NEW ISSUES—BOOK-ENTRY-ONLY **RATINGS: See "RATINGS" herein**

In the opinion of Bond Counsel, interest on the Bonds is excluded from gross income for Federal income tax purposes and is exempt from State of California personal income taxes, all as further discussed under "Tax Matters" herein.

STATE PUBLIC WORKS BOARD OF THE STATE OF CALIFORNIA

$186,110,000
Lease Revenue Refunding Bonds
(Department of Corrections)
2004 Series D
(California State Prison-Fresno County, Coalinga)

$93,975,000
Lease Revenue Refunding Bonds
(Department of Corrections)
2004 Series E
(California State Prison-Lassen County, Susanville)

Dated: April 1, 2004 **Due: As shown on the inside front cover**

This Official Statement describes the State Public Works Board of the State of California (the "Board"), an entity of the State of California (the "State") and its lease revenue refunding bonds (collectively, the "Bonds" and each a "Series of Bonds"), described above.

Interest on the Bonds is payable as set forth on the inside front cover page. Each Series of Bonds may be purchased in the principal amount of $5,000 or integral multiples thereof in book-entry form only. See "APPENDIX E—DTC AND THE BOOK-ENTRY SYSTEM." **Each Series of Bonds may be redeemed prior to its respective stated final maturity. See "TERMS APPLICABLE TO EACH SERIES OF BONDS—Redemption Provisions" with respect to each Series of Bonds.**

Each Series of Bonds is separately issued and separately secured under its related Indenture. The 2004E Bonds are secured, equally and ratably, on a parity with the Prior Susanville Bonds (as herein defined). The holders of a Series of Bonds will have no claim on the revenues or funds securing the other Series of Bonds, except to a limited extent as described herein. See "SECURITY AND SOURCES OF PAYMENT FOR EACH SERIES OF BONDS—General" and "STATE PUBLIC WORKS BOARD—Master Indenture Reserve Fund."

THE BONDS DO NOT REPRESENT OR CONSTITUTE A DEBT OF THE STATE, ANY POLITICAL SUBDIVISION THEREOF, THE BOARD OR THE DEPARTMENT WITHIN THE MEANING OF ANY CONSTITUTIONAL OR STATUTORY LIMITATION OR A PLEDGE OF THE FAITH AND CREDIT OF THE STATE, ANY POLITICAL SUBDIVISION THEREOF, THE BOARD OR THE DEPARTMENT. THE OWNERS OF THE BONDS SHALL HAVE NO RIGHT TO HAVE EXCISES OR TAXES LEVIED FOR THE PAYMENT OF AMOUNTS DUE ON THEIR BONDS. NEITHER THE BOARD NOR THE DEPARTMENT HAS ANY POWER TO PLEDGE THE CREDIT OR TAXING POWER OF THE STATE.

The scheduled payment of principal and interest when due with respect to the 2004D Bonds maturing on December 1 in each of the years 2007 through 2019 (the "2004D Insured Bonds"), will be insured under an insurance policy to be issued concurrently with the delivery of the Bonds by MBIA Insurance Corporation ("MBIA").

The scheduled payment of principal and interest when due with respect to the 2004E Bonds maturing on June 1 in each of the years 2007 through 2018 (the "2004E Insured Bonds") will be insured under an insurance policy to be issued concurrently with the delivery of the Bonds by XL Capital Assurance Inc.

See "THE BOND INSURERS AND THE BOND INSURANCE POLICIES" and "APPENDIX G—SPECIMENS OF THE INSURANCE POLICIES OF MBIA INSURANCE CORPORATION AND XL CAPITAL ASSURANCE INC." herein.

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

MATURITIES, PRINCIPAL AMOUNTS, INTEREST RATES, PRICES OR YIELDS AND CUSIPS
(See Inside Front Cover)

The Bonds are offered when, as and if issued and received by the Underwriters, subject to the approval of validity by the Honorable Bill Lockyer, Attorney General of the State of California, and by Stradling Yocca Carlson & Rauth, a Professional Corporation, Newport Beach, California, Bond Counsel, and certain other conditions. The Law Offices of Elizabeth C. Green, Los Angeles, California, is serving as Co-Disclosure Counsel and Sidley Austin Brown & Wood LLP, San Francisco, California is serving as Co-Disclosure Counsel to the State regarding APPENDIX A. Squire, Sanders & Dempsey L.L.P., San Francisco, California is serving as Underwriter's Counsel. It is expected that the Bonds will be available for delivery through the facilities of DTC on or about April 7, 2004.

HONORABLE PHILIP ANGELIDES
Treasurer of the State of California

E. J. De La Rosa & Co., Inc. **JPMorgan** **Jackson Securities**

A.G. Edwards & Sons, Inc. **Cabrera Capital Markets, Inc.**

Ramirez & Co., Inc. **Roberts & Ryan Investments, Inc.**

Dated: March 24, 2004

MATURITIES, PRINCIPAL AMOUNTS, INTEREST RATES, YIELDS AND CUSIPS

$186,110,000 Lease Revenue Refunding Bonds (Department of Corrections) 2004 Series D
(California State Prison-Fresno County, Coalinga)
(Base CUSIP* Number: 130684)

$186,110,000 Serial Bonds

Year (December 1)	Principal Amount	Interest Rate	Yield	CUSIP	Year (December 1)	Principal Amount	Interest Rate	Yield	CUSIP
2004†	$ 8,635,000	3.000%	NRO**	HU0	2013	$ 3,575,000	3.500%	3.350%	JN4
2005†	8,895,000	3.000	1.710%	HV8	2013	5,000,000	5.000	3.350	JM6
2006†	5,210,000	3.000	1.960	HX4	2013	3,405,000	3.125	3.350	JL8
2006†	3,975,000	4.000	1.960	HW6	2014	520,000	4.000	3.500	JR5
2007	9,560,000	4.500	1.700	HY2	2014	4,000,000	5.000	3.500	JQ7
2008	6,000,000	4.000	2.060	HZ9	2014	7,940,000	3.250	3.500	JP9
2008	3,940,000	2.500	2.060	JA2	2015	1,595,000	3.500	3.640	JT1
2009	950,000	4.000	2.370	JD6	2015††	11,420,000	5.000	3.640	JS3
2009	7,000,000	5.000	2.370	JC8	2016	645,000	3.625	3.730	JV6
2009	2,385,000	2.125	2.370	JB0	2016††	13,020,000	5.000	3.730	JU8
2010	500,000	4.000	2.710	JF1	2017	520,000	3.700	3.800	JX2
2010	10,190,000	2.500	2.710	JE4	2017††	13,835,000	5.000	3.800	JW4
2011	3,750,000	4.000	2.970	JH7	2018	520,000	3.800	3.870	JZ7
2011	7,250,000	2.750	2.970	JG9	2018††	14,565,000	5.000	3.870	JY0
2012	835,000	4.000	3.200	JK0	2019	620,000	3.875	3.920	KB8
2012	10,625,000	5.000	3.200	JJ3	2019††	15,230,000	5.000	3.920	KA0

(Plus accrued interest from April 1, 2004)
Interest on the 2004D Bonds is payable on June 1, 2004 and on each June 1 and December 1 thereafter.

* CUSIP numbers are provided for convenience of reference only. The Board assumes no responsibility for the accuracy of such numbers.
† Not insured by Bond Insurance Policies.
** Not reoffered to public.
†† Priced to December 1, 2014 call date at 100%.

$93,975,000 Lease Revenue Refunding Bonds (Department of Corrections) 2004 Series E
(California State Prison-Lassen County, Susanville)
(Base CUSIP* Number: 130684)

$93,975,000 Serial Bonds

Year (June 1)	Principal Amount	Interest Rate	Yield	CUSIP	Year (June 1)	Principal Amount	Interest Rate	Yield	CUSIP
2005†	$11,990,000	3.000%	1.630%	KC6	2012	$ 130,000	3.000%	3.250%	KL6
2006†	10,865,000	3.000	1.860	KE2	2015††	2,500,000	5.000	3.710	KN2
2006†	1,485,000	4.000	1.860	KD4	2015	2,905,000	3.500	3.710	KM4
2007	120,000	2.000	1.700	KF9	2016	20,140,000	5.000	NRO**	KP7
2008	115,000	2.000	2.080	KG7	2017	185,000	3.750	3.880	KR3
2009	125,000	2.200	2.400	KH5	2017††	20,960,000	5.000	3.880	KQ5
2010	125,000	2.500	2.750	KJ1	2018††	22,205,000	5.000	3.950	KS1
2011	125,000	2.750	3.020	KK8					

(Plus accrued interest from April 1, 2004)
Interest on the 2004E Bonds is payable on June 1, 2004 and on each June 1 and December 1 thereafter.

* CUSIP numbers are provided for convenience of reference only. The Board assumes no responsibility for the accuracy of such numbers.
† Not insured by Bond Insurance Policies.
** Not reoffered to public.
†† Priced to June 1, 2014 call date at 100%.

The information set forth herein has been obtained from the State, the Board, the Department of Corrections of the State of California and other sources which are believed to be reliable but it is not guaranteed as to accuracy or completeness. The information and expressions of opinion herein are subject to change without notice and neither 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 State, the Board, or the Department of the State of California since the date hereof.

IN CONNECTION WITH THIS OFFERING, THE UNDERWRITERS MAY OVERALLOT OR EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKET PRICES OF THE BONDS AT LEVELS ABOVE THAT WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME. THE UNDERWRITERS MAY OFFER AND SELL THE BONDS TO CERTAIN DEALERS, INSTITUTIONAL INVESTORS AND OTHERS AT PRICES LOWER THAN THE PUBLIC OFFERING PRICES STATED ON THE INSIDE FRONT COVER HEREOF, AND SAID PUBLIC OFFERING PRICES MAY BE CHANGED FROM TIME TO TIME BY THE UNDERWRITERS.

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

Copies of this Official Statement may be obtained from:

HONORABLE PHILIP ANGELIDES
Treasurer of the State of California
P.O. Box 942809
Sacramento, California 94209-0001
(800) 900-3873

This Official Statement is available as public information on the State Treasurer's Internet site at http://www.treasurer.ca.gov.

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Lease Revenue Refunding Bonds
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(California State Prison-Lassen County, Susanville)

INTRODUCTION

This Introduction contains only a brief summary of certain of the terms of the Bonds being offered and a brief description of this Official Statement. A full review should be made of the entire Official Statement, including the cover page and the Appendices. All statements contained in this Introduction are qualified in their entirety by reference to the entire Official Statement. References to, and summaries of; provisions of the Constitution and laws of the State of California or any other documents referred to herein do not purport to be complete, and such references are qualified in their entirety by reference to the complete provisions.

General Authorization; Purpose

This Official Statement describes the State Public Works Board of the State of California (the "Board"), an entity of the State of California (the "State"), and the Lease Revenue Refunding Bonds (Department of Corrections) 2004 Series D (California State Prison-Fresno County, Coalinga) (the "2004D Bonds") and Lease Revenue Refunding Bonds (Department of Corrections) 2004 Series E (California State Prison-Lassen County, Susanville) (the "2004E Bonds") to be issued by the Board. The 2004D Bonds and the 2004E Bonds are referred to herein collectively as the "Bonds" and each such series is occasionally referred to herein as a "Series of Bonds."

The proceeds of the 2004D Bonds and the 2004E Bonds shall be applied principally to accomplish a current refunding of all of the 1993B Coalinga Bonds referenced below, and selected maturities of the 1993D Susanville Bonds referenced below, previously issued by the Board:

- State Public Works Board of the State of California Lease Revenue Bonds (Department of Corrections) 1993 Series B (California State Prison-Fresno County, Coalinga) dated March 1, 1993 (the "1993B Coalinga Bonds"); and

- the State Public Works Board of the State of California Lease Revenue Bonds (Department of Corrections) 1993 Series D (California State Prison - Lassen County, Susanville) dated October 1, 1993 (the "1993D Susanville Bonds").

The outstanding 1993B Coalinga Bonds and the 1993D Susanville Bonds of selected maturities to be refunded are hereinafter referred to, collectively, as the "Refunded Bonds" and each as a "Series of Refunded Bonds."

The Bonds are being issued in two separate Series in the aggregate principal amounts shown above. The Bonds are being issued by the Board for the benefit of the Department of Corrections of the State of California (the "Department") to provide funds to (i) refund the Refunded Bonds, (ii) make a deposit to the Master Indenture Reserve Fund (as defined herein), and (iii) pay the costs of issuance of the Bonds. See "Estimated Sources and Uses of Funds" with respect to each Series of the Bonds, and "TERMS APPLICABLE TO EACH SERIES OF BONDS—Plan of Refunding." The 1993B Coalinga Bonds and the 1993D Susanville Bonds were previously issued by the Board for the benefit of the Department; the proceeds of the 1993B Coalinga Bonds and the 1993D Susanville Bonds were used to finance and refinance the costs of construction of certain correctional facilities of the Department. See "APPENDIX B—INFORMATION CONCERNING THE DEPARTMENT AND THE FACILITIES."

The terms and security provisions unique to each Series of Bonds are described herein under the heading bearing the name of such Series. The Bonds are being issued pursuant to the State Building Construction Act of 1955, being Part 10b of Division 3 of Title 2 (commencing with Section 15800) of the California Government Code, as amended (the "Act").

The 2004D Bonds are being issued pursuant to the terms of an indenture, dated as of April 1, 1994, as amended by the Tenth Supplemental Indenture dated as of September 1, 1996 and the Forty-Second Supplemental Indenture dated as of October 1, 2002 (collectively, the "Master Indenture"), as supplemented by a Fifty-First Supplemental Indenture dated as of April 1, 2004 (the "2004D Supplemental Indenture" and together with the Master Indenture, the " 2004D Indenture"), each by and between the Board and the State Treasurer, as trustee. The 1993B Coalinga Bonds were issued by the Board to finance the costs of acquisition, installation and construction of the California State Prison – Fresno County, Coalinga, also known as Pleasant Valley State Prison (the "Coalinga Facility").

The 2004E Bonds are being issued pursuant to the terms of an Indenture, dated as of October 1, 1993 (the "Original Indenture"), as supplemented by a First Supplemental Indenture dated as of May 1, 1997, a Second Supplemental Indenture dated as of March 1, 2001 (the "Second Supplemental Indenture"), and a Third Supplemental Indenture dated as of April 1, 2004 (the Original Indenture and the foregoing Supplemental Indentures relating to the 2004E Bonds being herein collectively referred to as the "2004E Indenture"), each by and between the Board and the State Treasurer, as trustee. Pursuant to the Original Indenture, the Board has previously issued its Lease Revenue Bonds (Department of Corrections) 1993 Series D (California State Prison - Lassen County, Susanville) (the "1993D Susanville Bonds") dated October 1, 1993, to provide for the financing of the acquisition, installation and construction of the California State Prison - Lassen County, Susanville, also known as High Desert State Prison (the "Susanville Facility"). Pursuant to the Second Supplemental Indenture, the Board issued its Lease Revenue Refunding Bonds (Department of Corrections) 2001 Series A (California State Prison – Lassen County, Susanville) (the "2001A Susanville Bonds") to refund a portion of the 1993D Susanville Bonds. The 2004E Bonds are issued on a parity with the 1993D Susanville Bonds which will remain outstanding after the issuance of the 2004E Bonds, and with the 2001A Susanville Bonds (collectively referred to herein as the "Prior Susanville Bonds" and together with the 1993B Coalinga Bonds, the "Prior Bonds"). See "TERMS OF THE 2004E BONDS—Security for the 2004E Bonds." The 2004D Indenture and the 2004E Indenture are referred to herein individually as an "Indenture" or "related Indenture," and collectively as the "Indentures."

The refunding of the Refunded Bonds will be accomplished pursuant to the respective Escrow Agreements relating to each Series of Bonds between the Board and the State Treasurer, as escrow agent, each dated as of April 1, 2004 (each an "Escrow Agreement" and collectively, the "Escrow Agreements").

The Bonds are being sold by the State Treasurer in accordance with the Act. Capitalized terms used in this Official Statement and not otherwise defined herein shall have the meanings assigned in the respective Indentures.

Security and Sources of Payment for the Bonds

Each Series of Bonds is separately issued and separately secured under its related Indenture which pertains exclusively to the related Series of Bonds (including outstanding parity bonds and any bonds later issued as parity bonds under the related Indenture, as hereinafter described), the related Base Rental, the related Facility Lease and the related Facility. The holders of a Series of Bonds will have no claim on the revenues or funds securing the other Series of Bonds, except to a limited extent as described under "Master Indenture Reserve Fund" below. The 2004E Bonds are secured equally and ratably by

Base Rental payable under the Susanville Facility Lease (hereinafter defined), on a parity with the Prior Susanville Bonds. Certain maturities of each Series of Bonds are also separately insured by the applicable Bond Insurance Policy (as hereinafter defined) relating to the 2004D Insured Bonds and the 2004E Insured Bonds. Certain maturities of the 2004D Bonds are insured as to payment of principal and interest under the Bond Insurance Policy (as hereinafter defined) issued by MBIA (as hereinafter defined). Certain maturities of the 2004E Bonds are insured as to payment of principal and interest under the Bond Insurance Policy (as hereinafter defined) issued by XL Capital Assurance (as hereinafter defined). See "THE BOND INSURERS AND THE BOND INSURANCE POLICIES" and "APPENDIX G—SPECIMENS OF THE INSURANCE POLICIES OF MBIA INSURANCE CORPORATION AND XL CAPITAL ASSURANCE INC."

General. Pursuant to an Agreement for the Transfer of Control and Possession of State Owned Real Property relating to the Coalinga Facility, dated as of April 1, 2004 (the "Transfer Agreement") between the Department and the Board, the Department will transfer control and possession of the site on which the Coalinga Facility is located to the Board. In connection with the issuance of the 1993D Susanville Bonds, the Board entered into a Site Lease dated as of October 1, 1993, as amended by the First Amendment to Site Lease dated March 1, 2002 (collectively, the "Site Lease") with the Department, under which the Department transferred control and possession of the site on which the Susanville Facility is located to the Board.

The Board will enter into a Facility Lease dated as of April 1, 2004 (the "Coalinga Facility Lease") with the Department, under which the Department will lease the Coalinga Facility from the Board. Relative to the Susanville Facility, the Board will enter into a Third Amendment to Facility Lease with the Department to be dated as of April 1, 2004, in connection with the issuance of the 2004E Bonds (the "Third Amendment to Facility Lease"). The Third Amendment to Facility Lease will amend, in part, that certain Facility Lease between the Board, as lessor, and the Department, as lessee, dated as of October 1, 1993, as amended by that certain First Amendment to Facility Lease (California State Prison – Lassen County, Susanville) dated as of March 1, 2001, and by that certain Second Amendment to Facility Lease (California State Prison – Lassen County, Susanville) dated as of March 1, 2002 (collectively with the Third Amendment to Facility Lease, the "Susanville Facility Lease"). Pursuant to the Susanville Facility Lease, the Department will lease the Susanville Facility from the Board. The Coalinga Facility Lease and Susanville Facility Lease are referred to herein collectively as the "Facility Leases" and separately, as a "Facility Lease." The Coalinga Facility and the Susanville Facility are hereinafter referred to collectively as the "Facilities."

Pursuant to the Facility Lease relating to each Facility, the Department will lease each Project (as herein defined) and the underlying real property (the "Site" and collectively with each Project, each a "Facility") and will make rental payments ("Base Rental") sufficient in the aggregate to pay the principal of and interest on the related Series of Bonds, and with respect to the 2004E Bonds, also sufficient to pay principal and interest on the Prior Susanville Bonds, as further described herein, and will make additional rental payments ("Additional Rental") sufficient to pay administrative expenses of the Board and other costs. See "SECURITY AND SOURCES OF PAYMENT FOR EACH SERIES OF BONDS—Budgeting for Rental Payments," "TERMS OF THE 2004D BONDS—Security for the 2004D Bonds," and "TERMS OF THE 2004E BONDS—Security for the 2004E Bonds."

Each Series of Bonds will be secured by a first pledge of Revenues (as defined in the related Indenture), which consist primarily of Base Rental to be paid by the Department under the terms of the related Facility Lease. The 2004E Bonds will be secured by the Base Rental payments to be applied, equally and ratably, to the principal and interest due with respect to the 2004E Bonds and approximately $147,530,000 in aggregate principal amount of outstanding Prior Susanville Bonds. Base Rental and Additional Rental attributable to the Bonds are payable from various funds of the State appropriated by the State legislature for that purpose. See "SECURITY AND SOURCES OF PAYMENT FOR EACH SERIES OF BONDS—Budgeting for Rental Payments," "TERMS OF THE 2004D BONDS—Security for the 2004D Bonds," and "TERMS OF THE 2004E

BONDS—Security for the 2004E Bonds," "—Prior Susanville Bonds" and "—Additional Bonds-2004E Bonds." See "APPENDIX A—THE STATE OF CALIFORNIA—STATE FINANCES."

The Act requires any State agency that has leased or otherwise contracts with the Board for a public building financed by revenue bonds issued by the Board to allocate from the "first lawfully available funds" appropriated to such State agency in each fiscal year an amount sufficient to pay all rental payments during such fiscal year with respect to the facility financed for such State agency by lease revenue bonds of the Board, including, with respect to the Department, rental payments securing the Bonds. The Act provides a continuing appropriation of moneys from the fund in the State Treasury from which each such State agency derives its appropriation for support when such rental payments are due during a period that the State is operating without funds appropriated by a budget or when the required rental payments have not been included in the budget adopted by the State, provided the Department of Finance certifies to the State Controller that sufficient funds are available for the support of such State agency for such public building. The statutory provisions of the Act regarding priority with respect to allocation of funds and continuing appropriation have not been interpreted by any court. See "SECURITY AND SOURCES OF PAYMENT FOR EACH SERIES OF BONDS—Budgeting for Rental Payments."

Master Indenture Reserve Fund. Each Series of Bonds will be secured by the pooled Master Indenture Reserve Fund (as defined herein). Amounts held in the Master Indenture Reserve Fund (which had a balance of $81,698,494 as of March 1, 2004) will be available for all bonds secured by the Master Indenture Reserve Fund (which were outstanding in the aggregate principal amount of $3,568,541,260 as of March 1, 2004) and, therefore, no assurance can be given that at any time amounts available therein will be sufficient to pay the principal of and interest on each Series of Bonds when and as due. See "THE STATE PUBLIC WORKS BOARD—Master Indenture Reserve Fund."

Abatement. The Base Rental due from the Department to the Board with respect to a Facility under the related Facility Lease will be abated proportionately during any period in which, by reason of any damage, destruction, partial condemnation or title defect, there is a substantial interference with the use and occupancy of all or a portion of such Facility. Base Rental payments securing the 2004E Bonds shall be abated proportionately and equally and ratably with Base Rental payments securing the Prior Susanville Bonds. Any abatement due to damage, destruction, partial condemnation or title defect will continue for the period commencing with such damage, destruction, condemnation or title defect and ending when use and occupancy are restored. See "SECURITY AND SOURCES OF PAYMENT FOR EACH SERIES OF BONDS—Abatement."

Insurance on the Facilities. Each Indenture and the related Facility Lease require the Board to maintain, or cause the Department to maintain, fire, lightning and extended coverage insurance on its related Facility. Each Facility Lease also requires the Department to maintain rental interruption insurance or use and occupancy insurance on the related Facility to cover certain losses as a result of certain hazards. See "SECURITY AND SOURCES OF PAYMENT FOR EACH SERIES OF BONDS—Insurance on the Facilities."

Bond Insurance. The scheduled payment of principal and interest when due with respect to the 2004D Bonds maturing on December 1 in each of the years 2007 through 2019 (the "2004D Insured Bonds"), will be insured under an insurance policy to be issued concurrently with the delivery of the Bonds by MBIA Insurance Corporation ("MBIA"). The scheduled payment of principal and interest when due with respect to the 2004E Bonds maturing on June 1 in each of the years 2007 through 2018 (the "2004E Insured Bonds"), will be insured under an insurance policy to be issued concurrently with the delivery of the Bonds by XL Capital Assurance Inc. ("XL Capital Assurance"). The two insurance policies and the two bond insurers are collectively referred to herein as the "Bond Insurance Policies" and the "Bond Insurers," respectively, and the 2004D Insured Bonds and 2004E Insured Bonds are collectively referred to herein as the "Insured Bonds." See "THE BOND INSURERS AND THE BOND INSURANCE POLICIES" and "APPENDIX G—SPECIMENS OF THE

INSURANCE POLICIES OF MBIA INSURANCE CORPORATION AND XL CAPITAL ASSURANCE INC." herein.

The 2004D Bonds maturing on December 1 in each of the years 2004 through 2006 are not insured, and the 2004E Bonds maturing on June 1 in each of the years 2004 through 2006 are not insured (such uninsured 2004D Bonds and 2004E Bonds being hereinafter referred to as the "Uninsured Bonds.").

Remedies Upon Default

If the Department defaults under a Facility Lease, the Board may enforce its remedies thereunder. In general, remedies under each Facility Lease include the right (i) to maintain such Facility Lease in full force and effect and receive all rent from the Department as it becomes due or re-let the related Facility encumbered thereunder, or (ii) to terminate such Facility Lease and the right of possession of the Department and recover damages recoverable at law. The Indentures provide that any Holder of a related Series of Bonds may by legal action compel the Board to carry out its duties under the Act and the related Indenture, including maintaining and enforcing its rights under the related Facility Lease. See "APPENDIX C--SUMMARY OF CERTAIN PROVISIONS OF THE LEGAL DOCUMENTS."

While each Facility Lease provides that the related Facility may be re-let following a default, achieving such a remedy may not be practical due to the lack of a replacement lessee, the specialized nature of the Facility or other reasons. See "APPENDIX B—INFORMATION CONCERNING THE DEPARTMENT AND THE FACILITIES."

Moreover, although acceleration is a remedy provided in each Indenture, the Base Rental payable pursuant to the Facility Leases may not be accelerated. Therefore, the circumstances under which the State Treasurer might declare the principal of and accrued interest on a Series of Bonds due and payable immediately are limited.

Redemption

Each Series of Bonds is subject to optional redemption and extraordinary redemption prior to its respective stated maturities, as described herein. See "TERMS APPLICABLE TO EACH SERIES OF BONDS—Redemption Provisions" with respect to each Series of Bonds.

Certain Information Related to this Official Statement

The descriptions herein of the Indentures, the Facility Leases, the Transfer Agreement, the Site Lease, the Escrow Agreements and 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 forms thereof and the information with respect thereto included in the aforesaid documents. See "APPENDIX C—SUMMARY OF CERTAIN PROVISIONS OF THE LEGAL DOCUMENTS" for a brief summary of the rights and duties of the Board, the rights and remedies of the State Treasurer and the Holders upon an event of default, provisions relating to amendments of the Indentures and Facility Leases and procedures for defeasance of the Bonds. Copies of the documents may be obtained from the Public Finance Division, Office of the State Treasurer, State of California, 915 Capitol Mall, Room 261, Sacramento, California 95814.

All capitalized terms used in this Official Statement and not otherwise defined herein have the same meanings as in the Indentures. See "APPENDIX C—SUMMARY OF CERTAIN PROVISIONS OF THE LEGAL DOCUMENTS" for definitions of certain words and terms used but not otherwise defined herein.

Certain information concerning the State's finances, economy and outstanding indebtedness is contained in APPENDIX A.

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 State, the Board or the Department since the date hereof.

All financial and other information presented in this Official Statement has been provided by the State from its records, except for information expressly attributed to other sources. The presentation of information 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 State. 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.

A wide variety of other information, including financial information, concerning the State is available from State agencies, State agency publications and State agency websites. No such information is a part of or incorporated into this Official Statement, except as expressly noted. See "APPENDIX A—THE STATE OF CALIFORNIA—FINANCIAL STATEMENTS." Any such information that is inconsistent with the information set forth in this Official Statement should be disregarded.

Continuing Disclosure

The Board, the Department and the State Treasurer will agree on behalf of the State to provide annually certain financial information and operating data relating to the State by not later than April 1 of each year in which each Series of Bonds is Outstanding (the "Annual Report"), commencing with the report for the 2003-2004 fiscal year to be filed on April 1, 2005, and to provide notices of the occurrence of certain enumerated events, if material. The Annual Report will be filed by the State Treasurer on behalf of the State with each Nationally Recognized Municipal Securities Information Repository certified by the Securities and Exchange Commission and the State Repository, if any (collectively, the "Repositories"), and may also be obtained from the State Treasurer. The notices of material events will be filed by the State Treasurer on behalf of the State with the Municipal Securities Rulemaking Board and the Repositories. The specific nature of the information to be contained in the Annual Report or the notices of material events and certain other terms of the continuing disclosure obligation are summarized in "APPENDIX D—SUMMARY OF CERTAIN PROVISIONS OF THE CONTINUING DISCLOSURE AGREEMENTS." These undertakings will be made in order to assist the Underwriters in complying with Securities and Exchange Commission Rule 15c2-12 ("Rule 15c2-12"). The State, the Board and the Department have never failed to comply in all material respects with any continuing disclosure undertakings pursuant to Rule 15c2-12.

Additional Information

Questions regarding this Official Statement and the issuance of the Bonds may be addressed to the office of the Honorable Philip Angelides, Treasurer of the State of California, Public Finance Division, P.O. Box 942809, Sacramento, California 94209-0001, Telephone (800) 900-3873.

TERMS APPLICABLE TO EACH SERIES OF BONDS

Each Series of Bonds is separately issued and separately secured under its related Indenture. The Holders of a Series of Bonds will have no claim on the revenues or funds securing the other Series of Bonds, except to the limited extent described in THE STATE PUBLIC WORKS BOARD—Master Indenture Reserve Fund. This section should be read in conjunction with the sections entitled "SECURITY AND SOURCES OF PAYMENT FOR EACH SERIES OF BONDS," "TERMS OF THE 2004D BONDS," "TERMS OF THE 2004E BONDS," "THE BOND INSURERS AND THE BOND INSURANCE POLICIES" and "APPENDIX G—SPECIMENS OF THE INSURANCE POLICIES OF MBIA INSURANCE CORPORATION AND XL CAPITAL ASSURANCE INC."

General

Each Series of Bonds is being issued in the aggregate principal amount and will mature on the dates and in the amounts shown on the front cover and inside front cover hereof, in denominations of $5,000 or any integral multiple thereof. The Bonds are to be dated April 1, 2004 (the "Dated Date"). Interest on the Bonds is payable from the Dated Date, at the rates set forth on the inside front cover hereof (each, an "Interest Payment Date"). Interest on the Bonds is calculated on the basis of a 360-day year composed of twelve 30-day months. The record date for interest payments is the close of business on the fifteenth day of the calendar month next preceding each applicable Interest Payment Date.

Each Series of Bonds will be registered in the name of a nominee of The Depository Trust Company ("DTC"), which will act as securities depository for the Bonds. Beneficial interests in each Series of Bonds may be purchased in book-entry form only, in denominations as set forth above. The principal of and interest on each Series of Bonds will be paid as described in "APPENDIX E—DTC AND THE BOOK-ENTRY SYSTEM."

Plan of Refunding

Upon the issuance and delivery of each Series of Bonds, pursuant to each Escrow Agreement with respect to each Series of Refunded Bonds, a portion of the proceeds of the Bonds, together with other lawfully available funds, will be applied to purchase Federal Securities (as defined in the Escrow Agreements) in the amounts specified in the respective Escrow Agreement. The Federal Securities will be deposited in an escrow fund with respect to each Series of Refunded Bonds (each an "Escrow Fund" and collectively, the "Escrow Funds"), each held by the State Treasurer, as escrow agent (the "Escrow Agent"). The 1993B Coalinga Bonds to be refunded will be refunded by the proceeds of the 2004D Bonds and the 1993D Susanville Bonds to be refunded will be refunded by the proceeds of the 2004E Bonds. The Escrow Agent will apply the principal of and interest on the Federal Securities, together with other moneys held by it as Escrow Agent, to redeem the related Series of Refunded Bonds on June 1, 2004, the date fixed for redemption. The securities and moneys held in the Escrow Funds will not secure any Series of Bonds and will not pay debt service on the related Series of Bonds.

The Federal Securities so deposited with the Escrow Agent will bear interest at such rates and will be scheduled to mature at such times and in such amounts, that when paid in accordance with their terms, together with any other funds held in the related Escrow Fund, sufficient moneys will be available to pay the redemption price of the Refunded Bonds on the date fixed for redemption. For information on mathematical verification of the adequacy of the Federal Securities and other funds held in the Escrow Funds to make such payments, see "VERIFICATION OF MATHEMATICAL COMPUTATIONS." Upon such irrevocable deposit with the Escrow Agent and execution of the Escrow Agreements, the Refunded Bonds will be defeased and will no longer be entitled to the benefits of the respective Indenture under which they were issued. See "TERMS OF THE 2004D BONDS—Plan of Refunding," and "TERMS OF THE 2004E BONDS—Plan of Refunding."

Redemption Provisions

Optional Redemption. The Bonds of each Series are subject to optional redemption prior to their respective maturity dates, at the option of the Board, from any available funds, in whole or in part on the dates, and at the redemption prices set forth herein. See "TERMS OF THE 2004D BONDS—Redemption," and "TERMS OF THE 2004E BONDS—Redemption."

Extraordinary Redemption. Each Series of Bonds is subject to redemption prior to its respective stated maturity dates, at the option of the Board, in whole or in part on any date, from proceeds of insurance or eminent domain received in connection with the related Facility, at the principal amount of the Bonds to be redeemed plus accrued interest thereon, to the date fixed for redemption, without premium.

Selection of Bonds for Redemption. If less than all Outstanding Bonds of a Series are to be redeemed at any one time from the proceeds of insurance or eminent domain, the State Treasurer shall select such Bonds to be redeemed from each maturity within such Series on a proportionate basis; provided that within each maturity such Bonds shall be selected by lot. If less than all Outstanding Bonds of a Series are to be redeemed at any one time other than from the proceeds of insurance or eminent domain, the State Treasurer shall select such Bonds to be redeemed from each maturity within such Series at his discretion; provided that within each maturity such Bonds shall be selected by lot. See "APPENDIX E—DTC AND THE BOOK-ENTRY SYSTEM" concerning DTC's redemption procedures.

Notice of Redemption. So long as DTC is acting as securities depository for the Bonds, notice of redemption will be given by sending copies of such notice to DTC (and not to the beneficial owners of any Series of Bonds designated for redemption) at least 30 days but not more than 60 days prior to the redemption date. Each Indenture provides that if notice of redemption has been duly given and money for payment of the redemption price of Bonds called for redemption is held by the State Treasurer, then on the redemption date designated in such notice, the Bonds so called for redemption will become due and payable, and from and after the redemption date, interest on the Bonds so called for redemption will cease to accrue and be payable, and the Holders of such Bonds will have no rights in respect thereof except to receive payment of the redemption price thereof.

SECURITY AND SOURCES OF PAYMENT FOR EACH SERIES OF BONDS

General

Each Series of Bonds is separately issued and separately secured solely under the related Indenture which pertains exclusively to the related Series of Bonds (and in the case of the 2004E Bonds, the Prior Susanville Bonds issued thereunder), the related Base Rental, the related Facility Lease and the related Facility. The Holders of a Series of Bonds will have no claim on the revenues or funds securing the other Series of Bonds, except to the extent that the Bonds share in a pooled reserve fund as described in "THE STATE PUBLIC WORKS BOARD—Master Indenture Reserve Fund." Nothing within this Official Statement is intended to imply that there exists any cross-application or crosscollateralization, including, without limitation, any cross-defaults between the respective Indentures.

Under each Facility Lease, the obligation of the Department to make Base Rental payments is subject to and dependent upon its beneficial use and occupancy of the related Facility. Each Series of Bonds will be special obligations of the Board payable solely from certain pledged revenues under the related Indenture, including Base Rental payments made pursuant to the related Facility Lease. All Base Rental payments received under the Coalinga Facility Lease shall be applied to the payment of principal and interest due on the 2004D Bonds. All Base Rental payments received under the Susanville Facility Lease shall be applied to the payment of principal and interest due on the 2004E Bonds, equally and ratably with principal and interest due with respect to the Prior Susanville Bonds. See "TERMS OF THE 2004E BONDS—Security for the 2004E Bonds."

The Bonds do not represent or constitute a debt of the State, any political subdivision thereof, the Board or the Department within the meaning of any constitutional or statutory limitation or a pledge of the faith and credit of the State, any political subdivision thereof, the Board or the Department. The owners of the Bonds shall have no right to have excises or taxes levied for the payment of amounts due on their Bonds. Neither the Board nor the Department has any power to pledge the credit or taxing power of the State.

Budgeting for Rental Payments

In each Facility Lease, the Department covenants to take such action as may be necessary to include or cause to be included all Base Rental and Additional Rental payments due under such Facility Lease in that portion of the budget of the State related to the Department and to make or cause to be made the necessary annual allocations for all such rental payments. Each Facility Lease requires that the Department furnish to the Board and the State Treasurer copies of that portion of the budget of the State related to the Department that contains the appropriation to pay rent under each Facility Lease, within ten days after the Governor submits his budget to the State Legislature. The Governor's Office, in consultation with the Department of Finance, makes the final determination of all amounts to be included in the annual budget proposed by the Governor to the Legislature. The annual Budget Act (as defined in APPENDIX A hereof) must be approved by a two-thirds majority vote of each House of the State Legislature and is subject to the power of the Governor to veto specific line items. See "APPENDIX A—THE STATE OF CALIFORNIA—THE BUDGET PROCESS—General." Under each Indenture, the Board is required to supply to the State Treasurer, as soon as practical after the beginning of each fiscal year of the Department, a certificate of the Board certifying that the Department has made or caused to be made adequate provision in the annual budget of the State for such fiscal year for the payment of all Base Rental and Additional Rental due under each Facility Lease in such fiscal year.

Under the State Constitution, money can be drawn from the State Treasury only through an appropriation made by law. An appropriation may be made in the Budget Act or in other legislation, each of which must be approved by the State Legislature and signed by the Governor. Budget Act appropriations are generally limited to a one-year period of availability. See "APPENDIX A—THE STATE OF CALIFORNIA—THE BUDGET PROCESS" for additional information concerning the budget process.

Under the State's budget process, Base Rental under each of the Facility Leases will be included in the operating budget of the Department. Such operating budget will contain specific items designating the amount of rental for all projects that are leased, directly or indirectly, from the Board. Section 15849.2 of the Act requires any State agency, including the Department, which has leased or otherwise contracts with the Board for a public building financed by revenue bonds issued by the Board to allocate from the "first lawfully available funds" appropriated in each fiscal year an amount sufficient to pay all rental payments during such fiscal year, including rental payments securing other revenue bonds and obligations of the Board. The statutory provisions of the Act regarding priority with respect to allocation of funds have not been interpreted by any court.

Section 15848 of the Act provides a continuing appropriation of moneys from the fund in the State Treasury from which a state agency, including the Department, derives its appropriation for support, when such rental payments are due during a period that the State is operating without funds appropriated by a budget, or when the required rental payment amounts have not been included in the budget adopted by the State; provided the Department of Finance certifies to the State Controller that sufficient funds are available for the support of such state agency for such public building. The statutory provisions of the Act regarding continuing appropriations have not been interpreted by any court.

The Department expects to pay the $39,559,506 amount of maximum annual Base Rental related to the Bonds from amounts included in its annual support budget. The maximum annual Base Rental related to the 2004D Bonds is $16,249,226, and for the 2004E Bonds and the Prior Susanville Bonds, is $23,672,500. The Department's total operating budget is approximately $5.7 billion for Fiscal Year 2003-04. Such maximum annual Base Rental equals less than one percent of the Department's overall budget for Fiscal Year 2003-04. The Department's budget is one of many line items in the State's annual budget. Despite recent developments regarding state finances and proposed General Fund expenditure reductions, it is not anticipated that the reductions will impact the Department's obligation to make the annual rental payments due under the Facility Leases. For more information regarding the State's budgetary process and finances, see "APPENDIX A—THE STATE OF CALIFORNIA—STATE FINANCES" and "—THE BUDGET PROCESS." See "APPENDIX B—INFORMATION CONCERNING THE DEPARTMENT AND THE FACILITIES."

Insurance on the Facilities

Casualty Insurance. Each Indenture and the related Facility Lease require the Board to maintain or cause the Department to maintain fire, lightning and extended coverage insurance on the related Facility in an amount equal to one hundred percent of the then current replacement cost thereof, excluding the then value of the unimproved portions of the related Site (except that such insurance may be subject to deductible clauses of not to exceed $500,000 for any one loss, under the Susanville Facility Lease and the 2004E Indenture, and $2,500,000 for any one loss, under the Coalinga Facility Lease and the 2004D Indenture), and earthquake insurance (if such insurance is available on the open market from reputable insurance companies at a reasonable cost, as determined, in the case of the 2004D Bonds in the sole discretion of the Board) on any structure comprising part of its related Facility, in an amount equal to the full insurable value of such structure or the principal amount of all Outstanding Bonds under the related Indenture, whichever is less (except that such insurance may be subject to a deductible clause of not to exceed $500,000 for any one loss, under the Susanville Facility Lease and the 2004E Indenture, and $2,500,000 for any one loss, under the Coalinga Facility Lease and the 2004D Indenture). **At the present time, neither the Board nor the Department maintains earthquake insurance on any of the Facilities.** The Board is unable to predict when or if such insurance will be available on the open market from reputable insurance companies at reasonable cost. See "APPENDIX C—SUMMARY OF CERTAIN PROVISIONS OF THE LEGAL DOCUMENTS."

Proceeds of Insurance on the Facilities. In the event of any damage to or destruction of any part of a Facility caused by the perils covered by the insurance required under the related Indenture and the related Facility Lease or, in the case of the Coalinga Facility Lease, in the event that the Board or the Department receives any title insurance proceeds relating to a Facility, the insurance proceeds shall be utilized, in the discretion of the Board, either (i) to redeem Outstanding Bonds under the related Indenture on a pro rata basis, to the extent possible and in accordance with the provisions of such Indenture, but only if the Base Rental payments due after such redemption would be sufficient to retire such Bonds then Outstanding in accordance with their terms, or (ii) to repair, reconstruct or replace such Facility to the end that such Facility shall be restored to at least the same condition that it was in prior to such damage or destruction. Under the Coalinga Facility Lease, if the Board so elects to repair, reconstruct or replace such Facility, it shall do so with all practicable dispatch in an expeditious manner and in conformity with the law so as to complete the same as soon as possible. Any balance of such proceeds not required for such repair, reconstruction or replacement shall be transferred to the Board and treated as Revenues and applied in the manner provided in the related Indenture. See "APPENDIX C—SUMMARY OF CERTAIN PROVISIONS OF THE LEGAL DOCUMENTS."

