the contrary notwithstanding, the Owners of a majority in aggregate principal amount of the Bonds then Outstanding shall have the right, by an instrument or concurrent instruments in writing executed and delivered to the Trustee, and upon indemnification of the Trustee to its reasonable satisfaction, to direct the method of conducting all remedial proceedings taken by the Trustee under the Indenture, provided that such direction shall not be otherwise than in accordance with law and the provisions of the Indenture, and that the Trustee shall have the right to decline to follow any such direction which in the opinion of the Trustee would be unjustly prejudicial to Owners not parties to such direction.

Limitation on Bond Owners' Right to Sue. No Owner of any Bonds shall have the right to institute any suit, action or proceeding at law or in equity, for the protection or enforcement of any right or remedy under the Indenture, the Act or any other applicable law with respect to such Bonds, unless (a) such Owner shall have 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 the Bonds then Outstanding shall have made written request upon the Trustee to exercise the powers hereinbefore granted or to institute such suit, action or proceeding in its own name, (c) such Owner or said Owners shall have tendered to the Trustee indemnity against the costs, expenses and liabilities to be incurred in compliance with such request, and (d) the Trustee shall have refused or omitted to comply with such request for a period of 60 days after such written request shall have been received by, and said tender of indemnity shall have been made to, the Trustee.

Such notification, request, tender of indemnity and refusal or omission are declared under the Indenture, in every case, to be conditions precedent to the exercise by any Owner of Bonds of any remedy under the Indenture or under law; it being understood and intended that no one or more Owners of Bonds shall have any right in any manner whatever by his or their action to affect, disturb or prejudice the security of the Indenture or the rights of any other Owners of Bonds, or to enforce any right under the Bonds, the Indenture, the Act or other applicable law with respect to the Bonds, except in the manner provided under the Indenture, and that all proceedings at law or in equity to enforce any such right shall be instituted, had and maintained in the manner provided under the Indenture and for the benefit and protection of all Owners of the Outstanding Bonds, subject to the provisions of the Indenture.

Absolute Obligation. Nothing in any provision of the Indenture or in the Bonds contained shall affect or impair the obligation of the City, which is absolute and unconditional, to pay the principal of and interest on the Bonds to the respective Owners of the Bonds at their respective dates of maturity, or upon call for redemption, as provided under the Indenture, or affect or impair the right of such Owners, which is also absolute and unconditional, to enforce such payment by virtue of the contract embodied in the Bonds.

Termination of Proceedings. In case any proceedings taken by the Trustee or any one or more Owners on account of any Event of Default shall have been discontinued or abandoned for any reason or shall have been determined adversely to the Trustee or the Owners, then in every such case the City, the Trustee and the Owners, subject to any determination in such proceedings, shall be restored to their former positions and rights under the Indenture, severally and respectively, and all rights, remedies, powers and duties of the City, the Trustee and the Owners shall continue as though no such proceedings had been taken.

Remedies Not Exclusive. No remedy under the Indenture conferred upon or reserved to the Trustee or to the Owners of the Bonds is intended to be exclusive of any other remedy or remedies, and each and every such remedy, to the extent permitted by law, shall be cumulative and in addition to any other remedy given under the Indenture or now or hereafter existing at law or in equity or otherwise.

No Waiver of Default. No delay or omission of the Trustee or of any Owner to exercise any right or power arising upon the occurrence of 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 given by the Indenture to the Trustee or to the Owners may be exercised from time to time and as often as may be deemed expedient.

PROVISIONS WITH RESPECT TO THE POLICY AND THE INSURER

Payment Procedure. The Trustee shall not make a claim for payment on the Policy until any and all funds held pursuant to the Indenture have been fully drawn to pay Debt Service on the Bonds. As long as the Policy shall be in full force and effect, the Trustee agrees to comply with the following provisions:

(a) At least three (3) days prior to all Interest Payment Dates, the Trustee, will determine whether there will be sufficient funds to pay the principal of or interest on the Bonds on such Interest Payment Date. If the Trustee determines that there will be insufficient funds, the Trustee shall so notify the Insurance Trustee. Such notice shall specify the amount of the anticipated deficiency, the Bonds to which such deficiency is applicable and whether such Bonds will be deficient as to principal or interest, or both. The Insurer will make payments of principal or interest due on the Bonds on or before the first (1st) day next following the date on which the Insurance Trustee shall have received notice of nonpayment from the Trustee.

(b) The Trustee shall, after giving notice to the Insurance Trustee as provided in (a) above, make available to the Insurer and the Insurance Trustee, the registration books of the City maintained by the Trustee, and all records relating to the funds maintained under the Indenture.

(c) The Trustee shall provide the Insurer and the Insurance Trustee with a list of registered owners of Bonds entitled to receive principal or interest payments from the Insurer under the terms of the Policy, and shall make arrangements with the Insurance Trustee (i) to mail checks or drafts to the registered owners of Bonds entitled to receive full or partial interest payments from the Insurer and (ii) to pay principal upon Bonds surrendered to the Insurance Trustee by the registered owners of Bonds entitled to receive full or partial principal payments from the Insurer.

(d) The Trustee shall at the time it provides notice to the Insurance Trustee pursuant to (a) above, notify registered owners of Bonds entitled to receive the payment of principal or interest thereon from the Insurer (i) as to the fact of such entitlement, (ii) that the Insurer will remit to them all or part of the interest payments next coming due upon proof of registered owner entitlement to interest payments and delivery to the Insurance Trustee, in form satisfactory to the Insurance Trustee as determined by the Insurer, of an appropriate assignment of the registered owner's right to payment, (iii) that should they be entitled to receive full payment of principal from the Insurer, they must surrender their Bonds (along with an appropriate instrument of assignment in form satisfactory to

the Insurer to permit ownership of such Bonds to be registered in the name of the Insurer) for payment to the Insurance Trustee, and not the Trustee and (iv) that should they be entitled to receive partial payment of principal from the Insurer, they must surrender their Bonds for payment thereon first to the Trustee, who shall note on such Bonds the portion of the principal paid by the Trustee and then, along with an appropriate instrument of assignment in form satisfactory to the Insurer, to the Insurance Trustee, which will then pay the unpaid portion of principal.

