

MEMO

To: Board of Directors
From: District Manager
Subject: Property Purchase Agreement; APN 81-204-03 and -07
Date: November 28, 2005

RECOMMENDATION:

It is recommended that the Board of Directors review this memo and approve the attached resolution.

BACKGROUND:

At the November 3, 2005 Board of Directors meeting, your Board approved Resolution No. 19 (05-06), which authorized the District Manager to execute a property purchase agreement in the sum of \$1,500,000.00 for APN 81-204-03 and -07, generally located at 12788 Highway 9, Boulder Creek. The property is presently owned by Melva Johnson, Trustee. The District will utilize the subject property for a central Administration and Operations Facility. At the November 3, 2005 Board of Directors meeting, your Board also directed staff to investigate the availability of a loan for the proposed purchase.

District staff contacted the California Special District Association (CSDA) Municipal Finance Corporation regarding the availability of a loan for the proposed property purchase. In its fifteen years of existence, the CSDA Municipal Finance Corporation has assisted and provided California Special District's with more than \$500 million through a variety of tax-exempt financing programs. The Municipal Finance Corporation has agreed to loan the District the principal amount of \$1,500,000.00, at an interest rate of 4.65%, for a term of fifteen (15) years. See Attachment 1 for a copy of the proposed Loan Agreement. The loan would be backed by a pledge of the District's "Net Water Revenues". "Net Water Revenues" means all water revenues received by the District from water service charges, including but not limited to connection charges and earnings on investments of funds held by the District. There is no option for prepayment of the loan during the first five (5) years. The loan may be prepaid, in whole, after the first five (5) years with a two percent (2%) prepayment penalty.

It is recommended that the Board of Directors approve the attached resolution which authorizes the District Manager to enter into a Loan Agreement with Municipal Finance Corporation.

James Mueller
District Manager

JAM/kas

SAN LORENZO VALLEY WATER DISTRICT

RESOLUTION NO. (05-06)

SUBJECT: AUTHORIZING THE EXECUTION AND DELIVERY OF AN LOAN AGREEMENT,
AND AUTHORIZING AND DIRECTING CERTAIN ACTIONS IN CONNECTION
WITH THE FINANCING OF THE ACQUISITION OF REAL PROPERTY

WHEREAS, the San Lorenzo Valley Water District (the "District") is a county water district duly organized and existing under and pursuant to the laws of the State of California; and

WHEREAS, the District desires to provide for financing in the amount of \$1,500,000.00 for the acquisition of real property for the District' administrative and operational facility (the "Project"); and

WHEREAS, Municipal Finance Corporation (the "Corporation") has proposed a cost-effective 15 year loan financing arrangement at a 4.65% interest rate;

NOW, THEREFORE, BE IT RESOLVED by the Board of Directors of the San Lorenzo Valley Water District as follows:

SECTION 1. Loan Agreement. The District Manager is hereby authorized to enter into a Loan Agreement (the "Loan") with the Corporation to finance the Project, subject to approval as to form by the District's legal counsel.

SECTION 2. Attestations. The Secretary of the Board is hereby authorized and directed to attest the signature of the District Manager and to affix and attest the seal of the District, as may be required or appropriate in connection with the execution and delivery of the Loan Agreement.

SECTION 3. Other Actions. The District Manager and other officers of the District are each hereby authorized and directed, jointly and severally, to take any and all actions and to execute and deliver any and all documents, agreements and certificates which they may deem necessary or advisable in order to carry out, give effect to and comply with the terms of this Resolution and the Loan. Such actions are hereby ratified, confirmed and approved.

SECTION 4. Qualified Tax-Exempt Obligations. The Loan is hereby designated as "qualified tax-exempt obligations" within the meaning of Section 265(b)(3) of the Internal Revenue Code of 1986, as amended (the "Code"). The District, together with all subordinate entities of the District, do not reasonably expect to issue during the calendar year in which the Loan is issued more than \$10,000,000 of obligations which it could designate as "qualified tax-exempt obligations" under Section 265(b) of the Code.

SECTION 5. Effect. This Resolution shall take effect immediately upon its passage.

PASSED AND ADOPTED by the Board of Directors of the San Lorenzo Valley Water District, County of Santa Cruz, State of California, on the 1st day of December, 2005, by the following vote of the members thereof:

AYES:
NOES:
ABSENT:

District Secretary
San Lorenzo Valley Water District

LOAN AGREEMENT #05-094

THIS LOAN AGREEMENT, (this "Loan Agreement"), dated for convenience as of December 1, 2005, is by and between Municipal Finance Corporation, a corporation duly organized and existing under the laws of the State of California (the "Corporation"), and the San Lorenzo Valley Water District, a county water district duly organized and existing under the laws of the State of California (the "District");

WITNESSETH:

WHEREAS, the District presently owns and operates certain facilities and property for the supply of water to residents within the service area of the District (the "Water System"), and the District wishes at this time to finance the acquisition of certain real property (the "Project"); and

WHEREAS, the Corporation has agreed to lend the District an amount which the District has determined will be sufficient to pay such costs of the Project, pursuant hereto; and

WHEREAS, the District is authorized to enter into this Loan Agreement and to borrow amounts hereunder and for the purpose of financing the Project under the laws of the State of California, including the provisions of Article 1, Chapter 1, Part 6 of Division 12 of the California Water Code, commencing with Section 31300 of said Code.

NOW, THEREFORE, in consideration of the above premises and of the mutual covenants hereinafter contained and for other good and valuable consideration, the parties hereto agree as follows:

ARTICLE I

DEFINITIONS AND EXHIBITS

SECTION 1.1. Definitions. All capitalized terms used in this Section 1.1 shall for all purposes of this Loan Agreement have the meanings herein specified or as hereinafter defined.