Rental Interruption Insurance. Each Indenture and the related Facility Lease require the Board to maintain or cause the Department to maintain rental interruption or use and occupancy insurance to cover loss, total or partial, of the use of the related Facility leased thereunder as a result of any of those certain hazards covered by the fire, lightning and extended coverage insurance and by any earthquake insurance (if acquired) required by the related Facility Lease in an amount to cover not less than the succeeding two consecutive years' Base Rental under the Coalinga Facility Lease, and the total Base Rental payable for any period of at least two (2) consecutive years, in the case of the Susanville Facility Lease. Such policies shall contain a loss payable clause making any loss thereunder payable to the State Treasurer. Alternatively, under the Coalinga Facility Lease, the Board may maintain or cause to be maintained by the Department or the Board rental interruption or use and occupancy insurance under a blanket or umbrella or similar type of policy to cover such losses in an amount not less than the succeeding two consecutive years' Base Rental under such Facility Lease. Any such insurance policy shall be in a form satisfactory to the Board, in the case of the Coalinga Facility Lease, and the State Treasurer, in the case of the Susanville Facility Lease, and shall contain a loss payable clause making any loss thereunder payable to the State Treasurer. Each Indenture and the related Facility Lease require that the State Treasurer use any proceeds of such insurance to reimburse the Department for any rental theretofore paid under such Facility Lease for the period of time during which the payment of Base Rental under such Facility

Lease is abated, and that any proceeds of such insurance not so used shall be applied, to the extent required, to pay principal of and interest on the related Series of Bonds and, in the case of the 2004E Bonds, the Prior Susanville Bonds, which are payable from Base Rental under the Facility Lease, or shall be applied to pay administrative costs of the Board in connection with such Facility (which, under the conditions set forth in the Susanville Facility Lease, may require additional insurance to be obtained by the Department). See "Abatement" below and "APPENDIX C---SUMMARY OF CERTAIN PROVISIONS OF THE LEGAL DOCUMENTS."

Abatement

The rental payments due with respect to a Facility shall be abated proportionately during any period in which by reason of any damage, destruction, condemnation or title defect, there is substantial interference with the use and occupancy of such Facility or any portion thereof. Base Rental payments securing the 2004E Bonds shall be abated proportionately and equally and ratably with Base Rental payments securing the Prior Susanville Bonds. See "APPENDIX B—INFORMATION CONCERNING THE DEPARTMENT AND THE FACILITIES." Certain surface and subsurface geothermal, steam, water, oil, gas and mineral rights in the real property on which the Coalinga Facility is located are not vested in the State. The Department has concluded that these existing rights vested in entities other than the State will not result in a substantial interference with the use and occupancy of the Coalinga Facility.

In the event of abatement of rental payments due to damage, destruction, partial condemnation or title defect, only rental payments with respect to the portion of a Facility that is damaged, destroyed, condemned or subject to title defect will be abated. Such abatement shall continue from the period commencing with such damage, destruction, partial condemnation or title defect and ending when use and occupancy is restored. Each Facility Lease requires that the proceeds of condemnation be applied to replace the portion of such Facility condemned if the remainder not condemned is useable, or to apply all condemnation proceeds to the redemption of the related Bonds, including any outstanding parity bonds under the related Indenture issued with respect to the Facility. See "TERMS APPLICABLE TO EACH SERIES OF BONDS—Redemption Provisions—Extraordinary Redemption." If all useable portions of a Facility are condemned, the Facility Lease will cease as of the day possession is taken and all condemnation proceeds will be applied to the payment of principal and interest with respect to the related Bonds and any related parity bonds issued with respect to the Facility. The Department is required to maintain or cause to be maintained rental interruption or use and occupancy insurance to cover loss, total or partial, of the use of the Facilities as a result of any of those certain hazards covered by the fire, lightning and extended coverage insurance and by any earthquake insurance (if acquired) as described in each Facility Lease. See "Casualty Insurance" and "Rental Interruption Insurance" above and "APPENDIX C—SUMMARY OF CERTAIN PROVISIONS OF THE LEGAL DOCUMENTS—THE FACILITY LEASES—Insurance." **At the present time, neither the Board nor the Department maintains earthquake insurance on the Coalinga Facility or the Susanville Facility. The Board is unable to predict when or if such insurance will be available on the open market from reputable insurance companies at a reasonable cost.**

If damage, destruction, title defect or eminent domain proceedings with respect to a Facility results in abatement of all or any portion of the Base Rental payments with respect to such Facility, and, if remaining Base Rental payments not subject to abatement, if any, together with any available moneys from rental interruption or use and occupancy insurance (in the event of any insured loss due to damage or destruction), eminent domain proceeds and moneys available in the Master Indenture Reserve Fund, as applicable, are insufficient to make all payments of principal of and interest on the related Series of Bonds, and any related parity bonds issued with respect to the Facility, during the period that such Facility is being replaced, repaired or reconstructed, then all or a portion of such payments of principal and interest may not be made. No remedy is available under the Facility Leases or the related Indentures to the Holders of the Bonds for nonpayment under such circumstances.

THE BOND INSURERS AND THE BOND INSURANCE POLICIES

The following information has been provided by the Bond Insurers, MBIA and XL Capital Assurance, for use in this Official Statement. Reference is made to APPENDIX G for specimens of the insurance policies of the Bond Insurers. No representation is made by the State, the Board, the Department or the Underwriters as to the accuracy, completeness or adequacy of such information or as to the absence of material adverse changes in the condition of the Bond Insurers subsequent to the date of this Official Statement.

MBIA BOND INSURANCE—2004D INSURED BONDS

The scheduled payment of principal and interest when due with respect to the 2004D Insured Bonds will be guaranteed under an insurance policy to be issued concurrently with the delivery of the 2004D Insured Bonds by MBIA. See APPENDIX G herein for a specimen of the insurance policy to be issued by MBIA.

The MBIA Insurance Corporation Insurance Policy

The following information has been furnished by MBIA Insurance Corporation ("MBIA") for use in this Official Statement. Reference is made to APPENDIX G for a specimen of MBIA's policy.

MBIA's policy unconditionally and irrevocably guarantees the full and complete payment required to be made by or on behalf of the Board to the State Treasurer, as Paying Agent (the "Paying Agent") or its successor, of an amount equal to (i) the principal of (either at the stated maturity or by an advancement of maturity pursuant to a mandatory sinking fund payment) and interest on, the 2004D Insured Bonds as such payments shall become due but shall not be so paid (except that in the event of any acceleration of the due date of such principal by reason of mandatory or optional redemption or acceleration resulting from default or otherwise, other than any advancement of maturity pursuant to a mandatory sinking fund payment, the payments guaranteed by MBIA's policy shall be made in such amounts and at such times as such payments of principal would have been due had there not been any such acceleration); and (ii) the reimbursement of any such payment which is subsequently recovered from any owner of the 2004D Insured Bonds pursuant to a final judgment by a court of competent jurisdiction that such payment constitutes an avoidable preference to such owner within the meaning of any applicable bankruptcy law (a "Preference").

MBIA's policy does not insure against loss of any prepayment premium which may at any time be payable with respect to any 2004D Insured Bonds. MBIA's policy does not, under any circumstance, insure against loss relating to: (i) optional or mandatory redemptions (other than mandatory sinking fund redemptions); (ii) any payments to be made on an accelerated basis; (iii) payments of the purchase price of 2004D Insured Bonds upon tender by an owner thereof; or (iv) any Preference relating to (i) through (iii) above. MBIA's policy also does not insure against nonpayment of principal of or interest on the 2004D Insured Bonds resulting from the insolvency, negligence or any other act or omission of the Paying Agent or any other paying agent for the 2004D Insured Bonds.

Upon receipt of telephonic or telegraphic notice, such notice subsequently confirmed in writing by registered or certified mail, or upon receipt of written notice by registered or certified mail, by MBIA from the Paying Agent or any owner of a Bond the payment of an insured amount for which is then due, that such required payment has not been made, MBIA on the due date of such payment or within one business day after receipt of notice of such nonpayment, whichever is later, will make a deposit of funds, in an account with U.S. Bank Trust National Association, in New York, New York, or its successor, sufficient for the payment of any such insured amounts which are then due. Upon presentment and surrender of such 2004D Insured Bonds or presentment of such other proof of ownership of the 2004D Insured Bonds, together with any appropriate instruments of assignment to evidence the assignment of the insured amounts due on the 2004D Insured Bonds as are paid by MBIA, and appropriate instruments to effect the appointment of MBIA as agent for such owners of the 2004D Insured Bonds in any legal proceeding related to payment of insured amounts on the 2004D

Insured Bonds, such instruments being in a form satisfactory to U.S. Bank Trust National Association, U.S. Bank Trust National Association shall disburse to such owners or the Paying Agent payment of the insured amounts due on such 2004D Insured Bonds, less any amount held by the Paying Agent for the payment of such insured amounts and legally available therefor.

MBIA

MBIA Insurance Corporation ("MBIA") is the principal operating subsidiary of MBIA Inc., a New York Stock Exchange listed company (the "Company"). The Company is not obligated to pay the debts of or claims against MBIA. MBIA is domiciled in the State of New York and licensed to do business in and subject to regulation under the laws of all 50 states, the District of Columbia, the Commonwealth of Puerto Rico, the Commonwealth of the Northern Mariana Islands, the Virgin Islands of the United States and the Territory of Guam. MBIA has three branches, one in the Republic of France, one in the Republic of Singapore and one in the Kingdom of Spain. New York has laws prescribing minimum capital requirements, limiting classes and concentrations of investments and requiring the approval of policy rates and forms. State laws also regulate the amount of both the aggregate and individual risks that may be insured, the payment of dividends by MBIA, changes in control and transactions among affiliates. Additionally, MBIA is required to maintain contingency reserves on its liabilities in certain amounts and for certain periods of time.

MBIA does not accept any responsibility for the accuracy or completeness of this Official Statement or any information or disclosure contained herein, or omitted herefrom, other than with respect to the accuracy of the information regarding the MBIA policy and MBIA set forth under the heading "THE BOND INSURERS AND THE BOND INSURANCE POLICIES." Additionally, MBIA makes no representation regarding the 2004D Insured Bonds or the advisability of investing in the 2004D Insured Bonds.

MBIA Information

The following document filed by the Company with the Securities and Exchange Commission (the "SEC") is incorporated herein by reference:

The Company's Annual Report on Form 10-K for the year ended December 31, 2003.

Any documents filed by the Company pursuant to Sections 13(a), 13(c), 14 or 15(d) of the Exchange Act of 1934, as amended, after the date of this Official Statement and prior to the termination of the offering of the 2004D Insured Bonds offered hereby shall be deemed to be incorporated by reference in this Official Statement and to be a part hereof. Any statement contained in a document incorporated or deemed to be incorporated by reference herein, or contained in this Official Statement, shall be deemed to be modified or superseded for purposes of this Official Statement to the extent that a statement contained herein or in any other subsequently filed document which also is or is deemed to be incorporated by reference herein modifies or supersedes such statement. Any such statement so modified or superseded shall not be deemed, except as so modified or superseded, to constitute a part of this Official Statement.

The Company files annual, quarterly and special reports, information statements and other information with the SEC under File No. 1-9583. Copies of the SEC filings (including (1) the Company's Annual Report on Form 10-K for the year ended December 31, 2003, and (2) the Company's Quarterly Reports on Form 10-Q for the quarters ended March 31, 2003, June 30, 2003 and September 30, 2003) are available (i) over the Internet at the SEC's web site at http://www.sec.gov; (ii) at the SEC's public reference room in Washington D.C.; (iii) over the Internet at the Company's web site at http://www.mbia.com; and (iv) at no cost, upon request to MBIA Insurance Corporation, 113 King Street, Armonk, New York 10504. The telephone number of MBIA is (914) 273-4545.

As of December 31, 2002, MBIA had admitted assets of $9.2 billion (audited), total liabilities of $6.0 billion (audited), and total capital and surplus of $3.2 billion (audited) determined in accordance with statutory accounting practices prescribed or permitted by insurance regulatory authorities. As of December 31, 2003 MBIA had admitted assets of $9.9 billion (unaudited), total liabilities of $6.2 billion (unaudited), and total capital and surplus of $3.7 billion (unaudited) determined in accordance with statutory accounting practices prescribed or permitted by insurance regulatory authorities.

Financial Strength Ratings of MBIA

Moody's Investors Service, Inc. rates the financial strength of MBIA "Aaa."

Standard & Poor's, a division of The McGraw-Hill Companies, Inc. rates the financial strength of MBIA "AAA."

Fitch Ratings rates the financial strength of MBIA "AAA."

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

The above ratings are not recommendations to buy, sell or hold the 2004D Insured Bonds, and such ratings may be subject to revision or withdrawal at any time by the rating agencies. Any downward revision or withdrawal of any of the above ratings may have an adverse effect on the market price of the 2004D Insured Bonds. MBIA does not guaranty the market price of the 2004D Insured Bonds nor does it guaranty that the ratings on the 2004D Insured Bonds will not be revised or withdrawn.

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

There can be no assurances that payments made by MBIA representing interest on the 2004D Insured Bonds will be excluded from gross income, for federal income tax purposes, in the event of nonappropriation by the State.

XL CAPITAL ASSURANCE BOND INSURANCE—2004E INSURED BONDS

The scheduled payment of principal and interest when due with respect to the 2004E Insured Bonds will be guaranteed under a financial guaranty insurance policy (the "XL Capital Assurance Insurance Policy") to be issued concurrently with the delivery of the Bonds by XL Capital Assurance, also referred to under this subcaption as the 2004E Bonds Insurer. See APPENDIX G herein for a specimen of the XL Capital Assurance Insurance Policy.

The 2004E Bonds 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 2004E Bonds Insurer and its affiliates set forth under this heading. In addition, the 2004E Bonds Insurer makes no representation regarding the 2004E Insured Bonds or the advisability of investing in the 2004E Insured Bonds.

General

XL Capital Assurance Inc. (the "2004E Bonds Insurer" or "XLCA") is a monoline financial guaranty insurance company incorporated under the laws of the State of New York. The 2004E Bonds Insurer is currently licensed to do insurance business in, and is subject to the insurance regulation and supervision by, the State of New York, forty-eight other states, the District of Columbia, Puerto Rico, the U.S. Virgin Islands and Singapore. The 2004E Bonds Insurer has a license application pending with the State of Wyoming, the only state in which it is not currently licensed.

The 2004E Bonds Insurer is an indirect wholly owned subsidiary of XL Capital Ltd, a Cayman Islands corporation ("XL Capital Ltd"). Through its subsidiaries, XL Capital Ltd is a leading provider of insurance and reinsurance coverages and financial products to industrial, commercial and professional service firms, insurance companies and other enterprises on a worldwide basis. The common stock of XL Capital Ltd is publicly traded in the United States and listed on the New York Stock Exchange (NYSE: XL). XL Capital Ltd is not obligated to pay the debts of or claims against the 2004E Bonds Insurer.

The 2004E Bonds Insurer was formerly known as The London Assurance of America Inc. ("London"), which was incorporated on July 25, 1991 under the laws of the State of New York. On February 22, 2001, XL Reinsurance America Inc. ("XL Re") acquired 100% of the stock of London. XL Re merged its former financial guaranty subsidiary, known as XL Capital Assurance Inc. (formed September 13, 1999) with and into London, with London as the surviving entity. London immediately changed its name to XL Capital Assurance Inc. All previous business of London was 100% reinsured to Royal Indemnity Company, the previous owner at the time of acquisition.

Reinsurance

The 2004E Bonds Insurer has entered into a facultative quota share reinsurance agreement with XL Financial Assurance Ltd ("XLFA"), an insurance company organized under the laws of Bermuda, and an affiliate of the 2004E Bonds Insurer. Pursuant to this reinsurance agreement, the 2004E Bonds Insurer expects to cede up to 90% of its business to XLFA. The 2004E Bonds Insurer may also cede reinsurance to third parties on a transaction-specific basis, which cessions may be any or a combination of quota share, first loss or excess of loss. Such reinsurance is used by the 2004E Bonds Insurer as a risk management device and to comply with statutory and rating agency requirements and does not alter or limit the 2004E Bonds Insurer's obligations under any financial guaranty insurance policy. With respect to any transaction insured by XLCA, the percentage of risk ceded to XLFA may be less than 90% depending on certain factors including, without limitation, whether XLCA has obtained third party reinsurance covering the risk. As a result, there can be no assurance as to the percentage reinsured by XLFA of any given financial guaranty insurance policy issued by XLCA, including the XL Capital Assurance Policy.

Based on the audited financials of XLFA, as of December 31, 2003, XLFA had total assets, liabilities, redeemable preferred shares and shareholders' equity of $831,762,000, $401,123,000, $39,000,000 and $391,639,000, respectively, determined in accordance with generally accepted accounting principles in the United States. XLFA's insurance financial strength is rated "Aaa" by Moody's Investor's Service ("Moody's") and "AAA" by Standard & Poor's Ratings Services ("S&P") and Fitch Inc. ("Fitch"). In addition, XLFA has obtained a financial enhancement rating of "AAA"from S&P.

The obligations of XLFA to the 2004E Bonds Insurer under the reinsurance agreement described above are unconditionally guaranteed by XL Insurance (Bermuda) Ltd ("XLI"), a Bermuda company and one of the world's leading excess commercial insurer. XLI is a wholly owned indirect subsidiary of XL Capital Ltd. In addition to A.M. Best's rating of "A+" (Negative Outlook), XLI's insurance financial strength rating is "Aa2" by Moody's, "AA-" by S&P and "AA" by Fitch. The ratings of XLFA and XLI are not recommendations to buy, sell or hold securities, including the 2004E Insured Bonds, and are subject to revision or withdrawal at any time by Moody's, S&P or Fitch.

Notwithstanding the capital support provided to the 2004E Bonds Insurer described in this section, the holders of the 2004E Insured Bonds will have direct recourse against the 2004E Bonds Insurer only, and neither XLFA nor XLI will be directly liable to the holders of the 2004E Insured Bonds.

Financial Strength and Financial Enhancement Ratings of XLCA

The 2004E Bonds Insurer's insurance financial strength is rated "Aaa" by Moody's and "AAA" by S&P and Fitch. In addition, XLCA has obtained a financial enhancement rating of "AAA" from S&P. These ratings reflect Moody's, S&P and Fitch's current assessment of the 2004E Bonds Insurer's creditworthiness and claims-paying ability as well as the reinsurance arrangement with XLFA described under "Reinsurance" above.

The above ratings are not recommendations to buy, sell or hold securities, including the 2004E Insured Bonds and are subject to revision or withdrawal at any time by Moody's, S&P or Fitch. Any downward revision or withdrawal of these ratings may have an adverse effect on the market price of the 2004E Insured Bonds. The 2004E Bonds Insurer does not guaranty the market price of the 2004E Insured Bonds nor does it guaranty that the ratings on the 2004E Insured Bonds will not be revised or withdrawn.

Capitalization of XLCA

Based on the audited statutory financial statements for XLCA as of December 31, 2002 filed with the State of New York Insurance Department, XLCA has total admitted assets of $180,993,189, total liabilities of $58,685,217 and total capital and surplus of $122,307,972 determined in accordance with statutory accounting practices prescribed or permitted by insurance regulatory authorities ("SAP"). Based on the unaudited statutory financial statements for XLCA as of December 31, 2003 filed with the State of New York Insurance Department, XLCA has total admitted assets of $329,701,823, total liabilities of $121,635,535 and total capital and surplus of $208,066,288 determined in accordance with SAP.

For further information concerning XLCA and XLFA, see the financial statements of XLCA and XLFA, and the notes thereto, incorporated by reference in this Official Statement. The financial statements of XLCA and XLFA are included as exhibits to the periodic reports filed with the Securities and Exchange Commission (the "Commission") by XL Capital Ltd and may be reviewed at the EDGAR website maintained by the Commission. All financial statements of XLCA and XLFA included in, or as exhibits to, documents filed by XL Capital Ltd pursuant to Section 13(a), 13(c), 14 or 15(d) of the Securities Exchange Act of 1934 on or prior to the date of this Official Statement, or after the date of this Official Statement but prior to termination of the offering of the 2004E Insured Bonds, shall be deemed incorporated by reference in this Official Statement. Except for the financial statements of XLCA and XLFA, no other information contained in XL Capital Ltd's reports filed with the Commission is incorporated by reference. Copies of the statutory quarterly and annual statements filed with the State of New York Insurance Department by XLCA are available upon request to the State of New York Insurance Department.

Regulation of the 2004E Bonds Insurer

The 2004E Bonds Insurer is regulated by the Superintendent of Insurance of the State of New York. In addition, the 2004E Bonds Insurer is subject to regulation by the insurance laws and regulations of the other jurisdictions in which it is licensed. As a financial guaranty insurance company licensed in the State of New York, the 2004E Bonds Insurer is subject to Article 69 of the New York Insurance Law, which, among other things, limits the business of each insurer to financial guaranty insurance and related lines, prescribes minimum standards of solvency, including minimum capital requirements, establishes contingency, loss and unearned premium reserve requirements, requires the maintenance of minimum surplus to policyholders and limits the aggregate amount of insurance which may be written and the maximum size of any single risk exposure which may be assumed. The 2004E Bonds Insurer is also required to file detailed annual financial statements with the New York Insurance Department and similar supervisory agencies in each of the other jurisdictions in which it is licensed.

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

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

The principal executive offices of the 2004E Bonds Insurer are located at 1221 Avenue of the Americas, New York, New York 10020 and its telephone number at this address is (212) 478-3400.

TERMS OF THE 2004D BONDS

This section should be read in conjunction with the sections entitled "TERMS APPLICABLE TO EACH SERIES OF BONDS," "SECURITY AND SOURCES OF PAYMENT FOR EACH SERIES OF BONDS," "THE BOND INSURERS AND THE BOND INSURANCE POLICIES—MBIA BOND INSURANCE—2004D INSURED BONDS," and "APPENDIX G—SPECIMENS OF THE INSURANCE POLICIES OF MBIA INSURANCE CORPORATION AND XL CAPITAL ASSURANCE INC.—Specimen of the MBIA Insurance Company Insurance Policy."

General

The 2004D Bonds will be issued under and secured by the 2004D Indenture, to provide funds which will be used to (i) accomplish a current refunding of all of the outstanding 1993B Coalinga Bonds, (ii) make a deposit to the Master Indenture Reserve Fund, and (iii) pay the costs of issuance of the 2004D Bonds. See "TERMS APPLICABLE TO THE 2004D BONDS—Plan of Refunding" and "APPENDIX B—INFORMATION CONCERNING THE DEPARTMENT AND THE FACILITIES."

Pursuant to the Coalinga Facility Lease, the Department agrees to make Base Rental payments for the beneficial use and occupancy of the Coalinga Facility leased thereunder, calculated to be sufficient to pay the principal of and interest on the 2004D Bonds. See "SECURITY AND SOURCES OF PAYMENT FOR EACH SERIES OF BONDS—Abatement." For additional information regarding the Coalinga Facility to be refinanced with the proceeds of the 2004D Bonds, see "APPENDIX B—INFORMATION CONCERNING THE DEPARTMENT AND THE FACILITIES."

Redemption Provisions

Extraordinary Redemption. The 2004D Bonds are subject to extraordinary redemption prior to their respective stated maturities, as described above under "TERMS APPLICABLE TO EACH SERIES OF BONDS—Redemption Provisions." The 2004D Bonds are subject to optional redemption prior to their respective stated maturities, as described below under "Optional Redemption."

Optional Redemption. The 2004D Bonds maturing on or before December 1, 2014 are not subject to optional redemption prior to their maturity dates. The 2004D Bonds maturing on and after December 1, 2015 are subject to redemption prior to their respective maturity dates, at the option of the Board, from any available funds, in whole or in part on any date on and after December 1, 2014, at a redemption price equal to the principal amount thereof, without premium, plus accrued interest to the date fixed for redemption.

Security for the 2004D Bonds

The 2004D Bonds are special obligations of the Board issued under and pursuant to the 2004D Indenture, payable solely from and secured by a first pledge of (i) all Base Rental payments received by the Board pursuant to the Coalinga Facility Lease, (ii) amounts deposited in the Interest Subaccount established under the 2004D Indenture (the "2004D Coalinga Interest Account") and (iii) all other benefits, charges, income, proceeds, profits, receipts, rents, proceeds of insurance and revenues derived by the Board from the ownership, operation or use of the Coalinga Facility, including interest or profits from the investment of money in any account or fund (other than the Rebate Fund and the Master Indenture Reserve Fund) established pursuant to the 2004D Indenture (the amounts described in clauses (i), (ii) and (iii) are collectively referred to herein as the "2004D Coalinga Revenues").

The 2004D Bonds are also secured by a first pledge of the amounts on deposit in the funds and accounts (except the Rebate Fund) related to the 2004D Bonds established by the 2004D Indenture and by the Master Indenture Reserve Fund as provided in the 2004D Indenture. The Base Rental, together with proceeds of the 2004D Bonds deposited in the 2004D Coalinga Interest Account, are calculated to be sufficient, in both time and amount, to pay when due the annual principal of and interest on the 2004D Bonds.

Additional Rental payments due from the Department to the Board pursuant to the Coalinga Facility Lease include amounts sufficient to pay all administrative costs and other expenses of the Board in connection with the Coalinga Facility, including, among other expenses, insurance premiums. Additional Rental is not a part of the 2004D Coalinga Revenues. The Department is responsible for repair and maintenance of the Coalinga Facility during the term of the Coalinga Facility Lease.

The scheduled payment of principal and interest when due with respect to the 2004D Insured Bonds will be insured under an insurance policy to be issued concurrently with the delivery of the Bonds by MBIA. See "THE BOND INSURERS AND THE BOND INSURANCE POLICIES—MBIA BOND INSURANCE—2004D INSURED BONDS," and "APPENDIX G—SPECIMENS OF THE INSURANCE POLICIES OF MBIA INSURANCE CORPORATION AND XL CAPITAL ASSURANCE INC.—Specimen of the MBIA Insurance Corporation Insurance Policy."

Additional Bonds—2004D Bonds

The Board may issue additional bonds under the Master Indenture (the "Master Indenture Additional Bonds") secured on a parity with the 2004D Bonds for the purposes of (i) financing or refinancing the acquisition, installation and construction of additions, extensions or improvements to the Coalinga Facility, including payment of all costs incidental to or connected with such financing, and (ii) refunding any outstanding bonds under the 2004D Indenture, including payment of all costs incidental to or connected with such refunding. In connection with the issuance of any such Master Indenture Additional Bonds, the Coalinga Facility Lease would be amended to provide for Base Rental thereunder sufficient, in both time and amount, to pay when due the annual principal of and interest on the 2004D Bonds and any such Master Indenture Additional Bonds. See "APPENDIX C—SUMMARY OF CERTAIN PROVISIONS OF THE LEGAL DOCUMENTS."

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Annual Debt Service Requirements—2004D Bonds

Set forth below are the principal, interest and total debt service requirements for the 2004D Bonds, assuming no redemptions:

Payment Date	2004D Bonds Principal	2004D Bonds Interest	Total Debt Service	Fiscal Year Debt Service
June 1, 2004	-	$1,290,623.47	$1,290,623.47	$ 1,290,623.47
December 1, 2004	$8,635,000.00	3,871,727.32	12,506,727.32	-
June 1, 2005	-	3,742,216.43	3,742,216.43	16,248,943.75
December 1, 2005	8,895,000.00	3,742,202.32	12,637,202.32	-
June 1, 2006	-	3,608,791.43	3,608,791.43	16,245,993.75
December 1, 2006	9,185,000.00	3,608,777.32	12,793,777.32	-
June 1, 2007	-	3,451,141.43	3,451,141.43	16,244,918.75
December 1, 2007	9,560,000.00	3,451,127.32	13,011,127.32	-
June 1, 2008	-	3,236,041.43	3,236,041.43	16,247,168.75
December 1, 2008	9,940,000.00	3,236,027.32	13,176,027.32	-
June 1, 2009	-	3,066,791.43	3,066,791.43	16,242,818.75
December 1, 2009	10,335,000.00	3,066,777.32	13,401,777.32	-
June 1, 2010	-	2,847,448.42	2,847,448.42	16,249,225.74
December 1, 2010	10,690,000.00	2,847,439.08	13,537,439.08	-
June 1, 2011	-	2,710,073.42	2,710,073.42	16,247,512.50
December 1, 2011	11,000,000.00	2,710,064.08	13,710,064.08	-
June 1, 2012	-	2,535,385.92	2,535,385.92	16,245,450.00
December 1, 2012	11,460,000.00	2,535,376.58	13,995,376.58	-
June 1, 2013	-	2,253,060.92	2,253,060.92	16,248,437.50
December 1, 2013	11,980,000.00	2,253,051.58	14,233,051.58	-
June 1, 2014	-	2,012,291.89	2,012,291.89	16,245,343.47
December 1, 2014	12,460,000.00	2,012,289.36	14,472,289.36	-
June 1, 2015	-	1,772,866.89	1,772,866.89	16,245,156.25
December 1, 2015	13,015,000.00	1,772,864.36	14,787,864.36	-
June 1, 2016	-	1,459,454.39	1,459,454.39	16,247,318.75
December 1, 2016	13,665,000.00	1,459,451.86	15,124,451.86	-
June 1, 2017	-	1,122,263.12	1,122,263.12	16,246,714.98
December 1, 2017	14,355,000.00	1,122,261.88	15,477,261.88	-
June 1, 2018	-	766,768.12	766,768.12	16,244,030.00
December 1, 2018	15,085,000.00	766,766.88	15,851,766.88	-
June 1, 2019	-	392,763.12	392,763.12	16,244,530.00
December 1, 2019	15,850,000.00	392,761.88	16,242,761.88	-
June 1, 2020	-	-	-	16,242,761.88
TOTAL	$186,110,000.00	$75,116,948.29	$261,226,948.29	$261,226,948.29

Estimated Sources And Uses Of Funds—2004D Bonds

The proceeds of the 2004D Bonds and other available amounts are expected to be applied approximately as set forth below:

Sources	
Principal Amount of 2004D Bonds	$186,110,000.00
Original Issue Premium	12,800,502.00
Reserve Fund from 1993B Coalinga Bonds	18,879,115.26
Interest Account from 1993B Coalinga Bonds	22.83
Accrued Interest[1]	129,057.81
Total Sources of Funds	$217,918,697.90
Uses	
Deposit to 2004D Bonds Refunding Escrow	$211,453,212.47
Deposit to Master Indenture Reserve Fund	57,642.14
Deposit to 2004D Bonds Interest Account[1]	129,057.81
Costs of Issuance[2]	5,334,555.02
Underwriter's Discount	944,230.46
Total Uses of Funds	$217,918,697.90

(1) Represents accrued interest on the 2004D Bonds from April 1, 2004 to the date of delivery of the 2004D Bonds.
(2) Including fees of rating agencies, financial advisors, legal counsel, bond insurance, verification agent, printing costs, and other miscellaneous expenses.

Plan of Refunding

The Board will apply the net proceeds of the sale of the 2004D Bonds, together with other lawfully available funds, to make an irrevocable deposit into the Escrow Fund established by the Escrow Agreement relating to the 2004D Bonds for the redemption of all of the outstanding 1993B Coalinga Bonds, described in the table below, and shall cause the 1993B Coalinga Bonds to be redeemed on June 1, 2004:

State Public Works Board of the State of California Lease Revenue Bonds
(Department of Corrections) 1993 Series B
(California State Prison-Fresno County, Coalinga)
Dated Date: March 1, 1993

Stated Maturity Date (December 1)	Coupon Rate	Par Amount To Be Refunded	Redemption Price	CUSIP* (Base: 130684)
2004	5.250%	$8,150,000	102%	GMW3
2005	5.300%	8,590,000	102%	GMX1
2006	5.500%	9,065,000	102%	GMY9
2007	5.500%	9,580,000	102%	GMZ6
2008	5.500%	10,120,000	102%	GNA0
2012	5.500%	46,550,000	102%	GND4
2019	5.375%	110,170,000	102%	GNG7

*CUSIP numbers are provided for convenience of reference only. The Board assumes no responsibility for the accuracy of such numbers.

TERMS OF THE 2004E BONDS

This section should be read in conjunction with the sections entitled "TERMS APPLICABLE TO EACH SERIES OF BONDS," "SECURITY AND SOURCES OF PAYMENT FOR EACH SERIES OF BONDS," "THE BOND INSURERS AND THE BOND INSURANCE POLICIES—XL CAPITAL ASSURANCE BOND INSURANCE—2004E INSURED BONDS" and "APPENDIX G—SPECIMENS OF THE INSURANCE POLICIES OF MBIA INSURANCE CORPORATION AND XL CAPITAL ASSURANCE INC.—Specimen of the XL Capital Assurance Inc. Insurance Policy."

General

The 2004E Bonds will be issued under and secured by 2004E Indenture to provide funds which will be used to (i) accomplish a current refunding of a portion of the 1993D Susanville Bonds, and (ii) pay the costs of issuance of the 2004E Bonds. See "TERMS APPLICABLE TO EACH SERIES OF BONDS—Plan of Refunding" and "APPENDIX B—INFORMATION CONCERNING THE DEPARTMENT AND THE FACILITIES."

Pursuant to the Susanville Facility Lease, the Department will agree to make Base Rental payments for the beneficial use and occupancy of the Susanville Facility leased thereunder, calculated to be sufficient to pay the principal of and interest on the 2004E Bonds and the Prior Susanville Bonds. For additional information regarding the Susanville Facility, see "APPENDIX B—INFORMATION CONCERNING THE DEPARTMENT AND THE FACILITIES."

Redemption Provisions

Extraordinary Redemption. The 2004E Bonds are subject to extraordinary redemption prior to their respective stated maturities, as described above under "TERMS APPLICABLE TO EACH SERIES OF BONDS—Redemption Provisions." The 2004E Bonds are subject to optional redemption prior to their respective stated maturities, as described below.

Optional Redemption. The 2004E Bonds maturing on or before June 1, 2014 are not subject to optional redemption prior to their maturity dates. The 2004E Bonds maturing on and after June 1, 2015 are subject to redemption prior to their respective maturity dates, at the option of the Board, from any available funds, in whole or in part on any date on and after June 1, 2014, at a redemption price equal to the principal amount thereof, without premium, plus accrued interest to the date fixed for redemption.

Security for the 2004E Bonds

The 2004E Bonds are special obligations of the Board issued under and pursuant to the 2004E Indenture, payable solely from and equally and ratably secured, on a parity with the Prior Susanville Bonds, by a first pledge of (i) all Base Rental payments received by the Board pursuant to the Susanville Facility Lease, (ii) amounts deposited in the Interest Subaccount established under the 2004E Indenture for the 2004E Bonds (the "2004E Susanville Interest Account"), and (iii) all other benefits, charges, income, proceeds, profits, receipts, rents, proceeds of insurance and revenues derived by the Board from the ownership, operation or use of the Susanville Facility, including interest or profits from the investment of money in any account or fund (other than the Rebate Fund and the Master Indenture Reserve Fund) established pursuant to the 2004E Indenture (the amounts described in clauses (i), (ii) and (iii) are collectively referred to herein as the "2004E Susanville Revenues"). The 2004E Bonds and the Prior Susanville Bonds are also equally and ratably secured by a first pledge of the amounts on deposit in the funds and accounts (except the Rebate Fund) related to the 2004E Bonds established by the 2004E Indenture and by the Master Indenture Reserve Fund. The Base Rental, together with proceeds of the 2004E Bonds deposited in the 2004E Susanville Interest Account, are calculated to be sufficient, in both time and amount, to pay when due the annual principal of and interest on the 2004E Bonds and the Prior Susanville Bonds, described below.

Additional Rental payments due from the Department to the Board pursuant to the Susanville Facility Lease include amounts sufficient to pay all administrative costs and other expenses of the Board in connection with the Susanville Facility, including, among other expenses, insurance premiums. Additional Rental is not a part of the 2004E Susanville Revenues. The Department is responsible for repair and maintenance of the Susanville Facility during the term of the Susanville Facility Lease.

The scheduled payment of principal and interest when due with respect to the 2004E Insured Bonds will be insured under an insurance policy to be issued concurrently with the delivery of the Bonds by XL Capital Assurance. See "THE BOND INSURERS AND THE BOND INSURANCE POLICIES—XL CAPITAL BOND INSURANCE—2004E INSURED BONDS" and "APPENDIX G—SPECIMENS OF THE INSURANCE POLICIES OF MBIA INSURANCE CORPORATION AND XL CAPITAL ASSURANCE INC.—Specimen of the XL Capital Assurance Inc. Insurance Policy."

Prior Susanville Bonds

The 2004E Bonds are equally and ratably secured by, and principal and interest is payable thereon from, Base Rental payable with respect to the Susanville Facility on a parity with the Prior Susanville Bonds which are outstanding under the 2004E Indenture. As of the date of issuance of the 2004E Bonds, approximately $61,165,000 in aggregate principal amount of the 1993D Susanville Bonds (excluding bonds to be refunded by the proceeds of the 2004E Bonds) will be outstanding and $86,365,000 in aggregate principal amount of the 2001A Susanville Bonds will be outstanding.

Additional Bonds—2004E Bonds

The Board may issue additional bonds under the 2004E Indenture (the "Susanville Additional Bonds") secured on a parity with the 2004E Bonds and the Prior Susanville Bonds, for the purposes of (i) financing or refinancing the acquisition, installation and construction of additions, extensions or improvements to the Susanville Facility, including payment of all costs incidental to or connected with such financing, and (ii) refunding any outstanding bonds under the 2004E Indenture, including payment of all costs incidental to or connected with such refunding. In connection with the issuance of any such Susanville Additional Bonds, the Susanville Facility Lease would be amended to provide for Base Rental thereunder sufficient, in both time and amount, to pay when due the annual principal of and interest on the 2004E Bonds, the Prior Susanville Bonds, and any such Susanville Additional Bonds. See "APPENDIX C—SUMMARY OF CERTAIN PROVISIONS OF THE LEGAL DOCUMENTS."

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Annual Debt Service Requirements—2004E Bonds and Susanville Parity Bonds

Set forth below are the principal, interest and total debt service requirements for the 2004E Bonds and the Prior Susanville Bonds, assuming no redemptions:

	2004E Bonds		2001A Bonds		Remaining 1993D Bonds			
Payment Date	Principal	Interest	Principal	Interest	Principal	Interest	Total Debt Service	Fiscal Year Debt Service
6/1/2004	-	$693,682.39	-	$2,267,081.25	$11,165,000.00	$1,586,042.50	$15,711,806.14	$15,711,806.14
12/1/2004		2,080,912.50		2,267,081.25		1,312,500.00	5,660,493.75	
6/1/2005	$11,990,000.00	2,080,912.50	-	2,267,081.25	-	1,312,500.00	17,650,493.75	23,310,987.50
12/1/2005		1,901,062.50		2,267,081.25		1,312,500.00	5,480,643.75	
6/1/2006	12,350,000.00	1,901,062.50	-	2,267,081.25	-	1,312,500.00	17,830,643.75	23,311,287.50
12/1/2006		1,708,387.50		2,267,081.25		1,312,500.00	5,287,968.75	
6/1/2007	120,000.00	1,708,387.50	$12,615,000.00	2,267,081.25	-	1,312,500.00	18,022,968.75	23,310,937.50
12/1/2007		1,707,187.50		1,935,937.50		1,312,500.00	4,955,625.00	
6/1/2008	115,000.00	1,707,187.50	13,285,000.00	1,935,937.50	-	1,312,500.00	18,355,625.00	23,311,250.00
12/1/2008		1,706,037.50		1,587,206.25		1,312,500.00	4,605,743.75	
6/1/2009	125,000.00	1,706,037.50	13,975,000.00	1,587,206.25	-	1,312,500.00	18,705,743.75	23,311,487.50
12/1/2009		1,704,662.50		1,220,362.50		1,312,500.00	4,237,525.00	
6/1/2010	125,000.00	1,704,662.50	14,710,000.00	1,220,362.50	-	1,312,500.00	19,072,525.00	23,310,050.00
12/1/2010		1,703,100.00		834,225.00		1,312,500.00	3,849,825.00	
6/1/2011	125,000.00	1,703,100.00	15,485,000.00	834,225.00	-	1,312,500.00	19,459,825.00	23,309,650.00
12/1/2011		1,701,381.25		427,743.75		1,312,500.00	3,441,625.00	
6/1/2012	130,000.00	1,701,381.25	16,295,000.00	427,743.75	-	1,312,500.00	19,866,625.00	23,308,250.00
12/1/2012		1,699,431.25		-		1,312,500.00	3,011,931.25	
6/1/2013	-	1,699,431.25	-	-	17,645,000.00	1,312,500.00	20,656,931.25	23,668,862.50
12/1/2013		1,699,431.25		-		849,318.75	2,548,750.00	
6/1/2014	-	1,699,431.25	-	-	18,575,000.00	849,318.75	21,123,750.00	23,672,500.00
12/1/2014		1,699,431.25		-		361,725.00	2,061,156.25	
6/1/2015	5,405,000.00	1,699,431.25	-	-	13,780,000.00	361,725.00	21,246,156.25	23,307,312.50
12/1/2015		1,586,093.75		-		-	1,586,093.75	
6/1/2016	20,140,000.00	1,586,093.75	-	-	-	-	21,726,093.75	23,312,187.50
12/1/2016		1,082,593.75		-		-	1,082,593.75	
6/1/2017	21,145,000.00	1,082,593.75	-	-	-	-	22,227,593.75	23,310,187.50
12/1/2017		555,125.00		-		-	555,125.00	
6/1/2018	22,205,000.00	555,125.00	-	-	-	-	22,760,125.00	23,315,250.00
TOTAL	$93,975,000.00	$45,763,357.39	$86,365,000.00	$27,880,518.75	$61,165,000.00	$27,633,130.00	$342,781,961.25	$342,782,006.14

Estimated Sources And Uses Of Funds—2004E Bonds

The proceeds of the 2004E Bonds and other available amounts are expected to be applied approximately as set forth below:

Sources	
Principal Amount of 2004E Bonds	$93,975,000.00
Original Issue Premium	6,622,934.70
Existing 1993D Susanville Bonds Funds	549,903.58
Accrued Interest[1]	69,363.75
Total Sources of Funds	$101,217,202.03
Uses	
Deposit to 2004E Bonds Refunding Escrow	$98,225,939.73
Deposit to 2004E Bonds Interest Account[1]	69,363.75
Costs of Issuance[2]	2,447,997.23
Underwriter's Discount	473,901.32
Total Uses of Funds	$101,217,202.03

(1) Represents accrued interest on the 2004E Bonds from April 1, 2004 to the date of delivery of the 2004E Bonds.
(2) Including fees of rating agencies, financial advisors, legal counsel, bond insurance, verification agent, printing costs, and other miscellaneous expenses.