(e) In the event that the Trustee has notice that any payment of principal of or interest on a Bond which has become due for payment and which is made to a registered owner by or on behalf of the City has been deemed a preferential transfer and theretofore recovered from its registered owner pursuant to the United States Bankruptcy Code by a trustee in bankruptcy in accordance with the final, nonappealable order of a court having competent jurisdiction, the Trustee shall, at the time the Insurance Trustee is notified pursuant to (a) above, notify all registered owners that in the event that any registered owner's payment is so recovered, such registered owner will be entitled to payment from the Insurer to the extent of such recovery if sufficient funds are not otherwise available, and the Trustee shall furnish to the Insurance Trustee and the Insurer its records evidencing the payments of principal of and interest on the Bonds which have been made by the Trustee and subsequently recovered from registered owners and the dates on which such payments are made.

(f) The Insurer shall, to the extent it makes payment of principal of or interest on Bonds, become subrogated to the rights of the recipients of such payments in accordance with the terms of the Policy, and to evidence such subrogation (i) in the case of subrogation as to claims for past due interest, the Trustee shall note the Insurer's rights as subrogee on the registration books of the City maintained by the Trustee, upon receipt from the Insurer of proof of the payment of interest thereon to the registered owners of the Bonds and (ii) in the case of subrogation as to claims for past due principal, the Trustee shall note the Insurer's rights as subrogee on the registration books of the City maintained by the Trustee upon surrender of the Bonds by the registered owners thereof together with proof of the payment of principal thereof.

DEFEASANCE

Discharge of Indenture. If the City shall pay or cause to be paid or there shall otherwise be paid to the Owners of all Outstanding Bonds the principal thereof and the interest thereon at the times and in the manner stipulated in such document or in the Indenture, then all agreements, covenants and other obligations of the City to the Owners of such Bonds under the Indenture shall thereupon cease, terminate and become void and be discharged and satisfied. In such event, the Trustee shall execute and deliver to the City all such instruments as may be necessary or desirable to evidence such discharge and satisfaction, and the Trustee shall pay over or deliver to the City all money or securities held by it pursuant to the terms of the Indenture which are not required for the payment of the principal of and interest on such Bonds.

Subject to the provisions of the above paragraph, when any of the Bonds shall have been paid and if, at the time of such payment, the City shall have kept, performed and observed all of the covenants and promises in such Bonds and in the Indenture required or contemplated to be kept, performed and observed by the City or on its part on or prior to that time, then the Indenture shall be considered to have been discharged in respect of such Bonds and such Bonds shall cease to be entitled to the lien of the Indenture and such lien and all covenants, agreements and other obligations of the City under the Indenture shall cease, terminate become void and be completely discharged as to such Bonds.

Notwithstanding the satisfaction and discharge of the Indenture or the discharge of the Indenture in respect of any Bonds, those provisions of the Indenture relating to the maturity of the Bonds, interest payments and dates thereof, exchange and transfer of Bonds, replacement of mutilated, destroyed, lost or stolen Bonds, the safekeeping and cancellation of Bonds, non-presentment of Bonds, and the duties of the Trustee in connection with all of the foregoing, shall remain in effect and shall be binding upon the Trustee and the Owners of the Bonds and the Trustee shall continue to be obligated to hold in trust any moneys or investments then held by the Trustee for the payment of the principal of and interest and premium, if any, on the Bonds, to pay to the Owners of Bonds the funds so held by the Trustee as and when such payment becomes due.

Bonds Deemed To Have Been Paid. If moneys shall have been set aside and held by the Trustee for the payment or redemption of any Bonds and the interest thereon at the maturity or redemption date thereof, such Bonds

shall be deemed to have been paid within the meaning and with the effect provided above under the caption "Discharge of Indenture." Any Outstanding Bonds shall prior to the maturity date or redemption date thereof be deemed to have been paid within the meaning of and with the effect expressed above under the caption "Discharge of Indenture" if (a) in case any of such Bonds are to be redeemed on any date prior to their maturity date, the City shall have given to the Trustee in form satisfactory to it irrevocable instructions to mail, on a date in accordance with the provisions of the Indenture, notice of redemption of such Bonds on said redemption date, said notice to be given in accordance with the Indenture, (b) there shall have been deposited with the Trustee either (i) money in an amount which shall be sufficient, or (ii) Federal Securities that are not subject to redemption other than at the option of the holder thereof, the interest on and principal of which when paid will provide money which, together with the money, if any deposited with the Trustee at the same time, shall, as verified by an independent certified public accountant, be sufficient to pay when due the interest to become due on such Bonds on and prior to the maturity date or redemption date thereof, as the case may be, and the principal of and premium, if any, on such Bonds; and (b) in the event such Bonds are not by their terms subject to redemption within the next succeeding 60 days, the City shall have given the Trustee in form satisfactory to it irrevocable instructions to mail as soon as practicable, a notice to the owners of such Bonds that the deposit required by clause (b) above has been made with the Trustee and that such Bonds, are deemed to have been paid in accordance with this section and stating the maturity date or redemption date upon which money is to be available for the payment of the principal of and premium, if any, on such Bonds.

To accomplish the discharge of liability in respect of the Bonds described in the preceding paragraph, the City shall cause to be delivered (a) a report of an independent firm of nationally recognized certified public accountants or such other accountant as shall be acceptable to the Insurer verifying the sufficiency of the escrow established to pay the Bonds in full on the maturity or payment date ("Verification"), (b) an escrow agreement (which shall be acceptable in form and substance to the Insurer), and (c) an opinion of nationally recognized bond counsel to the effect that the Bonds are no longer "Outstanding" under the Indenture; each Verification and defeasance opinion shall be acceptable in form and substance to the City and the Insurer, and shall be addressed to the City, the Trustee and the Insurer. In the event a forward purchase agreement is to be employed in the refunding, such agreement shall be subject to the approval of the Insurer and shall be accompanied by such opinions of counsel as may be required by the Insurer. The Insurer shall be provided with final drafts of the above-referenced documentation not less than five Business Days prior to the funding of the escrow. Bonds shall remain Outstanding under the Indenture unless and until they are in fact paid and retired or the criteria in this paragraph are met.