"Additional Parity Obligations" means any bonds, notes or other obligations of the District payable from and secured by a pledge of and lien upon any of the Net Water Revenues on parity with the Loan Repayments.

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

(i) An allowance for Net Water Revenues from any additions or improvements to or extensions of the Water System to be made with the proceeds of such Additional Parity Obligations and also for Net Water Revenues from any such additions, improvements or extensions which have been made from moneys from any source but in any case which, during all or any part of the latest Fiscal Year or such twelve (12) month period, were not in service, all in an amount equal to ninety percent (90%) of the estimated additional average annual Net Water Revenues to be derived from such additions, improvements and extensions for the first thirty-six (36) month period in which each addition, improvement or extension is respectively to be in operation, all as shown by the certificate or opinion of a qualified independent engineer (which may but need not be the outside firm providing engineering services) retained by the District.

(ii) An allowance for Net Water Revenues arising from any increase in the charges made for service from the Water System which has become effective prior to the incurring of such Additional Parity Obligations but which, during all or any part of the latest Fiscal Year or such twelve (12) month period, was not in effect, in an amount equal to the total amount by which the Net Water Revenues would have been increased if such increase in charges had been in effect during the whole of such Fiscal Year or twelve (12) month period, all as shown by the certificate or opinion of an independent certified public accountant (which may but need not be the outside firm providing auditing services) retained by the District.

"Assignee" means (a) initially, City National Bank, as assignee of certain rights of the Corporation hereunder, and (b) any other entity to whom the rights of the Corporation shall be assigned hereunder.

"Closing Date" means the date the Corporation deposits the Loan proceeds with the District pursuant to Section 3.2.

"Corporation" means Municipal Finance Corporation, a corporation duly organized and existing under the laws of the State of California. Whenever in this Loan Agreement any reference is made to the Corporation and such reference concerns rights which the Corporation has assigned to the Assignee, such reference shall be deemed to refer to the Assignee.

"District" means the San Lorenzo Valley Water District, a county water district duly organized and existing under the laws of the State of California.

"Event of Default" means any of the events of default as defined in Section 5.1.

"Federal Securities" means any direct general non-callable obligations of the United States of America (including obligations issued or held in book entry form on the books of the Department of the Treasury of the United States of America), or obligations

the timely payment of principal of and interest on which are directly guaranteed by the United States of America.

"Fiscal Year" means each twelve-month period during the Term of this Loan Agreement commencing on July 1 in any calendar year and ending on June 30 in the next succeeding calendar year, or any other twelve-month period selected by the District as its fiscal year period.

"Loan" means the loan made by the Corporation to the District pursuant to Section 3.1.

"Loan Agreement" means this Loan Agreement, dated as of December 1, 2005, between the Corporation and the District.

"Loan Repayment Date" means June 15 and December 15 in each year, commencing June 15, 2006 and continuing to and including the date on which the Loan Repayments have been paid in full.

"Loan Repayments" means all payments required to be paid by the District on any date pursuant to Section 3.4, including any prepayment thereof pursuant to Section 6.2 or 6.3.

"Maintenance and Operation Costs" means (a) the reasonable and necessary costs and expenses paid by the District for maintaining and operating the Water System, including but not limited to the reasonable expenses of management and repair and other costs and expenses necessary to maintain and preserve the Water System in good repair and working order, and including but not limited to administrative costs of the District attributable to the Water System and the financing thereof, but in all cases excluding depreciation, replacement and obsolescence charges or reserves therefore and excluding amortization of intangibles or other bookkeeping entries of a similar nature.

"Maximum Annual Debt Service" means, as of the date of any calculation, the maximum sum obtained for the current or any future Fiscal Year during the Term of this Loan Agreement by totaling the aggregate amount of (i) the Loan Repayments coming due in such Fiscal Year, and (ii) the principal and interest coming due and payable in such Fiscal Year on any Additional Parity Obligations, including the principal amount coming due and payable by operation of mandatory sinking fund redemption. There shall be excluded from such calculation any principal of and interest on the Loan Repayments and any Additional Parity Obligations which have been defeased or discharged, or for the payment of which a security deposit has been posted. With respect to any Additional Parity Obligations which then bear interest at a variable rate, such interest shall be calculated at an assumed rate equal to the average rate of interest per annum for each of the 5 previous whole calendar years as shown by the J. J. Kenny Index (or at any time in

the event and to the extent such index is not maintained for all or any portion of such period, any similar index of variable rate interest for tax-exempt obligations as may be selected by the District in its sole discretion).

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

"Prior Parity Obligations" means (a) the District's \$3,501,485.33 original principal amount California Safe Drinking Water Loan, (b) the District's \$826,000 original principal amount Refunding Payment Agreement, dated as of April 23, 2003, by and between the District and Western Municipal Securities Corporation, and (c) the District's \$2,255,000 original principal amount Refunding Payment Agreement, dated as of November 18, 2004, by and between the District and the Agency Funding Assistance Corporation.

"Project" means all of the facilities and improvements to be acquired, constructed and installed by the District from the proceeds of the Loan and constituting part of the Water System. Such facilities and improvements are originally described in Exhibit B attached hereto and by this reference incorporated herein, subject to the right of the District in its sole discretion to amend such description from time to time.

"Tax Code" means the Internal Revenue Code of 1986. Any reference herein to a provision of the Tax Code shall include all applicable temporary and permanent regulations promulgated under the Tax Code.

"Term of this Loan Agreement" or "Term" means the time during which this Loan Agreement is in effect, as provided in Section 3.3.

"Water Revenue Fund" means the fund heretofore established and held by the District for the receipt and deposit of Water Revenues.