Plan of Refunding

The Board will apply the net proceeds of the sale of the 2004E Bonds, together with other lawfully available funds, to make an irrevocable deposit into the Escrow Fund established by the Escrow Agreement relating to the 2004E Bonds for the redemption of the maturities of the 1993D Susanville Bonds described in the table below and shall cause the 1993D Susanville Bonds described in the table below to be redeemed on June 1, 2004:

State Public Works Board of the State of California Lease Revenue Bonds
(Department of Corrections) 1993 Series D
(California State Prison - Lassen County, Susanville)
Dated Date: October 1, 1993

Stated Maturity Date (June 1)	Coupon Rate	Par Amount To Be Refunded	Redemption Price	CUSIP* (Base: 130684)
2005	5.000%	$11,715,000	101%	GTK2
2006	5.100%	12,300,000	101%	GTL0
2018	5.375%	70,885,000	101%	GTQ9

*CUSIP numbers are provided for convenience of reference only. The Board assumes no responsibility for the accuracy of such numbers.

THE STATE PUBLIC WORKS BOARD

General

The Board was created in 1946 as an entity of State government upon enactment by the State Legislature in its 1946 First Extraordinary Session of Chapter 145 of the Statutes of 1946, now constituting Part 10.5 of Division 3 of Title 2 of the California Government Code, commencing at Section 15752. The Board is empowered to, among other things, acquire, construct, improve, equip, maintain, operate and lease public buildings and related facilities for the use of State agencies. The acquisition and construction of public buildings by the Board is subject to authorization by the State Legislature through a separate act or appropriation. Pursuant to the Act, the Board is empowered to issue revenue obligations to finance and refinance the cost of its projects which have been authorized by the Legislature. THE BOARD HAS NO POWER AT ANY TIME OR IN ANY MANNER TO PLEDGE THE CREDIT OR TAXING POWER OF THE STATE OR ANY OF ITS AGENCIES FOR THE PAYMENT OF PRINCIPAL OF, REDEMPTION PREMIUM, IF ANY, OR INTEREST ON ITS OBLIGATIONS.

The Board consists of the Director of the Department of Finance, the Director of the Department of Transportation and the Director of the Department of General Services. In addition, for the purpose of hearing and deciding upon matters relating to the issuance of revenue obligations pursuant to the Act, the State Treasurer and the State Controller are members of the Board.

The Board, pursuant to statute, is the principal entity for the approval and oversight of most major capital outlay projects of the State, other than State highway projects. The Board has responsibility for approval of the preliminary plans for State public works projects, including hospitals, prisons, office buildings and university and community college facilities, for the purpose of ensuring that the plans reflect both the legislatively approved scope of the project and the statutory limitation on authorized construction costs.

Indebtedness of the Board

In addition to the Bonds, the Board issues lease revenue bonds under the Act to finance a wide variety of capital projects, including buildings and equipment for many State agencies. See "APPENDIX A—STATE OF CALIFORNIA—STATE INDEBTEDNESS AND OTHER OBLIGATIONS—Capital Facilities Financing."

As of March 1, 2004, excluding the 2004D Bonds, the 2004E Bonds and the State Public Works Board Lease Revenue Bonds (Department of Mental Health) 2004 Series A (Coalinga State Hospital) and the State Public Works Board Lease Revenue Bonds (California Community Colleges) 2004 Series B (Various Community College Projects) authorized on March 12, 2004 for issuance by the Board in an aggregate principal amount not to exceed $550,000,000 (the "2004 Series A Bonds and 2004 Series B Bonds"), the State Legislature has authorized issuance of an additional $3,934,532,000 in aggregate principal amount of lease revenue and other bonds of the Board, which are yet unissued. Prior to issuance of such long-term bonds, the Board may obtain interim loans from the State Pooled Money Investment Account or the State's General Fund to commence projects which have been approved by the Legislature and the Board. As of March 1, 2004, the Board had approved interim loans totaling $1,141,440,250.

Each series of lease revenue bonds is separately secured from revenues relating to the particular projects being financed, and there is no sharing of security or cross-default between the various issues of the Board's bonds (except for series of bonds expressly issued on a parity with one another, and except that some series of bonds are secured by the Master Indenture Reserve Fund established under the Master Indenture and certain series of bonds may be designated as Related Series of Bonds under the Master Indenture).

The following table sets forth the Board's lease revenue bonds secured by the Master Indenture Reserve Fund, as of March 1, 2004:

STATE PUBLIC WORKS BOARD OF THE STATE OF CALIFORNIA LEASE REVENUE BONDS SECURED BY THE MASTER INDENTURE RESERVE FUND (1) (As of March 1, 2004)

California Community Colleges (Ten Series) (2)	$274,135,000.00
Department of Corrections (Thirteen Series) (3)	$1,545,751,260.00
The Regents of the University of California (Ten Series) (4)	$527,830,000.00
The Trustees of the California State University (Six Series) (5)	$257,720,000.00
Various Other Leased Projects (Eighteen Series) (6)	$963,105,000.00
Total	$3,568,541,260.00

(1) As of March 1, 2004, the Master Indenture Reserve Fund Requirement and the Master Indenture Reserve Fund balance under the provisions of the Master Indenture were $81,698,494.47.

(2) Includes $27,355,000.00 of Incorporated Master Indenture Bonds, described below.

(3) Includes two Series of Incorporated Master Indenture Bonds totaling $219,605,000.00.

(4) Includes $242,915,000.00 of Incorporated Master Indenture Bonds.

(5) Includes $20,910,000.00 of Incorporated Master Indenture Bonds.

Source: State of California, Office of the State Treasurer.

Master Indenture Reserve Fund

Pursuant to the Master Indenture, separate series of lease revenue bonds issued by the Board under the Master Indenture (each such series of bonds being referred to herein as a "Series of Master Indenture Bonds") and certain Master Indenture Incorporated Bonds (as hereinafter defined) are secured by a common, pooled reserve fund established pursuant to the Master Indenture (the "Master Indenture Reserve Fund"), but otherwise each is separately secured by the Revenues related to each respective Series of Master Indenture Bonds or Master Indenture Incorporated Bonds. The Master Indenture allows the Board to "incorporate" issues of its bonds (each such series of bonds being referred to herein as a "Series of Master Indenture Incorporated Bonds" or the "Master Indenture Incorporated Bonds") so that each Series of Master Indenture Incorporated Bonds will be secured by the Master Indenture Reserve Fund as and to the same extent as all bonds issued under the Master Indenture. The Board at all times reserves the right to determine whether it is in the best interests of the State for any particular project to be secured under the Master Indenture or separately. The Master Indenture Reserve Fund is and will be held in trust separate and apart from any other fund or account established under the Master Indenture.

Under the Master Indenture, moneys in the Master Indenture Reserve Fund may only be used (i) to replenish first the interest account and second the principal account for any Series of Master Indenture Bonds issued under the Master Indenture (including the 2004D Bonds) or any Series of Master Indenture Incorporated Bonds (including the 2004E Bonds and the Prior Susanville Bonds) in the event of any deficiency at any time in such account, or (ii) to pay debt service on any Series of Master Indenture Bonds or Series of Master Indenture Incorporated Bonds if no other moneys are lawfully available therefor (including upon acceleration of any Series of Master Indenture Bonds or Series of Master Indenture Incorporated Bonds). Pursuant to the Master Indenture, if aggregate claims against the Master Indenture Reserve Fund payable on any day as described in the preceding sentence exceed the amount then on deposit therein, then such amount in the Master Indenture Reserve Fund will be apportioned among each Series of Master Indenture Bonds and Master Indenture Incorporated Bonds making such claim in the proportion that the amount then on deposit in the Master Indenture Reserve Fund bears to the aggregate amount of all such claims for all such Series of Master Indenture Bonds and Master Indenture Incorporated Bonds). See "APPENDIX C—SUMMARY OF CERTAIN PROVISIONS OF THE LEGAL DOCUMENTS—The Master Indenture—Reserve Fund."

A payment default on any Series of Master Indenture Bonds or on any Series of Master Indenture Incorporated Bonds will not cause a default on any other Series of Master Indenture Bonds. A default on any other Series of Master Indenture Bonds or any other Series of Master Indenture Incorporated Bonds will not constitute a default on the Bonds. As a result, the Master Indenture Reserve Fund could be drawn upon and depleted without any of the amounts on deposit in the Master Indenture Reserve Fund being applied to pay the Bonds. For example, a payment default (which may or may not result in an acceleration) on any Series of Master Indenture Bonds or Master Indenture Incorporated Bonds secured by the Master Indenture Reserve Fund could result in a partial or complete depletion of the amounts then on deposit in the Master Indenture Reserve Fund. Although the Board has covenanted in the Master Indenture to use its best efforts to replenish the Master Indenture Reserve Fund to the Master Indenture Reserve Fund Requirement as described below, the Master Indenture provides that the Legislature is not required to make any appropriation for this purpose. Therefore, if no appropriation or other funds are available to replenish the Master Indenture Reserve Fund after a withdrawal, there would be less funds on deposit therein available to pay the Holders of the Bonds. **No assurance can be given that at any time amounts in the Master Indenture Reserve Fund will be sufficient to pay the principal of and interest on the Bonds when due.**

The Master Indenture Reserve Fund Requirement is defined in the Master Indenture as an amount equal to the sum of:

(A) the greatest of:

(i) the sum of the largest single payments of Semi-Annual Debt Service relating to the two facilities covered by the Master Indenture Reserve Fund with the largest single payment of Semi-Annual Debt Service remaining;

(ii) the sum of the largest single remaining payments of SemiAnnual Debt Service attributable to all facilities covered by the Master Indenture Reserve Fund situated within that Locality in the State for which such sum is the largest;

(iii) ten percent (10%) of the Maximum Aggregate SemiAnnual Debt Service; or

(iv) the largest payment(s) of Semi-Annual Debt Service remaining for any interest payment date(s) for bonds secured by the Master Indenture Reserve Fund coming due in any calendar month, *plus*

(B) an amount not to exceed one percent (1%) of the amount calculated under part (A) above, as determined by the State Treasurer at the time of issuance of any Series of Master Indenture Bonds.

Under the Master Indenture, the State Treasurer shall, on December 1 of each year (or whenever any moneys are withdrawn from the Master Indenture Reserve Fund or any Master Indenture Bonds or Master Indenture Incorporated Bonds have been defeased), calculate whether the balance in the Master Indenture Reserve Fund is equal to the Master Indenture Reserve Fund Requirement. If there is a shortfall, the Board will use its best efforts to replenish the Master Indenture Reserve Fund by December 1 of the year following the year in which the shortfall was determined. If on any calculation date there are excess funds in the Master Indenture Reserve Fund, the Board in its discretion may (but is not required to) allocate such surplus to the revenue fund or construction fund for one or more Series of Master Indenture Bonds or any fund or account for any Master Indenture Incorporated Bonds or otherwise disburse such moneys as directed by the Board including, if agreed to by the Board, to reimburse any department of the State whose bonds are covered by the Master Indenture Reserve Fund for any rentals paid under any lease for a period while such lease was abated. See "APPENDIX C—SUMMARY OF CERTAIN PROVISIONS OF THE LEGAL DOCUMENTS—The Master Indenture—Reserve Fund."

Prior to the issuance of the Bonds, as of March 1, 2004, the Master Indenture Reserve Fund Requirement (based on test (A)(iv) above) and the Master Indenture Reserve Fund balance was $81,698,494. The aggregate principal amount of lease revenue bonds secured by the Master Indenture Reserve Fund was $3,568,541,260 as of March 1, 2004. In addition, the 2004 Series A Bonds and 2004 Series B Bonds authorized for issuance on March 12, 2004 by the Board, if issued, will be Series of Master Indenture Bonds secured by the Master Indenture Reserve Fund. After the issuance of the Bonds, the Master Indenture Reserve Fund Requirement (based on test (A)(iv) above) will be $81,756,136.61 and the aggregate principal amount of outstanding lease revenue bonds secured by the Master Indenture Reserve Fund will be $3,848,626,260.00. See "THE STATE PUBLIC WORKS BOARD--Indebtedness of the Board" for information regarding other indebtedness of the Board secured by the Master Indenture Reserve Fund.

Amounts held in the Master Indenture Reserve Fund will be available for all bonds secured by the Master Indenture Reserve Fund and, therefore, no assurance can be given that at any time, amounts available therein will be sufficient to pay the principal of or interest on the Bonds when and as due.

In lieu of making a Master Indenture Reserve Fund deposit or replenishment, or in replacement of moneys then on deposit in the Master Indenture Reserve Fund, the Board may deliver to the State Treasurer a letter of credit, insurance policy or surety bond or a combination thereof (as described in the Master Indenture) securing an amount (together with moneys and Permitted Investments on deposit in the Master Indenture Reserve Fund) equal to the Master Indenture Reserve Fund Requirement. See "APPENDIX C—SUMMARY OF CERTAIN PROVISIONS OF THE LEGAL DOCUMENTS—The Master Indenture—Reserve Fund."

TAX MATTERS

In the opinion of Stradling Yocca Carlson & Rauth, a Professional Corporation, Newport Beach, California, Bond Counsel, under existing statutes, regulations, rulings and judicial decisions, interest on the Bonds is excluded from gross income for federal income tax purposes, and is not an item of tax preference for purposes of calculating the federal alternative minimum tax imposed on individuals and corporations. In the further opinion of Bond Counsel, interest on the Bonds is exempt from State of California personal income tax. Bond Counsel notes that, with respect to corporations, interest on the Bonds may be included as an adjustment in the calculation of alternative minimum taxable income which may affect the alternative minimum tax liability of corporations. In addition, the difference between the issue price of a Bond (the first price at which a substantial amount of the Bonds of a maturity is to be sold to the public) and the stated redemption price at maturity with respect to the Bond constitutes original issue discount. Original issue discount accrues under a constant yield method, and original issue discount will accrue to a Bondholder before receipt of cash attributable to such excludable income. The amount of original issue discount deemed received by a Bondholder will increase the Bondholder's basis in the applicable Bond. The amount of original issue discount that accrues to the owner of the Bond is excluded from gross income of such owner for federal income tax purposes, is not an item of tax preference for purposes of the federal alternative minimum tax imposed on individuals and corporations, and is exempt from State of California personal income tax.

Bond Counsel's opinion as to the exclusion from gross income of interest on the Bonds (and original issue discount) is based upon certain representations of fact and certifications made by the Board and the Department and others and is subject to the condition that the Board and the Department comply with all requirements of the Internal Revenue Code of 1986, as amended (the "Code"), that must be satisfied subsequent to the issuance of the Bonds to assure that interest on the Bonds (and original issue discount) will not become includable in gross income for federal income tax purposes. Failure to comply with such requirements of the Code might cause the interest on the Bonds (and original issue discount) to be included in gross income for federal income tax purposes retroactive to the date of issuance of the Bonds. The Board and the Department have covenanted to comply with all such requirements.

The amount by which a Bondholder's original basis for determining loss on sale or exchange in the applicable Bond (generally, the purchase price) exceeds the amount payable on maturity (or on an earlier call date) constitutes amortizable Bond premium, which must be amortized under Section 171 of the Code; such amortizable Bond premium reduces the Bondholder's basis in the applicable Bond (and the amount of tax-exempt interest received), and is not deductible for federal income tax purposes. The basis reduction as a result of the amortization of Bond premium may result in a Bondholder realizing a taxable gain when a Bond is sold by the holder for an amount equal to or less (under certain circumstances) than the original cost of the Bond to the holder. Purchasers of the Bonds should consult their own tax advisors as to the treatment, computation and collateral consequences of amortizable Bond premium.

Bond Counsel's opinions may be affected by actions taken (or not taken) or events occurring (or not occurring) after the date hereof. Bond Counsel has not undertaken to determine, or to inform any person, whether any such actions or events are taken or do occur. The Indentures and the Tax Certificate relating to the Bonds permit certain actions to be taken or to be omitted if a favorable opinion of a bond counsel is provided with respect thereto. Bond Counsel expresses no opinion as to the exclusion from gross income of interest (or original issue discount) on the Bonds for federal income tax purposes with respect to any Bond if any such action is taken or omitted based upon the advice of counsel other than Bond Counsel.

Although Bond Counsel has rendered an opinion that interest (and original issue discount) on the Bonds is excluded from gross income for federal income tax purposes provided that the Board and the Department continue to comply with certain requirements of the Code, the ownership of the Bonds and the accrual or receipt of interest (and original issue discount) with respect to the Bonds may otherwise affect the tax liability of certain persons. Bond Counsel expresses no opinion regarding any such tax consequences. Accordingly, before purchasing any of the Bonds, all potential purchasers should consult their tax advisors with respect to collateral tax consequences relating to the Bonds.

The Internal Revenue Service (the "IRS") has initiated an expanded program for the auditing of tax-exempt bond issues, including both random and targeted audits. It is possible that the Bonds will be selected for audit by the IRS. It is also possible that the market value of the Bonds might be affected as a result of such an audit of the Bonds (or by an audit of similar bonds). No assurance can be given that in the course of an audit, as a result of an audit, or otherwise, Congress or the IRS might not change the Code (or interpretation thereof) subsequent to the issuance of the Bonds to the extent that it adversely affects the exclusion from gross income of interest (and original issue discount) on the Bonds or their market value.

As described in the Preliminary Official Statement relating to the Bonds dated March 16, 2004 (the "Preliminary Official Statement"), in its Circular 230, the Department of the Treasury has proposed modifications to its regulations governing the practice before the Internal Revenue Service. The proposed modifications would treat opinions on tax-exempt bonds as tax shelter opinions subject to special restrictions relating to the form of the opinion, among other matters. Subsequent to publication of the Preliminary Official Statement, the Internal Revenue Service made an announcement the effect of which is that the proposed modifications to Circular 230 will not be applicable to the Bonds. As a result, Bond Counsel expects to deliver the proposed form of opinion attached hereto as APPENDIX F.

CERTAIN LEGAL MATTERS

The validity of the Bonds is subject to the approval of the Honorable Bill Lockyer, Attorney General of the State of California (the "Attorney General"), and Bond Counsel. Certain other legal matters, including without limitation, certain tax matters, are subject to the approval of Bond Counsel. The approving opinions of the Attorney General and Bond Counsel will be delivered with the Bonds in substantially the forms set forth in APPENDIX F. Copies of such approving opinions will be available at the time of delivery of the Bonds. The Law Offices of Elizabeth C. Green, Los Angeles, California is serving as Co-Disclosure Counsel and Sidley Austin Brown & Wood LLP, San Francisco, California, is serving as Co-Disclosure Counsel to the State regarding APPENDIX A. Squire, Sanders & Dempsey L.L.P., San Francisco, California, is serving as Underwriter's Counsel. Certain legal matters will be passed upon for the Department and the Board by their respective counsel. The Attorney General, Stradling Yocca Carlson & Rauth, a Professional Corporation, Newport Beach, California, Sidley & Austin Brown & Wood LLP, San Francisco, California, The Law Offices of Elizabeth C. Green, Los Angeles, California, Squire, Sanders & Dempsey L.L.P. and counsel to the Department and the Board, respectively, undertake no responsibility for the accuracy, completeness or fairness of this Official Statement, except as otherwise stated in their respective opinions delivered upon the issuance of the Bonds, and none of such opinions is addressed to or intended to be relied upon by purchasers of the Bonds.

LITIGATION

The Attorney General has advised that, to the best of his knowledge, no litigation is now pending (with service of process against the State having been accomplished) or threatened seeking to restrain or enjoin the sale, issuance, execution or delivery of the Bonds or the validity of the Bonds, the Indentures, the Facility Leases, the Transfer Agreement, the Site Lease, the Escrow Agreements or any proceeding of the Board or Department taken with respect to the foregoing.

At any given time, including the present, there are numerous civil actions pending against the State, that could, if determined adversely to the State, affect the State's expenditures and, in some cases, its revenues and cash flow. While there can be no assurances as to the ultimate outcome and fiscal impact of such litigation, the State believes that it is unlikely that the outcome of any such litigation, other than litigation that could delay or prevent the issuance of the State's fiscal recovery bonds should the State need to rely upon them, could adversely affect the ability of the State to pay the principal of and interest on the Bonds when due. See "APPENDIX A-THE STATE OF CALIFORNIA- RECENT DEVELOPMENTS REGARDING STATE ECONOMY AND FINANCES" and "- LITIGATION - Bond Related Matters" for a description of the fiscal recovery bonds and related litigation.

UNDERWRITING

The Bonds are being purchased by an underwriting group consisting of the underwriters named on the cover page hereto (collectively, the "Underwriters") from the State Treasurer, who is authorized pursuant to the Act to sell the Bonds on behalf of the Board. The Underwriters have agreed to purchase the 2004D Bonds at a purchase price of $197,966,271.54 (which represents the principal amount of the 2004D Bonds less an Underwriters' discount of $944,230.46, plus net original issue premium of $12,800,502.00), plus accrued interest. The Underwriters have agreed to purchase the 2004E Bonds at a purchase price of $100,124,033.38 (which represents the principal amount of the 2004E Bonds less an Underwriters' discount of $473,901.32, plus net original issue premium of $6,622,934.70), plus accrued interest.

The purchase contract pursuant to which the Bonds are being sold provides that the Underwriters will purchase all of the Bonds if any Bonds are purchased, and the obligation to make such purchase is subject to certain terms and conditions set forth in such purchase contract, the approval of certain legal matters by counsel and certain other conditions.

The Underwriters may offer and sell the Bonds to certain dealers and others at a price lower than the offering prices stated on the inside cover page hereof. The offering prices may be changed from time to time by the Underwriters.

RATINGS

The Insured Bonds are expected to receive ratings of "Aaa" by Moody's Investors Service, Inc. ("Moody's"), "AAA" by Fitch Ratings ("Fitch"), and "AAA" by Standard & Poor's Rating Services ("S & P"), with the understanding that, upon delivery of the Insured Bonds, an insurance policy insuring payment when due of the principal of and interest on the 2004D Insured Bonds will be issued by MBIA, and an insurance policy insuring payment when due of the principal of and interest on the 2004E Insured Bonds will be issued by XL Capital Assurance. See "THE BOND INSURERS AND THE BOND INSURANCE POLICIES " and "APPENDIX G—SPECIMENS OF THE INSURANCE POLICIES OF MBIA INSURANCE CORPORATION AND XL CAPITAL ASSURANCE INC." herein. The Uninsured Bonds have received ratings of "Baa2" by Moody's, "BBB" by Fitch, and "BBB-" by S & P.

An explanation of the significance and status of such credit ratings may be obtained from the rating agencies furnishing the same. There is no assurance that such ratings will continue for any given period of time or that they will not be revised or withdrawn entirely by any such rating agencies, if in their respective judgments, circumstances so warrant. A revision or withdrawal of any such credit rating could have an effect on the market price of the Bonds.

FINANCIAL STATEMENTS

Audited Basic Financial Statements of the State of California (the "Financial Statements") for the Year ended June 30, 2003 are attached as Exhibit 1 to Appendix A. See APPENDIX A – "EXHIBIT 1—AUDITED ANNUAL FINANCIAL STATEMENTS OF THE STATE OF CALIFORNIA FOR THE YEAR ENDED JUNE 30, 2003." Certain unaudited financial information for the eight months ended February 29, 2004 is included as Exhibit 2 to APPENDIX A. See APPENDIX A – "EXHIBIT 2—STATE CONTROLLER'S STATEMENT OF GENERAL FUND CASH RECEIPTS AND DISBURSEMENTS, July 1, 2003 THROUGH February 29, 2004 (UNAUDITED)."

FINANCIAL ADVISOR

Kelling, Northcross & Nobriga, Oakland, California, is serving as financial advisor (the "Financial Advisor") in connection with the issuance of the Bonds.

VERIFICATION OF MATHEMATICAL COMPUTATIONS

Upon delivery of the Bonds, Causey Demgen & Moore Inc., Denver, Colorado, will deliver a report stating that the firm has verified the mathematical accuracy of certain computations relating to the adequacy of the Federal Securities to be acquired under the Escrow Agreements relating to each series of the Refunded Bonds, stating that the Federal Securities are such that if interest thereon and principal thereof are paid as such interest and principal become due, the proceeds from the collection of such interest and principal together with the cash held in the Escrow Fund relating to each series of the Refunded Bonds will be sufficient to permit the prompt payment of the Refunded Bond Requirements (as defined in the Escrow Agreements) with respect to such series of the Refunded Bonds as such become due.

MISCELLANEOUS

References made herein to certain documents and reports 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.

Any statements in this Official Statement involving estimates, forecasts or 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 Board (or the Department or the State) and the purchasers or holders of any of the Bonds.

The execution and delivery of this Official Statement has been duly authorized by the State Treasurer and by the Board.

TREASURER OF THE STATE OF CALIFORNIA	STATE PUBLIC WORKS BOARD OF THE STATE OF CALIFORNIA
By: /s/ Juan C. Fernandez Deputy State Treasurer for State Treasurer Philip Angelides	By: /s/ Donna Arduin Chair

APPENDIX A

THE STATE OF CALIFORNIA

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INTRODUCTION TO APPENDIX A

Importance of APPENDIX A. APPENDIX A is the part of the Official Statement that provides investors with information concerning the State of California. Investors must read the entire Official Statement, including APPENDIX A, to obtain information essential to making an informed investment decision.

Election of New Governor. At a special election held on October 7, 2003, the Governor of the State, Gray Davis, was recalled and replaced by Arnold Schwarzenegger. Since taking office on November 17, 2003, Governor Schwarzenegger rescinded the suspension of vehicle license fee offsets, proposed a bond measure (Proposition 57) that would authorize the issuance of economic recovery bonds to finance the negative General Fund reserve balance as of June 30, 2004, and other General Fund obligations undertaken prior to June 30, 2004, and proposed a Constitutional amendment (Proposition 58) that would require the State to adopt and maintain a balanced budget, establish a reserve, and restrict future long-term deficit related borrowing. The bond measure and the Constitutional amendment were both adopted at the March 2, 2004 statewide primary election. See "RECENT DEVELOPMENTS REGARDING STATE ECONOMY AND FINANCES."

California's Credit History. California has always paid the principal of and interest on its general obligation bonds, general obligation commercial paper notes, lease-purchase obligations and short-term obligations, including revenue anticipation notes and revenue anticipation warrants, when due.

In July 2003, Standard & Poor's downgraded the State's general obligation credit rating to "BBB." In December 2003, the State's general obligation credit rating was downgraded to "BBB" by Fitch and "Baa1" by Moody's.

On March 3, 2004, Moody's, which had its rating of the State's general obligation bonds on "negative outlook," changed its outlook to "stable" following the outcome of the elections for Propositions 57 and 58 at the March 2, 2004, statewide primary. As a result of the election, Standard & Poor's has put its general obligation bond rating of the State on credit watch with positive implications. Fitch's rating of the State's general obligation bonds remains on ratings' watch – negative.

Any revisions or withdrawal of a credit rating could have an effect on the market price and liquidity of the Bonds. The State cannot predict the timing or impact of future actions by the rating agencies. See also "RATINGS" in the forepart of this Official Statement.

Overview of APPENDIX A. APPENDIX A begins with a description of recent developments regarding the State's economy and finances and then discusses the types of debt instruments that the State has issued and is authorized to issue in the future. See "RECENT DEVELOPMENTS REGARDING STATE ECONOMY AND FINANCES" and "STATE INDEBTEDNESS AND OTHER OBLIGATIONS." A discussion of the State's current and projected cash flow is contained under "CASH FLOW."

APPENDIX A continues with a discussion of the sources and uses of State funds. See "STATE FINANCES." The budget process and constraints on this process, as well as the budget proposed by the Governor and the economic assumptions underlying the revenue projections contained in the proposed budget, are discussed under "THE BUDGET PROCESS" and "CURRENT STATE BUDGET."

Then, APPENDIX A includes or incorporates by reference the Audited Annual Financial Statements of the State for the Year Ended June 30, 2003, together with certain information required by governmental accounting and financial reporting standards to be included in the Financial Statements, including a "Management's Discussion and Analysis" that describes and analyzes the financial position of the State and provides an overview of the State's activities for the fiscal year ended June 30, 2003. The

State Controller's unaudited reports of cash receipts and disbursements for the period July 1, 2003 through February 29, 2004 are also included in this APPENDIX A. See "FINANCIAL STATEMENTS."

Governance, management and employee information is set forth under "OVERVIEW OF STATE GOVERNMENT." Demographic and economic statistical information is included under "ECONOMY AND POPULATION."

APPENDIX A concludes with a description of material litigation involving the State (see "LITIGATION") and debt tables (see "STATE DEBT TABLES").

RECENT DEVELOPMENTS REGARDING STATE ECONOMY AND FINANCES

In recent years, the State has experienced a decline in State revenues attributable in large part to declines in personal income tax receipts including particularly stock market related income tax revenues, such as capital gains realizations and stock option income. The State estimates that stock market related revenue declined from $17.6 billion in fiscal year 2000-01 to $8.6 billion in fiscal year 2001-02, and to $5.2 billion in 2002-03, a total 70 percent decline. Total personal income tax revenue declined from $44.6 billion to $32.7 billion in the same period. The State's economy continued to grow slowly through the end of 2003 but is projected to grow moderately in 2004. See, "CURRENT STATE BUDGET—Economic Assumptions."

The 2004-05 Governor's Budget, released on January 9, 2004, reported that in the absence of structural corrective actions to change existing policies, operating deficits, estimated at $14 billion in 2004-05, would continue to be incurred. See "CURRENT STATE BUDGET—2004-05 Governor's Budget." See also "CURRENT STATE BUDGET—Continuing Structural Deficit."

Two measures intended to address the existing cumulative budget deficit and to implement structural reform were both approved at the March 2, 2004 statewide primary election. The California Economic Recovery Bond Act (Proposition 57) authorizes the issuance of up to $15 billion of economic recovery bonds to finance the negative General Fund reserve balance as of June 30, 2004, and other General Fund obligations undertaken prior to June 30, 2004. The bonds will be issued in lieu of fiscal recovery bonds authorized by the California Fiscal Recovery Financing Act (Government Code Section 99000 *et. seq.*). The Balanced Budget Amendment (Proposition 58) requires the State to adopt and maintain a balanced budget and establish a reserve, and restricts future long-term deficit-related borrowing. See "STATE INDEBTEDNESS AND OTHER OBLIGATIONS—Economic Recovery Bonds, "THE BUDGET PROCESS—General." and "THE BUDGET PROCESS—Constraints on the Budget Process."

On March 4, 2004 over three dozen cities filed a petition for writ of mandate in the Alameda County Superior Court (*City of Cerritos et al. v. State Board of Equalization*) seeking to prohibit the State Board of Equalization from implementing a one-quarter cent reduction in the amount of sales and use tax that may be collected by local governments. See "STATE FINANCES – Sources of Tax Revenue – Sales Tax." This reduction was approved by the Legislature as part of Chapter 2 of the Statues of 2003-04, Fifth Extraordinary Session, which also enacted the California Economic Recovery Bond Act (approved by the electorate as Proposition 57) and a one-quarter cent increase in the State sales and use tax to secure the bonds issued under the California Economic Recovery Bond Act. The petition filed by the cities does not challenge the authorization for the issuance of the economic recovery bonds or the imposition of the temporary one-quarter cent increase in the State sales and use tax. See "STATE INDEBTEDNESS AND OTHER OBLIGATIONS – Economic Recovery Bonds."

STATE INDEBTEDNESS AND OTHER OBLIGATIONS

General

The State Treasurer is responsible for the sale of debt obligations of the State and its various authorities and agencies. The State has always paid the principal of and interest on its general obligation bonds, general obligation commercial paper notes, lease-purchase debt and short-term obligations, including revenue anticipation notes and revenue anticipation warrants, when due.

Capital Facilities Financing

General Obligation Bonds

The State Constitution prohibits the creation of general obligation indebtedness of the State unless a bond measure is approved by a majority of the electorate voting at a general election or a direct primary. General obligation bond acts provide that debt service on general obligation bonds shall be appropriated annually from the General Fund and all debt service on general obligation bonds is paid from the General Fund. Under the State Constitution, debt service on general obligation bonds is the second charge to the General Fund after the application of moneys in the General Fund to the support of the public school system and public institutions of higher education. See "STATE FINANCES—State Expenditures." Certain general obligation bond programs receive revenues from sources other than the sale of bonds or the investment of bond proceeds.

As of February 1, 2004, the State had outstanding $31,348,287,000 aggregate principal amount of long-term general obligation bonds, and unused voter authorizations for the future issuance of $22,221,001,000 of long-term general obligation bonds. This latter figure consists of $12,650,927,000 of general obligation bonds which are authorized by State finance committees to be issued initially as commercial paper notes, described below, and $9,570,074,000 of other authorized but unissued general obligation bonds. See the table "Authorized and Outstanding General Obligation Bonds" under "STATE DEBT TABLES." See introduction to "STATE DEBT TABLES" for information as to bonds issued or expected to be issued after February 1, 2004.

General obligation bond law permits the State to issue as variable rate indebtedness up to 20 percent of the aggregate amount of long-term general obligation bonds outstanding. The State has issued $1.4 billion of variable rate general obligation bonds, representing 4.5% of the State's total outstanding general obligation bonds as of February 1, 2004.

In addition to the $15 billion of economic recovery bonds and the $12.3 billion of Kindergarten-University Public Education Facilities Bonds approved by the voters at the March 2, 2004 election, the Legislature has approved placing a $9.95 billion bond measure (the Safe, Reliable High-Speed Passenger Train Bond Act of the 21st Century) on the ballot in November of 2004. Additional bond proposals may also be added in 2004. See "2004-05 GOVERNOR'S BUDGET—Fiscal Year 2004-05."

Commercial Paper Program

Pursuant to legislation enacted in 1995, voter-approved general obligation indebtedness may be issued either as long-term bonds or, for some but not all bond issues, as commercial paper notes. Commercial paper notes may be renewed or may be refunded by the issuance of long-term bonds. The State issues long-term general obligation bonds from time to time to retire its general obligation commercial paper notes. Commercial paper notes are deemed issued upon authorization by the respective finance committees, whether or not such notes are actually issued. Pursuant to the terms of the bank credit agreement presently in effect supporting the general obligation commercial paper program, not more than $1.46 billion in general obligation commercial paper notes may be outstanding at any time. This amount may be increased or decreased in the future. See "STATE DEBT TABLES" for the amount of outstanding commercial paper notes.

Lease-Purchase Obligations

In addition to general obligation bonds, the State builds and acquires capital facilities through the use of lease-purchase borrowing. Under these arrangements, the State Public Works Board, another State or local agency or a joint powers authority issues bonds to pay for the construction of facilities such as office buildings, university buildings or correctional institutions. These facilities are leased to a State agency or the University of California under a long-term lease that provides the source of payment of the debt service on the lease-purchase bonds. In some cases, there is not a separate bond issue, but a trustee directly creates certificates of participation in the State's lease obligation, which are then marketed to investors. Under applicable court decisions, such lease arrangements do not constitute the creation of "indebtedness" within the meaning of the State Constitutional provisions that require voter approval. For purposes of this Appendix A and the tables under "STATE DEBT TABLES," "lease-purchase obligation" or "lease-purchase financing" means principally bonds or certificates of participation for capital facilities where the rental payments providing the security are a direct or indirect charge against the General Fund and also includes revenue bonds for a State energy efficiency program secured by payments made by various State agencies under energy service contracts. Certain of the lease-purchase financings are supported by special funds rather than the General Fund. See "STATE FINANCES—Sources of Tax Revenue—Special Fund Revenues." The tables under "STATE DEBT TABLES" do not include equipment leases or leases which were not sold, directly or indirectly, to the public capital markets. The State had $6,888,987,136 General Fund-supported lease-purchase obligations outstanding as of February 1, 2004. The State Public Works Board, which is authorized to sell lease revenue bonds, had $4,260,165,000 authorized and unissued as of February 1, 2004. In addition, as of that date, certain joint powers authorities were authorized to issue approximately $81,000,000 of revenue bonds to be secured by State leases. See introduction to "STATE DEBT TABLES" for information as to bonds issued or expected to be issued after February 1, 2004.

Non-Recourse Debt

Certain State agencies and authorities issue revenue obligations for which the General Fund has no liability. Revenue bonds represent obligations payable from State revenue-producing enterprises and projects, which are not payable from the General Fund, and conduit obligations payable only from revenues paid by private users of facilities financed by the revenue bonds. The enterprises and projects include transportation projects, various public works projects, public and private educational facilities (including the California State University and University of California systems), housing, health facilities and pollution control facilities. State agencies and authorities had $43,748,659,966 aggregate principal amount of revenue bonds and notes which are non–recourse to the General Fund outstanding as of June 30, 2003, as further described in the table "State Agency Revenue Bonds and Conduit Financing" under "STATE DEBT TABLES."

Detailed information regarding the State's long-term debt appears in the section "STATE DEBT TABLES."

Pension Obligation Bonds

Pursuant to the California Pension Obligation Financing Act, Government Code Section 16910 et seq. (the "Pension Bond Act"), the State proposed to issue $1.9 billion of pension obligation bonds to make fiscal year 2003-04 contributions to the California Public Employees' Retirement System ("CalPERS"). The payment of debt service on the pension obligation bonds would be payable from the General Fund subject to the priorities specified in the Pension Bond Act. The proposed pension obligation bonds are the subject of a validation action brought by the Pension Obligation Bond Committee for and on behalf of the State. In that validation action, the Pension Obligation Bond Committee seeks to obtain the court's determination that the pension obligation bonds will not be in violation of the Constitutional debt limit because the proceeds of the pension obligation bonds will be used to pay the State's employer obligation to CalPERS, which is an "obligation imposed by law" and not "debt." On October 2, 2003, the trial court issued a judgment denying the State's request that the bonds be validated. The State is appealing this decision, but it is likely that the courts will not resolve this litigation in time to issue pension obligation bonds in 2003-04. See "LITIGATION—Bond-Related Matters."

The Administration has proposed reforms to the State's pension benefits costs. See "STATE FINANCES—Pension Trusts" and "CURRENT STATE BUDGET—2004-05 Governor's Budget." The Governor has proposed to issue pension obligation bonds to pay a portion of the retirement contributions to CalPERS until the effects of the reforms are sufficiently recognized in CalPERS' actuarial projections. The Administration anticipates that the validation action discussed in the preceding paragraph will be resolved in time to permit the issuance of pension obligation bonds by April 2005. Assuming a favorable decision by the court in the validation matter and authorization of the issuance by the Legislature, the Administration anticipates issuing $929 million of pension obligation bonds to cover the State's April and June 2005 retirement payment obligations. The Administration also estimates that $19.5 million of pension obligation bonds will be issued in 2005-06.

Economic Recovery Bonds

The California Economic Recovery Bond Act ("Proposition 57") was approved by the voters at the statewide primary election on March 2, 2004. Proposition 57 authorizes the issuance of up to $15 billion in economic recovery bonds to finance the negative General Fund reserve balance as of June 30, 2004, and other General Fund obligations undertaken prior to June 30, 2004. Repayment of the economic recovery bonds will be secured by a pledge of revenues from a one-quarter cent increase in the State's sales and use tax starting July 1, 2004. Fifty percent, or up to $5 billion of future deposits in the reserve fund created by the Balanced Budget Amendment ("Proposition 58"), may be used to repay the economic recovery bonds. In addition, as voter-approved general obligation bonds, the economic recovery bonds will be secured by the State's full faith and credit in the event the dedicated revenue is insufficient to repay the bonds.

The State plans to issue a sufficient amount of economic recovery bonds to provide $12.254 billion of net proceeds to the General Fund in fiscal year 2003-04. The cash flow projections included in the 2004-05 Governor's Budget assume that $12.254 billion of net proceeds from economic recovery bonds will be deposited in the General Fund by June 2004. The State may issue the remainder of authorized economic recovery bonds in future fiscal years. The State's General Obligation Bond Law authorizes the issuance of short-term bond anticipation notes payable from the proceeds of voter-authorized bonds. The State may issue long-term bonds under Proposition 57 or bond anticipation notes followed by takeout long-term bonds, depending upon market conditions and timing requirements.

Enhanced Tobacco Settlement Revenue Bonds

In 1998 the State signed a settlement agreement with the four major cigarette manufacturers. Under the settlement agreement, the cigarette manufacturers agreed to make payments to the State in perpetuity, which payments amount to approximately $25 billion (subject to adjustments) over the first 25 years. Under a separate Memorandum of Understanding, half of the payments made by the cigarette manufacturers will be paid to the State and half to local governments (all counties and the cities of San Diego, Los Angeles, San Francisco and San Jose). The specific amount to be received by the State and local governments is subject to adjustment. Details in the settlement agreement allow reduction of the manufacturers' payments for decreases in cigarette shipment volumes by the settling manufacturers, payments owed to certain "Previously Settled States" and certain types of offsets for disputed payments, among other things. However, settlement payments are adjusted upward each year by at least 3 percent for inflation, compounded annually.

Chapter 414, Statutes of 2002, as amended, allows the issuance of revenue bonds secured by the tobacco settlement revenues received by the State beginning in the 2003-04 fiscal year. An initial sale of

56.57% of the State's tobacco settlement revenues producing $2.5 billion in proceeds was completed in January 2003.

A second sale of the remaining 43.43% of the State's tobacco settlement revenues, which produced $2.264 billion in proceeds, was completed in September 2003. Chapter 414, Statutes of 2002, as amended, requires the Governor to request an appropriation in the annual Budget Act to pay debt service and other related costs of the tobacco settlement revenue bonds secured by the second (and only the second) sale of tobacco settlement revenues when such tobacco settlement revenues are insufficient therefor. The 2003 Budget Act authorized the Director of Finance to make allocations with legislative notification if tobacco settlement revenues are insufficient to cover the cost of the tobacco securitization program in fiscal year 2003-04. The Legislature is not obligated to make any such requested appropriation in the future.