Payment of Bonds After Discharge of Indenture. Notwithstanding any provisions of the Indenture, to the extent permitted by law, any moneys held by the Trustee in trust for the payment of the principal of or interest on, any Bonds and remaining unclaimed for two years after the date of deposit of such moneys, shall be repaid to the City free from the trusts created by the Indenture, and all liability of the Trustee with respect to such moneys shall thereupon cease; provided, however, that before the repayment of such moneys to the City as aforesaid, the Trustee may (at the cost of the City) first mail, by first class mail postage prepaid, to the Owners of Bonds which have not yet been paid, at the respective addresses shown on the Registration Books, a notice, in such form as may be deemed appropriate by the Trustee with respect to the Bonds so payable and not presented and with respect to the provisions relating to the repayment to the City of the moneys held for the payment thereof.

Subrogation. Notwithstanding anything to the contrary in the Indenture, in the event that the principal and/or interest due on the Bonds shall be paid by Insurer pursuant to the Policy, the Bonds shall remain outstanding for all purposes, not be defeased or otherwise satisfied and not be considered paid by the City, and all covenants, agreements and other obligations of the City to the registered owners shall continue to exist and shall run to the benefit of Insurer and Insurer shall be subrogated to the rights of such registered owners.

MISCELLANEOUS

Benefits of the Indenture Limited. Nothing contained in the Indenture, expressed or implied, is intended or shall be construed to confer upon, or to give or grant to any Person or entity other than the Trustee, the City and the Owners and any right any right and remedy or claim under or by reason of the Indenture, and any covenant, condition or stipulation of the Indenture, and all covenants, stipulations, promises and agreements in the Indenture contained by and on behalf of the City shall be for the sole and exclusive benefit of the Trustee and the Owners.

Successor Is Deemed Included In All References To Predecessor. Whenever in the Indenture either the City or any officer or employee thereof or the Trustee is named or referred to, such reference shall be deemed to include the successor or assigns thereof, and all agreements and covenants required under the Indenture to be performed by or on behalf of the City or any officer or employee thereof or the Trustee shall bind and inure to the benefit of the respective successors thereof whether so expressed or not.

Destruction of Bonds. Whenever in the Indenture provision is made for the cancellation by the Trustee and the delivery to the City of any Bonds, the Trustee shall, in lieu of such cancellation and delivery, destroy such Bonds.

Waiver of Notice; Requirement of Mailed Notice. Whenever in the Indenture the giving of notice by mail or otherwise is required, the giving of such notice may be waived in writing by the Person entitled to receive such notice and in any such case the giving or receipt of such notice shall not be a condition precedent to the validity of any action taken in reliance upon such waiver. Whenever in the Indenture any notice shall be required to be given by mail, such requirement shall be satisfied by the deposit of such notice in the United States mail, postage prepaid, by first class mail.

Severability of Invalid Provisions. If any one or more of the provisions contained in the Indenture or in the Bonds shall for any reason be held to be invalid, illegal or unenforceable in any respect, then such provision or provisions shall be deemed severable from the remaining provisions contained in the Indenture and such invalidity, illegality or unenforceability shall not affect any other provision of the Indenture, and the Indenture shall be construed as if such invalid or illegal or unenforceable provision had never been contained in the Indenture. The City declares under the Indenture that it would have entered into the Indenture and each and every other section, subsection, paragraph, sentence, clause or phrase of the Indenture and authorized the issuance of the Bonds pursuant thereto irrespective of the fact that any one or more sections, subsections, paragraphs, sentences, clauses or phrases of the Indenture may be held illegal, invalid or unenforceable.

Evidence of Rights of Bond Owners. Any request, consent or other instrument required or permitted by the Indenture to be signed and executed by Owners may be in any number of concurrent instruments of substantially similar tenor and shall be signed or executed by such Owners in Person or by an agent or agents duly appointed in writing. Proof of the execution of any such request, consent or other instrument or of a writing appointing any such agent, or of the holding by any Person of Bonds transferable by delivery, shall be sufficient for any purpose of the Indenture and shall be conclusive in favor of the Trustee and the City if made in the manner provided in this section.

The fact and date of the execution by any Person of any such request, consent or other instrument or writing may be proved by the certificate of any notary public or other officer of any jurisdiction, authorized by the laws thereof to take acknowledgments of deeds, certifying that the Person signing such request, consent or other instrument acknowledged to him the execution thereof, or by an affidavit of a witness of such execution duly sworn to before such notary public or other officer. The ownership of Bonds shall be proved by the Registration Books.

Any request, consent, or other instrument or writing of the Owner of any Bond shall bind every future Owner of the same Bond and the Owner of every Bond issued in exchange therefor or in lieu thereof, in respect of anything done or suffered to be done by the Trustee or the City in accordance therewith or reliance thereon.

Disqualified Bonds. In determining whether the Owners of the requisite aggregate principal amount of Bonds have concurred in any demand, request, direction, consent or waiver under the Indenture, Bonds which are known by the Trustee to be owned or held by or for the account of the City, or by any other obligor on the Bonds, or by any Person directly or indirectly controlling or controlled by, or under direct or indirect common control with, the City or any other obligor on the Bonds, shall be disregarded and deemed not to be Outstanding for the purpose of any such determination.

Money Held for Particular Bonds. The money held by the Trustee for the payment of the interest or principal due on any date with respect to particular Bonds (or portions of Bonds in the case of Bonds redeemed in part only) shall, on and after such date and pending such payment, be set aside on its books and held in trust by it for the Owners of the Bonds entitled thereto, subject, however, to the provisions set forth herein under the caption "DEFEASANCE - Payment of Bonds After Discharge of Indenture" but without any liability for interest thereon.