"Water Revenues" means all gross charges received for, and all other gross income and receipts derived by the District from, the ownership and operation of the Water System or otherwise arising from the Water System, including but not limited to connection charges and earnings on the investment of any funds held by the District; but excluding (a) the proceeds of any ad valorem property taxes levied for the purpose of paying bonded indebtedness of the District and (b) the proceeds of any special assessments or special taxes levied upon real property within any improvement district served by the District for the purpose of paying special assessment bonds or special tax obligations of the District.

"Water System" means the existing facilities and property owned by the District in connection with the water supply services of the District, together with all extensions thereof and improvements thereto hereafter acquired, constructed or installed by the District. The Water System does not include the District's sewer system, or any part thereof.

SECTION 1.2. Exhibits. The following Exhibits are attached to, and by reference made a part of this Loan Agreement:

Exhibit A: The schedule of Loan Repayments to be paid by the District hereunder, showing the date and amount of each such Loan Repayment.

Exhibit B: The original description of the Project.

ARTICLE II

REPRESENTATIONS, COVENANTS AND WARRANTIES

SECTION 2.1. Representations, Covenants and Warranties of the District. The District represents, covenants and warrants to the Corporation as follows:

(a) Due Organization and Existence. The District is a county water district duly organized and existing under the laws of the State of California.

(b) Authorization. The laws of the State of California authorize the District to enter into this Loan Agreement and to enter into the transactions contemplated hereby and thereby, and to carry out its obligations under this Loan Agreement and the Board of Directors of the District has duly authorized the execution and delivery of this Loan Agreement.

(c) No Violations. Neither the execution and delivery of this Loan Agreement nor the fulfillment of or compliance with the terms and conditions hereof or thereof, nor the consummation of the transactions contemplated hereby or thereby, conflicts with or results in a breach of the terms, conditions or provisions of any restriction or any agreement or instrument to which the District is now a party or by which the District is bound, or constitutes a default under any of the foregoing, or results in the creation or imposition of any lien, charge or encumbrances whatsoever upon any of the property or assets of the District, other than as set forth herein.

(d) Prior Indebtedness. The District has previously issued the Prior Parity Obligations which are currently outstanding and are payable on a parity basis out of the Water Revenues and Net Water Revenues with the Loan Repayments. The District has not issued or incurred any obligations which are currently outstanding having any priority

in payment out of the Water Revenues or the Net Water Revenues over the payment of the Loan Repayments as provided herein.

SECTION 2.2. Representations, Covenants and Warranties of the Corporation. The Corporation represents, covenants and warrants to the District as follows:

(a) Due Organization and Existence. The Corporation is a corporation duly organized and existing under the laws of the State of California.

(b) Authorization. The laws of the State of California authorize the Corporation to enter into this Loan Agreement and to enter into the transactions contemplated hereby and thereby, and to carry out its obligations under this Loan Agreement and the Board of Directors of the Corporation has duly authorized the execution and delivery of this Loan Agreement.

(c) No Violations. Neither the execution and delivery of this Loan Agreement nor the fulfillment of or compliance with the terms and conditions hereof or thereof, nor the consummation of the transactions contemplated hereby or thereby, conflicts with or results in a breach of the terms, conditions or provisions of any restriction or any agreement or instrument to which the Corporation is now a party or by which the Corporation is bound, or constitutes a default under any of the foregoing, or results in the creation or imposition of any lien, charge or encumbrance whatsoever upon any of the property or assets of the Corporation.

(d) No Assignments. Except as provided herein, the Corporation will not assign this Loan Agreement, its right to receive Loan Repayments from the District, or its duties and obligations hereunder to any other person, firm or corporation so as to impair or violate the representations, covenants and warranties contained in this Section 2.2.

ARTICLE III

TERMS OF LOAN

SECTION 3.1. Obligation to Make Loan; Amount of Loan. The Corporation hereby agrees to lend to the District, and the District hereby agrees to borrow from the Corporation, the amount of \$1,500,000.00 under the terms and provisions set forth in this Loan Agreement. The Loan shall be to finance the acquisition, construction and installation of the Project.

SECTION 3.2. Acquisition the Project; Deposit of Moneys.

SECTION 3.3. Term. The Term of this Loan Agreement shall commence on the Closing Date, and shall end on the date on which the Loan shall be paid in full or provision for such payment shall be made as provided herein.

SECTION 3.4. Loan Repayments.

(a) Obligation to Pay. The District hereby agrees to repay the Loan in the aggregate principal amount of \$1,500,000.00 together with interest (calculated at the rate of 4.65% on the basis of a 360-day year of twelve 30-day months) on the unpaid principal balance thereof, payable in semiannual Loan Repayments in the respective amounts and on the respective Loan Repayment Dates specified in Exhibit A.

As a result of the assignment by the Corporation to the Assignee of the right of the Corporation to receive the Loan Repayments, the District shall pay all Loan Repayments when due directly to the Assignee.

(b) Effect of Prepayment. In the event that the District prepays the Loan Repayments in full pursuant to Article VI, the District's obligations under this Loan Agreement shall thereupon cease and terminate, including but not limited to the District's obligation to pay Loan Repayments under this Section 3.4; subject however, to the provisions of Section 6.1 in the case of prepayment by application of a security deposit. In the event that the District prepays the Loan in part but not in whole pursuant to Section 6.3, the principal components of the remaining Loan Repayments shall be reduced on a pro rata basis so as to produce equal Loan Repayments over the remaining Term of this Loan Agreement.

(c) Rate on Overdue Payments. In the event the District should fail to make any of the payments required in this Section 3.4, the payment in default shall continue as an obligation of the District until the amount in default shall have been fully paid, and the District agrees to pay the same with interest thereon, to the extent permitted by law, from the date of default to the date of payment at the rate of eight percent (8%) per annum.

SECTION 3.5. Nature of District's Obligations.