Tobacco settlement revenue bonds are neither general nor legal obligations of the State or any of its political subdivisions and neither the faith and credit nor the taxing power nor any other assets or revenues of the State or of any political subdivision is or shall be pledged to the payment of any such bonds.

Cash Flow Borrowings

As part of its cash management program, the State has regularly issued short-term obligations to meet cash flow needs. The State has issued revenue anticipation notes ("Notes" or "RANs") in 19 of the last 20 fiscal years to partially fund timing differences between revenues and expenditures, as the majority of General Fund revenues are received in the last part of the fiscal year. By law, RANs must mature prior to the end of the fiscal year of issuance. If additional external cash flow borrowings are required, the State has issued revenue anticipation warrants ("RAWs"), which can mature in a subsequent fiscal year. See "STATE FINANCES—State Warrants." RANs and RAWs are both payable from any "Unapplied Money" in the General Fund of the State on their maturity date, subject to the prior application of such money in the General Fund to pay Priority Payments. "Priority Payments" are payments as and when due to: (i) support the public school system and public institutions of higher learning (as provided in Section 8 of Article XVI of the Constitution of the State), (ii) pay principal of (whether at stated maturity or upon earlier redemption) and interest on general obligation bonds of the State, (iii) provide reimbursement from the General Fund to any special fund or account to the extent such reimbursement is legally required to be made to repay borrowings therefrom, and (iv) pay State employees' wages and benefits, State payments to pension and other State employee benefit trust funds, State Medi-Cal claims, and any amounts determined by a court of competent jurisdiction in a final and nonappealable judgment to be required by federal law or the State Constitution to be paid with State warrants that can be cashed immediately. Priority Payments also includes payments of principal and interest on registered warrants issued to make Priority Payments. See "State Finances" below.

The following table shows the amount of RANs and RAWs issued in the past five fiscal years and in the current fiscal year.

TABLE 1
State of California Revenue Anticipation Notes and Warrants Issued
Fiscal Years 1998-99 to 2003-04

Fiscal Year	Type	Principal Amount (Billions)	Date of Issue	Maturity Date
1998-99	Notes	$ 1.70	October 1, 1998	June 30, 1999
1999-00	Notes Series A-B	1.00	October 1, 1999	June 30, 2000
2000-01	No Notes issued			
2001-02	Notes Series A-C	5.70	October 4, 2001	June 28, 2002
	RAWs Series A	1.50	June 24, 2002	October 25, 2002
	RAWs Series B	3.00	June 24, 2002	November 27, 2002
	RAWs Series C	3.00	June 24, 2002	January 30, 2003†
2002-03	Notes Series A and C	6.00	October 16, 2002	June 20, 2003
	Notes Series B and D	3.00	October 16, 2002	June 27, 2003
	Notes Series E – G	3.50	November 6, 2002	June 20, 2003
	RAWs Series A and B	10.965	June 18, 2003	June 16, 2004
2003-04	Notes	3.00	October 28, 2003	June 23, 2004

† Called by the Controller and paid on November 27, 2002.

Source: State of California, Office of the Treasurer.

CASH FLOW

2003 Revenue Anticipation Warrants

On June 18, 2003, the Controller issued $10.965 billion of 2003 Revenue Anticipation Warrants (the "2003 Warrants"), which will mature on June 16, 2004. At the time of issuance, cash flows prepared by the Department of Finance projected that there would be sufficient available moneys in the General Fund (including from internal borrowing) to repay the 2003 Warrants at maturity. Cash flows prepared by the Department of Finance, based upon the 2004-05 Governor's Budget, also project that there will be sufficient available moneys in the General Fund (including from internal borrowing) to repay the 2003 Warrants at maturity. This most recent cash flow projection by the Department of Finance assumed, among other things, the receipt by the State during 2003-04 of $12.254 billion of economic recovery bond proceeds, which were approved by the voters in March 2004. See "STATE INDEBTEDNESS AND OTHER OBLIGATIONS—Economic Recovery Bonds." The payment of principal of and interest on the 2003 Warrants is subject to the prior application of moneys in the General Fund to pay Priority Payments. See "STATE INDEBTEDNESS AND OTHER OBLIGATIONS—Cash Flow Borrowings" for a definition of Priority Payments.

If it appears to the Controller that there will be insufficient available money in the General Fund to pay the 2003 Warrants at maturity, the Controller has agreed to use his best efforts to offer for sale at competitive bid and issue refunding warrants to pay the 2003 Warrants in full. See "STATE FINANCES—State Warrants—Refunding Warrants." While no assurance can be given that the State would be able to sell refunding warrants, the State has always been able to borrow funds to meet its cash flow needs in the past and expects to take all steps necessary to continue to have access to the short-term and long-term credit markets.

If the Controller were unable to issue refunding warrants in sufficient amounts, the State may decide to borrow under seven Forward Warrant Purchase Agreements into which the State has entered with seven financial institutions ("Participants"), on a several and not joint basis (the "Forward Purchase Agreements"), that will enable the State to borrow up to $11.2 billion to obtain additional cash resources to pay the principal of and interest on the 2003 Warrants on their maturity date. The Forward Purchase Agreements do not constitute a guaranty of the 2003 Warrants and contain certain conditions which must be met in order for the State to obtain advances of funds from the Participants. The conditions to be satisfied on June 16, 2004, include the condition that no event of default under the Forward Purchase Agreements shall have occurred. It is an event of default under the Forward Purchase Agreements if the State fails to pay when due, or otherwise defaults on, any general obligation bond or any short-term debt, or the validity of any general obligation bond or any short-term debt is contested by the State in a judicial or administrative proceeding. Events of default under the Forward Purchase Agreements also include a judgment that any 2003 Warrants issuable to the Participants is illegal or unenforceable or that any representation or warranty of the State in the Forward Purchase Agreements proved to have been untrue in any material respect when made on June 18, 2003.

If the State draws upon the Forward Purchase Agreements, it will deliver to the Participants registered warrants due immediately and without a maturity date. Repayment by the State of the registered warrants issued to Participants is subordinate in rank of the use of available cash resources on any day to payment of Priority Payments (defined above, which includes the payment of principal and interest on general obligation bonds due on such day) and to rental payments to support lease revenue bonds and principal of and interest on pension obligation bonds due on such day. Daily cash received in excess of the amounts necessary to pay Priority Payments due on such date would be required to be used to repay outstanding registered warrants. The issuance of registered warrants to the Participants will severely restrict the State's cash management flexibility in a manner which could, at least for one or several days, interfere with the State's ability to make Priority Payments on a timely basis. However, the State is confident that it would retain sufficient cash management flexibility to assure the timely payment of debt service on the State's general obligation bonds. See "STATE FINANCES—State Warrants—Registered Warrants" for a description of the nature of registered warrants and the method by which they are repaid, as it relates to other obligations of the State.

The Forward Purchase Agreements contain a number of covenants on the part of the State relating to cash flow management and cash flow borrowing. One covenant requires the State to maximize internal borrowing from special funds prior to borrowing under the Forward Purchase Agreements. See "STATE FINANCES—Inter-Fund Borrowings." Other covenants prohibit the State from issuing any warrants or revenue anticipation notes having a maturity date prior to seven days after the maturity date of the 2003 Warrants.

Fiscal Year 2003-04 Revenue Anticipation Notes

The State issued $3 billion of RANs on October 28, 2003 (the "2003-04 RANs"), which will mature on June 23, 2004. Repayment of principal and interest on $1.835 billion of the 2003-04 RANs is required to be paid from draws under letters of credit (the "Letters of Credit") issued by various financial institutions ("Credit Banks"). The remaining $1.165 billion of 2003-04 RANs ("Unenhanced 2003-04 RANs") were issued directly to various financial institutions (the "Parity Note Purchasers").

As a condition to issuance of the 2003-04 RANs, the Department of Finance estimated that there would be sufficient cash and unused borrowable resources available for use by the General Fund to pay principal of and interest on the 2003-04 RANs when due. Cash flows prepared by the Department of Finance, based upon the 2004-05 Governor's Budget, also estimate that there will be sufficient cash and unused borrowable resources to pay the 2003-04 RANs when due. Such estimate assumed, among other things, receipt by the State of $12.254 billion of economic recovery bond proceeds, which were approved by the voters in March 2004.

If it appears that there will be insufficient available money in the General Fund to pay the principal of and interest on the 2003-04 RANs at maturity, the State has covenanted to use its best efforts to issue registered reimbursement warrants or other obligations, as was done in June 2003, to assure additional cash resources for the General Fund. While no assurance can be given that the State would be able to sell registered reimbursement warrants or other obligations, the State has always been able to borrow funds to meet its cash flow needs in the past and expects to take all steps necessary to continue to have access to the short-term and long-term credit markets. See "STATE FINANCES—State Warrants—Reimbursement Warrants."

If the State is unable to repay the draws upon the Letters of Credit or pay the Unenhanced 2003-04 RANs at maturity, it will deliver registered warrants, due immediately and without a maturity date, to the Credit Banks and the Parity Note Purchasers, as applicable. Repayment by the State of any registered warrants issued to Credit Banks and the Parity Note Purchasers is subordinate in rank to the use of available cash resources on any day to payment of Priority Payments (defined above, which includes the payment of principal and interest on general obligation bonds due on such day), to rental payments to support lease revenue bonds and principal of and interest on pension obligation bonds due on such day and to registered warrants issued to Participants as described above under "2003 Revenue Anticipation Warrants." Daily cash received in excess of the amounts necessary to pay Priority Payments due on such date would be required to be used to repay outstanding registered warrants. The issuance of registered warrants to the Credit Banks and the Parity Note Purchasers will severely restrict the State's cash management flexibility in a manner which could, at least for one or several days, interfere with the State's ability to make Priority Payments on a timely basis. However, the State is confident that it would retain sufficient cash management flexibility to assure the timely payment of debt service on the State's general obligation bonds. See "STATE FINANCES—State Warrants—Registered Warrants" for a description of the nature of registered warrants and the method by which they are repaid, as it relates to other obligations of the State.

STATE FINANCES

The General Fund

The moneys of the State are segregated into the General Fund and over 900 other funds, including special, bond and trust funds. The General Fund consists of revenues received by the State Treasury and not required by law to be credited to any other fund, as well as earnings from the investment of State moneys not allocable to another fund. The General Fund is the principal operating fund for the majority of governmental activities and is the depository of most of the major revenue sources of the State. For additional financial data relating to the General Fund, see the financial statements incorporated in or attached to this APPENDIX A. See "FINANCIAL STATEMENTS." The General Fund may be expended as a consequence of appropriation measures enacted by the Legislature and approved by the Governor (including the annual Budget Act), as well as appropriations pursuant to various constitutional authorizations and initiative statutes.

The Special Fund for Economic Uncertainties

The Special Fund for Economic Uncertainties ("SFEU") is funded with General Fund revenues and was established to protect the State from unforeseen revenue reductions and/or unanticipated expenditure increases. The State Controller may transfer amounts in the SFEU to the General Fund as necessary to meet cash needs of the General Fund and such transfers are characterized as "loans." The State Controller is required to return moneys so transferred without payment of interest as soon as there are sufficient moneys in the General Fund. At the end of each fiscal year, the Controller is required to transfer from the SFEU to the General Fund any amount necessary to eliminate any deficit in the General Fund.

The legislation creating the SFEU (Government Code Section 16418) contains a continuous appropriation from the General Fund authorizing the State Controller to transfer to the SFEU, as of the end of each fiscal year, the lesser of (i) the unencumbered balance in the General Fund and (ii) the difference between the State's "appropriations subject to limitation" for the fiscal year then ended and its "appropriations limit" as defined in Section 8 of Article XIII B of the State Constitution and established in the Budget Act for that fiscal year, as jointly estimated by the State's Legislative Analyst's Office and the Department of Finance. For a further description of Article XIII B, see "State Appropriations Limit." In certain circumstances, moneys in the SFEU may be used in connection with disaster relief.

For budgeting and accounting purposes, any appropriation made from the SFEU is deemed an appropriation from the General Fund. For year-end reporting purposes, the State Controller is required to add the balance in the SFEU to the balance in the General Fund so as to show the total moneys then available for General Fund purposes.

See Table 2 entitled "Internal Borrowable Resources (Cash Basis)" for information concerning the recent balances in the SFEU and projections of the balances for the current and upcoming fiscal years. As in any year, the Budget Act and related trailer bills are not the only pieces of legislation which appropriate funds. Other factors, including re-estimates of revenues and expenditures, existing statutory requirements, existing contractual requirements with respect to the 2003 Warrants and additional legislation introduced and passed by the Legislature may impact the fiscal year-end balance in the SFEU.

Inter-Fund Borrowings

Inter-fund borrowing is used to meet temporary imbalances of receipts and disbursements in the General Fund. In the event the General Fund is or will be exhausted, the State Controller is required to notify the Governor and the Pooled Money Investment Board (the "PMIB," comprised of the State Director of Finance, the State Treasurer and the State Controller). The Governor may then order the State Controller to direct the transfer of all or any part of the moneys not needed in special funds to the General Fund, as determined by the PMIB. All money so transferred must be returned to the special fund from which it was transferred as soon as there is sufficient money in the General Fund to do so. Transfers cannot be made which will interfere with the objective for which such special fund was created, or from certain specific funds. When moneys transferred to the General Fund in any fiscal year from any special fund pursuant to the inter-fund borrowing mechanism exceed ten percent of the total additions to such special fund as shown in the statement of operations of the preceding fiscal year as set forth in the Budgetary (Legal Basis) annual report of the State Controller, interest must be paid on such excess at a rate determined by the PMIB to be the current earning rate of the Pooled Money Investment Account. See also, "CASH FLOW—2003 Revenue Anticipation Warrants" for a description of certain covenants of the State relating to internal borrowings.

As of February 29, 2004, $2.216 billion of outstanding loans from the SFEU and $2.540 billion of outstanding loans from other special funds were used to pay expenditures of the General Fund. See "STATE FINANCES—State Warrants," "EXHIBIT 1—AUDITED ANNUAL FINANCIAL STATEMENTS OF THE STATE OF CALIFORNIA FOR THE YEAR ENDED JUNE 30, 2003" and "EXHIBIT 2—STATE CONTROLLER'S STATEMENT OF GENERAL FUND CASH RECEIPTS AND DISBURSEMENTS, JULY 1, 2003 THROUGH FEBRUARY 29, 2004 (UNAUDITED)." In addition, as of this date, the State had $10.965 billion of RAWs maturing on June 16, 2004, and $3.0 billion of RANs maturing on June 23, 2004. See "STATE INDEBTEDNESS AND OTHER OBLIGATIONS—Cash Flow Borrowings."

Any determination of whether a proposed borrowing from one of the special funds is permissible must be made with regard to the facts and circumstances existing at the time of the proposed borrowing. The Attorney General of the State has identified certain criteria relevant to such a determination. For instance, amounts in the special funds eligible for inter-fund borrowings are legally available to be transferred to the General Fund if a reasonable estimate of expected General Fund revenues, based upon legislation already enacted, indicates that such transfers can be paid from the General Fund promptly if needed by the special funds or within a short period of time if not needed. In determining whether this requirement has been met, the Attorney General has stated that consideration may be given to the fact that General Fund revenues are projected to exceed expenditures entitled to a higher priority than payment of internal transfers, i.e., expenditures for the support of the public school system and public institutions of higher education and the payment of debt service on general obligation bonds of the State.

At the November 1998 election, voters approved Proposition 2. This proposition requires the General Fund to repay loans made from certain transportation special accounts (such as the State Highway Account) at least once per fiscal year, or up to 30 days after adoption of the annual Budget Act. Since the General Fund may reborrow from the transportation accounts any time after the annual repayment is made, the proposition does not have any adverse impact on the State's cash flow.

In addition to temporary inter-fund borrowings described in this section, budgets enacted in the current and past fiscal years have included other transfers and long-term loans from special funds to the General Fund. In some cases, such loans and transfers have the effect of reducing internal borrowable resources.

The following chart shows internal borrowable resources available for temporary loans to the General Fund on June 30 of each of the fiscal years 2000-01 through 2002-03 and estimates, as of January 9, 2004, for fiscal years 2003-04 and 2004-05. See also "EXHIBIT 2—STATE CONTROLLER'S STATEMENT OF GENERAL FUND CASH RECEIPTS AND DISBURSEMENTS, JULY 1, 2003 THROUGH FEBRUARY 29, 2004 (UNAUDITED)."

TABLE 2
Internal Borrowable Resources
(Cash Basis)
(Millions)

	June 30				
	2001	2002[(a)]	2003[(b)]	2004[(c)]	2005[(c)]
Available Internal Borrowable Resources	$12,342.4	$12,979.7	$10,401.5	$11,735.5	$7,172.8
Outstanding Loans					
From Special Fund for Economic Uncertainties	-0-	2,524.5	-0-	2,216.3	634.8
From Special Funds and Accounts	-0-	423.5	-0-	471.5	844.2
Total Outstanding Internal Loans	-0-	2,948.0	-0-	2,687.8	1,479.0
Unused Internal Borrowable Resources	$12,342.4	$10,031.7	$10,401.5	$9,047.7	$5,693.8

(a) At June 30, 2002, the State also had $7.5 billion of outstanding external borrowings in the form of revenue anticipation warrants.

(b) At June 30, 2003, the State also had $10.965 billion of outstanding external borrowings in the form of revenue anticipation warrants.

(c) Department of Finance estimates as of January 9, 2004. Estimates assume the receipt of $12.254 billion of economic recovery bond proceeds prior to June 30, 2004.

Source: State of California, Department of Finance. Information for the fiscal years ended June 30, 2001 through June 30, 2003, are actual figures. Figures for the fiscal years ending June 30, 2004, and June 30, 2005, were estimated as of January 9, 2004, by the Department of Finance.

State Warrants

No money may be drawn from the State Treasury except upon a warrant duly issued by the State Controller. The State Controller is obligated to draw every warrant on the fund out of which it is payable for the payment of money directed by State law to be paid out of the State Treasury; however, a warrant may not be drawn unless authorized by law and unless unexhausted specific appropriations provided by law are available to meet it. State law provides two methods for the State Controller to respond if the General Fund has insufficient "Unapplied Money" available to pay a warrant when it is drawn, referred to generally as "registered warrants" and "reimbursement warrants." "Unapplied Money" consists of money in the General Fund for which outstanding warrants have not already been drawn and which would remain in the General Fund if all outstanding warrants previously drawn and then due were paid subject to the prior application of such money to obligations of the State with a higher priority. See "STATE INDEBTEDNESS AND OTHER OBLIGATIONS—Cash Flow Borrowings." Unapplied Money may include moneys transferred to the General Fund from the SFEU and internal borrowings from State special funds (to the extent permitted by law). See "STATE FINANCES—The Special Fund for Economic Uncertainties" and "—Inter-Fund Borrowings."

Registered Warrants

If a warrant is drawn on the General Fund for an amount in excess of the amount of Unapplied Money in the General Fund, after deducting from such Unapplied Money the amount, as estimated by the State Controller, required by law to be set apart for obligations having priority over obligations to which such warrant is applicable, the warrant must be registered by the State Treasurer on the reverse side as not paid because of the shortage of funds in the General Fund. The State Controller then delivers such a "registered warrant" to persons or entities (e.g., suppliers and local governments) otherwise entitled to receive payments from the State. A registered warrant bears interest at a rate designated by the PMIB up to a maximum of five percent per annum or at a higher rate if issued for an unpaid revenue anticipation note or in connection with some form of credit enhancement such as the Forward Purchase Agreements. See "CASH FLOW—2003 Revenue Anticipation Warrants" for a discussion of the Forward Purchase Agreements. Registered warrants may or may not have a fixed maturity date. Registered warrants that have no fixed maturity date, and registered warrants that bear a maturity date but, for lack of Unapplied Moneys, were not paid at maturity, are paid, together with all interest due, when the Controller, with the approval of the PMIB, determines payment will be made. The State Controller then notifies the State Treasurer, who publishes a notice that the registered warrants in question are payable. The duties of the Controller and the PMIB are ministerial in nature, and the Controller and the PMIB may not legally refuse to pay the principal of or interest on any registered warrants on any date Unapplied Moneys are available in the General Fund after all Priority Payments have been made on that date.

As described under "CASH FLOW—2003 Revenue Anticipation Warrants" and "—Fiscal Year 2003-04 Revenue Anticipation Notes," if the State is required to obtain advances under the Forward Purchase Agreements to pay some or all of the 2003 Warrants (defined above) or draw on the Letters of Credit (defined above) to pay some or all of the 2003-04 RANs at maturity, or is otherwise unable to pay the 2003-04 RANs at maturity, the State will issue registered warrants without a maturity date to the Participants (defined above), Credit Banks (defined above) or Parity Note Purchasers (defined above), as applicable, bringing into effect the daily application of Unapplied Moneys in the General Fund described in the previous paragraph. The adverse results from issuing these registered warrants could include: (1) the State would be required by law to pay the registered warrants before issuing warrants that could be cashed immediately to persons or entities (e.g., suppliers and certain local governments) otherwise entitled to payments from the State General Fund, and the State's ability to manage its cash would therefore be limited; and (2) a default under the State's bank credit facilities backing the State's variable rate general obligation bonds and/or commercial paper notes (which would increase the State's borrowing costs and debt service payments).

Reimbursement Warrants

In lieu of issuing individual registered warrants to numerous creditors, State law provides an alternative procedure whereby the Governor, upon request of the Controller, may authorize utilizing the General Cash Revolving Fund in the State Treasury to borrow from other State special funds to meet payments authorized by law. The Controller may then issue "reimbursement warrants" in the financial market at competitive bid to reimburse the General Cash Revolving Fund, thereby increasing cash resources for the General Fund to cover required payments. The General Cash Revolving Fund exists solely to facilitate the issuance of reimbursement warrants. Reimbursement warrants may have a fixed maturity date.

The principal of and interest on reimbursement warrants must be paid by the Treasurer on their respective maturity dates from any Unapplied Money in the General Fund and available for such payment. In the event that Unapplied Money is not available for payment on the respective maturity dates of reimbursement warrants, and refunding warrants (see "—Refunding Warrants") have not been sold at such times as necessary to pay such reimbursement warrants, such reimbursement warrants will be paid, together with all interest due thereon (including interest accrued at the original interest rate after the maturity date), at such times as the Controller, with the approval of the PMIB, may determine.

The State issued reimbursement warrants on several occasions in order to meet its cash needs during the period 1992-1994, when State revenues were severely reduced because of an economic recession. Facing renewed economic pressures, the State issued reimbursement warrants in June 2002 and in June 2003 (the 2003 Warrants). See "STATE INDEBTEDNESS AND OTHER OBLIGATIONS—Cash Flow Borrowings," and "CASH FLOW—2003 Revenue Anticipation Warrants."

Refunding Warrants

If there is not sufficient Unapplied Money in the General Fund to pay maturing reimbursement warrants, the Controller is authorized under State law, with the written approval of the Treasurer, to offer and sell a new issue of reimbursement warrants as refunding warrants to refund the prior, maturing reimbursement warrants. Proceeds of such refunding warrants must be used exclusively to repay the maturing warrants. In all other respects, refunding warrants have the same legal status and provisions as reimbursement warrants, as described above.

Sources of Tax Revenue

The following is a summary of the State's major revenue sources. Further information on State revenues is contained under "CURRENT STATE BUDGET" and "STATE FINANCES—Recent Tax Receipts." See Table 4 entitled "Comparative Yield of State Taxes—All Funds, 1999-00 Through 2004-05" for a comparison, by amount received, of the sources of the State's tax revenue.

Personal Income Tax

The California personal income tax, which accounts for a significant portion of General Fund tax revenues, is closely modeled after the federal income tax law. It is imposed on net taxable income (gross income less exclusions and deductions), with rates ranging from 1.0 percent to 9.3 percent. The personal income tax is adjusted annually by the change in the consumer price index to prevent taxpayers from being pushed into higher tax brackets without a real increase in income. Personal, dependent and other credits are allowed against the gross tax liability. In addition, taxpayers may be subject to an alternative minimum tax (AMT), which is much like the federal AMT. The personal income tax structure is considered to be highly progressive. For example, the State Franchise Tax Board indicates that the top 1 percent of taxpayers paid 39.5 percent of the total personal income tax in tax year 2001.

Taxes on capital gains realizations and stock options, which are largely linked to stock market performance, became a larger component of personal income taxes over the last half of the 1990s. The increasing influence that these stock market-related income sources had on personal income tax revenues linked to the highly progressive structure added a significant dimension of volatility to personal income tax receipts. Capital gains and stock option tax receipts peaked in 2000 at $17.6 billion before plunging 51 percent in 2001 to $8.6 billion and dropping an estimated additional 39 percent in 2002 to $5.2 billion. The 2004-05 Governor's Budget forecast assumes moderate growth in capital gains and stock option receipts beginning in 2003-04. See "CURRENT STATE BUDGET—Economic Assumptions."

A proposal included in the 2004-05 Governor's Budget will seek to identify additional taxpayers that do not file tax returns but owe personal income tax. This proposal is estimated to increase revenues by $12 million in fiscal year 2004-05 and $43 million in fiscal year 2005-06.

Sales Tax

The sales tax is imposed upon retailers for the privilege of selling tangible personal property in California. Most retail sales and leases are subject to the tax. However, exemptions have been provided for certain essentials such as food for home consumption, prescription drugs, gas delivered through mains and electricity. Other exemptions provide relief for a variety of sales ranging from custom computer software to aircraft.

The breakdown of the base state and local sales tax rate of 7.25 percent in effect until July 1, 2004, is as follows:

- 5 percent is imposed as a State General Fund tax;
- 0.5 percent is dedicated to local governments for health and welfare program realignment (Local Revenue Fund);
- 0.5 percent is dedicated to local governments for public safety services (Local Public Safety Fund);
- 1.25 percent is a local tax imposed under the Uniform Local Sales and Use Tax Law. Of that amount, 0.25 percent is dedicated to county transportation purposes, and 1 percent is for city and county general-purpose use.

Effective July 1, 2004, the breakdown of the base state and local sales tax rate of 7.25 percent will be as follows:

- 5 percent imposed as a State General Fund tax;
- 0.5 percent dedicated to local governments for health and welfare program realignment (Local Revenue Fund);
- 0.5 percent dedicated to local governments for public safety services (Local Public Safety Fund);
- 1.0 percent local tax imposed under the Uniform Local Sales and Use Tax Law, with 0.25 percent dedicated to county transportation purposes and 0.75 percent for city and county general-purpose use (See "RECENT DEVELOPMENTS REGARDING STATE ECONOMY AND FINANCES" for a discussion of a court action seeking to prohibit the

State Board of Equalization from implementing this one-quarter cent reduction in the local government sales and use tax);

- 0.25 percent deposited into the Fiscal Recovery Fund to repay the State's economic recovery bonds.

Existing law provides that 0.25 percent of the basic 5.00 percent State tax rate may be suspended in any calendar year upon certification by the Director of Finance by November 1 in any year in which both of the following occur: (1) the General Fund reserve (excluding the revenues derived from the 0.25 percent sales and use tax rate) is expected to exceed 3 percent of revenues in that fiscal year (excluding the revenues derived from the 0.25 percent sales and use tax rate) and (2) actual revenues for the period May 1 through September 30 equal or exceed the May Revision forecast. The 0.25 percent rate will be reinstated the following year if the Director of Finance subsequently determines conditions (1) or (2) above are not met for that fiscal year. The reserve was not sufficient to trigger an additional year of reduction for calendar years 2002 through 2004, and the 2004-05 Governor's Budget forecast estimates that the reserve level will again be insufficient to trigger a reduction for calendar year 2005. See "CURRENT STATE BUDGET—Summary of State Revenues and Expenditures" for a projection of the 2004-05 General Fund reserve.

Corporation Tax

Corporation tax revenues are derived from the following taxes:

1. The franchise tax and the corporate income tax are levied at an 8.84 percent rate on profits. The former is imposed on corporations for the privilege of doing business in California, while the latter is imposed on corporations that derive income from California sources but are not sufficiently present to be classified as doing business in the State.

2. Banks and other financial corporations are subject to the franchise tax plus an additional tax at the rate of 2 percent on their net income. This additional tax is in lieu of personal property taxes and business license taxes.

3. The alternative minimum tax (AMT) is similar to that in federal law. In general, the AMT is based on a higher level of net income computed by adding back certain tax preferences. This tax is imposed at a rate of 6.65 percent.

4. A minimum franchise tax of up to $800 is imposed on corporations subject to the franchise tax but not on those subject to the corporate income tax. New corporations are exempted from the minimum franchise tax for the first two years of incorporation.

5. Sub-Chapter S corporations are taxed at 1.5 percent of profits.

Taxpayers with net operating losses (i.e., an excess of allowable deductions over gross income) are allowed to carry forward those losses for tax purposes and deduct a portion in subsequent years. Chapter 488, Statutes of 2002 (AB 2065), suspends the use of any carryover losses for the 2002 and 2003 tax years, but allows taxpayers to deduct those losses beginning in the 2004 tax year and extends the expiration date for those losses by two years. That Chapter also increases the percent of a taxpayer's net operating loss ("NOL") that can be carried forward from 65 percent to 100 percent beginning January 1, 2004, for NOLs generated after that date. About 85 percent of NOL is deducted from corporation taxes with the balance deducted from personal income tax.

On February 23, 2004, the U.S. Supreme Court denied the State Franchise Tax Board's appeal requesting review of the decision in *Farmer Brothers Company v. Franchise Tax Board*, a tax refund case which involved the deductibility of corporate dividends. The exact amount and timing of such refunds is yet to be determined, although potential tax refunds to affected entities could total $400 million over fiscal years 2003-04 through 2007-08. See "LITIGATION—Tax Refund Cases." The potential savings in Proposition 98 expenditures is unknown at this time.

Insurance Tax

The majority of insurance written in California is subject to a 2.35 percent gross premium tax. For insurers, this premium tax takes the place of all other state and local taxes except those on real property and motor vehicles. Exceptions to the 2.35 percent rate are certain pension and profit-sharing plans which are taxed at the lesser rate of 0.5 percent, surplus lines and nonadmitted insurance at 3 percent and ocean marine insurers at 5 percent of underwriting profits.

Estate Tax; Other Taxes

The California estate tax is based on the State death tax credit allowed against the federal estate tax. The California estate tax is designed to pick up the maximum credit allowed against the federal estate tax return. The federal Economic Growth and Tax Reconciliation Act of 2001 phases out the federal estate tax by 2010. As part of this, the Act reduced the State pick-up tax by 25 percent in 2002, 50 percent in 2003, and 75 percent in 2004, and eliminates it beginning in 2005. The provisions of this federal act sunset after 2010. At that time, the federal estate tax will be reinstated along with the State's estate tax, unless future federal legislation is enacted to make the provisions permanent. See Table 4 entitled "Comparative Yield of State Taxes—All Funds, 1999-00 Through 2004-05."

Other General Fund major taxes and licenses include: Inheritance and Gift Taxes; Cigarette Taxes; Alcoholic Beverage Taxes; Horse Racing License Fees and Trailer Coach License Fees.

Special Fund Revenues

The California Constitution and statutes specify the uses of certain revenue. Such receipts are accounted for in various special funds. In general, special fund revenues comprise three categories of income:

- Receipts from tax levies which are allocated to specified functions, such as motor vehicle taxes and fees and certain taxes on tobacco products.
- Charges for special services to specific functions, including such items as business and professional license fees.
- Rental royalties and other receipts designated for particular purposes (e.g., oil and gas royalties).

Motor vehicle related taxes and fees accounted for about 46 percent of all special fund revenues and transfers in 2002-03. Principal sources of this income are motor vehicle fuel taxes, registration and weight fees and vehicle license fees. During fiscal year 2002-03, $7.1 billion was derived from the ownership or operation of motor vehicles. About $5.1 billion of this revenue was returned to local governments. The remainder was available for various State programs related to transportation and services to vehicle owners.

Taxes on Tobacco Products

On November 8, 1988, voters approved Proposition 99, which imposed, as of January 1, 1989, a 25-cent per pack excise tax on cigarettes, and a new, equivalent excise tax on other tobacco products. The initiative requires that funds from this tax be allocated to anti-tobacco education and research, to indigent health services, and environmental and recreation programs.

Proposition 10, which was approved in 1998, increased the excise tax imposed on distributors selling cigarettes in California to 87 cents per pack effective January 1, 1999. At the same time, this proposition imposed a new excise tax on cigars, chewing tobacco, pipe tobacco, and snuff at a rate equivalent to the tax increase on cigarettes. In addition, the higher excise tax on cigarettes automatically triggered an additional increase in the tax on other tobacco products effective July 1, 1999, with the proceeds going to the Cigarette and Tobacco Products Surtax Fund.

The State excise tax on cigarettes of 87 cents per pack and the equivalent rates on other tobacco products are earmarked as follows:

1. Fifty cents of the per-pack tax on cigarettes and the equivalent rate levied on non–cigarette tobacco products are deposited in the California Children and Families First Trust Fund and are allocated primarily for early childhood development programs.

2. Twenty-five cents of the per-pack tax on cigarettes and the equivalent rates levied on non-cigarette tobacco products are allocated to the Cigarette and Tobacco Products Surtax Fund. These funds are appropriated for anti-tobacco education and research, indigent health services, and environmental and recreation programs.

3. Ten cents of the per-pack tax is allocated to the State's General Fund.

4. The remaining two cents of the per-pack tax is deposited into the Breast Cancer Fund.

Chapter 890, Statutes of 2003, imposed a tobacco products licensing requirement which was also designed to reduce overall tobacco tax evasion. Reduced evasion associated with this licensure requirement is expected to generate $36 million ($4 million General Fund) in additional tobacco revenue during the implementation phase in 2003-04 and $70 million ($8 million General Fund) in 2004-05.

Recent Tax Receipts

The following table shows the trend of major General Fund and total taxes per capita and per $100 of personal income for the past four years, the current fiscal year, and the budget year.

TABLE 3
RECENT TAX RECEIPTS

	Trend of State Taxes per Capita[a]		Taxes per $100 of Personal Income	
Fiscal Year	**General Fund**	**Total**	**General Fund**	**Total**
1999-00	2,095.53	2,447.03	7.04	8.22
2000-01	2,222.88	2,589.48	6.87	8.01
2001-02	1,804.21	2,108.96	5.55	6.48
2002-03	1,836.05	2,134.36	5.62	6.53
2003-04[b]	1,923.08	2,230.26	5.76	6.68
2004-05[b]	2,010.09	2,360.86	5.79	6.80

(a) Data reflect population figures based on the 2000 Census.

(b) Estimated.

Source: State of California, Department of Finance.

The following table gives the actual and estimated revenues by major source for the last four years, the current fiscal year, and the budget year. This table shows taxes, which provide revenue both to the General Fund and State special funds.

TABLE 4
COMPARATIVE YIELD OF STATE TAXES—ALL FUNDS
1999-00 THROUGH 2004-05
(Modified Accrual Basis)
(Thousands of Dollars)

Year Ending June 30	Sales and Use[a]	Personal Income	Corporation	Tobacco[b]	Inheritance, Estate and Gift	Insurance	Alcoholic Beverages	Horse Racing	Motor Vehicle Fuel[c]	Motor Vehicle Fees[d]
2000	25,525,788	39,578,237	6,638,898	1,216,651	928,146	1,299,777	282,166	44,130	3,069,694	5,263,245
2001	26,616,073	44,618,532	6,899,322	1,150,869	934,709	1,496,556	288,450	42,360	3,142,142	5,286,542
2002	26,004,521	33,051,107	5,333,030	1,102,806	890,627	1,595,846	292,627	42,247	3,295,903	3,836,795
2003	27,177,756	32,713,830	6,803,583	1,055,505	647,372	1,879,784	290,564	40,509	3,202,512	3,965,410
2004[e]	26,283,755[f]	35,117,000	7,466,000	1,055,100	396,800	1,985,000	292,000	42,245	3,300,369	4,203,880
2005[e]	28,974,348[f]	38,043,000	7,609,000	1,031,700	135,400	2,078,000	294,000	42,457	3,322,018	4,578,699

(a) Numbers include local tax revenue from the 0.5 percent rate increase dedicated to local governments for the State-local health and welfare program realignment program. The 0.5% rate is equivalent to about $2.3 billion to $2.5 billion per year. The figures also reflect a statutory 0.25 percent reduction which occurred only during calendar year 2001.

(b) Proposition 10 (November 1998) increased the cigarette tax to $0.87 per pack and added the equivalent of $1.00 tax to other tobacco products.

(c) Motor vehicle fuel tax (gasoline), use fuel tax (diesel and other fuels), and jet fuel.

(d) Registration and weight fees, motor vehicle license fees and other fees. Vehicle license fee values reflect a 25 percent reduction for 1999 from the 1998 rate of two percent of a vehicle's depreciated value; a 35 percent reduction from such rate for 2000 and the first half of 2001; a 67.5 percent reduction from such rate for the second half of 2001 and thereafter.

(e) Estimated as of January 9, 2004.

(f) The figures do not include voter approved local revenue, the 0.50 percent Local Public Safety Fund revenue, the 1.0 percent local city and county operations revenue (Bradley-Burns), or the 0.25 percent county transportation funds revenue. Estimate for 2004-05 includes $1.256 billion for a temporary one-quarter cent tax increase to be used for repayment of the proposed economic recovery bonds (See "Sources of Tax Revenue—Sales Tax").

NOTE: This table shows taxes which provide revenue both to the General Fund and State special funds. Also, some revenue sources are dedicated to local governments. This accounts for differences between the information in this table and Table 12.

Source: Fiscal years 1999-00 through 2002-03: State of California, Office of the State Controller.
Fiscal years 2003-04 and 2004-05: State of California, Department of Finance.

State Expenditures

The following table summarizes the major categories of State expenditures, including both General Fund and special fund programs.

TABLE 5
GOVERNMENTAL COST FUNDS
(Budgetary Basis)
Schedule of Expenditures by Function and Character
Fiscal Years 1998-99 to 2002-03
(Thousands)

	1998-99	1999-00	2000-01	2001-02	2002-03
Function					
Legislative, Judicial, Executive					
Legislative	$ 219,814	$ 232,323	$ 262,370	$ 265,312	$ 276,462
Judicial[(a)]	1,346,131	1,372,681	1,478,710	1,633,518	2,524,446
Executive	958,189	1,241,219	1,352,128	1,371,891	1,283,297
State and Consumer Services	829,745	856,096	950,192	1,100,942	955,054
Business, Transportation and Housing					
Business and Housing	136,893	156,499	601,053	240,237	184,574
Transportation	4,462,905	5,549,520	4,417,139	6,052,926	3,712,133
Technology, Trade and Commerce	130,796	488,489	140,833	81,832	50,335
Resources	1,695,323	1,858,844	3,349,003	2,284,269	1,993,957
Environmental Protection	600,060	689,678	869,539	993,144	762,052
Health and Human Services	19,616,132	21,806,291	24,204,531	26,563,743	27,420,862
Correctional Programs	4,181,474	4,412,542	4,952,927	5,242,369	5,614,849
Education					
Education–K through 12	22,783,975	26,356,838	28,720,596	28,078,228	27,611,356
Higher Education	7,838,117	8,553,343	9,655,954	9,945,193	9,951,750
Labor and Workforce Development[(b)]	N/A	N/A	N/A	N/A	250,617
General Government					
General Administration	859,703	982,923	1,294,587	2,475,564	1,832,018
Debt Service	1,988,176	2,072,960	2,270,649	2,432,942	2,067,816
Tax Relief	450,213	1,840,129	4,655,826	3,028,703	4,446,940
Shared Revenues	4,151,197	3,677,687	4,385,429	5,528,996	2,784,971
Brown vs. US Dept. of Health and Human Services	–	–	–	96,000	
Other Statewide Expenditures	891,070	580,307	635,475	476,170	525,124
Expenditure Adjustment for Encumbrances[(c)]	(461,310)	(628,506)	(1,943,208)	(681,856)	2,365,727
Credits for Overhead Services by General Fund	(144,041)	(170,594)	(197,343)	(251,575)	(288,871)
Statewide Indirect Cost Recoveries	(32,791)	(37,423)	(36,610)	(47,862)	(50,313)
Total	$72,501,771	$81,891,846	$92,019,780	$96,910,686	$96,275,156
Character					
State Operations	$21,092,849	$22,864,874	$24,850,286	$27,994,343	$26,241,079
Local Assistance	50,734,442	58,369,828	66,087,018	67,993,721	69,043,177
Capital Outlay	674,480	657,144	1,082,476	922,622	990,900
Total	$72,501,771	$81,891,846	$92,019,780	$96,910,686	$96,275,156

(a) Included in this amount are the expenditures of the Trial Court Trust Fund. As of July 1, 2002, the Trial Court Trust Fund was reclassified to a Governmental Cost Fund from a Non-Governmental Cost Fund.

(b) Legislation was enacted effective January 1, 2003 which created a new agency function called the Labor and Workforce Development. The following agencies were transferred from General Government to this new function: the Employment Development Department, the California Workforce Investment Board, the Agricultural Labor Relations Board, and the Department of Industrial Relations.

(c) Expenditures for the State Highway Account (Fund 0042) and the Traffic Congestion Relief Fund (Fund 3007) are reported on a modified cash basis. This method of accounting eliminated all of the continuing appropriations in these two funds.

Source: State of California, Office of the State Controller.

State Appropriations Limit

The State is subject to an annual appropriations limit imposed by Article XIII B of the State Constitution (the "Appropriations Limit"). The Appropriations Limit does not restrict appropriations to pay debt service on voter-authorized bonds.

Article XIII B prohibits the State from spending "appropriations subject to limitation" in excess of the Appropriations Limit. "Appropriations subject to limitation," with respect to the State, are authorizations to spend "proceeds of taxes," which consist of tax revenues, and certain other funds, including proceeds from regulatory licenses, user charges or other fees to the extent that such proceeds exceed "the cost reasonably borne by that entity in providing the regulation, product or service," but "proceeds of taxes" exclude most State subventions to local governments, tax refunds and some benefit payments such as unemployment insurance. No limit is imposed on appropriations of funds which are not "proceeds of taxes," such as reasonable user charges or fees and certain other non-tax funds.