Funds and Accounts. Any fund or account required by the Indenture to be established and maintained by the Trustee may be established and maintained in the accounting records of the Trustee, either as a fund or an account, and may, for the purposes of such records, any audits thereof and any reports or statements with respect thereto, be treated either as a fund or as an account; but all such records with respect to all such funds and accounts shall at all times be maintained in accordance with prudent corporate trust industry standards to the extent practicable, and with due regard for the requirements of the Indenture and for the protection of the security of the Bonds and the rights of every Owner thereof. The Trustee may establish any such additional funds or accounts as it deems necessary to perform its obligations under the Indenture.

Payment on Non-Business Days. In the event any payment is required to be made under the Indenture on a day which is not a Business Day, such payment shall be made on the next succeeding Business Day with the same effect as if made on such non-Business Day.

Waiver of Personal Liability. No member, officer, agent or employee of the City or the City shall be individually or personally liable for the payment of the principal of or interest on the Bonds or be subject to any personal liability or accountability by reason of the issuance thereof; but nothing contained in the Indenture shall relieve any such officer, agent or employee from the performance of any official duty provided by law or by the Indenture.

Governing Laws. The Indenture shall be governed by and construed in accordance with the laws of the State.

(THIS PAGE INTENTIONALLY LEFT BLANK)

APPENDIX D

PROPOSED FORM OF OPINION OF BOND COUNSEL

Upon delivery of the Bonds, Orrick, Herrington & Sutcliffe LLP, Los Angeles, California, Bond Counsel, proposes to render its final approving opinion with respect to the Bonds in substantially the following form:

[Date of Delivery]

City of Desert Hot Springs
65950 Pierson Boulevard
Desert Hot Springs, California

City of Desert Hot Springs
Judgment Obligation Bonds
(Final Opinion)

Ladies and Gentlemen:

We have acted as bond counsel in connection with the issuance by the City of Desert Hot Springs (the “City”) of \$9,725,000 aggregate principal amount of City of Desert Hot Springs Judgment Obligation Bonds (the “Bonds”) issued pursuant to the provisions of Articles 10 and 11 (commencing with Section 53570) of Chapter 3 of Division 2 of Title 5 of the California Government Code and all laws amendatory thereof or supplemental thereto and under and pursuant to the provisions of an Indenture (the “Indenture”), dated as of October 1, 2004, by and between the City of Desert Hot Springs and Wells Fargo Bank, National Association, as Trustee (the “Trustee”). Capitalized terms not otherwise defined herein shall have the meanings set forth in the Indenture.

In such connection, we have reviewed the Indenture, the Tax Certificate, certificates of the City, the Trustee and others, opinions of counsel to the City and the Trustee, and such other documents, opinions and matters to the extent we deemed necessary to render the opinions set forth herein.

Certain agreements, requirements and procedures contained or referred to in the Indenture, the Tax Certificate and other relevant documents may be changed and certain actions (including, without limitation, defeasance of the Bonds) may be taken or omitted under the circumstances and subject to the terms and conditions set forth in such documents. No opinion is expressed herein as to any Bond or the interest thereon if any such change occurs or action is taken or omitted upon the advice or approval of counsel other than ourselves.

The opinions expressed herein are based on an analysis of existing laws, regulations, rulings and court decisions, including the default judgment rendered on September 24, 2004 by the Superior Court of the City of Desert Hot Springs in the action entitled *City of Desert Hot Springs v. All Persons Interested in the Matter of the Validity and Confirmation of Proceedings Relating to the Authorization of the Issuance of Bonds*, Case No. INC 044456, filed July 16, 2004, and cover certain matters not directly addressed by such authorities. Such opinions may be affected by actions taken or omitted or events occurring after the date hereof. We have not undertaken to determine, or to inform any person, whether any such actions are taken or omitted or events do occur. We disclaim any obligation to update this opinion. We have assumed the genuineness of all documents and signatures presented to us (whether as

originals or as copies) and the due and legal execution and delivery thereof by, and validity against, any parties other than the City. We have not undertaken to verify independently, and have assumed, the accuracy of the factual matters represented, warranted or certified in the documents, and of the legal conclusions contained in the opinions, referred to in the second paragraph hereof. Furthermore, we have assumed compliance with all covenants and agreements contained in the Indenture and the Tax Certificate, including (without limitation) covenants and agreements compliance with which is necessary to assure that future actions, omissions or events will not cause interest on the Bonds to be included in gross income for federal income tax purposes. We call attention to the fact that the rights and obligations under the Bonds, the Indenture and the Tax Certificate and their enforceability may be subject to bankruptcy, insolvency, reorganization, arrangement, fraudulent conveyance, moratorium and other laws relating to or affecting creditors' rights, to the application of equitable principles, to the exercise of judicial discretion in appropriate cases and to the limitations on legal remedies against charter cities in the State of California. We express no opinion with respect to any indemnification, contribution, penalty, choice of law, choice of forum or waiver provisions contained in the foregoing documents. Finally, we undertake no responsibility for the accuracy, completeness or fairness of the Official Statement or other offering material relating to the Bonds and express no opinion with respect thereto.

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

1. The Bonds constitute the valid and binding obligations of the City. The obligations of the City under the Bonds, including the obligation to make all payments of the interest on and the principal of the Bonds when due, are obligations of the City imposed by law.

2. The Indenture has been duly executed and delivered by, and constitutes the valid and binding obligation of, the City.

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

Faithfully yours,

ORRICK, HERRINGTON & SUTCLIFFE LLP

APPENDIX E

BOOK-ENTRY-ONLY SYSTEM

The description that follows of the procedures and recordkeeping with respect to beneficial ownership interests in the Bonds, payment of the principal or Redemption Price of, or interest on, the Bonds to Participants or Beneficial Owners, confirmation and transfer of beneficial ownership interests in the Bonds, and other Bonds-related transactions by and between DTC, Participants and Beneficial Owners, is based on information furnished by DTC which the City believes to be reliable, but the City takes no responsibility for the completeness or accuracy thereof.