(a) Special Obligation. The District's obligation to pay the Loan Repayments is a special obligation of the District limited solely to the Net Water Revenues. Under no circumstances is the District required to advance moneys derived from any source of income other than the Net Water Revenues and other sources specifically identified herein for the payment of the Loan Repayments, and no other funds or property of the District are liable for the payment of the Loan Repayments. Notwithstanding the foregoing provisions of this Section, however, nothing herein prohibits the District voluntarily from making any payment hereunder from any source of available funds of the District.

(b) Obligations Absolute. The obligations of the District to pay the Loan Repayments from the Net Water Revenues and to perform and observe the other agreements contained herein are absolute and unconditional and are not subject to any defense or any right of setoff, counterclaim or recoupment arising out of any breach of the District or the Corporation of any obligation to the District or otherwise with respect to the Water System, whether hereunder or otherwise, or out of indebtedness or liability at any time owing to the District by the Corporation. Until such time as all of the Loan Repayments have been fully paid or prepaid, the District:

- (i) will not suspend or discontinue payment of any Loan Repayments,
- (ii) will perform and observe all other agreements contained in this Loan Agreement, and
- (iii) will not terminate this Loan Agreement for any cause, including, without limiting the generality of the foregoing, the occurrence of any acts or circumstances that may constitute failure of consideration, eviction or constructive eviction, destruction of or damage to the Water System, sale of the Water System, the taking by eminent domain of title to or temporary use of any component of the Water System, commercial frustration of purpose, any change in the tax or other laws of the United States of America or the State of California or any political subdivision of either thereof or any failure of the Corporation to perform and observe any agreement, whether express or implied, or any duty, liability or obligation arising out of or connected with this Loan Agreement.

(c) Protection of Rights. If the Corporation fails to perform any such agreements on its part, the District may institute such action against the Corporation as the District deems necessary to compel performance so long as such action does not abrogate the obligations of the District contained in the preceding subsection (b). The District may, however, at the District's own cost and expense and in the District's own name or in the name of the Corporation prosecute or defend any action or proceeding or take any other action involving third persons which the District deems reasonably necessary in order to secure or protect the District's rights hereunder, and in such event the Corporation will cooperate fully with the District and take such action necessary to effect the substitution of the District for the Corporation in such action or proceeding if the District shall so request.

SECTION 3.6. Pledge and Application of Net Water Revenues.

(a) Pledge. All of the Net Water Revenues are hereby irrevocably pledged to the punctual payment of the Loan Repayments on parity with the pledge and lien which secures the Prior Parity Obligations and on parity with any Additional Parity Obligations issued hereunder. The Net Water Revenues and such other funds may not be used for

any other purpose so long as any of the Loan Repayments and any Parity Obligations remain unpaid; except that out of the Net Water Revenues there may be apportioned such sums, for such purposes, as are expressly permitted by this Section 3.6. Such pledge constitutes a first and exclusive lien on the Net Water Revenues and such other moneys for the payment of the Loan Repayments, the Prior Parity Obligations and any Additional Parity Obligations in accordance with the terms hereof and the terms of the instruments authorizing the issuance of any Additional Parity Obligations.

(b) Deposit of Water Revenues; Transfers to Make Loan Repayments. The District has heretofore established the Water Revenue Fund, which the District agrees to continue to hold and maintain for the purposes and uses set forth herein. The District shall deposit all Water Revenues in the Water Revenue Fund promptly upon the receipt thereof.

All Net Water Revenues will be held by the District in the Water Revenue Fund in trust for the benefit of the Corporation and for the benefit of the owners of the Prior Parity Obligations and any Additional Parity Obligations. The District shall withdraw from such fund or funds and transfer to the Corporation an amount of Net Water Revenues equal to the aggregate amount of the Loan Repayment when and as the same becomes due and payable. In addition, the District shall withdraw from such fund or funds such amounts of Net Water Revenues at such times as required to pay the principal of and interest on the Prior Parity Obligations and any Additional Parity Obligations and otherwise comply with the provisions of the instruments authorizing the issuance of the Prior Parity Obligations and any Additional Parity Obligations.

(c) Other Uses Permitted. The District shall manage, conserve and apply the Net Water Revenues in such a manner that all deposits required to be made under the preceding paragraph will be made at the times and in the amounts so required. Subject to the foregoing sentence, so long as no Event of Default has occurred and is continuing hereunder, the District may at any time and from time to time use and apply Net Water Revenues for (i) the acquisition and construction of improvements to the Water System; (ii) the prepayment of the Loan, the Prior Parity Obligations and any Additional Parity Obligations, or (iii) any other lawful purpose of the District.

ARTICLE IV

COVENANTS OF THE DISTRICT

SECTION 4.1. *Release and Indemnification Covenants.* The District shall indemnify the Corporation and its officers, agents, successors and assigns and hold them harmless from and against all claims, losses and damages, including legal fees and expenses, arising out of the following:

(a) the use, maintenance, condition or management of, or from any work or thing done on or about the Water System by the District,

(b) any breach or default on the part of the District in the performance of any of its obligations under this Loan Agreement,

(c) any intentional misconduct or negligence of the District or of any of its agents, contractors, servants, employees or licensees with respect to the Water System, and

(d) any intentional misconduct or negligence of any lessee of the District with respect to the Water System.

No indemnification is made under this Section 4.1 or elsewhere in this Loan Agreement for willful misconduct, gross negligence, or breach of duty under this Loan Agreement by the Corporation, its officers, agents, employees, successors or assigns.