There are various types of appropriations excluded from the Appropriations Limit. For example, debt service costs of bonds existing or authorized by January 1, 1979, or subsequently authorized by the voters, appropriations required to comply with mandates of courts or the federal government, appropriations for qualified capital outlay projects, appropriations for tax refunds, appropriations of revenues derived from any increase in gasoline taxes and motor vehicle weight fees above January 1, 1990 levels, and appropriation of certain special taxes imposed by initiative (e.g., cigarette and tobacco taxes) are all excluded. The Appropriations Limit may also be exceeded in cases of emergency.

The Appropriations Limit in each year is based on the Appropriations Limit for the prior year, adjusted annually for changes in State per capita personal income and changes in population, and adjusted, when applicable, for any transfer of financial responsibility of providing services to or from another unit of government or any transfer of the financial source for the provisions of services from tax proceeds to non-tax proceeds. 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. The Appropriations Limit is tested over consecutive two-year periods. Any excess of the aggregate "proceeds of taxes" received over such two-year period above the combined Appropriations Limits for those two years, is divided equally between transfers to K-14 districts and refunds to taxpayers.

The Legislature has enacted legislation to implement Article XIII B which defines certain terms used in Article XIII B and sets forth the methods for determining the Appropriations Limit. California Government Code Section 7912 requires an estimate of the Appropriations Limit to be included in the Governor's Budget, and thereafter to be subject to the budget process and established in the Budget Act.

The following table shows the Appropriations Limit for 2000-01 through 2004-05.

As of the release of the 2004-05 Governor's Budget, the Department of Finance projected the Appropriations Subject to Limit to be $13.449 billion and $12.809 billion under the Appropriations Limit in fiscal years 2003-04 and 2004-05, respectively.

TABLE 6
STATE APPROPRIATIONS LIMIT
(Millions)

	Fiscal Years				
	2000-01	**2001-02**	**2002-03**	**2003-04**	**2004-05**
State Appropriations Limit	$54,073	$59,318	$59,591	$61,702	$63,977*
Appropriations Subject to Limit	(51,648)	(42,240)	(44,462)	(48,253)*	(51,168)*
Amount (Over)/Under Limit	$2,425	$ 17,078	$15,129	$13,449*	$12,809*

* Estimated/Projected.

Source: State of California, Department of Finance.

Proposition 98

On November 8, 1988, voters of the State approved Proposition 98, a combined initiative constitutional amendment and statute called the "Classroom Instructional Improvement and Accountability Act." Proposition 98 changed State funding of public education below the university level and the operation of the State Appropriations Limit, primarily by guaranteeing K-14 schools a minimum share of General Fund revenues. Proposition 98 (as modified by Proposition 111, enacted on June 5, 1990) guarantees K-14 schools the greater of: (a) in general, a fixed percentage of General Fund revenues ("Test 1"), (b) the amount appropriated to K-14 schools in the prior year, adjusted for changes in the cost of living (measured as in Article XIII B by reference to State per capita personal income) and enrollment ("Test 2"), or (c) a third test, which replaces Test 1 and Test 2 in any year the percentage growth in per capita General Fund revenues from the prior year plus one half of one percent is less than the percentage growth in State per capita personal income ("Test 3"). Under Test 3, schools receive the amount appropriated in the prior year adjusted for changes in enrollment and per capita General Fund revenues, plus an additional small adjustment factor. If Test 3 is used in any year, the difference between Test 3 and Test 2 becomes a "credit" (called the "maintenance factor") to schools and the basis of payments in future years when per capita General Fund revenue growth exceeds per capita personal income growth. Proposition 98 implementing legislation adopted prior to the end of the 1988-89 fiscal year determined the K-14 schools' funding guarantee under Test 1 to be 40.3 percent of the General Fund tax revenues, based on 1986-87 appropriations. However, this funding guarantee has been adjusted to approximately 35 percent of 1986-87 appropriations to account for subsequent changes in the allocation of local property taxes, since these changes altered the share of General Fund revenues received by schools. Proposition 98 also contains provisions for the transfer of certain State tax revenues in excess of the Article XIII B limit to K-14 schools in Test 1 years when additional moneys are available. No such transfers are anticipated during 2004-05. See "STATE FINANCES—State Appropriations Limit."

The Proposition 98 guarantee is funded from two sources: local property taxes and the General Fund. Any amount not funded by local property taxes is funded by the General Fund. Thus, local property tax collections represent an offset to General Fund costs in a Test 2 or Test 3 year.

The 2004-05 Governor's Budget reflects General Fund Proposition 98 expenditures in fiscal years 2002-03 through 2004-05 as outlined in the table below. This represents increases in Proposition 98 K-12 spending per pupil of 5.3 and 5.4 percent above the 2002-03 level in 2003-04 and 2004-05, respectively, as well as full funding for statutory growth and COLA. The 2004-05 Governor's Budget also reflects the deferral of Proposition 98 expenditures of $1.897 billion from 2002-03 to 2003-04 and $1.271 billion from 2003-04 to 2004-05 ($200 million for community colleges).

TABLE 7
Proposition 98 Funding
(Dollars in Millions)

	2002-03		2003-04		2004-05	Change From Revised 2003-04	
	Enacted	Revised	Enacted	Revised	Proposed	Amount	Percent
K-12 Proposition 98							
State General Fund.........	$28,647	$26,106	$27,630	$27,827	$27,233	-$594	-2.1%
Local property tax revenue	12,912	12,800	13,625	13,664	14,709	1,045	7.6%
Subtotals[(a)]	$41,559	$38,906	$41,255	$41,491	$41,942	$451	1.1%
Other Proposition 98							
State General Fund.........	$2,913	$2,737	$2,353	$2,339	$2,507	$168	7.2%
Local property tax revenue	2,008	1,981	2,105	2,115	2,265	150	7.1%
Subtotals[(a)]	$4,921	$4,718	$4,458	$4,454	$4,772	$318	7.1%
Total Proposition 98							
State General Fund.........	$31,560	$28,843	$29,983	$30,166	$29,740	-$426	-1.4%
Local property tax revenue	14,920	14,781	15,730	15,779	16,974	1,195	7.6%
Totals[(a)]................	$46,480	$43,624	$45,713	$45,945	$46,714	$769	1.7%

[(a)] Totals may not add due to rounding.

Source: State of California, Department of Finance

Proposition 98 permits the Legislature, by a two-thirds vote of both houses (on a bill separate from the Budget Act), and with the Governor's concurrence, to suspend the K-14 schools' minimum funding guarantee for a one-year period. Restoration of the Proposition 98 funding level to the level that would have been required in the absence of such a suspension occurs over future fiscal years according to a specified State Constitutional formula.

The 2004-05 Governor's Budget proposes that the level of Proposition 98 appropriations be reset at a level approximately $2 billion less than would otherwise be required for 2004-05. If approved, this action would add $2 billion to the existing maintenance factor (defined above) for a total maintenance factor of $4 billion as of the end of fiscal year 2004-05. This cumulative maintenance factor is required to be restored to the Proposition 98 budget in future years as explained above. Assuming a continued moderate economic growth scenario, the Administration projects that $2 billion of the total maintenance factor could be restored in the next three to five fiscal years. The remaining $2 billion maintenance factor would be restored over another three to five fiscal years. Therefore, resetting the minimum funding guarantee as proposed in the 2004-05 Governor's Budget would provide ongoing General Fund savings over several fiscal years until the maintenance factor was fully repaid in approximately 6-10 fiscal years according to current estimates.

Appropriations for 2002-03 and 2003-04 are currently estimated to be $517.8 million and $448.4 million below the amounts required by Proposition 98 because of increases in State tax revenues above original estimates. The Administration proposes to repay these obligations and $250.8 million owed from 1995-96 and 1996-97, over multiple years, beginning in 2006-07.

Local Governments

The primary units of local government in California are the counties, which range in population from 1,200 in Alpine County to approximately 10 million in Los Angeles County. Counties are responsible for the provision of many basic services, including indigent health care, welfare, jails, and public safety in unincorporated areas. There are also 478 incorporated cities and thousands of special districts formed for education, utilities, and other services. The fiscal condition of local governments has been constrained since Proposition 13, which added Article XIII A to the State Constitution, ("Proposition 13") was approved by California voters in 1978. Proposition 13 reduced and limited the future growth of property taxes and limited the ability of local governments to impose "special taxes" (those devoted to a specific purpose) without two-thirds voter approval. Proposition 218, another initiative constitutional amendment enacted in 1996, further limited the ability of local governments to raise taxes, fees, and other exactions. Counties, in particular, have had fewer options to raise revenues than many other local government entities, while they have been required to maintain many services.

In the aftermath of Proposition 13, the State provided aid to local governments from the General Fund to make up some of the loss of property tax moneys, including assuming principal responsibility for funding K-12 schools and community colleges. During the recession of the early 1990s, the Legislature eliminated most of the remaining components of post-Proposition 13 aid to local government entities other than K-12 schools and community colleges by requiring cities and counties to transfer some of their property tax revenues to school districts. However, the Legislature also provided additional funding sources, such as sales taxes, and reduced certain mandates for local services funded by cities and counties. See "STATE FINANCES—Sources of Tax Revenue—Sales Tax" for a discussion of the impact of the proposed bond issuances on local sales taxes. The 2004-05 Governor's Budget proposes to increase transfers to school districts to $1.3 billion, with $135 million coming from community redevelopment agencies and the remainder from cities, counties, and other special districts. In 2003-04, funding is provided for various programs, including the Citizens' Option for Public Safety ("COPS") program to support local front-line law enforcement ($100 million), county juvenile justice and crime prevention programs ($100 million), reimbursement of jail booking fees ($38.2 million), grants to county assessors to increase and enhance property tax assessment activities ($60 million), and open space subvention reimbursements to cities and counties ($39 million). The 2004-05 Governor's Budget proposes to continue funding at these levels for the COPS, county juvenile justice and crime prevention, and property tax assessment grants programs in 2004-05.

Vehicle License Fee

Vehicle license fees are 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. Beginning January 1, 1999, a permanent offset of 25 percent of the vehicle license fees paid by vehicle owners became operative. Various pieces of legislation increased the amount of the offset in subsequent years to the existing statutory level of 67.5 percent. This level of offset is expected to provide tax relief of $3.95 billion in fiscal year 2003-04 and $4.06 billion in fiscal year 2004-05.

In connection with the offset of the vehicle license fees, 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, vehicle license fees 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 have resumed. Local governments received "backfill" payments totaling $3.80 billion in fiscal year 2002-03. "Backfill" payments totaling $2.65 billion and $4.06 billion are anticipated to be paid to local governments in fiscal years 2003-04 and 2004-05, respectively. Chapter 231, Statutes of 2003, provides for the repayment in August 2006, of approximately $1.3 billion that was not received by locals during the time period between the suspension of the offsets and the implementation of higher fees. See "LITIGATION—Challenges Related to the Vehicle License Fee Offset and Related Payments to Local Governments."

In an unpublished decision issued in September, 2003, the Court of Appeal (*County of San Diego v. Commission on State Mandates et al.*, D039471; petition for review denied by the California Supreme Court, in December, 2003) ruled in favor of the County of San Diego on certain claims related to the medically indigent adult (MIA) program, and determined that the State owed the County of San Diego approximately $3.5 million for medical services rendered to MIAs during the two-year period (1991-1992). See "LITIGATION—Local Government Mandate Claims and Actions." The decision also made the statutory depreciation schedule, which was enacted to fund a portion of the 1991 program realignment between the State and local governments that included MIA programs, inoperative as of March 1, 2004. The Department of Motor Vehicles (DMV) has adopted emergency regulations which establish a replacement depreciation schedule at the prior level. DMV is also proceeding to have these regulations established permanently. If these regulations are established, there will be no change in vehicle license fee revenues available to counties. See "LITIGATION—Local Government Mandate Claims and Actions."

Trial Courts

Prior to legislation enacted in 1997, local governments provided the majority of funding for the State's trial court system. The legislation consolidated the trial court funding at the State level in order to streamline the operation of the courts, provide a dedicated revenue source, and relieve fiscal pressure on the counties. This resulted in decreasing the county contribution for court operations by $415 million and allowed cities to retain $68 million in fine and penalty revenue previously remitted to the State. The State's trial court system will receive approximately $1.8 billion and $1.7 billion in State resources in 2003-04 and 2004-05, respectively, and $475 million in resources from the counties in each fiscal year.

Welfare System

The entire statewide welfare system was changed in response to the change in federal welfare law enacted in 1996 (see "Welfare Reform"). Under the CalWORKs program, counties are given flexibility to develop their own plans, consistent with State law, to implement the program and to administer many of its elements, with costs for administrative and supportive services capped at the 1996-97 levels. As noted above, counties are also given financial incentives if, at the individual county level or statewide, the CalWORKs program produces savings associated with specified standards. Counties are still required to provide "general assistance" aid to certain persons who cannot obtain welfare from other programs.

Welfare Reform

The Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (P.L. 104–193, the "Law") fundamentally reformed the nation's welfare system. The Law included provisions to: (i) convert Aid to Families with Dependent Children ("AFDC"), an entitlement program, to Temporary Assistance for Needy Families ("TANF"), a block grant program with lifetime time limits on TANF recipients, work requirements and other changes; (ii) deny certain federal welfare and public benefits to legal noncitizens (subsequent federal law has amended this provision), allow states to elect to deny additional benefits (including TANF) to legal noncitizens, and generally deny almost all benefits to illegal immigrants; and (iii) make changes in the Food Stamp program, including to reduce maximum benefits and impose work requirements. The block grant formula under the Law is operative through March 31, 2004.

Chapter 270, Statutes of 1997, embodies California's response to the federal welfare reforms. Effective January 1, 1998, California Work Opportunity and Responsibility to Kids ("CalWORKs") replaced the former AFDC and Greater Avenues to Independence programs. Consistent with the federal law, CalWORKs contains time limits on the receipt of welfare aid, both lifetime as well as current period. The centerpiece of CalWORKs is the linkage of eligibility to work participation requirements.

Caseload under CalWORKs is continuing to flatten after many consecutive years of decline. The revised CalWORKs caseload projections are 479,000 cases in 2003-04 and 481,000 cases in 2004-05. This represents a major decline in caseload from the rapid growth of the early 1990s, when caseload peaked at 921,000 cases in 1994-95. Since CalWORKs' inception in January 1998, caseload has declined by nearly 35 percent, and the number of working recipients has increased from less than 20 percent in 1996 to nearly 50 percent in 2002.

California will continue to meet, but not exceed, the federally-required $2.7 billion combined State and county maintenance of effort ("MOE") requirement in 2003-04 and 2004-05. In an effort to keep program expenditures within the TANF Block Grant and TANF MOE amounts, the 2004-05 Governor's Budget proposes to eliminate TANF funding for county juvenile probation services, adjust State funding for tribal TANF programs to meet the actual caseloads being served, eliminate the 2004-05 CalWORKs cost-of-living adjustment, and reduce the basic CalWORKs grant.

The 2004-05 Governor's Budget includes an augmentation of $191.9 million in 2003-04 and 2004-05 for employment services to enable recipients to move off of aid and into sustainable employment. The 2004-05 Governor's Budget includes total CalWORKs-related expenditures of $6.9 billion for 2003-04 and $6.4 billion for 2004-05, including child care transfer amounts for the Department of Education and the State's general TANF reserve. The Budget also includes a TANF reserve of $210.1 million, which is available for unanticipated needs in any program for which TANF Block Grant funds are appropriated, including CalWORKs benefits, employment services, county administration, and child care costs. This reserve may be needed for such pressures as litigation or the cost of increased participation rate requirements that have been proposed at the federal level with the reauthorization of the TANF program.

Authorization for the TANF program currently ends March 31, 2004 (having been extended several times from its original September 30, 2002 expiration date). For the TANF program to continue, the U.S. Congress must pass, and the President must sign, legislation reauthorizing the program prior to that date. While Congress and the President will consider several key policy changes, federal reauthorization legislation introduced to date would significantly increase the work participation rate requirements. One proposal would increase work participation rate requirements by 5 percent annually from the current statutory rate of 50 percent to 70 percent in federal fiscal year 2008. The State would need to make substantial investments in child care and employment services in order to meet the increased work participation rate requirements if this proposal was adopted. Failure to meet these increased requirements could result in significant federal penalties.

Pension Trusts

The assets and liabilities of the three principal retirement systems in which the State participates, the California Public Employees' Retirement System ("CalPERS"), the California State Teachers' Retirement System ("CalSTRS") and the University of California Retirement System ("UCRS"), are included in the financial statements of the State as fiduciary funds and described in Note 20 to the Audited Annual Financial Statements of the State of California for the year ended June 30, 2003 (the "Audited Financial Statements"), incorporated by reference in or attached to this APPENDIX A. See "FINANCIAL STATEMENTS."

The three largest defined benefit retirement plans contained in the retirement systems and the excess of the actuarial value of assets over the actuarial accrued liability or unfunded actuarial accrued liability of those plans at June 30, 2002 (June 30, 2001, for CalSTRS) was reported to be as follows:

TABLE 8
ACTUARIAL VALUE OF STATE RETIREMENT SYSTEMS

Name of Plan	Excess of Actuarial Value of Assets Over Actuarial Accrued Liabilities (Unfunded Actuarial Accrued Liability)
Public Employees' Retirement Fund (CalPERS)[1/]	$ (6.653) billion
State Teachers' Retirement Fund Defined Benefit Program (CalSTRS)	(2.227) billion
University of California Retirement Plan	11.549 billion

1/ Excludes the value of the local government plans of the system.

The actuarial information for CalSTRS for the year ended June 30, 2002, is updated on a two-year cycle and will be available in the spring of 2004. However, according to CalSTRS, its investment portfolio market value as of July 31, 2003, was approximately $100,893,000,000, compared to $92,599,000,000 as of July 31, 2002. The CalPERS reports that its investment portfolio market value as of July 31, 2003, was approximately $145,000,000,000, compared to $135,500,000,000 as of July 31, 2002.

The State's contribution to the CalPERS and the UC Retirement System is actuarially determined each year, while the State's contribution to the CalSTRS is established by statute and is currently 2.017 percent of teacher payroll for the fiscal year ending in the immediately preceding calendar year. The following table shows the State's contributions to CalPERS for fiscal years 1997-98 through 2003-04:

TABLE 9
STATE CONTRIBUTION TO CALPERS
Fiscal Years 1997-98 to 2003-04

1997-98	$1,223,000,000
1998-99	766,100,000
1999-00	463,600,000
2000-01	156,700,000
2001-02	677,200,000
2002-03	1,190,000,000
2003-04	2,213,000,000

Due to past investment losses and increased retirement benefits, the State contribution to CalPERS has increased from $156.7 million in 2000-01 to $2.213 billion in 2003-04. The CalPERS estimates the State's 2004-05 contribution will be approximately $2.564 billion. This estimate will be reevaluated in April 2004, and formal action will be taken by the Board to set the State's 2004-05 retirement contribution in May 2004.

The 2004-05 Governor's Budget proposes a Pension Reform Package to control the State's future costs of pension benefits. The Administration proposes a one-percent increase to existing State employees' annual retirement contributions and will simultaneously pursue legislation to return to the less generous retirement formulae that existed before fiscal year 1999-00 for new State employees. In anticipation of and in order to realize immediate benefits from these reforms, the State plans to issue pension obligation bonds to pay retirement contributions to CalPERS until the effect of returning to pre-2000 benefit levels is sufficiently recognized in CalPERS' actuarial projections. The Administration expects that the litigation concerning the pension obligation bonds will be resolved in sufficient time to allow the State to issue $929 million pension obligation bonds to cover April and June 2005 contributions. It is also estimated that $19.5 million of bonds will be issued in 2005-06. The State would make interest-only payments on the pension obligation bonds in fiscal years 2004-05 through 2007-08 and interest and principal payments in the sixteen fiscal years following. Details concerning the three largest plans and information concerning the other plans contained in the retirement systems are included in Note 20 to the Audited Financial Statements. See "FINANCIAL STATEMENTS."

Repayment of Energy Loans

The Department of Water Resources of the State ("DWR") borrowed $6.1 billion from the General Fund of the State for DWR's power supply program between January and June 2001. DWR issued approximately $11.25 billion in revenue bonds in several series and in the fall of 2002 used the net proceeds of the revenue bonds to repay outstanding loans from banks and commercial lenders in the amount of approximately $3.5 billion and a loan from the General Fund in the amount of $6.1 billion plus accrued interest of approximately $500 million. Issuance of the DWR revenue bonds had been delayed since mid-2001 by a number of factors, including administrative and legal challenges.

The cost of the loans from the General Fund and the banks and commercial lenders that financed DWR's power supply program costs during 2001 exceeded DWR's revenues from the sale of electricity. Since that time, the power supply program has become self-supporting, and no additional loans from the General Fund are authorized. As of January 1, 2003, the DWR's authority to enter into new power purchase contracts terminated, and the three major investor-owned electric utilities (the "IOUs") resumed responsibility for obtaining electricity for their customers.

The general purpose of the power supply program has been to provide to customers of the IOUs the portion of their power not provided by the IOUs. The primary source of money to pay debt service on the DWR revenue bonds is revenues derived from customers of the IOUs resulting from charges set by the California Public Utilities Commission. The DWR revenue bonds are not a debt or liability of the State and do not directly or indirectly or contingently obligate the State to levy or to pledge any form of taxation whatever therefor or to make any appropriation for their payment.

Unemployment Insurance Fund

In fiscal year 2002-03 the State paid $8.161 billion in unemployment benefits from the Unemployment Insurance ("UI") Fund. In fiscal year 2003-04 the State expects to pay $8.203 billion in benefits from the UI Fund. The UI Fund (which is not part of the General Fund) is projected to have a $1.2 billion deficit in calendar year 2004, notwithstanding the automatic unemployment insurance tax rate increase that took effect January 1, 2004. The State may address this issue with one or more of the following options: (1) obtain a loan from the federal government, (2) rollback unemployment benefits and/or (3) increase unemployment insurance taxes which are the sole source of funds for the UI Fund. There is no reason to believe that one or all of these options will not be available to the State. The

Employment Development Department (EDD) has applied for a loan from the federal government that would provide cash flow relief so that unemployment benefits can continue to be paid. The federal loan would eventually be repaid from increased UI tax revenue or the available resources resulting from decreased benefits. Interest payments on the loan would be paid by the EDD Contingent Fund and not the General Fund. The Administration and the Legislature will have to determine how to resolve the cash flow imbalance in the UI Fund for the long-term. This issue is expected to be addressed in the upcoming session of the Legislature.

Investment of Funds

Moneys on deposit in the State's Centralized Treasury System are invested by the Treasurer in the Pooled Money Investment Account (the "PMIA"). As of January 31, 2004, the PMIA held approximately $31.2 billion of State moneys, and $22.8 billion invested for about 2,760 local governmental entities through the Local Agency Investment Fund ("LAIF"). The assets of the PMIA as of January 31, 2004, are shown in the following table:

TABLE 10
Analysis of the Pooled Money Investment Account Portfolio*

Type of Security	Amount (Thousands)	Percent of Total
U.S. Treasury	$8,742,154	16.2%
Commercial Paper	8,921,446	16.5
Certificates of Deposits	7,325,035	13.6
Corporate Bonds	1,837,634	3.4
Federal Agency	14,634,558	27.1
Bankers Acceptances	–	0.0
Bank Notes	808,642	1.5
Loans Per Government Code	5,852,821	10.8
Time Deposits	5,862,095	10.9
Repurchases	–	0.0
Reverse Repurchases	–	0.0
	$53,984,385	100.0%

* Totals may differ due to rounding.

Source: State of California, Office of the Treasurer.

The State's treasury operations are managed in compliance with the California Government Code and according to a statement of investment policy which sets forth permitted investment vehicles, liquidity parameters and maximum maturity of investments. The PMIA operates with the oversight of the PMIB. The LAIF portion of the PMIA operates with the oversight of the Local Agency Investment Advisory Board (consisting of the State Treasurer and four other appointed members).

The Treasurer does not invest in leveraged products or inverse floating rate securities. The investment policy permits the use of reverse repurchase agreements subject to limits of no more than 10 percent of the PMIA. All reverse repurchase agreements are cash matched either to the maturity of the reinvestment or an adequately positive cash flow date which is approximate to the maturity of the reinvestment.

The average life of the investment portfolio of the PMIA as of January 31, 2004, was 179 days.

THE BUDGET PROCESS

General

The State's fiscal year begins on July 1 and ends on June 30 of the following year. The State operates on a budget basis, using a modified accrual system of accounting for its General Fund, with revenues credited in the period in which they are measurable and available and expenditures debited in the period in which the corresponding liabilities are incurred.

The annual budget is proposed by the Governor by January 10 of each year for the next fiscal year (the "Governor's Budget"). Under State law, the annual proposed Governor's Budget cannot provide for projected expenditures in excess of projected revenues for the ensuing fiscal year. Following the submission of the Governor's Budget, the Legislature takes up the proposal. As required by the Balanced Budget Amendment ("Proposition 58"), beginning with fiscal year 2004-05, the Legislature may not pass a budget bill in which General Fund expenditures exceed estimated General Fund revenues and fund balances at the time of the passage and as set forth in the budget bill.

If the Governor determines that the State is facing substantial revenue shortfalls or spending deficiencies, the Governor is authorized to declare a fiscal emergency. He or she would then be required to propose legislation to address the emergency, and call the Legislature into special session for that purpose. If the Legislature fails to pass and send to the Governor legislation to address the budget fiscal emergency within 45 days, the Legislature would be prohibited from (i) acting on any other bills or (ii) adjourning in joint recess until such legislation is passed. See "THE BUDGET PROCESS – Constraints on the Budget Process" below.

Under the State Constitution, money may be drawn from the Treasury only through an appropriation made by law. The primary source of the annual expenditure appropriations is the annual Budget Act as approved by the Legislature and signed by the Governor. The Budget Act must be approved by a two-thirds majority vote of each House of the Legislature. See "THE BUDGET PROCESS — Constraints on the Budget Process" below. The Governor may reduce or eliminate specific line items in the Budget Act or any other appropriations bill without vetoing the entire bill. Such individual line-item vetoes are subject to override by a two-thirds majority vote of each House of the Legislature.

Appropriations also may be included in legislation other than the Budget Act. Except as noted in the previous paragraph and in the next sentence, bills containing General Fund appropriations must be approved by a two-thirds majority vote in each House of the Legislature and be signed by the Governor. Bills containing appropriations for K-12 schools or community colleges ("K-14 education") only require a simple majority vote. Continuing appropriations, available without regard to fiscal year, may also be provided by statute or the State Constitution.

Funds necessary to meet an appropriation need not be in the State Treasury at the time such appropriation is enacted; revenues may be appropriated in anticipation of their receipt.

Constraints on the Budget Process

Over the years, a number of laws and constitutional amendments have been enacted, often from voter initiatives, which have made it more difficult to raise State taxes, have restricted the use of State General Fund or special fund revenues, or have otherwise limited the Legislature and Governor's discretion in enacting budgets. Prior examples of provisions that make it more difficult to raise taxes include Proposition 13, which, among other provisions, required that any change in State taxes enacted for the purpose of increasing revenues collected pursuant thereto, whether by increased rates or changes in computation, be enacted by a two-thirds vote in each house of the Legislature. Prior examples of provisions restricting the use of General Fund revenue are Proposition 98, which mandates a minimum percentage of General Fund revenues to be spent on local education, and Proposition 10, which raised taxes on tobacco products but mandated how the additional revenues would be expended. See "STATE FINANCES—Proposition 98" and "—Sources of Tax Revenue—Taxes on Tobacco Products."

An initiative statute, Proposition 49, called the "After School Education and Safety Program of 2002," was approved by the voters on November 5, 2002, and will require the State to expand funding for before and after school programs in the State's public elementary and middle schools. In the first year after 2003-04 that non-Proposition 98 appropriations exceed the base year level by $1.5 billion, the initiative will require the State to appropriate up to $550 million annually, depending on the amount of appropriations above the trigger level. The initiative defines the base year level as the fiscal year during the period July 1, 2000, through June 30, 2004, for which the State's non-guaranteed General Fund appropriations are the highest as compared to any other fiscal year during that period. Using data from December 2003, the 2000-01 fiscal year is the base year. Based upon expected non-Proposition 98 General Fund appropriations as of the 2004-05 Governor's Budget, the initiative is unlikely to require implementation of the funding increase for before and after school programs until 2006-07. By comparison, the 2004-05 Governor's Budget includes approximately $121.6 million for these after school programs in both 2003-04 and 2004-05, $428.4 million below the amount which the initiative would require if the full funding increase were in effect.

As noted above, Proposition 58 requires the State to enact a balanced budget, establish a special reserve in the General Fund and restricts future borrowing to cover budget deficits. As a result of the provisions requiring the enactment of a balanced budget and restricting borrowing, the State would, in some cases, have to take more immediate actions to correct budgetary shortfalls. Beginning with the budget for fiscal year 2004-05, Proposition 58 requires the Legislature to pass a balanced budget and provides for mid-year adjustments in the event that the budget falls out of balance.

Proposition 58 also requires that a special reserve (the Budget Stabilization Account) be established in the state's General Fund. Beginning with fiscal year 2006-07, a portion of estimated annual General Fund revenues would be transferred by the Controller into the Budget Stabilization Account no later than September 30 of each fiscal year. These transfers would continue until the balance in the Budget Stabilization Account reaches $8 billion or 5 percent of the estimated General Fund revenues for that fiscal year, whichever is greater. The annual transfer requirement would be in effect whenever the balance falls below the $8 billion or 5 percent target. The annual transfers could be suspended or reduced for a fiscal year by an executive order issued by the Governor no later than June 1 of the preceding fiscal year.

Proposition 58 will also prohibit certain future borrowing to cover budget deficits. This restriction applies to general obligation bonds, revenue bonds, and certain other forms of long-term borrowing. The restriction does not apply to certain other types of borrowing, such as (i) short-term borrowing to cover cash shortfalls in the General Fund (including revenue anticipation notes or revenue anticipation warrants currently used by the State), or (ii) inter-fund borrowings.

Another initiative, Proposition 56, the Budget Accountability Act, which was on the March 2, 2004 ballot and would have reduced from two-thirds to 55 percent the number of votes required to pass the budget bill and other bills related to the budget, including tax increase measures was not approved by the voters.

PRIOR FISCAL YEARS' BUDGETS

Following a severe recession in the early 1990s, the State's financial condition improved markedly starting in 1995-96, due to a combination of better than expected revenues, slowdown in growth of social welfare programs, and continued spending restraint based on actions taken in earlier years. The economy grew strongly between 1994 and 2000, generally outpacing the nation, and as a result, for the five fiscal years from 1995-96 to 1999-00, the General Fund tax revenues exceeded the estimates made at the time the budgets were enacted. These additional funds were largely directed to school spending as mandated by Proposition 98, to make up shortfalls from reduced federal health and welfare aid in 1995-96 and 1996-97 and to fund new program initiatives, including education spending above Proposition 98 minimums, tax reductions, aid to local governments and infrastructure expenditures.

2001 Budget Act

The 2001 Budget Act (for fiscal year 2001-02) was signed by Governor Davis on July 26, 2001. The spending plan for 2001-02 included General Fund expenditures of $78.8 billion, a reduction of $1.3 billion from the prior year. The spending plan utilized more than half of the budget surplus as of June 30, 2001, but still left a projected balance in the SFEU at June 30, 2002, of $2.6 billion. The 2001 Budget Act assumed that, during the course of the fiscal year, the $6.2 billion advanced by the General Fund to the Department of Water Resources for power purchases would be repaid with interest. See "STATE FINANCES—Repayment of Energy Loans."

The final estimate of fiscal year 2001-02 revenues and expenditures, included in the 2003-04 Governor's Budget in January 2003, showed an unprecedented drop in revenues compared to the prior year. The final estimate for the three largest tax sources was $59.7 billion, a drop of over $13 billion from 2000-01, the vast bulk of which was attributable to reduced personal income taxes from stock option and capital gains activity. This revenue shortfall and the delay of the DWR power revenue bonds past June 30, 2002, resulted in a substantial budgetary deficit and cash flow difficulties. Despite a mid-year spending freeze for many State agencies and spending reductions and deferrals totaling $2.3 billion for the 2001-02 fiscal year in January 2002, the State ended fiscal year 2001-02 with a $2.1 billion negative fund balance.

The 2001 Budget Act as initially enacted included Proposition 98 per-pupil spending increases of 4.9 percent. Total General Fund spending of $32.4 billion for K-12 education fully funded enrollment and cost of living increases and also provided additional funding for a number of programs. Higher education funding was increased to allow for enrollment increases at both the University of California and the California State University system with no fee increases. Health and human services generally were fully funded for anticipated caseload growth. Funding for many of these programs was subsequently reduced as a result of the mid-year corrections noted above.

2002 Budget Act

The 2002-03 Governor's Budget, released on January 10, 2002 (the "2002-03 Governor's Budget") projected a combined budget gap for 2001-02 and 2002-03 of approximately $12.5 billion due, in part, to a decline in General Fund revenues attributable to the national economic recession combined with the stock market decline. Personal income tax receipts, which include stock option and capital gains realizations, were particularly affected by the slowing economy and stock market decline. The May Revision to the 2002-03 Governor's Budget projected further deterioration in revenues and additional costs, increasing the two year budget gap to $23.6 billion.

The 2002 Budget Act was signed by Governor Davis on September 5, 2002. The 2002 Budget Act addressed the $23.6 billion gap between expenditures and resources through a combination of program reductions, interfund borrowings, fund shifts, payment deferrals, accelerations and transfers, debt service restructuring savings and modest tax changes.

Within a few months after the 2002 Budget Act was adopted, it became evident that revenue projections incorporated in the 2002 Budget Act were substantially overstated and that certain program cost savings included in the 2002 Budget Act would not be realized.

In late November 2002, Governor Davis directed State agencies to take immediate action to reduce any non-critical or non-essential activities by not filling any vacant positions; to cancel, postpone or amend contracts, grants, purchase orders and similar commitments; to eliminate additional non-essential vacant positions; to delay construction or signing of new leases for space; to cancel or postpone non-essential trips; and to generate new proposals for current year program reductions. In the spring of 2003, the Legislature passed budget adjustment legislation, totaling about $10.4 billion in spending reductions, deferrals and funding transfers ($5.1 billion for 2002-03 and $5.3 billion for 2003-04). The largest part of the reductions (including a $1.1 billion deferral into the 2003-04 fiscal year) were for K-12 education funding.

CURRENT STATE BUDGET

The discussion below of the fiscal year 2003-04 budget and the table under "Summary of State Revenues and Expenditures" are based on estimates and projections of revenues and expenditures for the current fiscal year and future fiscal years and must not be construed as statements of fact. These estimates and projections are based upon various assumptions, which may be affected by numerous factors, including future economic conditions in the State and the nation, and there can be no assurance that the estimates will be achieved. See "RECENT DEVELOPMENTS REGARDING STATE ECONOMY AND FINANCES" and "CURRENT STATE BUDGET—Revenue and Expenditure Assumptions."

Background

The 2003-04 Governor's Budget, released on January 10, 2003 (the "2003-04 Governor's Budget"), projected a significant downward revision in State revenues. The 2003-04 Governor's Budget projected revenues from the three largest tax sources to be about $61.7 billion in 2002-03, more than $6 billion lower than projected in the 2002 Budget Act. The 2003-04 Governor's Budget projected total revenues and transfers of $73.1 billion and $69.2 billion in 2002-03 and 2003-04 respectively. The 2003-04 Governor's Budget projected a $34.6 billion cumulative budget shortfall through June 30, 2004.

The May Revision to the 2003-04 Governor's Budget (the "May Revision") reduced the revenue estimate for 2002-03 to $70.8 billion from the 2003-04 Governor's Budget estimate of $73.1 billion, primarily from the loss of $2 billion of revenues due to the delay of the second sale of tobacco securitization bonds. The May Revision estimated that the cumulative budget shortfall for 2002-03 and 2003-04 had increased from $34.6 billion to $38.2 billion.

2003 Budget Act

After months of negotiation between Governor Davis and the Legislature, the 2003 Budget Act was adopted by the Legislature on July 29, 2003, along with a number of implementing measures, and signed by Governor Davis on August 2, 2003. The 2003 Budget Act largely reflected the proposals contained in the May Revision to the 2003-04 Budget, including, most significantly, the issuance of "fiscal recovery bonds" to address the budget deficit accumulated through June 30, 2003, which was estimated to be $10.675 billion at that time. This estimate has been revised to $8.563 billion, but may be modified further as more financial data is received. Governor Schwarzenegger subsequently proposed, and the voters approved a bond measure on the March 2004 ballot which authorizes the issuance of up to

$15 billion of economic recovery bonds to replace the fiscal recovery bonds. See "STATE INDEBTEDNESS AND OTHER OBLIGATIONS—Economic Recovery Bonds."

Under the 2003 Budget Act, General Fund revenues were projected to increase 3.3 percent, from $70.9 billion in 2002-03 to $73.3 billion in 2003-04. The revenue projections incorporated a 4 percent increase in State tax revenues (as projected by the LAO's office in August of 2003), reflecting a correspondingly moderate growth in the State's economy believed to be reasonable by the State Department of Finance. The projection also incorporated approximately $2 billion of proceeds from the tobacco settlement bonds and $680 million of additional revenue resulting from renegotiating compact agreements between Indian tribes and the State.

General Fund expenditures were estimated to drop 9 percent from $78.1 billion in 2002-03 to $71.1 billion in 2003-04. See "CURRENT STATE BUDGET—2004-05 Governor's Budget" for updated projections regarding fiscal year 2003-04 expenditures. Most of this decline was explained by four factors:

(1) the suspension of vehicle license fee "backfill" payments to local governments, which was estimated to result in $4.2 billion of savings in 2003-04. However, on November 17, 2003, by executive order, Governor Schwarzenegger rescinded the vehicle license fee increase retroactive to October 1 and proposed legislation appropriating $3.625 billion during fiscal year 2003-04 to resume "backfill" payments and to make refund payments to taxpayers. See "LITIGATION—Challenges Related to the Vehicle License Fee Offset and Related Payments to Local Governments;"

(2) approximately $1.8 billion of federal funds under the federal Jobs and Growth Tax Relief Reconciliation Act of 2003 to cover State costs in 2003-04 of which approximately $694 million was to be used to offset Medi-Cal costs in 2003-04, and the remainder was to be used to cover other critical State program spending. These new federal funds are not expected to be available in 2004-05 and beyond;

(3) the receipt of $1.9 billion of pension obligation bond proceeds to cover all of the State's quarterly contributions to CalPERS for 2003-04, which would reduce General Fund expenditures by $900 million and increase revenues by $1 billion. See "STATE INDEBTEDNESS AND OTHER OBLIGATIONS—Pension Obligation Bonds." Delays caused by litigation contesting the issuance of such bonds have made it likely that such bonds will not be issued until fiscal year 2004-05; and

(4) a one-time shift of Medi-Cal accounting from accrual to cash basis ($930 million).

In the LAO's Budget Analysis, dated August 1, 2003, the LAO concluded that, absent the above-described factors, underlying spending for 2002-03 and 2003-04 would be roughly equal. Moreover, the LAO concluded that "the 2003-04 spending level is considerably less than what would be required to maintain "baseline spending" for the [2003-04 fiscal] year." The LAO defines "baseline spending" to include spending requirements imposed by existing law, policies and State mandates at the beginning of the fiscal year.

The June 30, 2004 reserve was projected in the 2003 Budget Act to be just over $2 billion. This projection reflected the elimination of the $10.675 billion accumulated deficit through June 30, 2003, through the issuance of the fiscal recovery bonds (which will be replaced by the issuance of economic recovery bonds). See "STATE INDEBTEDNESS AND OTHER OBLIGATIONS—Economic Recovery Bonds."

Budget Controls and Flexibility

Chapter 228, Statutes of 2003 (AB 1756), authorizes the Director of Finance to reduce appropriations and to reallocate funds among appropriations available to each department in order to ensure the integrity of the 2003 Budget Act. Additionally, the 2003 Budget Act limits the Department of Finance's authority to approve requests for additional funding in the current year ("deficiency requests"). Deficiency requests to fund prior year expenditures, costs associated with legislation enacted without an appropriation, and start-up costs for programs not yet authorized may not be approved.

2004-05 Governor's Budget

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 $14 billion for fiscal 2004-05, would continue to be incurred. The 2004-05 Governor's Budget proposes various corrective actions that result in a balanced budget as described below. The 2004-05 Governor's Budget also revises various revenue and expenditure estimates for 2003-04 and assumes implementation of several mid-year spending reductions as described below.

Fiscal Year 2003-04 Revised Estimates in 2004-05 Governors Budget

In December 2003, the Governor proposed reductions (the "Mid-Year Spending Reduction Proposals") 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. The Mid-Year Spending Reduction 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 Governor's Budget (described below) assumes Legislative approval of these proposals.

The 2004-05 Governor's Budget assumed voter approval in the March 2, 2004 statewide primary election of two measures intended to address these issues: the California Economic Recovery Bond Act (Proposition 57) and the Balanced Budget Amendment (Proposition 58). Both measures were approved by the voters. See "RECENT DEVELOPMENTS REGARDING STATE ECONOMY AND FINANCES." Approval of these measures authorizes the State to issue up to $15 billion in bonds to finance the negative General Fund balance as of June 30, 2004, and other General Fund obligations undertaken prior to June 30, 2004. The State expects to sell a sufficient amount of economic recovery bonds to provide net proceeds to the General Fund in 2003-04 of $12.254 billion. Of this amount, $9.242 billion would be used to address the accumulated budget deficit through 2002-03 and $3.012 billion would be transferred to a newly created special "Deficit Recovery Fund" to offset General Fund spending in fiscal year 2004-05. See "RECENT DEVELOPMENTS REGARDING STATE ECONOMY AND FINANCES" and "STATE INDEBTEDNESS AND OTHER OBLIGATIONS—Economic Recovery Bonds."

The 2004-05 Governor's Budget projects that the State will end fiscal year 2003-04 with a reserve of $290 million, down approximately $1.9 billion from estimates made at the time of the 2003 Budget Act. Under the 2004-05 Governor's Budget, General Fund revenues for 2003-04 are projected at $77.6 billion, an increase of $4.3 billion compared with 2003 Budget Act estimates. This includes the following significant adjustments since the 2003 Budget Act:

- $2 billion increase in major tax revenues due to the improved economic forecast;
- $3 billion from additional bond proceeds (from the issuance of economic recovery bonds);

- $855 million increase in transfers from transportation funds to the General Fund proposed in the Mid-Year Spending Reduction Proposals;

- $680 million loss in revenues due to delays in renegotiations of tribal gaming compacts;

- $996 million loss in revenues due to present litigation contesting the issuance of pension obligation bonds;

- $120 million increase for other various proposed revenue solutions.