The Depository Trust Company - Book-Entry Only System

The Depository Trust Company (“DTC”), New York, NY, will act as securities depository for the securities (the “Securities”). The Securities will be executed and delivered as fully-registered securities registered in the name of Cede & Co. (DTC’s partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully-registered Security certificate will be executed and delivered for each maturity of the Securities, each in the aggregate principal amount of such issue, and will be deposited with DTC. DTC, the world’s largest depository, is a limited-purpose trust company organized under the New York Banking Law, a “banking organization” within the meaning of the New York Banking Law, a member of the Federal Reserve System, a “clearing corporation” within the meaning of the New York Uniform Commercial Code, and a “clearing agency” registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for over 2 million issues of U.S. and non-U.S. equity issues, corporate and municipal debt issues, and money market instruments from over 85 countries that DTC’s participants (“Direct Participants”) deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities, through electronic computerized book-entry transfers and pledges between Direct Participants’ accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation (“DTCC”). DTCC, in turn, is owned by a number of Direct Participants of DTC and Members of the National Securities Clearing Corporation, Government Securities Clearing Corporation, MBS Clearing Corporation, and Emerging Markets Clearing Corporation (NSCC, GSCC, MBSCC, and EMCC, also subsidiaries of DTCC), as well as by the New York Stock Exchange, Inc., the American Stock Exchange LLC, and the National Association of Securities Dealers, Inc. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, 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.

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

ownership interests in Securities, except in the event that use of the book-entry system for the Securities is discontinued.

To facilitate subsequent transfers, all Securities deposited by Direct Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co., or such other name as may be requested by an authorized representative of DTC. The deposit of Securities with DTC and their registration in the name of Cede & Co. or such other DTC nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Securities; DTC's records reflect only the identity of the Direct Participants to whose accounts such Securities are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers. Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. Redemption notices shall be sent to DTC. If less than all of the Securities within an issue are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such issue to be redeemed.

Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to Securities unless authorized by a Direct Participant in accordance with DTC's Procedures. Under its usual procedures, DTC mails an Omnibus Proxy to the City 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 Securities are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Redemption proceeds, distributions, and dividend payments on the Securities will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts upon DTC's receipt of funds and corresponding detail information from the City 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 Trustee, or the City, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of redemption proceeds, distributions, and dividend payments to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the City or the Trustee, disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners will be the responsibility of Direct and Indirect Participants.

DTC may discontinue providing its services as depository with respect to the Securities at any time by giving reasonable notice to the City or the Trustee. Under such circumstances, in the event that a successor depository is not obtained, Security certificates are required to be printed and delivered. Further, the City may decide to discontinue use of the system of book-entry transfers through DTC (or a successor securities depository). In that event, Security certificates will be printed and delivered.

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

Discontinuance of DTC Services

In the event (i) DTC, including any successor as securities depository for the Bonds, determines not to continue to act as securities depository for the Bonds; or (ii) the City determines that the incumbent securities depository will no longer so act, and delivers a written certificate to the Trustee to that effect, then the City will discontinue the book-entry system with the incumbent securities depository for the Bonds. If the City determines to replace the incumbent securities depository for the Bonds with another qualified securities depository, the City will prepare or direct the preparation of a new single, separate fully registered Bond for the aggregate outstanding principal amount of Bonds of each maturity, registered in the name of such successor or substitute qualified securities depository, or its nominee, or make such other arrangement acceptable to the City, the Trustee and the successor securities depository for the Bonds as are not inconsistent with the terms of the Indenture. If the City fails to identify another qualified successor securities depository of the Bonds to replace the incumbent securities depository, then the Bonds will no longer be restricted to being registered in the Registration Books in the name of the incumbent securities depository or its nominee, but will be registered in whatever name or names the incumbent securities depository for the Bonds, or its nominee, will designate. In such event the Trustee will authenticate and deliver a sufficient quantity of Bonds as to carry out the transfers and exchanges provided in the Indenture. All such Bonds will be in fully registered form in denominations authorized by the Indenture.

(THIS PAGE INTENTIONALLY LEFT BLANK)

APPENDIX F

FORM OF CONTINUING DISCLOSURE AGREEMENT

THIS CONTINUING DISCLOSURE AGREEMENT (this "Disclosure Agreement"), dated as of October 1, 2004, is by and between WELLS FARGO BANK, NATIONAL ASSOCIATION, a national banking association organized and existing under the laws of the United States of America with a corporate trust office in Los Angeles, California (the "Trustee"), and the CITY OF DESERT HOT SPRINGS, a charter city organized and existing under the laws of the State of California (the "City").

WITNESSETH:

WHEREAS, the City has caused to be issued and delivered \$9,725,000 aggregate amount of City of Desert Hot Springs Judgment Obligation Bonds (the "Bonds") pursuant to an Indenture (the "Indenture"), dated as of October 1, 2004, by and between the City and Wells Fargo Bank, National Association, as trustee (the "Bond Trustee") and to be executed and delivered the City of Desert Hot Springs Certificates of Participation (Interim Cash Flow Financing) (the "Certificates") in the aggregate amount of \$3,060,000, pursuant to a Trust Agreement (the "Trust Agreement"), dated as of October 1, 2004, by and among Wells Fargo Bank, National Association, as trustee (the "Certificate Trustee" and, together with the Bond Trustee, the "Trustee"), the City of Desert Hot Springs Nonprofit Corporation and the City; and

WHEREAS, this Disclosure Agreement is being executed and delivered by the City and the Trustee for the benefit of the holders and beneficial owners of the Bonds and in order to assist the underwriters of the Bonds in complying with S.E.C. Rule 15c2-12(b)(5);

NOW, THEREFORE, for and in consideration of the mutual promises and covenants herein contained, the parties hereto agree as follows:

Section 1. Definitions. In addition to the definitions set forth in the Trust Agreement and the Indenture, as applicable, 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" means any Annual Report provided by the City pursuant to, and as described in, Sections 2 and 3 hereof.

"Disclosure Representative" means the City Manager of the City, or such other officer or employee of the City as the City shall designate in writing to the Trustee from time to time.

"Dissemination Agent" means 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.

"Listed Events" means any of the events listed in subsection (a) of Section 4 hereof.