SECTION 4.2. *Sale or Eminent Domain of Water System.* Except as provided herein, the District covenants that the Water System will not be encumbered, sold, leased, pledged, any charge placed thereon, or otherwise disposed of, as a whole or substantially as a whole if such encumbrance, sale, lease, pledge, charge or other disposition would materially impair the ability of the District to pay the Loan Repayments or the principal of or interest on any Parity Obligations, or would materially adversely affect its ability to comply with the terms of this Loan Agreement or the instruments authorizing the issuance of the Prior Parity Obligations and any Additional Parity Obligations. The District shall not enter into any agreement which impairs the operation of the Water System or any part of it necessary to secure adequate Net Water Revenues to pay the Loan Repayments, the Prior Parity Obligations and any Additional Parity Obligations, or which otherwise would impair the rights of the Corporation with respect to the Net Water Revenues. If any substantial part of the Water System is sold, the payment therefore must either (a) be used for the acquisition or construction of improvements and extensions or replacement facilities or (b) be applied to prepay or redeem the Loan, the Prior Parity Obligations or any Additional Parity Obligations, on a pro rata basis, in the manner provided herein and in the instruments authorizing the Prior Parity Obligations or such Additional Parity Obligations.

Any amounts received as awards as a result of the taking of all or any part of the Water System by the lawful exercise of eminent domain, if and to the extent that such right can be exercised against such property of the District, shall either (a) be used for the acquisition or construction of improvements and extension or replacement facilities of the Water System, or (b) be applied to prepay or redeem the Loan, the Prior Parity Obligations or any Additional Parity Obligations, on a pro rata basis, in the manner

provided herein and in the instruments authorizing the Prior Parity Obligations or such Additional Parity Obligations.

SECTION 4.3. *Insurance.* The District shall at all times maintain with responsible insurers all such insurance on the Water System as is customarily maintained with respect to works and properties of like character against accident to, loss of or damage to the Water System. If any useful part of the Water System is damaged or destroyed, such part shall be restored to usable condition. All amounts collected from insurance against accident to or destruction of any portion of the Water System shall be used to repair or rebuild such damaged or destroyed portion of the Water System or if determined not to repair or rebuild such portion and in any event to the extent not so applied, must either (a) be used for the acquisition or construction or improvements and extensions or replacement facilities or (b) be applied on a pro rata basis to prepay or redeem the Loan, the Prior Parity Obligations or any Additional Parity Obligations in the manner provided in this Loan Agreement and in the instruments authorizing the Prior Parity Obligations or such Additional Parity Obligations. The District shall also maintain, with responsible insurers, worker's compensation insurance and insurance against public liability and property damage to the extent reasonably necessary to protect the District, the Corporation and the Assignee. Any insurance required to be maintained hereunder may be maintained under and in accordance with a joint exercise of powers agreement, or may be maintained by the District in the form of self-insurance or in the form of participation by the District in a program of pooled insurance.

SECTION 4.4. *Records and Accounts.* The District shall keep proper books of records and accounts of the Water System, separate from all other records and accounts, in which complete and correct entries shall be made of all transactions relating to the Water System. Said books shall, upon prior request, be subject to the reasonable inspection of the Corporation.

The District shall cause the books and accounts of the Water System to be audited annually by an independent certified public accountant or firm of certified public accountants, not more than 180 days after the close of each Fiscal Year, and shall furnish a copy of such report to the Corporation or the Assignee. The audit of the accounts of the Water System may be included as part of a general District-wide audit.

The District shall cause to be published annually, not more than 180 days after the close of each Fiscal Year, a summary statement showing the amount of Water Revenues and the disbursements from Water Revenues and from other funds of the District in reasonable detail. The District shall furnish a copy of the statement, upon reasonable written request, to the Corporation and the Assignee.

SECTION 4.5. *Rates and Charges.*

(a) Covenant Regarding Water Revenues. The District shall fix, prescribe, revise and collect rates, fees and charges for the services and facilities furnished by the Water System during each Fiscal Year which (together with existing unencumbered cash and cash-equivalent balances which are lawfully available to the District for payment of any of the following amounts during such Fiscal Year) are at least sufficient, after making allowances for contingencies and error in the estimates, to pay the following amounts in the following order:

(i) All Maintenance and Operation Costs estimated by the District to become due and payable with respect to such Fiscal Year;

(ii) The Loan Repayments and all principal of and interest and premium (if any) on and the Prior Parity Obligations and any Additional Parity Obligations as they become due and payable with respect to such Fiscal Year, without preference or priority;

(iii) All payments coming due and payable with respect to such Fiscal Year and required for compliance with this Loan Agreement and the instruments authorizing the Prior Parity Obligations and any Additional Parity Obligations; and

(iv) All payments required to meet any other obligations of the District which are charges, liens, encumbrances upon or payable from the Water Revenues with respect to such Fiscal Year.

(b) Covenant Regarding Net Water Revenues. In addition to the covenant set forth in the preceding clause (a) of this Section, the District shall fix, prescribe, revise and collect rates, fees and charges for the services and facilities furnished by the Water System during each Fiscal Year which are sufficient to yield Net Water Revenues which, together with existing unencumbered cash and cash-equivalent fund balances which are lawfully available to the District with respect to such Fiscal Year, are at least equal to 115% of the aggregate amount of Loan Repayments and principal of and interest on the Prior Parity Obligations and any Additional Parity Obligations coming due and payable with respect to such Fiscal Year. If the amount of such existing unencumbered cash and cash-equivalent fund balances, excluding Net Water Revenues, falls below the amount of Maximum Annual Debt Service with respect to such Fiscal Year, the District shall thereupon fix, prescribe, revise and collect rates, fees and charges for the services and facilities furnished by the Water System with respect to such Fiscal Year which are sufficient to yield Net Water Revenues with respect to such Fiscal Year (excluding connection charges) at least equal to 100% of the aggregate amount of Loan Repayments and principal of and interest on the Prior Parity Obligations and any Additional Parity Obligations coming due and payable with respect to such Fiscal Year.