Under the 2004-05 Governor's Budget, General Fund expenditures for 2003-04 were projected at $78.0 billion, an increase of $6.9 billion compared with 2003 Budget Act estimates. This includes the following significant changes since the 2003 Budget Act:

- $885 million in payments of retirement contributions from the General Fund, due to present litigation contesting the issuance of pension obligation bonds;

- $3.0 billion transfer of bond proceeds to the "Deficit Recovery Fund" (from the issuance of economic recovery bonds), a newly created special fund;

- $2.65 billion in expenditures for vehicle license fee offsets due to the rescinding of their suspension (See "STATE FINANCES—Local Governments");

- $183 million (net) additional Proposition 98 expenditures ($631 million due to revenue growth less $448 million for funding below the minimum);

- $660 million additional expenditures due to enrollment and population growth as well as other natural cost increases;

- $155 million for natural disasters (wildfires in Southern California);

- $725 million of savings from various spending reduction proposals, including, among other proposals, additional Medi-Cal provider rate reductions ($161 million), additional reductions pursuant to Control Section 4.10 (which gives the Department of Finance authority to reduce appropriations in certain circumstances) of the 2003 Budget Act ($150 million), and the elimination of the In-Home Supportive Services Residual Program ($88 million). Any potential lost savings (total of $264 million for 2003-04 and $699 million for 2004-05) due to a preliminary injunction preventing the State from implementing Medi-Cal provider rate reductions will be reflected in the May Revision.

Fiscal Year 2004-05 Budget

The 2004-05 Governor's Budget contained the following major components:

1. Resetting Proposition 98 Minimum Funding Guarantee—The level of Proposition 98 appropriations was proposed to be reset at a level approximately $2 billion less than would otherwise be required for 2004-05. This proposal requires a two-thirds vote of the Legislature. See "STATE FINANCES—Proposition 98."

2. Higher Education—The Governor's Budget reflected fee increases of 10 percent for undergraduate and 40 percent for graduate students at the University of California and the California State University, of which 20 percent will be set aside for financial aid. (In fiscal year 2003-04, such fees were

increased 30 percent.) The Governor's Budget also reflected fees of $26 per unit for community college undergraduates and $50 per unit for degree holders, up from $18 in 2003-04.

3. Health and Human Services—The Administration proposed major reform of the Medi-Cal program in the Governor's Budget. Key components included realigning eligibility standards, requiring copayments, implementing a tiered benefit structure, and conforming basic optional benefits to those offered under private plans. The Administration also proposed to increase work incentives under the CalWORKs program as well as reductions to the services and assistance payments provided under that program.

4. Tax Relief—Full reimbursement to local governments for the vehicle license fee offsets program is proposed. See "STATE FINANCES—Local Governments."

5. Pension Reform—The Governor's Budget proposed to increase existing State employees' retirement contributions by one percent, pursue legislation to repeal retirement benefit enhancements implemented in 1999 for new State employees, and issue pension obligation bonds to cover a portion of the pension contributions in 2004-05 and 2005-06.

6. California Performance Review—The Administration revealed its plan to conduct a fundamental review of State government that would focus on the following areas: executive branch reorganization, program performance assessment and budgeting, improved services and productivity, and acquisition reform.

7. Substantially Reduced External Borrowings—The Administration proposes to issue $929 million pension obligation bonds to pay a portion of the pension obligations in 2004-05. In addition, approximately $3 billion of economic recovery bond proceeds deposited in the Deficit Recovery Fund will be used to offset fiscal year 2004-05 expenditures. In contrast, in fiscal year 2003-04, aggregate borrowings to address current expenses and accumulated deficits are estimated at $11.5 billion, including $2.3 billion of tobacco securitization proceeds and the projected $9.2 billion of economic recovery proceeds (representing $12.3 billion of total bond proceeds, less $3 billion deposited into the Deficit Recovery Fund).

The 2004-05 Governor's Budget projected to end fiscal year 2004-05 with a $635 million reserve. General Fund revenues for 2004-05 were projected at $76.4 billion, a decrease of $1.2 billion compared with revised estimates for 2003-04. This budget reflects the following major items and changes from fiscal year 2003-04:

- $4.2 billion (or six percent) increase in major revenues due to the improved economic forecast;
- $577 million of transfers to the General Fund, resulting from the issuance of pension obligation bonds in fiscal year 2004-05 to cover a portion of the pension contributions;
- $500 million additional revenues as a result of the renegotiation of tribal gaming compacts and the negotiation of new compacts with tribes that wish to expand gaming activities;
- $300 million additional revenues from proposed fees on Medi-Cal managed care plans;
- $855 million decrease for transportation transfers (one-time transfer in 2003-04);
- $650 million decrease for one-time transfers and loans in 2003-04.

General Fund expenditures for 2004-05 were projected at $76.1 billion, a decrease of $2.0 billion compared with revised estimates for 2003-04. This reflects a total of $13.3 billion of General Fund expenditure solutions, spending reductions from the level of expenditures that would have been required to comply with the Constitution and State law, federal government mandates, court orders, and to provide for cost of living adjustments and growth in enrollment, caseload, and population. These expenditure solutions, include, among others, the following major items and changes from fiscal year 2003-04:

- $3.012 billion of General Fund payment offsets from economic recovery bond proceeds deposited in the Deficit Recovery Fund;
- $2.004 billion for the proposal to rebase the Proposition 98 guarantee (see "STATE FINANCES—Proposition 98");
- $1.336 billion for funding Proposition 98 expenditures with local property taxes that previously were funded with General Fund;
- $1.256 billion for debt service savings reflecting the anticipated lower cost of economic recovery bonds compared with debt service on fiscal recovery bonds;
- $1.127 billion for the proposed suspension of the Transportation Investment Fund transfer;
- $352 million from the proposed issuance of pension obligation bonds in fiscal year 2004-05 to cover a portion of the pension contributions;
- $350 million for additional federal funds anticipated to be received in 2004-05;
- $462 million for proposed Medi-Cal provider rate reductions. Any potential lost saving due to a preliminary injunction preventing the State from implementing Medi-Cal provider rate reductions will be reflected in the May Revision;
- $1.524 billion for various spending reductions in social services programs;
- $400 million for spending reductions that would result from changes in the correctional system. This proposal is still in the process of being developed and will be submitted to the Legislature in May;
- $150 million for additional savings pursuant to Control Section 4.10 (which gives the Department of Finance authority to reduce appropriations in certain circumstances) of the 2003 Budget Act;
- $729 million for various spending reductions in higher education.

Continuing "Structural Deficit"

In its November 2003 "Fiscal Recovery" Report, the Legislative Analyst's Office ("LAO") concluded: "the State faces a major mismatch between revenues and expenditures, and this will ultimately need to be addressed through spending reductions and/or revenue enhancements if the State is to regain fiscal balance."

In its February 18, 2004 analysis of the 2004-05 Governor's Budget the LAO states: "[T]he Governor's proposal [i.e., the 2004-05 Governor's Budget] is a solid starting point for budgetary negotiations." However, the LAO cautions that some of the solutions (including savings realized from the issuance of pension obligation bonds, Medi-Cal rate reduction and the renegotiation of tribal gaming compacts) in the Governor's proposal may not be realized and could increase the budget shortfall for 2004-05 to about $4 billion. The LAO adds that a "$7 billion ongoing gap between revenues and expenditures would occur in 2005-06 and continue in subsequent years, absent further corrective action." The LAO concludes that additional savings proposals or revenue increases will be necessary to resolve the state's "budget shortfall."

The Administration expects that any shortfall in 2005-06 would be lower than projected by the LAO due to savings that are expected to be achieved in 2005-06 and thereafter from proposals to reform Medi-Cal, In-Home Supportive Services, CalWORKs, corrections and pension contributions.

Summary of State Revenues and Expenditures

The table below presents the actual revenues, expenditures and changes in fund balance for the General Fund for fiscal years 2000-01, 2001-02, and 2002-03, estimated results for fiscal year 2003-04 and projected results (based upon the 2004-05 Governor's Budget) for fiscal year 2004-05.

TABLE 11
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE–GENERAL FUND (Budgetary Basis)[a] FISCAL YEARS 2000-01 THROUGH 2004-05 (Millions)

	2000-01	2001-02	2002-03	Estimated[b] 2003-04[c]	Proposed[b] 2004-05[c]
Fund Balance–Beginning of Period	$ 9,639.7	$ 9,017.5	$ (2,109.8)	$ (7,536.2)	$ 1,218.6
Restatements					
Economic Recovery Bonds[d]	–	–	–	9,242.0	–
Prior Year Revenue, Transfer Accrual Adjustments	(158.8)	(729.8)	154.4	3.5	–
Prior Year Expenditure, Accrual Adjustments	(229.9)	217.4	374.2	(102.0)	–
Fund Balance–Beginning of Period, as Restated	$ 9,251.0	$ 8,505.1	$ (1,581.2)	$1,607.3	$ 1,218.6
Revenues	$77,609.9	$ 64,060.3	$68,545.8	$73,107.9	$75,609.3
Other Financing Sources					
Economic Recovery Bonds[d]	–	–	–	3,012.0	–
Transfers from Other Funds	6,561.8[e]	2,143.3	3,289.5	1,519.5	797.4
Other Additions	46.3	33.9	143.9	–	–
Total Revenues and Other Sources	$84,218.0	$ 66,237.5	$71,979.2	77,639.4	$76,406.7
Expenditures					
State Operations	$17,641.7	$ 19,085.7	$18,277.6	$16,946.3	$18,463.2
Local Assistance	58,441.4	57,142.0	59,145.3	57,659.7	60,927.9
Capital Outlay	2,044.3	323.5	141.3	410.1	32.8
Unclassified	–	–	–	3,012.0[f]	(3,362.0)[g]
Other Uses					
Transfer to Other Funds	6,324.1[e]	301.2	370.0	–[h]	–[h]
Total Expenditures and Other Uses	$84,451.5	$ 76,852.4	$ 77,934.2	$78,028.1	$ 76,061.9
Revenues and Other Sources Over or (Under) Expenditures and Other Uses	$ (233.5)	$(10,614.9)	$ (5,955.0)	$ (388.7)	$ 344.8
Fund Balance					
Reserved for Encumbrances	$ 1,834.3	$ 1,491.5	$ 1,037.4	$ 928.7	$ 928.7
Reserved for Unencumbered Balances of Continuing Appropriations[i]	1,436.7	827.3	996.9	471.3	155.9
Reserved for School Loans[j]	349.7	–	–	–	–
Unreserved–Undesignated[k]	5,396.8	(4,428.6)	(9,570.5)	(181.4)	478.8
Fund Balance–End of Period	$ 9,017.5	$ (2,109.8)	$ (7,536.2)	$1,218.6	$ 1,563.4

Footnotes on following page.

Source: Fiscal years 2000-01 to 2002-03: State of California, Office of the State Controller.
Fiscal years 2003-04 and 2004-05: State of California, Department of Finance.

(a) These statements have been prepared on a budgetary basis in accordance with State law and some modifications would be necessary in order to comply with generally accepted accounting principles ("GAAP"). The Supplementary Information contained in the State's Audited Annual Financial Statements for the year ended June 30, 2003, incorporated by reference in this APPENDIX A, contains a description of the differences between the budgetary basis and the GAAP basis of accounting and a reconciliation of the June 30, 2002 fund balance between the two methods.

(b) Estimates are shown net of reimbursements and abatements.

(c) Estimated as of the 2004-05 Governor's Budget, January 9, 2004.

(d) Reflects the Administration's proposal to finance the negative General Fund reserve balance as of June 30, 2004, and other General Fund obligations undertaken prior to June 30, 2004, through the issuance of economic recovery bonds sufficient to provide net proceeds to the General Fund of $12.254 billion in 2003-04. See "STATE INDEBTEDNESS AND OTHER OBLIGATIONS—Economic Recovery Bonds." For budgeting purposes, $9.242 billion of this amount is shown in 2002-03 to reflect that the accumulated deficit has been eliminated as of the start of fiscal year 2003-04.

(e) "Transfers to Other Funds" includes the $6.2 billion General Fund loan to the Department of Water Resources Electric Power Purchase Fund. See "STATE FINANCES—Repayment of Energy Loans" and "CURRENT STATE BUDGET" in this APPENDIX A. "Transfers from Other Funds" includes this loan as a receivable in 2000-01. The loan was subsequently repaid with interest as follows: $116 million in July 2001, $164 million in October 2002, and $6.456 billion in November 2002. The loan was reported in the State's Budgetary/Legal Basis Annual Report as an asset of the General Fund and a liability of the Department of Water Resources Electric Power Purchase Fund.

(f) Reflects the transfer of $3.012 billion economic recovery bond proceeds from the General Fund to the Deficit Recovery Fund.

(g) Reflects General Fund payment offsets from moneys deposited in the Deficit Recovery Fund ($3.012 billion) and from new federal funds ($350 million).

(h) "Transfer to Other Funds" is included either in the expenditure totals detailed above or as "Transfer from Other Funds."

(i) For purposes of determining whether the General Fund budget, in any given fiscal year, is in a surplus or deficit condition, Chapter 1238, Statutes of 1990, amended Government Code Section 13307. As part of the amendment, the unencumbered balances of continuing appropriations which exist when no commitment for an expenditure is made should be an item of disclosure, but the amount shall not be deducted from the fund balance. Accordingly, the General Fund condition included in the 2004-05 Governor's Budget includes the unencumbered balances of continuing appropriations as a footnote to the statement ($587.4 million in 2002-03, $471.3 million in 2003-04 and $155.9 million in 2004-05). However, in accordance with Government Code Section 12460, the State's Budgetary/Legal Basis Annual Report reflects a specific reserve for the encumbered balance for continuing appropriations.

(j) During 1995, a reserve was established in the General Fund balance for the $1.7 billion of previously recorded school loans which had been authorized by Chapter 703, Statutes of 1992 and Chapter 66, Statutes of 1993. These loans were repaid from future General Fund appropriations as part of the settlement of litigation. This accounting treatment is consistent with the State's audited financial statements prepared in accordance with GAAP.

(k) Includes Special Fund for Economic Uncertainties (SFEU). The Department of Finance generally includes in its estimates of the SFEU and set aside reserves, if any, the items reported in the table under "Reserved for Unencumbered Balances of Continuing Appropriations," "Reserved for School Loans," and "Unreserved—Undesignated." The Department of Finance projects a $289.9 million SFEU balance on June 30, 2004, and a $634.8 million SFEU balance on June 30, 2005, based upon the 2004-05 Governor's Budget released on January 9, 2004.

Revenue and Expenditure Assumptions

The table below presents the Department of Finance's budget basis statements of major General Fund revenue sources and expenditures for the 2002-03 fiscal year and 2004-05 Governor's Budget estimates for the 2003-04 and 2004-05 fiscal years.

TABLE 12
Major General Fund Revenue Sources and Expenditures

Revenues (Millions)

	Fiscal Years			
Source	**2002-03[a] Actual**	**2003-04[b] Enacted**	**2003-04[c] Revised**	**2004-05[c] Proposed**
Personal Income Tax	$32,710	$33,596	$35,117	$38,043
Sales and Use Tax	22,415	23,518	23,714	25,022
Corporation Tax	6,804	7,035	7,466	7,609
Insurance Tax	1,880	2,068	1,985	2,078
Economic Recovery Bonds[d]	9,242	–	3,012	–
All Other	7,513[e]	7,136[f]	6,345[g]	3,655[h]
Total Revenues and Transfers	$80,564	$73,353	$77,639	$76,407

Expenditures (Millions)

	Fiscal Years			
Function	**2002-03[a] Actual**	**2003-04[b] Enacted**	**2003-04[c] Revised**	**2004-05[c] Proposed**
K-12 Education	$28,788	$29,318	$29,558	$30,317
Health and Human Services	23,060	23,358	22,789	24,600
Higher Education	9,488	8,679	8,722	8,694
Youth and Adult Correctional	5,837	5,644	5,326	5,732
Legislative, Judicial and Executive	2,459	2,406	2,528	2,616
Tax Relief	4,447	707[i]	3,365	4,730
Resources	1,147	865	985	939
State and Consumer Services	468	444	471	478
Business, Transportation and Housing	206	512	518	375
All Other	1,582	-796[j]	3,766[k]	-2,419[l]
Total Expenditures	$76,482	$71,137	$78,028	$76,062

Footnotes continue on following page.

Source: State of California, Department of Finance. Figures in this table may differ from the figures in Table 4; see "Note" to Table 4.

(a) Figures for 2002-03, prepared by the Department of Finance, are slightly different than the figures in Table 11, prepared by the State Controller's Office, because of certain differences in accounting methods used by the two offices.

(b) 2003 Budget Act, August 2, 2003.

(c) 2004-05 Governor's Budget, January 9, 2004.

(d) Reflects the Administration's proposal to finance the cumulative deficit over several years through the issuance of economic recovery bonds sufficient to provide $12.254 billion net proceeds to the General Fund in 2003-04. See "STATE INDEBTEDNESS AND OTHER OBLIGATIONS— Economic Recovery Bonds."

(e) Includes $2.5 billion for tobacco securitization bond proceeds and about $2.8 billion in inter-fund loans and transfers.

(f) Includes $2.0 billion for tobacco securitization bond proceeds. See "STATE INDEBTEDNESS AND OTHER OBLIGATIONS—Enhanced Tobacco Settlement Revenue Bonds." Also includes the anticipated receipt of $996 million from pension obligation bonds, which would be used to offset special fund contributions to pension funds. See "STATE INDEBTEDNESS AND OTHER OBLIGATIONS—Pension Obligation Bonds."

(g) Includes $2.264 billion for tobacco securitization bond proceeds and about $1.5 billion in inter-fund loans and transfers. See "STATE INDEBTEDNESS AND OTHER OBLIGATIONS—Enhanced Tobacco Settlement Revenue Bonds."

(h) Includes $500 million for Indian gaming revenues and about $800 million in inter-fund loans and transfers.

(i) Reflects the suspension of vehicle license fee "backfill" payments to local governments, which was rescinded on November 17, 2003. See "STATE FINANCES—Local Governments."

(j) Reflects reduced expenditures of $912 million due to the anticipated receipt of pension obligation bond proceeds to cover General Fund contributions to pension funds. See "STATE INDEBTEDNESS AND OTHER OBLIGATIONS—Pension Obligation Bonds."

(k) Reflects the transfer of $3.012 billion of economic recovery bond proceeds to the Deficit Recovery Fund.

(l) Reflects $3.012 billion of General Fund payments to be offset with moneys deposited in the Deficit Recovery Fund.

Development of Revenue Estimates

The development of the forecast for the major General Fund revenues begins with a forecast of national economic activity prepared by an independent economic forecasting firm. The Department of Finance's Economic Research Unit, under the direction of the Chief Economist, adjusts the national forecast based on the Department's economic outlook. The national economic forecast is used to develop a forecast of similar indicators for California activity.

After finalizing the forecasts of major national and California economic indicators, revenue estimates are generated using revenue forecasting models developed and maintained by the Department of Finance. With each forecast, adjustments are made for any legislative, judicial, or administrative changes, as well as for recent cash results. The forecast is updated twice a year and released with the Governor's Budget by January 10 and the May Revision by May 14.

Economic Assumptions

The revenue and expenditure assumptions set forth above have been based upon certain estimates of the performance of the California and national economies in calendar years 2004 and 2005. In the 2004-05 Governor's Budget, the Department of Finance projected that the California economy would grow moderately in calendar year 2004 and at a faster pace in calendar year 2005.

Both the California economy and the national economy have been sluggish in the last calendar year. From December 2002 to December 2003, nonfarm payroll employment fell by 0.2 percent in the State and 0.1 percent in the nation. The state unemployment rate was 6.4 percent in December, down from 6.9 percent a year earlier. Similarly, the national unemployment rate in December 2003 was 5.7 percent, down from 6.0 percent a year earlier. On the other hand, both homebuilding and housing markets were strong in both the State and the nation in 2003.

While California labor markets did not show signs of improvement in 2003, broader economic measures did. Total personal income increased for the sixth consecutive quarter in the second quarter of 2003. Exports of made-in-California merchandise began to increase again in the third quarter of 2003 after falling for nearly three years. Taxable sales posted a fifth consecutive year-over-year gain in the third quarter of 2003. Two regional manufacturing surveys showed improvement comparable to that seen in the second half of 2003 for the nation's manufacturing sector. Personal state income tax withholdings were up 5.9 percent in 2003, at least partly due to increased employee stock option income.

In addition, construction and real estate markets remained strong in the state in 2003. Permits for 178,900 new residential units were issued in the first 11 months, up 15 percent from the year-ago level.

For 2003 as a whole, residential construction will be higher than it has been since 1989. Private nonresidential building continued to decline marginally, however.

Home prices continued to rise in 2003. The median price of existing, single-family houses sold in California was up between 14 and 16 percent, with the median price over $400,000 for the first time in August. Sales also increased slightly—between 4 and 6 percent. According to the California Association of Realtors, only one in four California households would have been able to afford a median-priced home in November of 2003.

As noted above, the 2004-05 Governor's Budget projects moderate growth in calendar year 2004 and faster growth in calendar year 2005. Unemployment is expected to remain above 6 percent throughout the period. Personal income is projected to grow 5.6 percent in 2004 and 5.9 percent in 2005, which is slower than has been observed in past recoveries. While low interest rates and federal fiscal stimulus are expected to boost the state economy in 2004, expenditure reductions will have the opposite effect.

The Department of Finance set out the following estimates for the State's economic performance in calendar years 2004 and 2005, which were used in predicting revenues and expenditures for the 2004-05 Governor's Budget. Also shown is the Department of Finance's previous forecast for the same calendar years, contained in the May Revision to the 2003-04 Governor's Budget.

TABLE 13
ESTIMATES OF STATE'S ECONOMIC PERFORMANCE

	For Calendar Year 2004		For Calendar Year 2005	
	2003-04 May Revision[(a)]	2004-05 Governor's Budget[(b)]	2003-04 May Revision[(a)]	2004-05 Governor's Budget[(b)]
Non-farm wage and salary employment (000)	14,922	14,602	15,282	14,906
Percent Change	2.1%	1.1%	2.4%	2.1%
Personal income ($ billions)	$1,232	$1,266	$1,302	$1,341
Percent Change	4.9%	5.6%	5.7%	5.9%
Housing Permits (Units 000)	174	192	189	198
Consumer Price Index (percent change)	2.4%	1.9%	2.8%	2.7%

(a) Fiscal Year 2003-04 May Revision to the Governor's Budget: May 14, 2003.

(b) Fiscal Year 2004-05 Governor's Budget Summary: January 9, 2004.

Source: State of California, Department of Finance.

FINANCIAL STATEMENTS

The Audited Annual Financial Statements of the State of California for the Year Ended June 30, 2003 (the "Financial Statements") are attached hereto as Exhibit 1 to Appendix A. As of June 30, 2002, the State of California has implemented a new financial reporting model, as required by the Governmental Accounting Standards Board ("GASB") in conformity with accounting principles generally accepted in the United States of America. The GASB sets standards of accounting and financial reporting for state and local governments, which have significantly changed the presentation of the financial statements. The Financial Statements consists of an Independent Auditor's Report, a Management Discussion and Analysis, Basic Financial Statements of the State for the Year Ended June 30, 2003 ("Basic Financial

Statements"), and Supplementary Information. Only the Basic Financial Statements have been audited, as described in the Independent Auditor's Report. A description of the new accounting and financial reporting standards is contained in Note 1 of the Basic Financial Statements.

Potential investors may obtain or review a copy of the Financial Statements from the following sources:

1. By accessing the internet website of the State Controller (www.sco.ca.gov) and selecting "California Government—State and Local," then "State Government," then finding the heading "Publications" and selecting "Comprehensive Annual Financial Report—Year Ended June 30, 2003," or by contacting the Office of the State Controller at (916) 445-2636.

2. By accessing the internet website of the State Treasurer (www.treasurer.ca.gov) and selecting "Financial Information" and then "Audited General Purpose Financial Statements," or by contacting the Office of the State Treasurer at (800) 900-3873.

The State Controller's unaudited reports of cash receipts and disbursements for the period July 1, 2003 through February 29, 2004 is also included as an Exhibit to this APPENDIX A and is available on the State Controller's website.

Periodic reports on revenues and/or expenditures during the fiscal year are issued by the Administration, the State Controller's Office and the Legislative Analyst's Office. The State Controller issues a monthly report on cash receipts and disbursements recorded on the Controller's records. The Department of Finance issues a monthly bulletin, available by accessing the internet website of the Department of Finance (www.dof.ca.gov), which reports the most recent revenue receipts as reported by State departments, comparing those receipts to budget projections. The Administration also formally updates its budget projections three times during each fiscal year, in January, May, and at the time of budget enactment. These bulletins and reports are available on the internet at websites maintained by the agencies and by contacting the agencies at their offices in Sacramento, California. Such bulletins and reports are not part of or incorporated into the Official Statement. Investors are cautioned that interim financial information is not necessarily indicative of results for a fiscal year. Information which may appear in the Official Statement from the Department of Finance concerning monthly receipts of "agency cash" may differ from the State Controller's reports of cash receipts for the same periods because of timing differences in the recording of in-transit items.

OVERVIEW OF STATE GOVERNMENT

Organization of State Government

The State Constitution provides for three separate branches of government: the legislative, the judicial and the executive. The Constitution guarantees the electorate the right to make basic decisions, including amending the Constitution and local government charters. In addition, the State voters may directly influence State government through the initiative, referendum and recall processes.

California's Legislature consists of a forty-member Senate and an eighty-member Assembly. Assembly members are elected for two-year terms, and Senators are elected for four-year terms. Assembly members are limited to three terms in office and Senators to two terms. The Legislature meets almost year round for a two-year session. The Legislature employs the Legislative Analyst, who provides reports on State finances, among other subjects. The Bureau of State Audits, headed by the State Auditor, an independent office since 1993, annually issues an auditor's report based on an examination of the General Purpose Financial Statements of the State Controller, in accordance with generally accepted accounting principles. See "FINANCIAL STATEMENTS."

The Governor is the chief executive officer of the State and is elected for a four-year term. The Governor presents the annual budget and traditionally presents an annual package of bills constituting a legislative program. In addition to the Governor, State law provides for seven other statewide elected officials in the executive branch. The current elected statewide officials, their party affiliation and the dates on which they were first elected are as follows:

Office	Name	Party Affiliation	First Elected
Governor	Arnold Schwarzenegger	Republican	2003
Lieutenant Governor	Cruz Bustamante	Democrat	1998
Controller	Steve Westly	Democrat	2002
Treasurer	Philip Angelides	Democrat	1998
Attorney General	Bill Lockyer	Democrat	1998
Secretary of State	Kevin Shelley	Democrat	2002
Superintendent of Public Instruction	Jack O'Connell	Democrat	2002
Insurance Commissioner	John Garamendi	Democrat	2002

The current term for each office expires in January 2007. Persons elected to statewide offices are limited to two terms in office (eight years) from the dates shown above. Mr. Garamendi previously served as elected Insurance Commissioner before term limits were enacted. Governor Schwarzenegger may seek re-election in 2006 to one term.

The executive branch is principally administered through eleven major agencies and departments: Business, Transportation and Housing Agency, Child Development and Education Agency, Environmental Protection Agency, Department of Finance, Department of Food and Agriculture, Health and Human Services Agency, Labor and Workforce Development Agency, Resources Agency, State and Consumer Services Agency, Department of Veterans Affairs and Youth and Adult Correctional Agency. In addition, some State programs are administered by boards and commissions, such as The Regents of the University of California, Public Utilities Commission, Franchise Tax Board and California Transportation Commission, which have authority over certain functions of State government with the power to establish policy and promulgate regulations. The appointment of members of boards and commissions is usually shared by the Legislature and the Governor, and often includes ex officio members.

California has a comprehensive system of public higher education comprised of three segments: the University of California, the California State University System and California Community Colleges. The University of California provides undergraduate, graduate and professional degrees to students. Approximately 49,650 degrees were awarded in the 2002-03 school year. About 197,450 full-time students were enrolled at the nine UC campuses and the Hastings College of Law in the 2002-03 school year. The California State University System, provides undergraduate and graduate degrees to students. Approximately 76,755 degrees were awarded in the 2002-03 school year. About 331,400 full-time students were enrolled at the 23 campuses in the 2002-03 school year. The third sector consists of 108 campuses operated by 72 community college districts which provide associate degrees and certificates to students. Additionally students may attend community colleges to meet basic skills and other general education requirements prior to transferring to a four-year undergraduate institution. Approximately 118,000 associate degrees and certificates were awarded in the 2002-03 school year. About 1.7 million students were enrolled in California's community colleges in the spring of 2003.

Employee Relations

In 2003-04, the State work force is comprised of approximately 318,000 personnel years, of which approximately 116,000 personnel years represent employees of institutions of higher education. Of the remaining 202,000 personnel years, approximately 166,000 are subject to collective bargaining and approximately 36,000 are excluded from collective bargaining. State law provides that State employees, defined as any civil service employee of the State and teachers under the jurisdiction of the Department of Education or the Superintendent of Public Instruction, and excluding certain other categories, have a right to form, join, and participate in the activities of employee organizations for the purpose of representation on all matters of employer-employee relations. The chosen employee organization has the right to represent its members, except that once an employee organization is recognized as the exclusive representative of a bargaining unit, only that organization may represent employees in that unit.

The scope of representation is limited to wages, hours, and other terms and conditions of employment. Representatives of the Governor are required to meet and confer in good faith and endeavor to reach agreement with the employee organization, and, if agreement is reached, to prepare a memorandum of understanding and present it to the Legislature for ratification. The Governor and the recognized employee organization are authorized to agree mutually on the appointment of a mediator for the purpose of settling any disputes between the parties, or either party could request the Public Employment Relations Board to appoint a mediator.

State employees are represented by 21 collective bargaining units. The State recently signed Memoranda of Understanding with 17 of these collective bargaining units to achieve current year savings in State personnel costs, a way of mitigating the State's difficult fiscal condition. Two of these contracts expire in June 2004, seven expire in June 2005, five expire in June 2006, and two expire in June 2008. Another collective bargaining unit is under contract until July 2006. The remaining four collective bargaining units, comprising less than 5 percent of the State workforce, do not have a signed contract; the terms of the prior agreements remain in effect. The Department of Personnel Administration (DPA) is continuing to negotiate with these units. The State has not experienced a major work stoppage since 1972. The California State Employees' Association (CSEA) is the exclusive representative for nine of the 21 collective bargaining units, or approximately 50 percent of those employees subject to collective bargaining. Each of the remaining exclusive representatives represents only one bargaining unit.

ECONOMY AND POPULATION

Introduction

California's economy, the largest among the 50 states and one of the largest in the world, has major components in high technology, trade, entertainment, agriculture, manufacturing, tourism, construction and services. In early 2001, California's economy slipped into a recession, which was concentrated in the State's high-tech sector and, geographically, in the San Francisco Bay Area. The economy has since stabilized with only 2,400 lost jobs between January 2002 and December 2003 compared with 290,000 lost jobs between March 2001 and January 2002. See "CURRENT STATE BUDGET—Economic Assumptions."

Population and Labor Force

The State's July 1, 2003 population of over 35 million represented over 12 percent of the total United States population.

California's population is concentrated in metropolitan areas. As of the April 1, 2000 census, 97 percent resided in the 25 Metropolitan Statistical Areas in the State. As of July 1, 2002, the 5-county Los Angeles area accounted for 49 percent of the State's population, with over 17.0 million residents, and the 10-county San Francisco Bay Area represented 20 percent, with a population of over 7.0 million.

The following table shows California's population data for 1994 through 2003.

TABLE 14
Population 1994-2003[(a)]

Year	California Population	% Increase Over Preceding Year	United States Population	% Increase Over Preceding Year	California as % of United States
1994	31,523,080	0.7%	263,125,821	1.2%	12.0%
1995	31,711,094	0.6	266,278,393	1.2	11.9
1996	31,962,050	0.8	269,394,284	1.2	11.9
1997	32,451,746	1.5	272,646,925	1.2	11.9
1998	32,861,779	1.3	275,854,104	1.2	11.9
1999	33,417,247	1.7	279,040,168	1.2	12.0
2000	34,040,489	1.9	282,177,754	1.1	12.1
2001	34,726,513	2.0	285,093,813	1.0	12.2
2002	35,336,138	1.8	287,973,924	1.0	12.3
2003	35,933,943	1.7	290,809,777	1.0	12.4

(a) Population as of July 1.

Source: U. S. figures from U.S. Department of Commerce, Bureau of the Census; California figures from State of California, Department of Finance.

The following table presents civilian labor force data for the resident population, age 16 and over, for the years 1994 to 2003.

TABLE 15
Labor Force 1993-2002
(Thousands)

Year	Labor Force	Employment	Unemployment Rate (%) California	Unemployment Rate (%) United States
1994	15,450	14,122	8.6%	6.1%
1995	15,412	14,203	7.8	5.6
1996	15,512	14,392	7.2	5.4
1997	15,947	14,943	6.3	4.9
1998	16,337	15,368	5.9	4.5
1999	16,597	15,732	5.2	4.2
2000	16,884	16,049	4.9	4.0
2001	17,183	16,260	5.4	4.7
2002	17,405	16,242	6.7	5.8
2003[(a)]	17,629	16,455	6.7	6.0

(a) Preliminary.

Source: State of California, Employment Development Department.

Employment, Income, Construction and Export Growth

The following table shows California's non-agricultural employment distribution and growth for 1993 and 2003.

TABLE 16
Payroll Employment By Major Sector
1992 and 2002

Industry Sector	Employment (Thousands) 1993	Employment (Thousands) 2003[(a)]	% Distribution of Employment 1993	% Distribution of Employment 2003[(a)]
Natural Resources and Mining	29.8	22.7	0.3%	0.2%
Construction	458.9	788.8	3.8	5.4
Manufacturing				
Nondurable goods	613.4	580.1	5.1	4.0
High Technology	523.2	413.0	4.4	2.8
Other Durable Goods	558.6	591.1	4.6	4.1
Trade, Transportation and Utilities	2,337.6	2,734.7	19.4	18.9
Information	386.2	471.3	3.2	3.3
Financial Activities	787.0	826.6	6.5	6.0
Professional and Business Services	1,541.6	2,113.8	12.8	14.6
Educational and Health Services	1,195.8	1,526.8	9.9	10.6
Leisure and Hospitality	1,124.5	1,407.4	9.3	9.7
Other Services	408.2	501.2	3.4	3.5
Government				
Federal Government	336.2	255.0	2.8	1.8
State and Local Government	1,744.4	2,185.2	14.5	15.1
TOTAL NON-AGRICULTURAL	12,045.4	14,453.7	100%	100%

(a) Preliminary.

Source: State of California, Employment Development Department.

The following tables show California's total and per capita income patterns for selected years.

TABLE 17
Total Personal Income in California 1994-2003[a]

Year	Millions	% Change[b]	California % of U.S.
1994[c]	$ 735,104	2.9%	12.5%
1995.............	771,470	4.9	12.5
1996.............	812,404	5.3	12.4
1997.............	861,557	6.1	12.4
1998.............	931,564	8.1	12.6
1999.............	995,326	6.8	12.8
2000.............	1,100,679	10.6	13.1
2001.............	1,129,868	2.7	13.0
2002.............	1,155,247	2.2	13.0
2003[d]	1,199,000	3.8	13.1

(a) Bureau of Economic Analysis (BEA) estimates as of April 2003.
(b) Change from prior year.
(c) Reflects Northridge earthquake, which caused an estimated $15 billion drop in personal income.
(d) Estimated by California Department of Finance.

Note: Omits income for government employees overseas.

Source: U.S. Department of Commerce, BEA, State of California, Department of Finance.

TABLE 18
Per Capita Personal Income 1994-2003[a]

Year	California	% Change[b]	United States	% Change[b]	California % of U.S.
1994[c]	$23,348	2.3%	$22,340	3.7%	104.5%
1995	24,339	4.2	23,255	4.1	104.7
1996	25,373	4.2	24,270	4.4	104.5
1997	26,521	4.5	25,412	4.7	104.4
1998	28,240	6.5	26,893	5.8	105.0
1999	29,712	5.2	27,880	3.7	106.6
2000	32,363	8.9	29,760	6.7	108.7
2001	32,655	0.9	30,413	2.2	107.4
2002	32,898	0.7	30,832	1.4	106.7
2003[d]	33,367	1.4	31,552	2.3	105.8

(a) BEA's estimates as of April 2003.
(b) Change from prior year.
(c) Reflects Northridge earthquake, which caused an estimated $15 billion drop in personal income.
(d) Estimated by California Department of Finance.

Note: Omits income for government employees overseas.

Source: U.S. Department of Commerce, BEA, State of California, Department of Finance.

The following tables show California's residential and non-residential construction.

TABLE 19
Residential Construction Authorized by Permits

Year	Units			Valuation[a]
	Total	Single	Multiple	(millions)
1995	85,293	68,689	16,604	$13,879
1996	94,283	74,923	19,360	15,289
1997	111,716	84,780	26,936	18,752
1998	125,707	94,298	31,409	21,976
1999	140,137	101,711	38,426	25,783
2000	148,540	105,595	42,945	28,142
2001	148,757	106,902	41,855	28,804
2002	167,761	123,865	43,896	33,305
2003[b]	194,956	138,679	56,277	38,857

(a) Valuation includes additions and alterations.

(b) Preliminary.

Source: Construction Industry Research Board

TABLE 20
Nonresidential Construction
(Thousands of dollars)

Year	Commercial	Industrial	Other	Additions and Alterations	Total
1995	$2,308,911	$ 732,874	$1,050,693	$4,062,273	$ 8,154,751
1996	2,751,925	1,140,574	1,152,443	4,539,219	9,584,161
1997	4,271,378	1,598,428	1,378,220	5,021,792	12,269,818
1998	5,419,251	2,466,530	1,782,337	5,307,901	14,976,019
1999	5,706,719	2,256,166	2,350,213	6,269,194	16,582,292
2000	6,962,031	2,206,169	2,204,754	7,252,004	18,624,958
2001	6,195,368	1,552,047	2,584,321	6,421,551	16,753,287
2002	5,195,348	1,227,754	2,712,681	5,393,329	14,529,112
2003[a]	4,022,091	1,315,710	2,932,157	5,581,412	13,851,370

(a) Preliminary.

Source: Construction Industry Research Board

The following table shows California's export growth for the period from 1995 through 2002.

TABLE 21
Exports Through California Ports
(In millions)

Year	Exports[a]	% Change
1995	$116,825.5	22.2%
1996	124,120.0	6.2
1997	131,142.7	5.7
1998	116,282.4	-11.3
1999	122,092.8	5.0
2000	148,554.6	21.7
2001	127,255.3	-14.3
2002	111,340.1	-12.5

(a) "Free along ship" Value Basis

Source: U.S. Department of Commerce, Bureau of the Census

LITIGATION

The State is a party to numerous legal proceedings. The following are the most significant pending proceedings, as reported by the Office of the Attorney General. See "LITIGATION" in the main body of the Official Statement.

Challenges Related to the Vehicle License Fee Offset and Related Payments to Local Governments

State law establishes an excise tax on motor vehicles and manufactured homes in the amount of two percent (2%) of the vehicle's or home's fair market value. In 1999, pursuant to Revenue and Taxation Code section 10754, the Legislature adopted successive offsets to the vehicle license fee paid by vehicle owners and mobile home owners. As a result of these offsets, the State transferred money each month from the General Fund to local governments in the amount of the cumulative offsets.

In June 2003, the Davis Administration determined that there were insufficient moneys available to be transferred from the General Fund to fund vehicle license fee offset payments the State was making to local governments. See "STATE FINANCES – Local Governments – Vehicle License Fee." This caused the State Department of Motor Vehicles and the State Department of Housing and Community Development to discontinue the offsets and, correspondingly, the amount of vehicle license fees paid by vehicle owners and mobile home owners increased.

Shortly after taking office on November 17, 2003, the Governor issued Executive Order S-1-03, rescinding the Davis Administration's action and directing the Department of Motor Vehicles to reinstate the General Fund offset to the vehicle license fee provided in Revenue and Taxation Code Section 10754 "as soon as administratively feasible." By subsequent administrative action, the Administration adjusted current year expenditures in order to commence transfers from the General Fund to local governments in the amount of the offsets.

These various actions have given rise to the following litigation:

On July 1, 2003, several plaintiffs, including several Republican legislators and a non-profit public interest group, filed *Howard Jarvis Taxpayers Association, et al. v. California Department of Motor Vehicles* (Sacramento County Superior Court, Case No. 03AS03665), in which plaintiffs seek declaratory relief based on several theories, each of which would find the Davis Administration's discontinuation of the offset invalid. The State has demurred to plaintiffs' second amended complaint, stating that it fails to state a cause of action. The court has sustained the demurrer without leave to amend, which will, once finalized, permit the Department of Motor Vehicles to obtain a judgment dismissing this action. That judgment will be subject to appeal, and it is not yet known whether the plaintiffs intend to appeal.

On January 21, 2004, an original proceeding, *University of California Students Association, et al., v. Governor Arnold Schwarzenegger, et al.* (Case No. S122032), was instituted in the California Supreme Court. The petition for writ of mandate claims there were insufficient moneys in the General Fund available to reinstate the vehicle license fee offsets, and that the State cannot reduce appropriations to various programs in order to make offset-related transfers to local governments. Petitioners ask the Supreme Court to issue a writ commanding various State officers that they may not enforce Executive Order S-1-03, and ordering them to refrain from implementing any appropriation reductions made for the purpose of funding offset-related transfers to local governments. On February 18, 2004, the Supreme Court denied the petition without prejudice to the commencement of any appropriate proceeding in the superior court. The petitioners have not filed any subsequent action.

On January 30, 2004, *Robert Brooks and David Gautreaux v. Governor Arnold Schwarzenegger* (Case No. BC309929) was filed in the Los Angeles County Superior Court. In this case, plaintiffs allege that the adjustments of current year expenditures made by the Administration in order to provide for the transfers to local governments violates the California Constitution, and ask the Court to enjoin the Director of Finance and the Controller from making offset-related payments to local governments until an appropriation for that purpose is made by the Legislature.