"National Repository" means any Nationally Recognized Municipal Securities Information Repository for purposes of the Rule. As of the date hereof, the National Repositories approved by the Securities and Exchange Commission are identified at <http://www.sec.gov/info/municipal/nrmsir.htm>. The Nationally Recognized Municipal Securities Information Repositories approved by the Securities and Exchange Commission as of the date of this Disclosure Agreement are set forth in Exhibit B hereto.

“Official Statement” means each Official Statement, dated October 14, 2004, relating to the Bonds and the Certificates

“Participating Underwriter” means any of the original underwriters of the Bonds and the original underwriters of the Certificates required to comply with the Rule in connection with the offering of the Bonds and the Certificates.

“Repository” means each National Repository and each State Repository.

“Rule” means Rule 15c2-12(b)(5) adopted by the Securities and Exchange Commission under the Securities Exchange Act of 1934, as the same may be amended from time to time.

“State Repository” means any public or private repository or entity designated by the State of California as a state repository for the purpose of the Rule and recognized by the Securities and Exchange Commission. As of the date of this Disclosure Agreement, there is no State Repository.

Section 2. Provision of Annual Reports. (a) The City shall, or shall cause the Dissemination Agent to, not later than the date that is nine months after the end of the City’s fiscal year (which date currently would be April 1), commencing with the report for the 2003-04 Fiscal Year, provide to each Repository an Annual Report which is consistent with the requirements of Section 3 hereof. The Annual Report may be submitted as a single document or as separate documents comprising a package, and may include by reference other information as provided in Section 3 hereof; provided that the audited financial statements of the City may be submitted separately from the balance of the Annual Report, and later than the date required above for the filing of the Annual Report if not available by that date. If the City’s fiscal year changes, it shall give notice of such change in the same manner as for a Listed Event under subsection (f) of Section 4 hereof.

(b) Not later than 15 business days prior to the date specified in subsection (a) of this Section for the providing of the Annual Report to the Repositories, the City shall provide the Annual Report to the Dissemination Agent and the Trustee (if the Trustee is not the Dissemination Agent). If by such date, the Trustee has not received a copy of the Annual Report, the Trustee shall contact the City and the Dissemination Agent to determine if the City is in compliance with the first sentence of this subsection (b).

(c) If the Trustee is unable to confirm that an Annual Report has been provided to Repositories by the date required in subsection (a) of this Section, the Trustee shall send a notice to the Municipal Securities Rulemaking Board and each State Repository, if any, in substantially the form attached as Exhibit A.

(d) The Dissemination Agent shall:

(i) determine each year prior to the date for providing the Annual Report the name and address of each National Repository and each State Repository, if any; 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 pursuant to this Disclosure Agreement, stating the date it was provided and listing all the Repositories to which it was provided.

Section 3. Content of Annual Reports. The City’s Annual Report shall contain or incorporate by reference the following:

(a) Audited financial statements 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 subsection (a) of Section 2 hereof, the Annual Report shall contain unaudited financial statements in a format similar to the financial statements contained in the Official Statement, and the audited financial statements shall be filed in the same manner as the Annual Report when they become available.

(b) An update of the information contained in the tables with the following headings in the Official Statement for the then current fiscal year:

Table 2 – City of Desert Hot Springs – City of Desert Hot Springs General Fund, Tax Revenues By Source;

Table 3 – City of Desert Hot Springs – Transient Occupancy Tax;

Table 4 – City of Desert Hot Springs – Underlying Room Receipts;

Table 6 – City of Desert Hot Springs – Historical Taxable Sales;

Table 7 – City of Desert Hot Springs – Utility User's Tax;

Table 8 – City of Desert Hot Springs – Assessed Valuation;

Table 9 – City of Desert Hot Springs – Secured Tax Levies;

Table 10 – City of Desert Hot Springs – Largest Taxpayers; and

An update of the financial and operating data contained in the Official Statement under the caption "CITY FINANCIAL INFORMATION – Pensions; Plan Descriptions" and " – Investments of City Funds."

(c) In addition to any of the information expressly required to be provided under subsections (a) and (b) of this Section, the City shall provide such further information, if any, as may be necessary to make the specifically required statements, in the light of the circumstances under which they are made, not misleading.

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 each of the Repositories or the Securities and Exchange Commission. If the document included by reference is a final official statement, it must be available from the Municipal Securities Rulemaking Board. The City shall clearly identify each such other document so included by reference.

Section 4. 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 and interest payment delinquencies.
- (2) Non-payment related defaults.
- (3) Unscheduled draws on debt service reserves reflecting financial difficulties.

- (4) Unscheduled draws on credit enhancements reflecting financial difficulties.
- (5) Substitution of credit or liquidity providers, or their failure to perform.
- (6) Adverse tax opinions or events affecting the tax-exempt status of the security.
- (7) Modifications to rights of security holders.
- (8) Contingent or unscheduled Bond calls.
- (9) Defeasances.
- (10) Release, substitution, or sale of property securing repayment of the securities.
- (11) Rating changes.

(b) The Trustee shall, within one business day of obtaining actual knowledge of the occurrence of any of the Listed Events, contact the Disclosure Representative, inform such person of the event, and request that the City promptly notify the Trustee in writing whether or not to report the event pursuant to subsection (f) of this Section.

(c) Whenever the City obtains knowledge of the occurrence of a Listed Event, whether because of a notice from the Trustee pursuant to subsection (b) of this Section or otherwise, the City shall as soon as possible determine if such event would be material under applicable Federal securities law.

(d) If the City has determined that knowledge of the occurrence of a Listed Event would be material under applicable Federal securities law, the City shall promptly notify the Trustee in writing. Such notice shall instruct the Trustee to report the occurrence pursuant to subsection (f) of this Section.

(e) If in response to a request under subsection (b) of this Section, the City determines that the Listed Event would not be material under applicable Federal securities law, the City shall so notify the Trustee in writing and instruct the Trustee not to report the occurrence pursuant to subsection (f) of this Section.