SECTION 4.6. *No Priority for Additional Obligations.* The District may not issue or incur any bonds or other obligations having any priority in payment of principal or interest out of the Net Water Revenues over the Loan Repayments.

SECTION 4.7. *Issuance of Additional Parity Obligations.* Except for obligations incurred to prepay or post a security deposit for the Loan in whole, the District may not issue or incur any Additional Parity Obligations unless:

(a) The District is not then in default under the terms of this Loan Agreement.

(b) The Net Water Revenues (excluding connection charges), calculated in accordance with sound accounting principles, as shown by the books of the District for the latest Fiscal Year or as shown by the books of the District for any more recent 12 month period selected by the District, in either case verified by a certificate or opinion of an independent certified public accountant (which may be, but not need be, the outside firm providing auditing services) employed by the District, plus (at the option of the District) the Additional Revenues, at least equal 115% of the amount of Maximum Annual Debt Service; *provided, however*, that this subsection (b) does not apply to any issue of Additional Parity Obligations the net proceeds of which are applied to refund the Loan, the Prior Parity Obligations or any Additional Parity Obligations in whole or in part, so long as (i) the final maturity of such Additional Parity Obligations does not exceed the final maturity of the obligations being refunded, and (ii) the aggregate amount of debt service on such Additional Parity Obligations in each Fiscal Year does not exceed the amount of debt service which would otherwise come due and payable in such Fiscal Year on the obligations being refunded.

For purposes of the foregoing calculation of Net Water Revenues under this subsection (b), the District may add to such Net Water Revenues any Additional Revenues.

(c) Notwithstanding the above, the District may incur debt payable from Net Water Revenues (i) to cause a defeasance of this Loan Agreement or (ii) which is payable on a basis which is junior to the payment of the Loan Repayments.

SECTION 4.9. *Assignment by the Corporation.* The Corporation's rights under this Loan Agreement, including the right to receive and enforce payment of the Loan Repayments to be made by the District under this Loan Agreement, have been assigned to the Assignee pursuant to an Assignment of Loan Agreement. Whenever in this Loan Agreement any reference is made to the Corporation and such reference concerns rights which the Corporation has assigned to the Assignee, such reference shall be deemed to refer to the Assignee.

The Corporation or the Assignee has the right to make additional assignments of its rights and obligations under this Loan Agreement, but the District shall not be required to pay more than a single payee, regardless of the number of Assignees, and no such assignment will be effective as against the District unless and until the Corporation or the Assignee files with the District written notice thereof. The District shall pay all Loan Repayments hereunder under the written direction of the Corporation or the Assignee named in the most recent assignment or notice of assignment filed with the District. During the Term of this Loan Agreement, the District shall keep a complete and accurate record of all such notices of assignment.

SECTION 4.10. *Assignment by the District.* Neither the Loan nor this Loan Agreement may be assigned by the District, other than to a public agency which shall succeed to the interests of the District in and to the Water System and which (by operation of law, by contract or otherwise) becomes legally bound to all of the terms and provisions hereof.

SECTION 4.11. *Amendment of this Loan Agreement.* This Loan Agreement may be amended by the District and the Corporation, but only with the prior written consent of the Assignee (which consent may not be unreasonably withheld).

SECTION 4.12. *Tax Covenants.*

(a) Generally. The District may not take any action or permit to be taken any action within its control which would cause or which, with the passage of time if not cured would cause, the interest components of the Loan Repayments to become includable in gross income for federal income tax purposes.

(b) Private Activity Bond Limitation. The District shall assure that the proceeds of the Loan are not so used as to cause the Loan to satisfy the private business tests of section 141(b) of the Tax Code or the private loan financing test of section 141(c) of the Tax Code.

(c) Federal Guarantee Prohibition. The District may not take any action or permit or suffer any action to be taken if the result of the same would be to cause the Loan Repayments to be "federally guaranteed" within the meaning of Section 149(b) of the Tax Code.

(d) No Arbitrage. The District may not take, or permit or suffer to be taken, any action with respect to the proceeds of the Loan Repayments which, if such action had been reasonably expected to have been taken, or had been deliberately and intentionally taken, on the Closing Date would have caused the Loan to be "arbitrage bonds" within the meaning of Section 148(a) of the Tax Code.

(e) Small Issuer Exemption from Bank Nondeductibility Restriction. The District hereby designates this Loan Agreement for purposes of paragraph (3) of Section 265(b) of the Tax Code and represents that not more than \$10,000,000 aggregate principal amount of obligations the interest on which is excludable (under Section 103(a) of the Tax Code) from gross income for federal income tax purposes (excluding (i) private activity bonds, as defined in Section 141 of the Tax Code, except qualified 501(c)(3) bonds as defined in Section 145 of the Tax Code and (ii) current refunding obligations to the extent the amount of the refunding obligation does not exceed the outstanding amount of the refunded obligation), including this Loan Agreement, has been or will be issued by the District, including all subordinate entities of the District, during the calendar year 2005.

(f) Arbitrage Rebate. The District shall take any and all actions necessary to assure compliance with section 148(f) of the Tax Code, relating to the rebate of excess investment earnings, if any, to the federal government, to the extent that such section is applicable to the Loan.

(g) Acquisition, Disposition and Valuation of Investments. Except as otherwise provided in the following sentence, the District covenants that all investments of amounts deposited in any fund or account created by or pursuant to this Loan Agreement, or otherwise containing gross proceeds of the Loan (within the meaning of section 148 of the Tax Code) shall be acquired, disposed of, and valued (as of the date that valuation is required by this Indenture or the Tax Code) at Fair Market Value. Investments in funds or accounts (or portions thereof) that are subject to a yield restriction under applicable provisions of the Tax Code shall be valued at their present value (within the meaning of section 148 of the Tax Code).