Bond-Related Matters

The Legislature established the Pension Obligation Bond Committee for the purpose, among others, of issuing bonds to fund all or a portion of the State's fiscal year 2003-04 employer obligation to the Public Employee's Retirement System. The Committee sought validation of the bonds and certain contracts pursuant to a validation process established by Code of Civil Procedure sections 860 et seq. in *Pension Obligation Bond Committee v. All Persons Interested in the Matter of the Validity of the State of California's Pension Obligation, etc.*, filed in the Sacramento County Superior Court. The trial court issued a judgment denying the Committee's request for validation of the bonds, and the case is currently on appeal before the Court of Appeal (Third District, Case No. CO45240). Briefing is underway, and no date for oral argument has been set.

The Legislature has adopted a statute (Stats. 2003, 1st Ex. Sess. 2003, ch.13) authorizing the establishment of the Fiscal Recovery Finance Authority for the purpose, among others, of issuing bonds to fund the State's accumulated budget deficit as of June 30, 2003. The amount of this accumulated budget deficit is identified by the Department of Finance to be approximately $8.6 billion. On September 24, 2003, a complaint was filed in the Sacramento County Superior Court (*Fullerton Association of Concerned Taxpayers v. California Fiscal Recovery Financing Authority, et al.*, Case No. 93AS05319), seeking a declaration that any bonds issued pursuant to the statute without prior voter approval would violate the State constitutional debt limit and a determination that such bonds are invalid, and seeking an injunction against issuing bonds pursuant to the statute. This matter has not been served on any State officers. As a result of this action, the Fiscal Recovery Finance Authority filed a validation action pursuant to Code of Civil Procedure sections 860 et seq. in the same court (*California Fiscal Recovery Financing Authority v. All Persons Interested, etc.*; Case No. 03AS06875). Fullerton

Association of Concerned Taxpayers, the plaintiff in the case filed in September, was the only party to answer the Fiscal Recovery Finance Authority's complaint. The Fullerton Association of Concerned Taxpayers has dismissed its action. The Fiscal Recovery Financing Authority's case has been set for trial on June 7, 2004.

Challenge Seeking Payment to Teacher's Retirement Board

In May 2003, the Legislature enacted legislation which reduces a continuing appropriation to the State Teacher's Retirement System's ("CalSTRS") Supplemental Benefit Maintenance Account ("SBMA") for fiscal year 2003-04 by $500 million. The legislative changes also provide that in future fiscal years, the $500 million may be returned if necessary to make the SBMA actuarially sound. On October 14, 2003, the CalSTRS board and certain CalSTRS members filed *Teacher's Retirement Board, as Manager of the California State Teachers, Retirement System, et al. v. Steve Peace, Director of California Department of Finance, and Steve Westly, California State Controller,* in the Sacramento County Superior Court (Case No. 03CS01503). This lawsuit seeks, primarily, a writ of mandate compelling the State Controller to transfer funds from the State's General Fund to the SBMA in an amount equal to the continuing appropriation as it existed prior to the enactment of the May legislation. It also seeks injunctive and declaratory relief to the same effect. Trial is currently scheduled to begin on May 21, 2004

Actions Seeking Flood-Related Damages

In January of 1997, California experienced major flooding with preliminary estimates of property damage of approximately $1.6 to $2.0 billion. In *McMahan v. State*, (Sacramento County Superior Court, Case No. 02-AS-06058), a substantial number of plaintiffs have joined suit against the State, local agencies, and private companies and contractors seeking compensation for the damages they suffered as a result of the flooding. A trial date has been scheduled for October 24, 2004. The State is vigorously defending the action.

Paterno v. State of California (Yuba County Superior Court, Judicial Counsel Coordination Proceeding 2104) is a coordinated action involving 3,000 plaintiffs seeking recovery for damages caused by the Yuba River flood of February 1986. The trial court found liability in inverse condemnation and awarded damages of $500,000 to a sample of plaintiffs. The State's potential liability to the remaining plaintiffs ranges from $800 million to $1.5 billion. In 1992, the State and plaintiffs filed appeals of the decision in the sample plaintiffs' action, and upon remand, plaintiffs' inverse condemnation cause of action was re-tried. The trial court ruled that plaintiffs take nothing from defendants. The outcome of this trial controls with regard to the claims of all other plaintiffs. Plaintiffs appealed this decision, and the appellate court reversed the trial court judgment in favor of the State, remanded the case to the trial court with directions to enter judgment in favor of plaintiffs and ordered the State to pay costs on appeal and costs of suit, including reasonable attorney, appraisal and engineering fees actually incurred. On March 17, 2003, the Supreme Court denied the State's petition for review (California Supreme Court, Case No. S121713) of the appellate court's decision. This brings the liability phase of this litigation to a close. The issue of damages is being litigated in the Yuba County Superior Court.

Tax Refund Cases

In *Farmer Brothers Company v. Franchise Tax Board*, the trial court determined that Revenue and Taxation Code section 24402 ("Section 24402"), which establishes a corporate tax deduction for received dividends, to the extent such dividends are based on the dividend-paying corporation's income subject to California franchise taxes, violates the commerce clause of the United States Constitution. That decision was affirmed on appeal (Second Appellate District, Division 1, Case No. B160061), and the California Supreme Court denied the Franchise Tax Board's petition for review. The United States

Supreme Court denied the Franchise Tax Board's petition for certiorari on February 23, 2004, bringing the case to a close.

Three pending cases also allege that Section 24402 violates the commerce clause. *Montgomery Ward LLC v. Franchise Tax Board* is pending in the San Diego Superior Court (Case No. 802767). In *General Motors Corp. v. Franchise Tax Board* (Court of Appeal, Second Appellate District, Division 2, Case No. B165665) and in *Microsoft Corporation v. Franchise Tax Board* (Court of Appeal, Second Appellate District, Division 3, Case No. A105612), the Franchise Tax Board is appealing adverse trial court judgments.

Six pending cases challenge the Franchise Tax Board's treatment of receipts from investment of cash in short-term financial instruments, and the resulting impact on the apportionment of corporate income allegedly earned outside of California to the corporation's California tax obligation. Three of these cases (*Montgomery Ward, General Motors, and Microsoft*) are also cases in which Revenue and Tax Code section 24402 has been challenged, as discussed in the previous paragraph. *Montgomery Ward LLC v. Franchise Tax Board* is pending in the San Diego Superior Court (Case No. 802767), and *Colgate-Palmolive v. Franchise Tax Board* is pending in the Sacramento County Superior Court (Case No. 03AS00707). *The Limited Stores, Inc. and Affiliates v. Franchise Tax Board* is pending in the Court of Appeal, First Appellate District (Case No. A102915); *General Motors Corp. v. Franchise Tax Board* is pending in the Court of Appeal, Second Appellate District, Division 2 (Case No. B165665); *Toys "R" Us, Inc. v. Franchise Tax Board* is pending in the Court of Appeal, Third Appellate District (Case No. C045386); and *Microsoft Corporation v. Franchise Tax Board* is pending in the Court of Appeal, First Appellate District (Case No. A105312). The trial courts in *The Limited Stores, General Motors* and *Toys "R" Us* ruled in favor of the Franchise Tax Board on this issue; and in *Microsoft Corporation*, the trial court ruled against the Franchise Tax Board. Other taxpayers have raised this same issue in administrative actions. A final decision in favor of any of these plaintiffs could result in tax refunds to similarly situated taxpayers in an amount exceeding $500 million, with a potential future annual revenue loss of $50 million. The State is vigorously litigating this issue.

In *Eisenhower Medical Center, et al. v. State Board of Equalization* (San Francisco Superior Court, Case No. 994985), 117 hospitals claim that certain intravenous sets and diagnostic substances are "medicines" within the meaning of the Revenue and Tax Code, and thus are exempt from sales and use taxes. The State Board of Equalization ("SBE") does not consider intravenous sets (other than those used primarily for enteral feeding) and diagnostic substances to be medicines and, therefore, those items are subject to sales and use taxes. The trial court ruled in favor of the SBE, and an appeal is expected. Due to a retroactive regulatory change that the SBE adopted during the pendency of this case, specified types of enteral feeding supplies are now exempt from sales and use taxes. Therefore, even if the State prevails on appeal, refunds will be required in the amount of up to $5 million. Should the plaintiffs ultimately prevail on all contested issues, estimated refunds to plaintiffs and others similarly situated hospitals would total approximately $400 million and estimated future revenue loss would be $70 million per year.

In *County of Orange v. Orange County Assessment Appeals Board #3; Bezaire, et al., Real Parties in Interest*, (Court of Appeal, Fourth Appellate District, Division 3, Case No. G032412), the trial court determined that the Orange County assessor's office received property taxes from two taxpayers in excess of the amounts collectable under Article XIII A of the California Constitution (implemented in 1978 by Proposition 13). The plaintiffs' legal claim focuses on the constitutionality of the practice of the Orange County assessor's office to increase or "recapture" the assessed values of real properties that temporarily decline and then increase in value. The trial court ruled in favor of the plaintiffs. The trial court decision was appealed and oral argument was conducted on January 7, 2004, in the Court of Appeal. The effects of a final determination by an appellate court that the contested assessment practices are contrary to Proposition 13 could result in an increase in the State general fund component of the financing guarantee to public schools established by Proposition 98 (see "STATE FINANCES—Proposition 98") in an amount in excess of several billion dollars.

Environmental Cleanup Matter

In a federal Environmental Protection Agency ("U.S. EPA") administrative abatement action entitled *In the Matter of: Leviathan Mine, Alpine County, California, Regional Water Quality Control Board, Lahontan Region, State of California* (U.S. EPA Region IX CERCLA Docket No. 00-16(a)), the State, as owner of the Leviathan Mine, is a party through the Lahontan Regional Water Quality Control Board ("Board"), which is the State entity potentially responsible for performing certain environmental remediation at the Leviathan Mine site. Also a party is ARCO, the successor in interest to the mining company that caused certain pollution of the mine site. The Leviathan Mine site is listed on the U.S. EPA "Superfund" List, and both remediation costs and costs for Natural Resource Damages may be imposed on the State. The Board has undertaken certain remedial action at the mine site, but the U.S. EPA's decision on the interim and final remedies are pending. ARCO has filed several state law claims against the State with the California Victim Compensation and Government Claims Board (an administrative agency with which certain claims must be filed as a prerequisite to litigation seeking damages against the State which was formerly named the Board of Control, the "Government Claims Board"), but litigation on these claims have been tolled by agreement of the parties until at least October, 2004. It is possible these matters could result in a potential loss to the State in excess of $400 million.

Energy-Related Matters

In *People v. ACN Energy, Inc., et al.* (Sacramento County Superior Court, Case No. 01AS05497), the court is considering whether and to what extent compensation is due to market participants which have claimed compensation as a result of the Governor's issuance of executive orders, under the California Emergency Service Act, "commandeering" power purchase arrangements held by Pacific Gas & Electric Company ("PG&E") and Southern California Edison ("SCE"), referred to as "block forward contracts." In this action the State seeks a declaration that the State is not liable for damages as a result of these orders, nor for compensation for inverse condemnation, and that any damages suffered by any of the defendants is offset by payments made by the Department of Water Resources for electricity received under the "commandeered" "block forward contracts." Complaints and cross-complaints for inverse condemnation, recovery under the Emergency Services Act and other causes of action brought by PG&E, Reliant Energy Services, Dynegy Power Marketing, Williams Energy Services, Sempra Energy Trading, the California Power Exchange, Mirant Americas Energy, Duke Energy Trading and Marketing, and numerous other market participants have been joined with the declaratory relief action in Judicial Council Coordination Proceeding No. 4203, in Sacramento County Superior Court. In an administrative proceeding action before the Government Claims Board (which was dismissed on procedural grounds), the California Power Exchange stated claims for "commandeering" the "block forward contracts" in the amount of approximately $1 billion.

Pacific Gas and Electric Company v. The State of California is now pending in the Court of Appeal, Third Appellate District (Case No. C043507). In the trial court, PG&E filed a complaint for breach of contract alleging that statutes enacted in 1996 as part of the restructuring of the electric power industry in California ("AB 1890") established a "regulatory contract" between the State and PG&E that authorized PG&E to sell the output of its retained generation facilities in interstate power markets at prices regulated by FERC and to sell the facilities themselves, and that by amending AB 1890 in 2001, the State deprived PG&E of the right to such sales and thereby breached that "regulatory contract." PG&E's complaint sought damages in an amount to be proven, but in an administrative proceeding before the Government Claims Board, in which PG&E's claims were denied, PG&E sought damages of at least $4.3 billion to compensate for the losses alleged in this action. The trial court sustained the demurrer of the State without leave to amend, dismissing the lawsuit. The pending action is PG&E's appeal of that dismissal.

Escheated Property Claims

In five pending cases, plaintiffs claim that the State Controller has a constitutional and statutory duty to give notice prior to the time the Controller sells property that has escheated to the State (in these cases, shares of stock): *Fong v. Connell* (Court of Appeal, Third District, Case No. C042007); *Harris v. Connell* (Court of Appeal, Second District, Case No. B160741); *Lusby-Taylor v. Connell* (U.S. Court of Appeals for the Ninth Circuit, Case No. 02-16511); *Orfield v. Connell* (Los Angeles County Superior Court, Case No. BC288429); and *Suever v. Connell* (United States District Court, Northern District, Case No. C03-001556). The plaintiffs also claim that the Controller failed to comply with statutory notice requirements when it first received property that had escheated to the State. The plaintiffs seek damages, which the *Fong* plaintiffs have articulated as being in the amount of the difference between the amount they were paid for the stock upon its sale, and either the current value of the stock or the highest market value of the stock between the date the Controller sold the stock and the present. All of these cases, except *Fong,* are styled as class actions, though in *Lusby-Taylor* and *Harris*, that issue was not determined prior to the trial court decisions that are being appealed. If one or more of these cases are successful as a class action and the class ultimately prevails on the merits, damages for the class could be in excess of $500 million. The State has prevailed at the trial court in *Fong* and *Lusby-Taylor,* and at both the trial court and appellate court in *Harris*. It is not yet known whether the plaintiffs in *Harris* will seek review of the appellate court decision. The *Suever* case has been dismissed by the U.S. District Court. The court dismissed the federal claims on the basis of 11th Amendment immunity, and dismissed the state law claims without prejudice, which will permit plaintiffs to pursue their state law claims in state court. *Orfield* is being litigated in the trial court. The State is vigorously defending all of these actions.

Action Seeking Damages for Alleged Violations of Privacy Rights

In *Gail Marie Harrington-Wisely, et al. v. State of California, et al.*, (Los Angeles County Superior Court, Case No. BC 227373), a proposed class action, plaintiffs seek damages for alleged violations of prison visitors' rights resulting from the Department of Corrections' use of a body imaging machine to search visitors entering state prisons for contraband. If this action is certified as a class action, and a court were to award damages pursuant to the California Civil Code for every use of the body imaging machine, damages could be as high as $3 billion. The State is vigorously defending this action.

Actions Seeking Program Modifications

In the following cases, plaintiffs seek court orders or judgments that would require the State to modify existing programs and, except as specified, do not seek monetary damages. Nevertheless, a judgment against the State in any one of these cases could require changes in the challenged program that could result in increased programmatic costs to the State in a future fiscal year in excess of $400 million. Alternatively, in some circumstances, it may be possible that a judgment against the State could be addressed by legislative changes to the program that would cost less.

In *Williams, et al., v. State of California, et al.*, (San Francisco County Superior Court, Case No. 312236), a class action for declaratory relief and injunction brought by public school students against the State, the Board of Education, and Department of Education and the Superintendent of Public Instruction, the class alleges inadequacies in the public education system and seeks a variety of programmatic changes to the system including elimination of some types of multi-track, year-round school schedules. The State is vigorously defending this action. Trial is expected to begin in January, 2005.

In *Natural Resources Defense Council et al., v. California Department of Transportation et al.*, (United States District Court, Central District, Case No. 93-6073-ER-(JRX)), plaintiffs obtained an injunction requiring the Department of Transportation (the "Department") to comply with National Pollution Discharge Elimination System ("NPDES") requirements under the federal Clean Water Act ("Act") in connection with storm water discharges from State highways and construction sites in an area that includes most of Los Angeles and Ventura Counties. There is an established dispute resolution procedure intended to resolve disputes without a return to federal court. Subsequent modifications of the injunction have provided for, among other things, studies of pilot projects to address control of the sources of storm water pollution and the performance of studies of pilot projects to retrofit highways with storm water pollution control facilities. There has been no agreement regarding what measures arising out of the pilot projects and studies will be implemented. Plaintiffs' position is that the Department should be required to retrofit its facilities to treat storm water, regardless of whether any construction is otherwise planned in any given area. For planning purposes, the Department is including an additional 3 percent in the cost of future statewide construction and maintenance projects to pay for compliance measures. This 3 percent increase amounts to $500 million through fiscal year 2006-07. While the impact of a judgment of the scope sought by plaintiffs is difficult to determine, it is possible that a judgment that would require the State to retrofit all its highway facilities throughout the State could cost billions of dollars.

The following cases seek reforms to State programs for the treatment of institutionalized disabled persons. Some rough estimates suggest the financial impact of a judgment against the State defendants in any of these cases could be as high as $1 billion per year in programmatic costs going forward. The State is vigorously defending these actions.

In *Stephen Sanchez, et al. v. Grantland Johnson, et al.*, (U.S. Court of Appeals for the Ninth Circuit, Case No 04-15228), the plaintiffs have appealed a decision by the U.S. District Court dismissing plaintiffs' class action seeking declaratory and injunctive relief. The plaintiffs sought relief, alleging, in part, that provider rates for community-based services for developmentally disabled individuals are discriminatory under the ADA, and violate the Social Security Act, Civil Rights Act and the Rehabilitation Act, because they result in unnecessary institutionalization of developmentally disabled persons.

In *Capitol People First v. Department of Developmental Services* (Alameda County Superior Court, Case No. 2002-038715) a consortium of state and national law firms and public-interest groups brought suit against the Departments of Finance, California Department of Developmental Services and California Department of Health Services, alleging violations of the Lanterman Act, the ADA, and section 504 of the Rehabilitation Act by defendants needlessly isolate thousands of people with developmental disabilities in large facilities. The case seeks sweeping reforms, including requiring the State to offer a full range of community-based services.

Local Government Mandate Claims and Actions

In a test claim filed by the County of San Bernardino, now pending before the Commission on State Mandates (the "Commission") (Medically Indigent Adults, 01-TC-26 County of San Bernardino, Claimant, Statutes 1982, Chapters 328 and 1594), the Commission is being asked to determine the costs incurred by the county to provide state-mandated care of medically indigent adults ("MIAs"). The amount demanded in the claim for unreimbursed costs for fiscal year 2000-2001 is just over $9.2 million. In an unpublished decision issued in September, 2003, the Court of Appeal (*County of San Diego v. Commission on State Mandates et al.* D039471; petition for review denied by the California Supreme Court, in December, 2003) ruled in favor of the County of San Diego on certain of its claims related to the same mandated program, and determined that the State owed the County of San Diego $3.4 million for medical services rendered to MIAs during the two-year period (1991-1992). The Supreme Court has denied the parties' petitions seeking review of the appellate court's decision.

The County of San Bernardino's test claim, particularly in light of the determination made by the Court of Appeal in the County of San Diego case, poses a potential for a negative impact on the General Fund in the amount of the unreimbursed costs for all similarly situated county claimants for a period of years, as determined by the Commission. Certain estimates of the annual cost of the services rendered by all counties to MIAs exceed $4 billion. How much of that will be determined to be "unreimbursed" to the counties by the State is unknown. Currently the counties receive approximately $1.4 billion annually in vehicle license fee revenue and $2.3 billion annually in sales tax revenue to fund various social services, public health and mental health programs, which include the programs that provide services to MIAs. This vehicle license fee revenue made available to the counties may be reduced as a result of regulations to be promulgated by the Department of Motor Vehicles on or before July 1, 2004, although, as presently proposed, such regulations would not reduce the amount of vehicle license fees paid to counties. See "STATE FINANCES -- Local Governments -- Vehicle License Fee." The sales tax revenue made available to the counties may be reduced as a result of existing statutory provisions that would redirect those funds upon a finding by the Commission that these mandates are unfunded in an annual amount of $1 million or more.

On February 3, 2004, the County of San Diego filed two matters, each entitled *County of San Diego v. State of California et al.*. One action was filed in the San Diego County Superior Court (Case No. GIC 825109) and the other was filed in the Sacramento County Superior Court (Case No. 04AS00371). The San Diego court action alleges that the State's practice of deferring payments to local governments for certain state-mandated services and programs by making a budgetary appropriation of $1,000 for each program, statewide, is unconstitutional. This action seeks a declaration that the State is constitutionally and statutorily obligated to promptly and fully reimburse the County, and seeks reimbursement in an amount in excess of $40 million. The Sacramento County court action makes a similar allegation as to the State's statewide appropriation for a program to provide services to handicapped and seriously emotionally disturbed students. The County seeks reimbursement in the amount of approximately $9 million for this program, and a declaration that until such time as reimbursement is received, the County is excused from providing services or incurring costs in relation to the program. The effects of a final determination by an appellate court that the contested appropriation practices are unconstitutional and that the State is required to appropriate an amount equal to the amount of the mandated costs, if applied to each of California's 58 counties, could result in costs in excess of $1.5 billion.

Reparations Claim

On July 15, 2003, the matter of *Emilia Castaneda v. State of California, et al.* was filed in the Los Angeles County Superior Court (Case No. BC299062). The class action complaint alleges illegalities associated with the repatriation of Mexican Americans during the 1930's and 1940's, and names the State of California, County of Los Angeles, City of Los Angeles and Los Angeles Chamber of Commerce as defendants. Plaintiff claims the class consists of "approximately 400,000 American citizens and resident aliens who were wrongfully expelled from California because of their Mexican ancestry." The complaint alleges causes of action for unlawful race discrimination, conspiracy to deprive plaintiffs of their civil rights, violations of due process, denial of equal protection, unjust taking of property, violation of freedom of association, and violation of the right to travel. The State is vigorously defending this case. The amount of any potential impact this case may have on the General Fund is unclear because it is unclear whether any claims can be brought within the applicable statute of limitations.

On October 12, 2003, Governor Gray Davis vetoed Senate Bill 933, which would have provided that United States citizens or legal residents of Mexican descent who were coerced, forced, or falsely induced to emigrate from California during the period from 1929 to 1944, could seek recovery of damages, and that any such action brought on or before December 31, 2006, would not have been dismissed for failure to comply with the applicable statute of limitations.

Action for Damages for Alleged Destruction at Indian Burial Sites

On January 16, 2004, *John Tommy Rosas v. United States of America, et al.* was filed in the United States District Court, Central District of California (Case No. CV04-312 WMB (SSx)). Plaintiff, in his individual capacity and as vice-chairman of the Tribal Counsel, Gabrielino/Tongva Indians of California, alleges violation of various federal statutes by a variety of federal agencies, corporations, individuals and four State entities (the California Coastal Commission, the Regional Water Quality Control Board, the State Historic Preservation Officer and the California Native American Heritage Commission). Plaintiff alleges that in allowing the development of certain property, defendants violated federal laws protecting sacred Indian burial sites. Plaintiff seeks damages in the amount of $525 million. The State is in the process of assessing these allegations.

STATE DEBT TABLES

The tables which follow provide information on outstanding State debt, authorized but unissued general obligation bonds and commercial paper notes, debt service requirements for State general obligation and lease-purchase bonds, and authorized and outstanding State revenue bonds. For purposes of these tables, "General Fund bonds," also known as "non-self liquidating bonds," are general obligation bonds expected to be paid from the General Fund without reimbursement from any other fund. Although the principal of general obligation commercial paper notes in the "non-self liquidating" category is legally payable from the General Fund, the State expects that principal of such commercial paper notes will be paid only from the issuance of new commercial paper notes or the issuance of long-term general obligation bonds to retire the commercial paper notes. Interest on "non-self liquidating" general obligation commercial paper notes is payable from the General Fund.

"Enterprise Fund bonds," also known as "self liquidating bonds," are general obligation bonds for which program revenues are expected to be sufficient to reimburse in full the General Fund for debt service payments, but any failure to make such a reimbursement does not affect the obligation of the State to pay principal and interest on the bonds from the General Fund.

On February 26, 2004, the State issued $2.0 billion of general obligation bonds.

As of March 24, 2004, the State did not have any General Obligation Commercial Paper Notes outstanding.

In addition to the Bonds offered by this Official Statement, the State Public Works Board expects to issue approximately $492,240,000 of lease revenue bonds in April 2004.

AUTHORIZED AND OUTSTANDING GENERAL OBLIGATION BONDS

As of February 1, 2004
(Thousands)

	Voter Authorization Date	Amount	Bonds Outstanding (a)	CP Program Authorized (b)	Unissued (c)
GENERAL FUND BONDS (Non-Self Liquidating)					
California Clean Water, Clean Air, Safe Neighborhood Parks, and Coastal Protection Act of 2002	3/5/02	$ 2,600,000	$ 128,185	$ 134,455	$ 2,337,360
California Library Construction and Renovation Bond Act of 1988	11/8/88	75,000	46,530	0	2,595
California Library Construction and Renovation Bond Act of 2000	3/7/00	350,000	4,530	47,350	298,100
California Park and Recreational Facilities Act of 1984	6/5/84	370,000	118,790	n.a.	1,100
California Parklands Act of 1980	11/4/80	285,000	25,795	n.a.	0
California Safe Drinking Water Bond Law of 1976	6/8/76	175,000	37,030	n.a.	2,500
California Safe Drinking Water Bond Law of 1984	11/6/84	75,000	23,195	n.a.	0
California Safe Drinking Water Bond Law of 1986	11/4/86	100,000	57,470	n.a.	0
California Safe Drinking Water Bond Law of 1988	11/8/88	75,000	48,980	5,100	2,000
California Wildlife, Coastal, and Park Land Conservation Act of 1988	6/7/88	776,000	394,050	n.a.	7,330
Class Size Reduction Public Education Facilities Bond Act of 1998 (Hi Ed)	11/3/98	2,500,000	1,908,135	549,525	0
Class Size Reduction Public Education Facilities Bond Act of 1998 (K-12)	11/3/98	6,700,000	6,079,150	347,235	0
Clean Air and Transportation Improvement Bond Act of 1990	6/5/90	1,990,000	1,304,110	242,490	40,925
Clean Water and Water Conservation Bond Law of 1978	6/6/78	375,000	32,920	n.a.	0
Clean Water and Water Reclamation Bond Law of 1988	11/8/88	65,000	45,975	0	0
Clean Water Bond Law of 1970	11/3/70	250,000	3,500	n.a.	0
Clean Water Bond Law of 1974	6/4/74	250,000	7,665	n.a.	0
Clean Water Bond Law of 1984	11/6/84	325,000	75,450	n.a.	0
Community Parklands Act of 1986	6/3/86	100,000	37,695	n.a.	0
County Correctional Facility Capital Expenditure and Youth Facility Bond Act of 1988	11/8/88	500,000	296,330	0	0
County Correctional Facility Capital Expenditure Bond Act of 1986	6/3/86	495,000	197,780	n.a.	0
County Jail Capital Expenditure Bond Act of 1981	11/2/82	280,000	49,375	n.a.	0
County Jail Capital Expenditure Bond Act of 1984	6/5/84	250,000	47,000	n.a.	0
Earthquake Safety and Public Buildings Rehabilitation Bond Act of 1990	6/5/90	300,000	204,765	59,450	0
Fish and Wildlife Habitat Enhancement Act of 1984	6/5/84	85,000	23,670	n.a.	3,000
Hazardous Substance Cleanup Bond Act of 1984	11/6/84	100,000	5,000	n.a.	0
Higher Education Facilities Bond Act of 1986	11/4/86	400,000	119,200	n.a.	0
Higher Education Facilities Bond Act of 1988	11/8/88	600,000	293,525	3,440	7,000
Higher Education Facilities Bond Act of June 1990	6/5/90	450,000	250,855	2,130	0
Higher Education Facilities Bond Act of June 1992	6/2/92	900,000	638,735	4,840	3,440
Housing and Emergency Shelter Trust Fund Act of 2002	11/5/02	2,100,000	0	980,000	1,120,000
Housing and Homeless Bond Act of 1990	6/5/90	150,000	6,400	n.a.	0
Kindergarten - University Public Education Facilities Bond Act of 2002 (K-12)	11/5/02	11,400,000	5,232,640	6,167,360	0
Kindergarten - University Public Education Facilities Bond Act of 2002 (Hi-Ed)	11/5/02	1,650,000	15,320	266,680	1,368,000
Lake Tahoe Acquisitions Bond Act	8/2/82	85,000	25,740	n.a.	0

AUTHORIZED AND OUTSTANDING GENERAL OBLIGATION BONDS
(Continued)

	Voter Authorization Date	Voter Authorization Amount	Bonds Outstanding (a)	CP Program Authorized (b)	Unissued (c)
New Prison Construction Bond Act of 1981	6/8/82	$ 495,000	$ 44,250	$ n.a.	$ 0
New Prison Construction Bond Act of 1984	6/5/84	300,000	32,500	n.a.	0
New Prison Construction Bond Act of 1986	11/4/86	500,000	162,170	n.a.	1,500
New Prison Construction Bond Act of 1988	11/8/88	817,000	400,725	12,260	0
New Prison Construction Bond Act of 1990	6/5/90	450,000	231,445	6,125	0
Passenger Rail and Clean Air Bond Act of 1990	6/5/90	1,000,000	583,080	10,565	0
Public Education Facilities Bond Act of 1996 (K-12)	3/26/96	2,025,000	1,703,580	46,790	0
Public Education Facilities Bond Act of 1996 (Hi-Ed)	3/26/96	975,000	866,660	29,630	8,700
1988 School Facilities Bond Act	11/8/88	800,000	417,490	2,665	0
1990 School Facilities Bond Act	6/5/90	800,000	439,760	2,990	0
1992 School Facilities Bond Act	11/3/92	900,000	569,997	6,614	0
Safe, Clean Reliable Water Supply Act of 1996	11/5/96	995,000	460,125	507,165	0
Safe Drinking Water Bond Act of 2000	3/7/00	1,970,000	382,705	702,002	873,800
Safe Neighborhood Parks Bond Act of 2000	3/7/00	2,100,000	794,895	758,885	528,805
School Building and Earthquake Bond Act of 1974	11/5/74	40,000	30,655	n.a.	0
School Facilities Bond Act of 1988	6/7/88	800,000	370,480	n.a.	0
School Facilities Bond Act of 1990	11/6/90	800,000	475,170	2,550	0
School Facilities Bond Act of 1992	6/2/92	1,900,000	1,169,055	17,290	0
Seismic Retrofit Bond Act of 1996	3/26/96	2,000,000	1,601,895	269,645	0
Senior Center Bond Act of 1984	11/6/84	50,000	7,250	n.a.	0
State School Building Lease-Purchase Bond Law of 1982	11/2/82	500,000	20,210	n.a.	0
State School Building Lease-Purchase Bond Law of 1984	11/6/84	450,000	102,100	n.a.	0
State School Building Lease-Purchase Bond Law of 1986	11/4/86	800,000	266,300	n.a.	0
State, Urban, and Coastal Park Bond Act of 1976	11/2/76	280,000	12,845	n.a.	0
Veterans' Homes Bond Act of 2000	3/7/00	50,000	0	45,000	5,000
Voting Modernization Bond Act of 2002	3/5/02	200,000	0	155,000	45,000
Water Conservation and Water Quality Bond Law of 1986	6/3/86	150,000	66,070	n.a.	27,600
Water Conservation Bond Law of 1988	11/8/88	60,000	37,255	6,266	5,234
Water Security, Clean Drinking Water, Coastal and Beach Protection Act of 2002	11/5/02	3,440,000	72,670	1,259,430	2,107,900
Total General Fund Bonds		$ 62,828,000	$ 29,106,827	$ 12,650,927	$ 8,796,889
ENTERPRISE FUND BONDS (Self Liquidating)					
California Water Resources Development Bond Act of 1959	11/8/60	$ 1,750,000	$ 795,270	$ n.a.	$ 167,600
Veterans Bonds	(d)	4,510,000	1,446,190	0	605,585
Total Enterprise Fund Bonds		$ 6,260,000	$ 2,241,460	$ 0	$ 773,185
TOTAL GENERAL OBLIGATION BONDS		$ 69,088,000	$ 31,348,287	$ 12,650,927	$ 9,570,074

(a) Includes the initial value of capital appreciation bonds rather than the accreted value.
(b) Represents the total amount of commercial paper authorized by Finance Committees that could be issued for new money projects. Of this amount, no more than $1.5 billion of commercial paper principal and interest can be owing at any time. Currently, there is $0.00 of commercial paper issued and outstanding. The bond acts marked as "n.a." are not legally permitted to utilize commercial paper, or all bonds were issued before the commercial paper program began.
(c) Treats full commercial paper authorization as issued; see footnote (b).
(d) Various dates.

SOURCE: State of California, Office of the Treasurer.

SCHEDULE OF DEBT SERVICE REQUIREMENTS FOR LEASE-PURCHASE DEBT
As of February 1, 2004

Fiscal Year Ending June 30	Current Debt Interest	Principal (a)	Total	
2004	$ 167,978,169.84	$ 83,390,000.00	$ 251,368,169.84	(b)
2005	360,898,044.05	353,394,507.20	714,292,551.25	
2006	340,992,400.18	382,227,554.60	723,219,954.78	
2007	326,839,245.59	335,618,920.44	662,458,166.03	
2008	307,123,128.35	344,471,787.98	651,594,916.33	
2009	293,821,550.44	366,922,732.44	660,744,282.88	
2010	269,679,662.75	356,036,633.76	625,716,296.51	
2011	240,215,388.93	369,250,000.00	609,465,388.93	
2012	220,936,131.81	353,255,000.00	574,191,131.81	
2013	202,426,896.45	362,740,000.00	565,166,896.45	
2014	183,432,753.81	366,455,000.00	549,887,753.81	
2015	163,742,807.52	385,845,000.00	549,587,807.52	
2016	143,210,856.24	367,865,000.00	511,075,856.24	
2017	123,189,311.84	373,680,000.00	496,869,311.84	
2018	103,374,292.16	389,160,000.00	492,534,292.16	
2019	83,225,999.33	348,360,000.00	431,585,999.33	
2020	64,929,395.95	319,395,000.00	384,324,395.95	
2021	49,548,835.74	253,900,000.00	303,448,835.74	
2022	36,257,006.24	224,945,000.00	261,202,006.24	
2023	26,167,926.62	171,090,000.00	197,257,926.62	
2024	18,357,327.00	81,190,000.00	99,547,327.00	
2025	14,135,430.00	85,410,000.00	99,545,430.00	
2026	10,169,818.75	72,910,000.00	83,079,818.75	
2027	6,414,873.75	76,625,000.00	83,039,873.75	
2028	2,533,562.50	64,850,000.00	67,383,562.50	
Total	$ 3,759,600,815.84	$ 6,888,987,136.42	$ 10,648,587,952.26	

(a) Includes scheduled mandatory sinking fund payments.
(b) Total represents the remaining debt service requirements from March 1, 2004 through June 30, 2004.

SOURCE: State of California, Office of the Treasurer.

SCHEDULE OF DEBT SERVICE REQUIREMENTS
FOR GENERAL FUND GENERAL OBLIGATION BONDS (a)
(Non-Self Liquidating)
As of February 1, 2004

Fiscal Year Ending June 30	Current Debt			
	Interest	Principal (b)	Total	
2004	$ 497,330,849.84	$ 160,420,000.00	$ 657,750,849.84	(c)
2005	1,449,363,968.84	1,244,789,388.71	2,694,153,357.55	
2006	1,375,409,771.25	1,173,910,000.00	2,549,319,771.25	
2007	1,306,439,337.18	1,204,445,000.00	2,510,884,337.18	
2008	1,240,804,714.18	1,331,543,078.31	2,572,347,792.49	
2009	1,167,054,165.00	1,374,235,000.00	2,541,289,165.00	
2010	1,091,057,527.55	1,426,795,000.00	2,517,852,527.55	
2011	1,015,291,061.09	1,390,714,045.16	2,406,005,106.25	
2012	935,554,193.69	1,074,220,000.00	2,009,774,193.69	
2013	881,085,237.50	897,435,000.00	1,778,520,237.50	
2014	837,079,907.14	776,660,000.00	1,613,739,907.14	
2015	798,878,383.44	788,870,000.00	1,587,748,383.44	
2016	757,460,517.71	726,230,000.00	1,483,690,517.71	
2017	718,361,200.85	761,175,000.00	1,479,536,200.85	
2018	678,855,958.48	787,655,000.00	1,466,510,958.48	
2019	637,598,866.00	836,920,000.00	1,474,518,866.00	
2020	594,077,727.25	866,810,000.00	1,460,887,727.25	
2021	550,094,173.50	818,795,000.00	1,368,889,173.50	
2022	507,784,484.75	957,920,000.00	1,465,704,484.75	
2023	457,366,886.45	971,500,000.00	1,428,866,886.45	
2024	408,809,654.36	846,010,000.00	1,254,819,654.36	
2025	363,806,868.80	994,540,000.00	1,358,346,868.80	
2026	314,530,032.59	904,875,000.00	1,219,405,032.59	
2027	268,607,851.34	909,680,000.00	1,178,287,851.34	
2028	221,981,005.34	952,430,000.00	1,174,411,005.34	
2029	173,862,665.00	867,880,000.00	1,041,742,665.00	
2030	127,581,089.50	997,990,000.00	1,125,571,089.50	
2031	79,387,267.00	615,635,000.00	695,022,267.00	
2032	49,585,607.50	543,155,000.00	592,740,607.50	
2033	22,406,250.00	402,420,000.00	424,826,250.00	
2034	2,782,175.00	101,170,000.00	103,952,175.00	
Total	$ 19,530,289,398.12	$ 27,706,826,512.18	$ 47,237,115,910.30	

(a) Does not include debt service payments on $1,400,000,000 State of California General Obligation Variable Rate Bonds due 2033.

(b) Includes scheduled mandatory sinking fund payments.

(c) Total represents the remaining debt service requirements from March 1, 2004 through June 30, 2004.

SOURCE: State of California, Office of the Treasurer.

STATE PUBLIC WORKS BOARD AND OTHER LEASE-PURCHASE FINANCING OUTSTANDING ISSUES

February 1, 2004

Name of Issue		Outstanding
GENERAL FUND SUPPORTED ISSUES:		
State Public Works Board		
California Community Colleges	$	529,180,000
Department of the Youth Authority		16,975,000
Department of Corrections *		2,568,889,754
Energy Efficiency Program (Various State Agencies) (a)		74,770,000
The Regents of The University of California * (b)		1,136,987,382
Trustees of The California State University		581,445,000
Various State Office Buildings		1,112,100,000
Total State Public Works Board Issues	**$**	**6,020,347,136**
Total Other State Building Lease Purchase Issues(c)	**$**	**868,640,000**
Total General Fund Supported Issues	**$**	**6,888,987,136**
SPECIAL FUND SUPPORTED ISSUES:		
East Bay State Building Authority Certificates of Participation (State of California Department of Transportation) *	$	67,047,955
San Bernardino Joint Powers Financing Authority (State of California Department of Transportation)		53,465,000
San Francisco State Building Authority (State of California Department of General Services Lease) (d)		38,685,000
Total Special Fund Supported Issues	**$**	**159,197,955**
TOTAL	**$**	**7,048,185,091**

* Includes the initial value of capital appreciation bonds rather than the accreted value.

(a) This program is self-liquidating based on energy cost savings.

(b) The Regents' obligations to the State Public Works Board are payable from lawfully available funds of The Regents which are held in The Regents' treasury funds and are separate from the State General Fund. A portion of The Regents' annual budget is derived from General Fund appropriations.

(c) Includes $180,450,000 Sacramento City Financing Authority Lease Revenue Bonds State of California - Cal EPA Building, 1998 Series A, which are supported by lease rentals from the California Environmental Protection Agency; these rental payments are subject to annual appropriation by the State Legislature.

(d) The sole tenant is the California Public Utilities Commission.

SOURCE: State of California, Office of the Treasurer.

SCHEDULE OF DEBT SERVICE REQUIREMENTS FOR ENTERPRISE FUND GENERAL OBLIGATION BONDS (Self Liquidating) As of February 1, 2004

Fiscal Year Ending June 30	Current Debt Interest	Current Debt Principal (a)	Current Debt Total	
2004	$ 55,957,477.12	$ 30,660,000.00	$ 86,617,477.12	(b)
2005	125,529,089.75	122,930,000.00	248,459,089.75	
2006	116,735,431.00	124,500,000.00	241,235,431.00	
2007	107,712,864.76	129,705,000.00	237,417,864.76	
2008	97,875,136.04	136,770,000.00	234,645,136.04	
2009	87,974,336.25	139,695,000.00	227,669,336.25	
2010	78,587,639.05	118,565,000.00	197,152,639.05	
2011	71,193,275.77	88,750,000.00	159,943,275.77	
2012	65,825,233.50	124,660,000.00	190,485,233.50	
2013	60,033,305.62	119,420,000.00	179,453,305.62	
2014	54,035,409.75	135,835,000.00	189,870,409.75	
2015	48,038,653.05	118,735,000.00	166,773,653.05	
2016	42,123,571.90	121,930,000.00	164,053,571.90	
2017	35,895,849.29	129,925,000.00	165,820,849.29	
2018	29,865,583.99	105,035,000.00	134,900,583.99	
2019	24,519,579.11	100,850,000.00	125,369,579.11	
2020	20,506,283.61	52,590,000.00	73,096,283.61	
2021	17,704,637.50	45,615,000.00	63,319,637.50	
2022	15,228,971.25	41,240,000.00	56,468,971.25	
2023	13,480,617.01	21,730,000.00	35,210,617.01	
2024	12,264,105.52	23,025,000.00	35,289,105.52	
2025	10,949,341.91	25,350,000.00	36,299,341.91	
2026	9,740,973.75	18,805,000.00	28,545,973.75	
2027	8,650,135.00	20,645,000.00	29,295,135.00	
2028	7,687,360.00	14,215,000.00	21,902,360.00	
2029	6,741,760.00	19,955,000.00	26,696,760.00	
2030	5,404,392.50	28,100,000.00	33,504,392.50	
2031	3,892,867.50	25,920,000.00	29,812,867.50	
2032	2,395,225.00	27,375,000.00	29,770,225.00	
2033	812,977.50	28,930,000.00	29,742,977.50	
Total	$ 1,237,362,084.00	$ 2,241,460,000.00	$ 3,478,822,084.00	

(a) Includes scheduled mandatory sinking fund payments.
(b) Total represents the remaining debt service requirements from March 1, 2004 through June 30, 2004.