(f) If the Trustee has been instructed by the City to report the occurrence of a Listed Event, the Trustee shall file a notice of such occurrence with the Municipal Securities Rulemaking Board and each State Repository. Notwithstanding the foregoing, notice of Listed Events described in paragraphs (8) and (9) of subsection (a) of this Section 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 5. Termination of Reporting Obligation. The City's obligations under this Disclosure Agreement shall terminate upon the legal defeasance, prior redemption, prepayment or payment in full of all of the Bonds and all of the Corticated. If such termination occurs prior to the final maturity of the Bonds and the Certificates, the City shall give notice of such termination in the same manner as for a Listed Event under subsection (f) of Section 4 hereof.

Section 6. 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 shall be the Dissemination Agent; provided it shall receive written notice of such designation at the time of such designation.

Section 7. Amendment; Waiver. Notwithstanding any other provision of this Disclosure Agreement, the City and the Trustee may amend this Disclosure Agreement (and the Trustee 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 subsection (a) of Section 2 hereof, Section 3 hereof or subsection (a) of Section 4 hereof, 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 Certificates, or type of business conducted;

(b) the undertakings herein, as proposed to be amended or waived, would, in the opinion of nationally recognized bond counsel, have complied with the requirements of the Rule at the time of the primary offering of the Bonds and the Certificates, after taking into account any amendments or interpretations of the Rule, as well as any change in circumstances; and

(c) the proposed amendment or waiver (i) is approved by holders of the Bonds and the Certificates in the manner provided in the Trust Agreement and the Indenture, as applicable, for amendments to the Trust Agreement and the Indenture, as applicable with the consent of holders, or (ii) does not, in the opinion of the Trustee or nationally recognized bond counsel, materially impair the interests of holders.

If the annual financial information or operating data to be provided in the Annual Report is amended pursuant to the provisions hereof, the annual financial information containing the amended operating data or financial information shall explain, in narrative form, the reasons for the amendment and the impact of the change in the type of operating data or financial information being provided.

If an amendment is made to the undertaking specifying the accounting principles to be followed in preparing financial statements, the annual financial information for the year in which the change is made shall present a comparison between the financial statements or information prepared on the basis of the new accounting principles and those prepared on the basis of the former accounting principles. The comparison shall include a qualitative discussion of the differences in the accounting principles and the impact of the change in the accounting principles on the presentation of the financial information, in order to provide information to investors to enable them to evaluate the ability of the City to meet its obligations. To the extent reasonably feasible, the comparison shall be quantitative. A notice of the change in the accounting principles shall be sent to the Repositories.

Section 8. 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 9. Default. In the event of a failure of the City, the Trustee or the Dissemination Agent to comply with any provision of this Disclosure Agreement, the Trustee may (and, at the written direction of any Participating Underwriter or the holders of at least 25% of the aggregate principal amount of Outstanding Bonds and holders of at least 25% aggregate amount of principal evidenced by Outstanding Certificates, shall), or any holder or beneficial owner of the Bonds and the Certificates may, take such

actions as may be necessary and appropriate, including seeking mandate or specific performance by court order, to cause the City, Trustee or the Dissemination Agent, as the case may be, to comply with its obligations under this Disclosure Agreement. A default under this Disclosure Agreement shall not be deemed an Event of Default under the Trust Agreement and the Indenture, as applicable, and the sole remedy under this Disclosure Agreement in the event of any failure of the City, the Trustee or the Dissemination Agent to comply with this Disclosure Agreement shall be an action to compel performance.

Section 10. Duties, Immunities and Liabilities of Trustee and Dissemination Agent. Article VIII of the Trust Agreement and the Indenture, as applicable is hereby made applicable to this Disclosure Agreement as if this Disclosure Agreement were (solely for this purpose) contained in the Trust Agreement and the Indenture, as applicable. Neither the Trustee nor the Dissemination Agent shall be responsible for the form or content of any Annual Report or notice of Listed Event. The Dissemination Agent shall receive reasonable compensation for its services provided under this Disclosure Agreement. The Dissemination Agent (if other than the Trustee or 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 liabilities due to the Dissemination Agent's negligence or willful misconduct. The obligations of the City under this Section shall survive resignation or removal of the Dissemination Agent and payment of the Bonds and the Certificates.

Section 11. Beneficiaries. This Disclosure Agreement shall inure solely to the benefit of the City, the Trustee, the Dissemination Agent, the Participating Underwriter and holders and beneficial owners from time to time of the Bonds and the Certificates, and shall create no rights in any other person or entity.

Section 12. 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, the parties hereto have executed this Disclosure Agreement as of the date first above written.

CITY OF DESERT HOT SPRINGS

By: _____
Mayor

By: _____
City Manager

APPROVED AS TO FORM:

By: _____
City Attorney

WELLS FARGO BANK, NATIONAL
ASSOCIATION, as Trustee

By: _____
Authorized Officer

EXHIBIT A

NOTICE TO MUNICIPAL SECURITIES RULEMAKING BOARD OF
FAILURE TO FILE ANNUAL REPORT

Name of Issuer: City of Desert Hot Springs

Name of Issue: City of Desert Hot Springs Judgment Obligation Bonds

Date of Issuance: October 27, 2004

NOTICE IS HEREBY GIVEN that the City of Desert Hot Springs (the "City") has not provided an Annual Report with respect to the above-named Bonds as required by Section 6.07 of the Indenture, dated as of October 1, 2004, by and between Wells Fargo Bank, National Association, as Trustee, and the City. [The City anticipates that the Annual Report will be filed by _____.]

Dated: _____

WELLS FARGO BANK, NATIONAL
ASSOCIATION, as Trustee, on behalf of the
City of Desert Hot Springs

By: _____
Authorized Officer

cc: City of Desert Hot Springs

EXHIBIT B

NATIONALLY RECOGNIZED MUNICIPAL SECURITIES INFORMATION REPOSITORIES

The Nationally Recognized Municipal Securities Information Repositories approved by the Securities and Exchange Commission as of the date of the Disclosure Agreement are set forth below. Such information should be confirmed hereafter by reference to the list of National Repositories approved by the Securities and Exchange Commission, which are currently identified at <http://www.sec.gov/info/municipal/nrmsir.htm>.