For purposes of this subsection (g), the term "Fair Market Value" means the price at which a willing buyer would purchase the investment from a willing seller in a bona fide, arm's length transaction (determined as of the date the contract to purchase or sell the investment becomes binding) if the investment is traded on an established securities market (within the meaning of section 1273 of the Tax Code) and, otherwise, the term "Fair Market Value" means the acquisition price in a bona fide arm's length transaction (as referenced above) if (i) the investment is a certificate of deposit that is acquired in accordance with applicable regulations under the Tax Code, (ii) the investment is an agreement with specifically negotiated withdrawal or reinvestment provisions and a specifically negotiated interest rate (for example, a guaranteed investment contract, a forward supply contract or other investment agreement) that is acquired in accordance with applicable regulations under the Tax Code, (iii) the investment is a United States Treasury Security – State and Local Government Series that is acquired in accordance with applicable regulations of the United States Bureau of Public Debt, or (iv) any commingled investment fund in which the District and related parties do not own more

than a 10% beneficial interest therein if the return paid by the fund is without regard to the source of the investment.

ARTICLE V

EVENTS OF DEFAULT AND REMEDIES

SECTION 5.1. Events of Default Defined. The following shall be Events of Default under this Loan Agreement.

(a) Failure by the District to pay the Corporation any Loan Repayment or to pay other amounts required to be paid hereunder within fifteen (15) days of the time specified herein, and such failure is not cured within ten (10) days after written notice thereof by the Corporation.

(b) Failure by the District to observe and perform any covenant, condition or agreement on its part to be observed or performed hereunder other than as referred to in the preceding clause (a) of this Section, for a period of thirty (30) days after written notice specifying such failure and requesting that it be remedied has been given to the District by the Corporation *provided, however*, if in the reasonable opinion of the District the failure stated in the notice can be corrected, but not within such thirty (30) day period, the Corporation shall not unreasonably withhold its consent to an extension of such time if corrective action is instituted by the District within such thirty (30) day period and diligently pursued until the default is corrected.

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

(d) An event of default as defined under any contracts or agreements relating to any Prior Parity Obligations.

SECTION 5.2 Remedies on Default. Whenever any Event of Default shall have happened and be continuing, the Corporation shall have the rights, at its option and without any further demand or notice to:

(a) declare all principal components of the unpaid Loan Repayments, together with accrued interest thereon at the rate of interest per annum represented by the Loan from the immediately preceding Loan Payment Date on which payment was made, to be

immediately due and payable, whereupon the same shall immediately become due and payable; and,

(b) take whatever action at law or in equity may appear necessary or desirable to collect the Loan Repayments then due or thereafter to become due during the Term of this Loan Agreement, or enforce performance and observance of any obligation, agreement or covenant of the District under this Loan Agreement.

The provisions of the preceding clause (a) are subject to the condition that if, at any time after the principal components of the unpaid Loan Repayments shall have been so declared due and payable pursuant to the preceding clause (a), and before any judgment or decree for the payment of the moneys due shall have been obtained or entered, the District shall deposit with the Corporation a sum sufficient to pay all principal components of the Loan Repayments coming due prior to such declaration and all matured interest components (if any) of the Loan Repayments, with interest on such overdue principal and interest components calculated at the rate set forth in Section 3.4(c) and the reasonable expenses of the Corporation (including any fees and expenses of its attorneys), and any and all other defaults known to the Corporation (other than in the payment of the principal and interest components of the Loan Repayments due and payable solely by reason of such declaration) shall have been made good, then, and in every such case, the Corporation may, by written notice to the District rescind and annul such declaration and its consequences. However, no such rescission and annulment shall extend to or shall affect any subsequent default, or shall impair or exhaust any right or power consequent thereon.

SECTION 5.3. No Remedy Exclusive. No remedy herein conferred upon or reserved to the Corporation is intended to be exclusive and every such remedy shall be cumulative and shall be in addition to every other remedy given under this Loan Agreement or now or hereafter existing at law or in equity. No delay or omission to exercise any right or power accruing upon any default shall impair any such right or power or shall be construed to be a waiver thereof, but any such right and power may be exercised from time to time and as often as may be deemed expedient. In order to entitle the Corporation to exercise any remedy reserved to it in this Article V it shall not be necessary to give any notice, other than such notice as may be required in this Article V or by law.

SECTION 5.4. Agreement to Pay Attorneys' Fees and Expenses. In the event either party of this Loan Agreement should default under any of the provisions hereof and the nondefaulting party should employ attorneys (including in-house counsel) or incur other expenses for the collection of moneys or the enforcement of performance or observance of any obligation or agreement on the part of the defaulting party herein contained, the defaulting party agrees that it will on demand therefore pay to the

nondefaulting party the reasonable fees of such attorneys (including the allocable cost of in-house counsel) and such other expenses so incurred by the nondefaulting party.

SECTION 5.5. No Additional Waiver Implied by One Waiver. In the event any agreement contained in this Loan Agreement should be breached by either party and thereafter waived by the other party, such waiver shall be limited to the particular breach so waived and shall not be deemed to waive any other breach hereunder.

SECTION 5.6. Assignee to Exercise Rights Such rights and remedies as are given to the Corporation under this Article V have been assigned by the Corporation to the Assignee and shall be exercised solely by the Assignee.