Bloomberg Municipal Repository

100 Business Park Drive
Skillman, New Jersey 08558
Phone: (609) 279-3225
Fax: (609) 279-5962
<http://www.bloomberg.com/markets/rates/municontacts.html>
Email: Munis@Bloomberg.com

DPC Data Inc.

One Executive Drive
Fort Lee, New Jersey 07024
Phone: (201) 346-0701
Fax: (201) 947-0107
<http://www.dpcdata.com>
Email: nrmsir@dpcdata.com

FT Interactive Data

Attn: NRMSIR
100 William Street
New York, New York 10038
Phone: (212) 771-6999
Fax: (212) 771-7390 (Secondary Market Information)
(212) 771-7391 (Primary Market Information)
<http://www.interactivedata.com>
Email: NRMSIR@FTID.com

Standard & Poor's Securities Evaluations, Inc.

55 Water Street
45th Floor
New York, New York 10041
Phone: (212) 438-4595
Fax: (212) 438-3975
www.jjkenny.com/jjkenny/pser_descrip_data_rep.html
Email: nrmsir_repository@sandp.com

State Information Depository (SID)

Municipal Advisory Council of Texas

P.O. Box 2177
Austin, Texas 78768-2177
Phone: (512) 476-6947
Fax: (512) 476-6403
<http://www.mactexas.com>
Email for filings: mac@mactexas.com

(THIS PAGE INTENTIONALLY LEFT BLANK)

APPENDIX G

FORM OF FINANCIAL GUARANTY INSURANCE POLICY FINANCIAL GUARANTY INSURANCE POLICY

(THIS PAGE INTENTIONALLY LEFT BLANK)

FINANCIAL GUARANTY INSURANCE POLICY

Obligor:

Bonds:

Bond Trustee:

Insurance Trustee:

Policy Number:

Premium:

Radian Asset Assurance Inc. ("Insurer"), a corporation organized under the laws of the State of New York, in consideration of the payment of the premium and subject to the terms of this Policy, hereby unconditionally and irrevocably guarantees the payment of the Obligation (hereinafter defined) to the Insurance Trustee for the benefit of the Holders (hereinafter defined) from time to time of the Bonds. This Policy does not insure against any risk other than nonpayment of the Obligation by or on behalf of the Obligor or any other obligor to the Bond Trustee. Nonpayment includes recovery from a Holder of Bonds or the Bond Trustee of any portion of the Obligation pursuant to a final judgment by any court of competent jurisdiction holding that such payment constituted a voidable preference within the meaning of any applicable bankruptcy law.

Upon receipt by the Insurer of telephonic or telegraphic notice, such notice subsequently confirmed to the Insurer in writing by registered or certified mail, from the Insurance Trustee that the Obligor (or other obligor responsible for payment of the Obligation) has failed to provide the Bond Trustee with sufficient funds for payment of the Obligation on the Due Date (hereinafter defined), the Insurer shall, not later than such Due Date or the first business day after receipt of such notice, whichever is later, pay to the Insurance Trustee for the benefit of the Holders of the Bonds an amount which shall be sufficient to pay the Obligation, but only upon receipt by the Insurer, in a form reasonably satisfactory to it, of (a) evidence of the Holder's right to receive such payment and (b) evidence, including any appropriate instruments of assignment, that all the Holder's rights with respect to such payment shall thereupon vest in the Insurer. "Due Date" means, when referring to the principal of the Obligation, the stated maturity date thereof or the date on which the same shall have been duly called for mandatory sinking fund prepayment and does not refer to any earlier date on which payment is due by reason of any other call for redemption, acceleration or other advancement of maturity unless the Insurer shall elect, in its sole discretion, to pay such principal due upon such redemption, acceleration or other advancement of maturity together with any accrued interest to the date of redemption, acceleration or other advancement of maturity. Tendering of payment, to the Bond Trustee, of such principal due upon such redemption, acceleration or other advancement of maturity, together with any accrued interest to the date of such redemption, acceleration or other advancement of maturity, shall satisfy the Insurer's obligations under this Policy, in full. When referring to interest on the Obligation, "Due Date" means the stated date for payment of interest.

The Insurer shall, to the extent of any payment made by it pursuant to this Policy, be deemed to have acquired and become the Holder of the Bonds or portions thereof or interest thereon paid from such payment and shall be fully subrogated to all rights to payment thereof.

As used herein, the term "Holder" or "Holders" means the registered owners of the Bonds as indicated in the registration books maintained by the Bond Trustee for such purpose at the time of nonpayment of the Obligation. The terms "Holder" or "Holders" shall not include the Obligor or any person or entity whose direct or indirect obligation constitutes the underlying security for the Obligation. As used herein, the term "Bond Trustee" means the Bond Trustee above named and any successor trustee duly appointed. As used herein, the term "Insurance Trustee" means the Insurance Trustee above named and any successor insurance trustee duly appointed. As used herein, the term "Obligation" means the payment of principal and interest regularly scheduled to be paid on the Bonds, which shall have become due for payment but shall be unpaid on the Due Date, but does not include any premium payable with respect to the Bonds, nor any redemption (except mandatory sinking fund redemption), acceleration or other advancement of maturity.

This Policy is non-cancelable for any reason. Premiums paid on this Policy are not refundable for any reason including without limitation the payment prior to maturity of the Bonds.

IN WITNESS WHEREOF, the Insurer has caused this Policy to be issued to the Insurance Trustee for the benefit of the Holders from time to time of the Bonds and to be executed and delivered by its duly authorized officer to become effective and binding upon the Insurer by virtue of the execution and delivery thereof on this ____ day of ____, 20__.

RADIAN ASSET ASSURANCE INC.

By: _____
Name: [ANALYST]
Title: [TITLE]

In the event the insurer becomes insolvent, any claims arising under this policy are excluded from coverage by the California Insurance Guaranty Association, established pursuant to Article 15.2 (commencing with Section 1063) of Chapter 1 of Part 2 of Division 1 of the California Insurance Code.

This policy is not covered by the Property/Casualty Insurance Security Fund established by Article 76 of the New York Insurance Law.