ARTICLE VI

PREPAYMENT OF LOAN

SECTION 6.1. Security Deposit. Notwithstanding any other provision of this Loan Agreement, the District may on any date secure the payment of Loan Repayments, in whole, by irrevocably depositing with a fiduciary an amount of cash which, together with other available amounts, is either (a) sufficient to pay all such Loan Repayments, including the principal and interest components thereof, when due pursuant to Section 3.4(a), or (b) invested in whole or in part in Federal Securities in such amount as will, in the opinion of an independent certified public accountant, together with interest to accrue thereon and together with any cash which is so deposited, be fully sufficient to pay all such Loan Repayments when due pursuant to Section 3.4(a) or when due on any optional prepayment date pursuant to Section 6.2, as the District shall instruct at the time of said deposit. In the event of a security deposit pursuant to this Section for the payment of all remaining Loan Repayments, all obligations of the District under this Loan Agreement, and the pledge of Net Water Revenues and all other security provided by this Loan Agreement for said obligations, shall cease and terminate, excepting only the obligation of the District to make, or cause to be made, all of Loan Repayments from such security deposit. Said security deposit shall be deemed to be and shall constitute a special fund for the payment of such Loan Repayments in accordance with the provisions of this Loan Agreement.

SECTION 6.2. Optional Prepayment. Commencing five years after the Closing Date, the District shall have the option to prepay the unpaid principal balance of the Loan, in whole, on any Loan Repayment Date, by paying a prepayment price equal to the principal amount of the Loan to be prepaid, together with the interest required to be paid on such date and together with a prepayment penalty equal to two percent (2%) of the then unpaid principal balance. The District shall give the Corporation notice of its intention to exercise its option not less than thirty (30) days in advance of the date of exercise.

SECTION 7.2. Binding Effect. This Loan Agreement shall inure to the benefit of and shall be binding upon the Corporation and the District and their respective successors and assigns.

SECTION 7.3. Severability. In the event any provision of this Loan Agreement shall be held invalid or unenforceable by any court of competent jurisdiction, such holding shall not invalidate or render unenforceable any other provision hereof.

SECTION 7.4. Net-net-net Contract. This Loan Agreement shall be deemed and construed to be a “net-net-net” contract, and the District hereby agrees that the Loan Repayments shall be an absolute net return to the Corporation, free and clear of any expenses, charges or set-offs whatsoever.

SECTION 7.5. Further Assurances and Corrective Instruments. The Corporation and the District agree that they will, from time to time, execute, acknowledge and deliver, or cause to be executed, acknowledged and delivered, such supplements hereto and such further instruments as may reasonably be required for carrying out the expressed intention of this Loan Agreement.

SECTION 7.6. Execution in Counterparts. This Loan 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.

SECTION 7.7. Applicable Law. This Loan Agreement shall be governed by and construed in accordance with the laws of the State of California.

SECTION 7.8. Captions. The captions or headings in this Loan Agreement are for convenience only and in no way define, limit or describe the scope or intent of any provisions or Section of this Loan Agreement.

IN WITNESS WHEREOF, the Corporation has caused this Loan Agreement to be executed in its corporate name by its duly authorized officer, and the District has caused this Loan Agreement to be executed in its name by its duly authorized officer, as of the date first above written.

MUNICIPAL FINANCE CORPORATION

By _____
President

SAN LORENZO VALLEY WATER DISTRICT

By _____
District Manager

ATTEST:

By _____
Secretary

EXHIBIT A

SCHEDULE OF LOAN REPAYMENTS

PMT #	Due Date	Loan Repayment	To Principal	To Interest
1	06/15/06	\$70,004.73	\$35,129.73	34,875.00
2	12/15/06	70,004.73	35,946.50	34,058.23
3	06/15/07	70,004.73	36,782.25	33,222.48
4	12/15/07	70,004.73	37,637.44	32,367.29
5	06/15/08	70,004.73	38,512.51	31,492.22
6	12/15/08	70,004.73	39,407.93	30,596.80
7	06/15/09	70,004.73	40,324.16	29,680.57
8	12/15/09	70,004.73	41,261.70	28,743.03
9	06/15/10	70,004.73	42,221.03	27,783.70
10	12/15/10	70,004.73	43,202.67	26,802.06
11	06/15/11	70,004.73	44,207.13	25,797.60
12	12/15/11	70,004.73	45,234.95	24,769.78
13	06/15/12	70,004.73	46,286.66	23,718.07
14	12/15/12	70,004.73	47,362.83	22,641.90
15	06/15/13	70,004.73	48,464.01	21,540.72
16	12/15/13	70,004.73	49,590.80	20,413.93
17	06/15/14	70,004.73	50,743.79	19,260.94
18	12/15/14	70,004.73	51,923.58	18,081.15
19	06/15/15	70,004.73	53,130.80	16,873.93
20	12/15/15	70,004.73	54,366.09	15,638.64
21	06/15/16	70,004.73	55,630.11	14,374.62
22	12/15/16	70,004.73	56,923.51	13,081.22
23	06/15/17	70,004.73	58,246.98	11,757.75
24	12/15/17	70,004.73	59,601.22	10,403.51
25	06/15/18	70,004.73	60,986.95	9,017.78
26	12/15/18	70,004.73	62,404.89	7,599.84
27	06/15/19	70,004.73	63,855.81	6,148.92
28	12/15/19	70,004.73	65,340.46	4,664.27
29	06/15/20	70,004.73	66,859.62	3,145.11
30	12/15/20	70,004.73	68,413.89	1,590.84

TOTALS: \$2,100,141.90 \$1,500,000.00 \$600,141.90

EXHIBIT B

DESCRIPTION OF THE PROJECT

The Project consists of the costs associated with acquisition by the District of certain real property generally located at 12788 Highway 9 in the unincorporated town of Boulder Creek. The acquisition is comprised of two (2) separate contiguous parcels; APN 081-204-03 & -07. Each parcel contains approximately 14,400 square feet. APN 081-204-03 is improved with an existing 8,800 square foot wood frame office building structure. The District will occupy said property for the purposes of the District's main administration office and center for operational facilities, including storage and corporation yard appurtenant thereto.