SOURCE: State of California, Office of the Treasurer.

OUTSTANDING STATE DEBT
FISCAL YEARS 1998-99 THROUGH 2002-03
(Dollars in Thousands Except for Per Capita Information)

	1998-99	1999-00	2000-01	2001-02	2002-03
Outstanding Debt (a)					
General Obligation Bonds					
General Fund (Non-Self Liquidating)	$ 16,202,211	$ 17,869,616	$ 20,472,893	$ 22,115,362	$ 26,758,626
Enterprise Fund (Self Liquidating)	3,674,020	3,474,900	3,396,215	3,211,310	2,801,775
Total	$ 19,876,231	$ 21,344,516	$ 23,869,108	$ 25,326,672	$ 29,560,401
Lease-Purchase Debt	6,671,534	6,627,944	6,413,260	6,341,935	6,704,599
Total Outstanding General Obligation Bonds and Lease-Purchase Debt	$ 26,547,765	$ 27,972,460	$ 30,282,368	$ 31,668,607	$ 36,265,000
Bond Sales During Fiscal Year					
Non-Self Liquidating General Obligation Bonds	$ 2,650,000	$ 2,750,000	$ 4,419,665	$ 3,905,025	$ 5,150,000
Self Liquidating General Obligation Bonds	$ 351,500	$ 126,500	$ 358,625	$ 111,325	$ 0
Lease-Purchase Debt	$ 456,410	$ 293,235	$ 214,585	$ 229,105	$ 673,975
Debt Service (b)					
Non-Self Liquidating General Obligation Bonds	$ 1,934,628	$ 2,045,566	$ 2,279,636	$ 2,367,570	$ 1,738,740
Lease-Purchase Debt	$ 652,131	$ 654,485	$ 670,228	$ 647,568	$ 664,846
General Fund Receipts (b)	$ 58,510,860	$ 72,226,473	$ 78,330,406	$ 66,604,508	$ 78,587,019
Non-Self Liquidating General Obligation Bonds Debt Service as a Percentage of General Fund Receipts	3.31%	2.83%	2.91%	3.55%	2.21%
Lease-Purchase Debt Service as a Percentage of General Fund Receipts	1.11%	0.91%	0.86%	0.97%	0.85%
Population (c)	32,861,779	33,417,247	34,036,376	34,698,173	35,301,480
Non-Self Liquidating General Obligation Bonds Outstanding Per Capita	$ 493.04	$ 534.74	$ 601.50	$ 637.36	$ 758.00
Lease-Purchase Debt Outstanding Per Capita	$ 203.02	$ 198.34	$ 188.42	$ 182.77	$ 189.92
Personal Income (d)	$ 931,564,000	$ 995,326,000	$1,100,679,000	$1,129,868,000	$1,155,247,000
Non-Self Liquidating General Obligation Bonds Outstanding as Percentage of Personal Income	1.74%	1.80%	1.86%	1.96%	2.32%
Lease-Purchase Debt Outstanding as Percentage of Personal Income	0.72%	0.67%	0.58%	0.56%	0.58%

(a) As of last day of fiscal year. Includes the initial value of capital appreciation bonds rather than the accreted value.
(b) Calculated on a cash basis; debt service costs of bonds issued in any fiscal year largely appear in subsequent fiscal year.
(c) As of July 1, the beginning of the fiscal year.
(d) Source: U.S. Department of Commerce, Bureau of Economic Analysis, http://www.bea.doc.gov/
Annual Totals: "Pre-benchmark" Revisions: Released April 2003. California Department of Finance.

SOURCES: Population: State of California, Department of Finance
Personal Income: State of California, Department of Finance; United States, Department of Commerce, Bureau of Economic Analysis (BEA)
Outstanding Debt, Bonds Sales During Fiscal Year and Debt Service: State of California, Office of the Treasurer.
General Fund Receipts: State of California, Office of the State Controller.

STATE AGENCY REVENUE BONDS AND CONDUIT FINANCING
As of June 30, 2003

Issuing Agency		Outstanding[(a)(b)]
State Programs Financing:		
California State University	$	966,998,000
Department of Water Resources - Central Valley Project		2,403,430,000
Department of Water Resources - Power Supply Program		11,263,500,000
The Regents of the University of California		4,372,045,000
Housing Financing:		
California Housing Finance Agency		8,154,066,733
Veterans Revenue Debenture		521,475,000
Conduit Financing:		
California Alternative Energy and Advanced Transportation Financing Authority		58,535,000
California Educational Facilities Authority		3,115,186,962
California Health Facilities Financing Authority		6,205,771,919
California Infrastructure and Economic Development Bank [(c)]		2,153,565,193
California Pollution Control Financing Authority		4,438,736,159
California School Finance Authority		90,000
California Student Loan Authority		95,260,000
TOTAL	**$**	**43,748,659,966**

(a) Totals for California State University, Department of Water Resources-Central Valley Project, and Veterans Revenue Debenture were provided by the State of California, Office of the Treasurer. All other totals were provided by the listed issuing agency.

(b) Does not include $3 Billion of "tobacco settlement revenue bonds" issued by Golden State Tobacco Securitization Corporation.

(c) Does not include $6 billion of "rate reduction bonds" issued by special purpose trusts for the benefit of four investor-owned electric utility companies representing interests in certain electric rate surcharges.

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EXHITBIT 1

STATE OF CALIFORNIA

AUDITED ANNUAL FINANCIAL STATEMENT

For the Year Ended
June 30, 2003

Prepared by the Office of the State Controller

STEVE WESTLY
California State Controller

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Contents

FINANCIAL SECTION

Financial Section

CALIFORNIA STATE AUDITOR

ELAINE M. HOWLE
STATE AUDITOR

STEVEN M. HENDRICKSO
CHIEF DEPUTY STATE AUDITC

Independent Auditor's Report

THE GOVERNOR AND THE LEGISLATURE OF THE
STATE OF CALIFORNIA

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of California, as of and for the year ended June 30, 2003, which collectively comprise the State of California's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the State of California's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the following significant amounts in the financial statements of:

<u>*Government-wide Financial Statements*</u>

- Certain enterprise funds that, in the aggregate, represent 84 percent, 42 percent, and 58 percent, respectively, of the assets, net assets and revenues of the business-type activities.
- The University of California, State Compensation Insurance Fund, California Housing Finance Agency, and certain other funds that, in the aggregate, represent 74 percent, 88 percent, and 74 percent, respectively, of the assets, net assets and revenues of the discretely presented component units.

<u>*Fund Financial Statements*</u>

- Certain funds that represent 99 percent, 95 percent, and 98 percent, respectively, of the assets, net assets and revenues of the Housing Loan fund, a major enterprise fund.
- The following major enterprise funds: Electric Power fund, Water Resources fund, Public Building Construction fund, and State Lottery fund.
- Certain nonmajor enterprise funds that represent 68 percent, 46 percent, and 85 percent, respectively, of the assets, net assets and revenues of the nonmajor enterprise funds.

- The funds of the Public Employees' Retirement System and the State Teachers' Retirement System and the University of California Retirement System that, in the aggregate, represent 90 percent, 91 percent, and 94 percent, respectively, of the assets, net assets and additions of the fiduciary funds.
- The discretely presented component units noted above.

Those financial statements were audited by other auditors whose reports have been furnished to us, and our opinion, insofar as it relates to the amounts included for those funds and entities, is based on the reports of the other auditors.

Except as discussed in the following paragraph, we conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the reports of other auditors provide a reasonable basis for our opinions.

The financial statements of the State Compensation Insurance Fund (SCIF) have not been audited, as discussed further in Note 2, and we were not engaged to audit the SCIF financial statements as part of our audit of the State of California's basic financial statements. SCIF's financial activities are included in the State of California's basic financial statements as a discretely presented component unit and represent 25 percent, 9 percent, and 25 percent, respectively, of the assets, net assets and revenues of the State of California's aggregate discretely presented component units.

In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had SCIF's financial statements been audited, the financial statements referred to above present fairly, in all material respects, the financial position of the aggregate discretely presented component units for the State of California, as of June 30, 2003, and the changes in financial position thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In addition, in our opinion, based on our audit and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the State of California, as of June 30, 2003, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, reports on the State's internal control structure and on its compliance with laws and regulations will be issued in our single audit report. These reports are an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The management's discussion and analysis on pages 7 through 25, and schedule of funding progress, infrastructure information, budgetary comparison information, reconciliation of budgetary and GAAP-basis fund balances and related notes on pages 152 through 159 are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We and other auditors have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we 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 State of California's basic financial statements. The combining financial statements listed in the accompanying table of contents are presented for purposes of additional analysis and are not a required part of the basic financial statements. The combining financial statements have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, based upon our audit and the reports of other auditors, are fairly stated, in all material respects, in relation to the basic financial statements taken as a whole. The introductory and statistical sections of this report 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.

BUREAU OF STATE AUDITS

Philip Jelicich

PHILIP J. JELICICH, CPA
Deputy State Auditor

December 19, 2003

Management's Discussion and Analysis

The following Management's Discussion and Analysis is a required supplement to the State of California's financial statements. It describes and analyzes the financial position of the State, providing an overview of the State's activities for the year ended June 30, 2003. We encourage readers to consider the information presented here in conjunction with information that is provided in our letter of transmittal at the front of this report and in the State's financial statements and notes, which follow this section.

Financial Highlights – Primary Government

Government-Wide Highlights

The effects of California's near-stagnant economy and continued budgetary imbalances are reflected in the State's financial statements. The State experienced lower than expected general revenues, primarily personal income and sales and use tax revenues, and increased expenses. Revenues for the State's business-type activities approximated its expenses for all categories except unemployment programs, which had expenses that were $2.4 billion in excess of revenues. As a result, net assets for both governmental and business-type activities decreased during the 2002-03 fiscal year, but governmental net assets experienced a much greater decline, almost 300%.

Net Assets — The liabilities of the primary government exceeded its assets on June 30, 2003, by $15.3 billion. After reducing this total amount by $15.6 billion for investment in capital assets (net of related debt) and by $13.2 billion for restricted net assets, the resulting unrestricted net assets were a negative $44.1 billion. Restricted net assets are dedicated for specified uses and are not available to fund current activities. More than half of the large negative unrestricted net assets is a result of the $22.2 billion in outstanding bonded debt issued to build capital assets for school districts and other local governmental entities. The bonded debt reduces the unrestricted net assets, but the capital assets that would offset the reduction are recorded by local government, instead of the State.

Changes in Net Assets — The primary government's total net assets decreased by $20.2 billion (a 416% decrease) during the year ended June 30, 2003. Net assets of governmental activities decreased by $18.4 billion (298%), while net assets of business-type activities decreased by $1.8 billion (16.4%).

Fund Highlights

Governmental Funds — As of June 30, 2003, the primary government's governmental funds reported a combined ending fund deficit of $2.1 billion, a decrease of $10.7 billion from the previous fiscal year. After reducing this total fund balance amount by $17.1 billion in reserves, the unreserved fund balance totaled a negative $19.2 billion.

Proprietary Funds — As of June 30, 2003, the primary government's proprietary funds reported combined ending net assets of $9.8 billion, a decrease of $1.9 billion from the previous fiscal year. After reducing the total net assets by $9.8 billion for investment in capital assets (net of related debt) and expendable restrictions, the unrestricted net assets totaled $35 million.

Noncurrent Assets and Liabilities

As of June 30, 2003, the primary government's noncurrent assets totaled $49.9 billion, of which $24.7 billion was related to capital assets. However, state highway infrastructure projects completed prior to July 1, 2001, are not included in the capital assets of this report. As a result, the financial statements report liabilities, such as bonded debt, incurred to build infrastructure, but the related assets are not yet reported. The assets will be included during the retroactive reporting phase for infrastructure, which will occur no later than the year ending June 30, 2006.

The primary government's noncurrent liabilities totaled $68.7 billion, which consisted of $28.0 billion of general obligation bonds, $24.7 billion of revenue bonds, and $16.0 billion in other noncurrent liabilities.

Overview of the Financial Statements

This discussion and analysis is an introduction to the State's basic financial statements, which include three components: (1) government-wide financial statements, (2) fund financial statements, and (3) notes to the financial statements. This report also contains required supplementary information and other supplementary information.

Government-Wide Financial Statements

Government-wide financial statements are designed to provide readers with a broad overview of the State's finances, in a manner similar to that of a private-sector business. The government-wide financial statements do not include programs and activities of the primary government and component units that are fiduciary in nature because their resources are not available to support state programs. The statements provide both short-term and long-term information about the State's financial position, which assists the reader in assessing the State's economic condition at the end of the fiscal year. These statements are prepared using the economic resources measurement focus and the accrual basis of accounting. This means they follow methods that are similar to those used by most businesses. They take into account all revenues and expenses connected with the fiscal year, regardless of when the cash involved was received or paid. The government-wide financial statements include two statements: the Statement of Net Assets and the Statement of Activities.

- The *Statement of Net Assets* presents all of the State's assets and liabilities, except for most state highway infrastructure assets, with the difference between the two reported as net assets. Over time, increases or decreases in net assets are expected to serve as a useful indicator of whether the financial position of the State is improving or deteriorating.

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

The government-wide financial statements have separate columns for three different types of state programs or activities: governmental activities, business-type activities, and component units.

- *Governmental activities* are mostly supported by taxes, such as personal income and sales and use taxes, and intergovernmental revenues, primarily federal grants. Most services and expenses normally associated with state government fall into this activity category, including health and human services, education (public kindergarten through twelfth-grade schools and higher education), business and transportation, correctional programs, general government, resources, tax relief, state and consumer services, and interest on long-term debt.

- *Business-type activities* are normally intended to recover all or a significant portion of their costs through user fees and charges to external users of goods and services. The business-type activities of the State of California include providing unemployment insurance programs, providing housing loans to California veterans, providing water to local water districts, providing building aid to school districts, operating toll collection facilities, providing services to California State University students, leasing public assets, selling lottery tickets, selling electric power, managing public employee retirement benefits, and administering long-term care and deferred compensation plans. These activities are carried out with minimal financial assistance from the governmental activities of the State.

- *Component units* are organizations that are legally separate from the State, but the State is either financially accountable for them, or the nature and significance of their relationship with the State is such that their exclusion would cause the State's financial statements to be misleading or incomplete. The State of California has both blended and discretely presented component units.

    - *Blended component units*, although legally separate entities, are in substance part of the primary government's operations. Therefore, data from blended component units are integrated into the appropriate funds for reporting purposes. The Golden State Tobacco Securitization Corporation and certain building authorities that are blended component units of the State have been included in the governmental activities.

    - *Discretely presented component units* are legally separate from the primary government and provide services to entities and individuals outside the primary government. Activity of discretely presented component units, other than the activity of the University of California Retirement System, is presented in a single column in the government-wide financial statements. The University of California Retirement System is reported separately as a fiduciary fund.

Information on how to obtain financial statements of the individual component units is available from the State Controller's Office, Division of Accounting and Reporting, P.O. Box 942850, Sacramento, CA 94250.

Fund Financial Statements

Fund financial statements are provided for governmental funds, proprietary funds, fiduciary funds, and component units. A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The State of California, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal and contractual requirements. Following are general descriptions of the three types of funds.

- Governmental funds are used to account for essentially the same functions that are reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on near-term inflows and outflows of spendable resources, as well as on balances of spendable resources available at the end of the fiscal year. Such information may be useful in evaluating a government's near-term financing requirements. This approach is known as using the flow of current financial resources measurement focus and the modified accrual basis of accounting. These statements provide a detailed short-term view of the State's finances that assists in determining whether there will be adequate financial resources available to meet the current needs of the State.

  Because the focus of governmental fund financial statements is narrower than that of government-wide financial statements, it is useful to compare these statements with the governmental activities information presented in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the governmental fund Balance Sheet and the governmental fund Statement of Revenues, Expenditures, and Changes in Fund Balances provide a reconciliation, to facilitate a comparison between governmental funds and governmental activities in the government-wide statements. These reconciliations are presented on the page immediately following the governmental fund financial statements. Primary differences between the government-wide and fund statements relate to noncurrent assets, such as land and buildings, and noncurrent liabilities, such as bonded debt and amounts owed for compensated absences and capital lease obligations, which are reported in the government-wide statements but not in the fund-based statements.

- *Proprietary funds* are used to show activities that operate more like those found in the private sector. The State of California has two proprietary fund types: enterprise funds and internal service funds.

  - *Enterprise funds* record activity for which a fee is charged to external users and are presented as business-type activities in the government-wide financial statements.

  - *Internal service funds* are used to accumulate and allocate costs internally among the State of California's various functions. For example, internal service funds provide information technology, printing, fleet management, and architectural services primarily for state departments. As a result, their activity is considered governmental.

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

Discretely Presented Component Units Financial Statements

As discussed previously, *discretely presented component units* have operations for which the State has financial accountability but they have certain independent qualities as well, and they operate similarly to private-sector businesses.

The activity of the component units other than that of the University of California Retirement System is classified as enterprise activity. The University of California Retirement System's financial information is provided in the statements of fiduciary net assets and changes in fiduciary net assets in the Primary Government and Component Unit – Pension and Other Employee Benefit Trust Funds section of the Combining Financial Statements and Schedules – Nonmajor and Other Funds.

Notes to the Financial Statements

The *notes to the financial statements* provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes to the financial statements, which discuss particular accounts in more detail, can be found immediately following the discretely presented component units financial statements.

Required Supplementary Information

A section of *required supplementary information* follows the notes to the basic financial statements. This section includes a schedule of funding progress for certain pension trust funds, information on infrastructure assets using the modified approach, a budgetary comparison schedule, and a separate reconciliation between the statutory fund balance for budgetary purposes and the fund balance for the major governmental funds presented in the governmental fund financial statements.

Other Supplementary Information

The next section contains *combining statements* that provide separate financial statements for nonmajor governmental funds, proprietary funds, fiduciary funds, and nonmajor component units. Information for these entities is presented only in summary form in the basic financial statements. Finally, the *statistical section* provides various statistical data generally related to the State's financial condition.

Government-Wide Financial Analysis

Net Assets

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. The primary government's combined net assets (governmental and business-type activities) declined 416%, from $4.8 billion, as restated, at June 30, 2002, to a negative $15.3 billion a year later.

A large segment of the primary government's net assets is its $15.6 billion investment in capital assets such as land, building, equipment, and some infrastructure (roads, bridges, and other immovable assets), less any related debt used to acquire those assets that is still outstanding. However, state highway infrastructure completed prior to July 1, 2001, is not included in the capital assets of this report. The debt related to infrastructure is netted against the capital assets that are included in this report. The State uses capital assets to provide services to citizens; consequently, these assets are not available for future spending. Although the State's investment in capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, because the capital assets themselves cannot be used to liquidate the liabilities.

Another $13.2 billion of the primary government's net assets represents resources, such as resources pledged to debt service, that are subject to external restrictions on how they may be used. Internally imposed designations of resources are not presented as restricted net assets. The balance of unrestricted net assets of governmental activities (if positive) may be used to meet the State's ongoing obligations to citizens and creditors. As of June 30, 2003, governmental activities showed an unrestricted net assets deficit of $43.9 billion and business-type activities showed an unrestricted net assets deficit of $126 million.

A large portion of the negative unrestricted net assets of governmental activities is a result of the $22.2 billion in outstanding bonded debt issued to build capital assets for school districts and other local governmental entities. Because the State does not own these capital assets, neither the assets nor the bonded debt is included in the portion of net assets reported as "investment in capital assets, net of related debt." Instead, the bonded debt reduces the State's unrestricted net assets. A deficit in unrestricted net assets of governmental activities can be expected to continue as long as the State has significant obligations outstanding for school districts and other local governmental entities.

Table 1 presents condensed financial information derived from the Statement of Net Assets for the primary government of the State of California.

Table 1

Net Assets – Primary Government
June 30, 2003
(amounts in millions)

	Governmental Activities		Business-Type Activities		Total	
	2003	2002*	2003	2002*	2003	2002*
ASSETS						
Current and other assets	$ 35,005	$ 40,987	$ 34,188	$ 26,982	$ 69,193	$ 67,969
Capital assets	19,321	17,412	5,374	4,638	24,695	22,050
Total assets	**54,326**	**58,399**	**39,562**	**31,620**	**93,888**	**90,019**
LIABILITIES						
Noncurrent liabilities	41,657	31,449	27,030	19,160	68,687	50,609
Other liabilities	37,186	28,666	3,327	3,745	40,513	32,411
Total liabilities	**78,843**	**60,115**	**30,357**	**22,905**	**109,200**	**83,020**
NET ASSETS						
Investment in capital assets net of related debt	14,180	10,984	1,405	905	15,585	11,889
Restricted	5,231	6,717	7,926	7,794	13,157	14,511
Unrestricted	(43,928)	(19,417)	(126)	16	(44,054)	(19,401)
Total net assets	**$ (24,517)**	**$ (1,716)**	**$ 9,205**	**$ 8,715**	**$ (15,312)**	**$ 6,999**

*Not restated

Changes in Net Assets

The expenses of the primary government totaled $165 billion for the year ended June 30, 2003. Of this amount, $72.9 billion (44.3%) was funded with program revenues (charges for services or program-specific grants and contributions), leaving $91.9 billion to be funded with general revenues (mainly taxes). However, the primary government's general revenues and transfers totaled only $71.7 billion, so total net assets decreased by $20.2 billion, or 416%, during the year ended June 30, 2003.

Of the total decrease, net assets for governmental activities decreased by $18.4 billion, while those of business-type activities decreased by $1.8 billion. The decrease in governmental activities was caused by lower than expected personal income tax receipts and a structural budget shortfall. The decrease in business-type activities was mainly caused by unemployment benefit payments exceeding employer contributions and other revenue for unemployment programs.

Table 2 presents condensed financial information derived from the Statement of Activities for the primary government of the State of California.

Table 2

Changes in Net Assets – Primary Government
Year ended June 30, 2003
(amounts in millions)

	Governmental Activities		Business-Type Activities		Total	
	2003	2002	2003	2002	2003	2002
REVENUES						
Program revenues:						
Charges for services	$ 13,131	$ 13,205	$ 19,937	$ 18,386	$ 33,068	$ 31,591
Operating grants and contributions	38,409	34,013	1	1	38,410	34,014
Capital grants and contributions	1,302	1,584	145	—	1,447	1,584
General revenues:						
Taxes	70,733	68,099	—	—	70,733	68,099
Investment and interest	372	791	—	—	372	791
Miscellaneous	582	375	—	—	582	375
Total revenues	**124,529**	**118,067**	**20,083**	**18,387**	**144,612**	**136,454**
EXPENDITURES						
Program expenses:						
General government	8,601	7,974	—	—	8,601	7,974
Education	51,447	45,883	—	—	51,447	45,883
Health and human services	59,141	53,057	—	—	59,141	53,057
Resources	3,431	3,594	—	—	3,431	3,594
State and consumer services	437	1,015	—	—	437	1,015
Business and transportation	7,515	7,532	—	—	7,515	7,532
Correctional programs	6,681	5,803	—	—	6,681	5,803
Tax relief	3,921	3,672	—	—	3,921	3,672
Interest on long-term debt	1,781	1,747	—	—	1,781	1,747
Housing Loan	—	—	207	217	207	217
Electric Power	—	—	4,985	4,241	4,985	4,241
Water Resources	—	—	740	770	740	770
Public Building Construction	—	—	348	295	348	295
State Lottery	—	—	2,791	2,913	2,791	2,913
Unemployment Programs	—	—	10,652	8,901	10,652	8,901
Nonmajor enterprise	—	—	2,093	2,166	2,093	2,166
Total expenses	**142,955**	**130,277**	**21,816**	**19,503**	**164,771**	**149,780**
Deficiency before transfers	**(18,426)**	**(12,210)**	**(1,733)**	**(1,116)**	**(20,159)**	**(13,326)**
Transfers	67	13	(67)	(13)	—	—
Change in net assets	(18,359)	(12,197)	(1,800)	(1,129)	(20,159)	(13,326)
Net assets, beginning of year (restated)	**(6,158)**	**10,481**	**11,005**	**9,844**	**4,847**	**20,325**
Net assets, end of year	**$ (24,517)**	**$ (1,716)**	**$ 9,205**	**$ 8,715**	**$ (15,312)**	**$ 6,999**

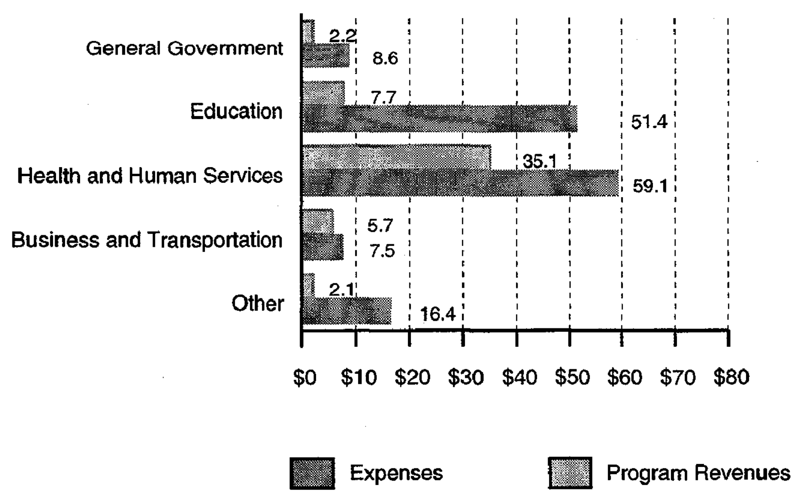
Governmental Activities

The expenses of governmental activities totaled $143 billion. Only $52.9 billion (37.0%) was funded with program revenues, $39.7 billion of which was federal grant money, leaving $90.1 billion to be funded with general revenues (mainly taxes). However, general revenues and transfers for governmental activities totaled only $71.7 billion, so governmental activities' total net assets decreased by $18.4 billion, or 298%, during the year ended June 30, 2003. The State issued short-term debt, revenue anticipation notes, and revenue anticipation warrants to help meet its cash flow needs.

Chart 1 presents a comparison of governmental activities expenses by program, with related revenues.

Chart 1

Expenses and Program Revenues – Governmental Activities
Year Ended June 30, 2003
(amounts in billions)



For the year ended June 30, 2003, total state tax revenues collected for governmental activities increased over the last year; however, personal income tax, the largest state tax revenue, had a slight decrease. The largest increase in state tax revenue occurred in corporation taxes, due to changes in tax law.

Overall expenses for governmental activities increased by $12.7 billion (9.7%). The largest increases in expenses were a $5.6 billion increase in education spending and a $6.1 billion increase in health and human services spending. The increased education spending was mainly attributable to student population growth and cost-of-living adjustments. The increase in health and human services spending was the result of increased medical and social services caseloads. Most of the increase in expenses occurred in the General Fund. The General Fund is discussed in more detail under governmental funds in the Fund Financial Analysis section.

Charts 2 and 3 present the percentage of total expenses for each program of governmental activities and the percentage of total revenues by source.

Chart 2

Expenses – Governmental Activities
Year ended June 30, 2003
(as a percent)

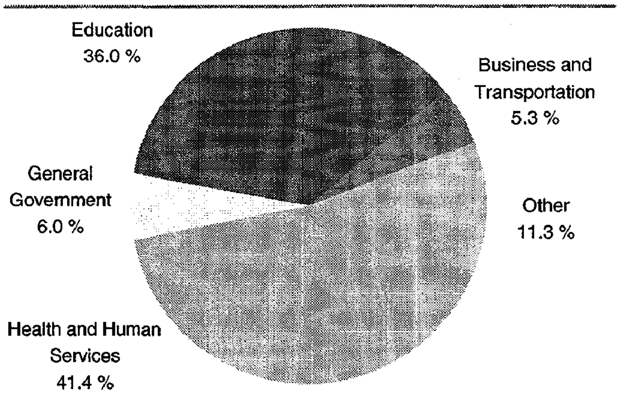
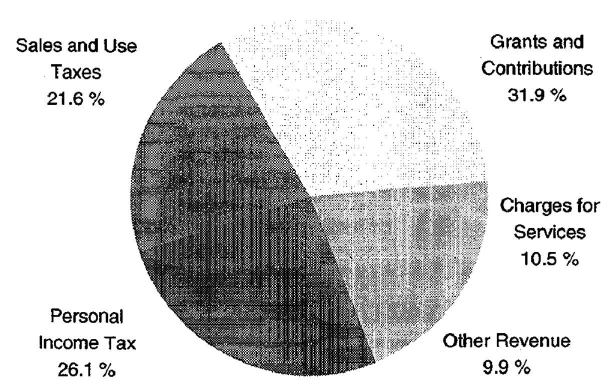


Chart 3

Revenues by Source – Governmental Activities
Year ended June 30, 2003
(as a percent)



Business-Type Activities

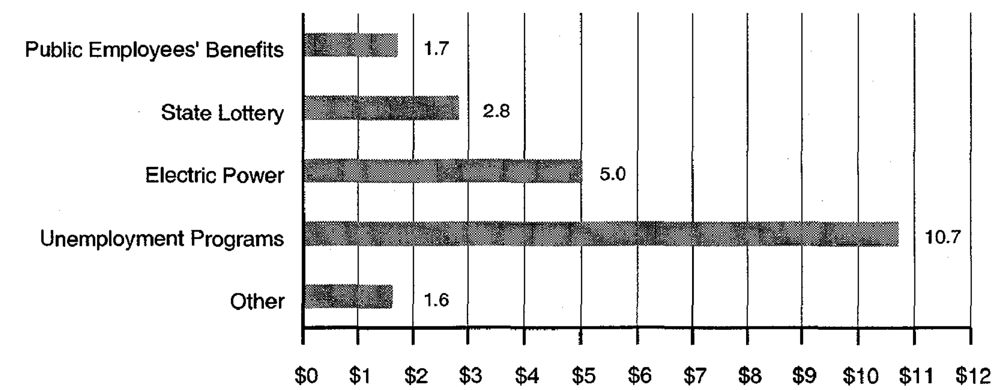
The expenses of business-type activities totaled $21.8 billion, with $20.1 billion, or 92.1%, paid by program revenues, such as charges for services, and fees and penalties. Business-type activities' total net assets decreased by $1.8 billion, or 16.4%, during the year ended June 30, 2003.

Most of the decrease in net assets was the result of a $2.4 billion reduction in unemployment programs' net assets, discussed in more detail under proprietary funds in the Fund Financial Analysis section. As a result of the 2001 and 2002 economic downturn and increases in benefits, payments of unemployment and unemployment disability claims exceeded the insurance receipts for the fiscal year.

Chart 4 presents a comparison of the expenses of the State's business-type activities.

Chart 4

Expenses – Business-Type Activities
Year ended June 30, 2003
(amounts in billions)



Fund Financial Analysis

The State's stagnant economy and budget shortfalls primarily affected governmental funds resulting in significant fund deficits. Governmental funds rely heavily on taxes to support the majority of the State's services and programs. On the other hand, all but one of the major proprietary funds, the Unemployment Programs Fund, had revenues that were not substantially different from expenses during the year ended June 30, 2003.

Governmental Funds
The Balance Sheet of the governmental funds reported $39.4 billion in assets, $41.5 billion in liabilities, and $2.1 billion in fund deficits as of June 30, 2003. The largest change in account balances occurred in liabilities as a result of the issuance of short-term notes, loans from special funds, and the larger deferral of school apportionments. Within the total fund balance, $17.1 billion has been set aside in reserves. The reserved amounts are not available for new spending, because they have already been committed for outstanding contracts and purchase orders ($7.3 billion), noncurrent interfund receivables and loans receivable ($4.4 billion), and continuing appropriations ($5.4 billion). The balance of the governmental funds that is unreserved is a negative $19.2 billion.

The Statement of Revenues, Expenditures, and Changes in Fund Balances of the governmental funds shows $125 billion in revenues, $145 billion in expenditures, and a net $9.2 billion in receipts from other financing sources (uses). The ending fund balance of the governmental funds for the year ended June 30, 2003, was a negative $2.1 billion, which was $10.8 billion less than the previous year's restated ending fund balance of $8.7 billion. The primary reason for the decrease in the combined fund balance of the governmental funds was the stagnant economy, which resulted in lower than expected state tax revenue and increased expenditures. Personal income taxes, which account for 45.9% of tax revenues and 26.2% of total governmental fund revenues, decreased slightly, by $213 million from the previous fiscal year, mainly as a result of continuing low capital gains and stock option income.

The State's major governmental funds are the General Fund, the Federal Fund, and the Transportation Construction Fund. The General Fund ended the fiscal year with a negative fund balance of $13.4 billion. The Federal Fund and the Transportation Construction Fund ended the fiscal year with fund balances of $607 million and $2.1 billion, respectively. The nonmajor governmental funds ended the year with a total fund balance of $8.6 billion.

As shown on the Balance Sheet, the General Fund (the State's main operating fund) ended the fiscal year with assets of $11.8 billion, liabilities of $25.1 billion, and fund balance reserves of $2.1 billion. This left the General Fund with an unreserved fund deficit of $15.4 billion. The largest account balance changes in the General Fund's Balance Sheet can be attributed to the State's cash-flow crisis as a result of continued budgetary shortfalls. To manage cash needs, the General Fund collected amounts due and borrowed additional amounts from special funds during the year and issued additional short-term notes. These actions resulted in a shift of $6.8 billion from a net due from other funds to a net due to other funds, a $2.0 billion increase in interfund payables, and a $3.5 billion increase in contracts and notes payable. The $3.2 billion increase in cash and pooled investments was the result of cash borrowed in June for expenditures in July and August of the next fiscal year. There was also a $868 million increase in due to other governments as a result of the larger deferral of school apportionment payments.

As shown on the Statement of Revenues, Expenditures, and Changes in Fund Balances of the governmental funds, the General Fund had $66.1 billion in revenues, $76.6 billion in expenditures, and a net $1.5 billion in receipts from other financing sources (uses) for the year ended June 30, 2003. The largest source of General Fund revenue was $65.0 billion in taxes, primarily personal income taxes ($32.7 billion) and sales and use taxes ($22.4 billion). Total personal income and sales and use tax revenues to the General Fund were basically unchanged from those of the prior fiscal year. Corporation taxes, which make up a much smaller portion of revenues to the General Fund, increased by $2.3 billion, to $6.9 billion, as a result of changes in the tax law relating to net operating loss provisions and bank bad debt reserves. Additionally, General Fund expenditures increased by $2.7 billion, to $76.6 billion. The programs with the largest increase in expenditures were health and human services, which increased by $1.4 billion, to $22.8 billion, and tax relief, which increased by $1.1 billion, to $3.9 billion. The increase in health and human services spending was the result of increased medical and social services caseloads. The tax relief increase was the result of higher payments of vehicle license fee relief to local governments. The General Fund's ending fund balance (including reserves) for the year ended June 30, 2003, was a deficit of $13.4 billion, which is $8.9 billion greater than the previous year's restated ending fund deficit of $4.5 billion.

The Federal Fund, also a major fund, reports federal grant revenues and the related expenditures to support the grant programs. By far the largest of these program areas is health and human services, which accounted for $28.3 billion (73.2%) of the total $38.6 billion in expenditures of the Federal Fund. The Medical Assistance Program and the Temporary Assistance for Needy Families program are included in this program area. Education programs also constituted a large part of the fund's expenditures, $5.8 billion (15.1%), most of which were apportionments made to local educational agencies. Overall revenues and expenditures increased by approximately $4.7 billion and $4.9 billion, respectively, over prior-year fund activity. The main reason for these increases is the increased medical and social services caseloads that caused large expenditure increases in the General Fund. The Federal Fund had a fund balance increase of $563 million, to $607 million.

The third major governmental fund, the Transportation Construction Fund, accounts for gasoline taxes, bond proceeds, and other revenues used for highway and passenger rail construction. Both revenues and expenditures decreased slightly (4% and 2%, respectively) compared to prior-year activity. Transportation Construction Fund expenditures of $3.6 billion exceeded revenues of $3.1 billion by approximately $451 million, which contributed to the fund balance's decrease to $2.1 billion.

Proprietary Funds

Enterprise Funds: In general, the stagnant economy did not have the negative effect on enterprise funds that it did on governmental funds. Most major enterprise funds' activity remained stable, with revenues approximating expenses. The exception was the Unemployment Programs Fund, which had expenses that exceeded revenues by $2.4 billion.

As shown on the Balance Sheet of the proprietary funds, total assets of the enterprise funds were $40.0 billion as of June 30, 2003. Of this amount, current assets totaled $11.8 billion and noncurrent assets totaled $28.2 billion. The largest change in asset account balances was a decrease of $3.2 billion in the amount on deposit with the U.S. Treasury for unemployment programs, because payments of unemployment and unemployment disability claims exceeded the insurance receipts for the fiscal year. The total liabilities of the enterprise funds were $30.8 billion. The largest liability accounts were revenue bonds payable of $21.0 billion and general obligation bonds payable of $2.6 billion. The largest changes in liability account balances were a $12.4 billion increase in revenue bonds payable, a $6.5 billion decrease in interfund payables, and a $3.8 billion decrease in other borrowings in the Electric Power Fund. These changes are the results of the issuance of energy revenue bonds, the proceeds of which were used to repay a loan from the General Fund and interim energy loans from commercial lenders.

Total net assets of the enterprise funds were $9.2 billion as of June 30, 2003. Total net assets consisted of three segments: expendable restricted net assets of $7.9 billion; investment in capital assets (net of related debt) of $1.4 billion; and unrestricted net assets of a negative $126 million. The fund with the largest net assets was the Unemployment Programs Fund, with $3.2 billion (34.2% of the enterprise funds' total net assets).

As shown on the Statement of Revenues, Expenses, and Changes in Fund Net Assets of the proprietary funds, the enterprise funds ended the year with operating revenues of $18.9 billion, operating expenses of $20.2 billion, and net disbursements from other transactions of $541 million. The largest sources of operating revenue were unemployment and disability insurance receipts of $6.4 billion in the Unemployment Programs Fund, and power sales of $4.5 billion collected by the Electric Power Fund. The largest operating expenses were distributions to beneficiaries of $10.5 billion by the Unemployment Programs Fund and power purchases (net of recoverable costs) of $4.4 billion by the Electric Power Fund. The ending net assets of the enterprise funds for the year ended June 30, 2003, were $9.2 billion, or $1.8 billion less than the previous year's ending fund balance of $11.0 billion, as restated. The main reasons for the decrease were a $2.4 billion loss from the Unemployment Programs Fund offset by a $565 million gain from nonmajor enterprise funds. A large number of unemployed workers caused by a stagnant economy and increases in benefit amounts resulted in the Unemployment Programs Fund continuing to lose net assets. In the previous year, the Unemployment Programs Fund lost $1.1 billion.

Internal Service Funds: Total net assets of the internal service funds were $639 million as of June 30, 2003. These net assets consist of two segments: investment in capital assets (net of related debt) of $478 million and unrestricted net assets of $161 million.

Fiduciary Funds
The State of California has four types of fiduciary funds: private purpose trust funds, pension and other employee benefit trust funds, investment trust funds, and agency funds. The private purpose trust funds ended the fiscal year with net assets of $1.0 billion. The pension and other employee benefit trust funds ended the fiscal year with net assets of $295 billion. The State's only investment trust fund, the Local Agency Investment Fund, ended the fiscal year with net assets of $21.8 billion. Agency funds act as clearing accounts and thus do not have net assets.

For the year ended June 30, 2003, the fiduciary funds' combined net assets were $318 billion, a $10.3 billion increase from the prior year. The main reason for the increase in net assets was an increase in the fair value of investments of retirement funds.

The Economy for the Year Ending June 30, 2003

The economic rebound expected in 2002 and early 2003 did not occur. As the nation pulled out of the 2001 recession, the economy stalled. Through June 2003, in both the U.S. and California, employment displayed an erratic pattern of overall decline. The sluggish economy extended to many sectors of the California economy, some exceptions being finance, education, health, and other services. Housing construction continued at a strong pace, and real estate sales and refinancing supported growing employment in those sectors. Manufacturing continued its decline and employment in professional services continued to languish. Both of these are relatively high-paying sectors, and their decline contributed to the slow growth of personal income in California during the fiscal year.

General Fund Highlights

In late November 2002, it became evident that projected revenues would not be realized. The near stagnant economy was continuing to depress the State's major tax revenues: personal income, corporate, and sales and use taxes. Additionally, anticipated program savings in state operations and proposed retirement incentives were not occurring. The Governor directed all state agencies to reduce any non-critical activities and to submit current-year program reduction plans. Further, the issuance of a $10.7 billion deficit financing bond and a $1.9 billion pension obligation bond, that were included as financing sources for the 2002-03 fiscal year budget, were delayed by court proceedings. Prompted by the budgetary shortfall, the Legislature enacted in March and April 2003 a total of $6.3 billion ($3.3 billion for the 2002-03 fiscal year and $3.0 billion for the 2003-04 fiscal year) in spending reductions and deferrals and funding transfers. The largest reduction was the deferral of $1.1 billion of kindergarten through twelfth-grade education funding into the 2003-04 fiscal year.

Despite the mid-year budget reductions, lower-than-expected cash receipts and higher disbursements continued to plague the General Fund. The State Controller issued $11.0 billion of revenue anticipation warrants on June 18, 2003, to assist the General Fund in meeting its cash needs in late June and the first part of the 2003-04 fiscal year. These additional funds also helped repay $12.5 billion of revenue anticipation notes that matured in June 2003.

The General Fund's final budget was $607 million higher than the original budget. The major increase was in health and human services and was caused by increased medical assistance caseloads. More detailed information on the General Fund budget is presented in the required supplementary information that follows the notes to the financial statements.

Table 3

General Fund Original and Final Budgets
Year ended June 30, 2003
(amounts in millions)

	Original	Final	Increase/ (Decrease)
Budgeted Amounts			
State and consumer services	$ 474	$ 476	$ 2
Business and transportation	81	64	(17)
Resources	1,009	1,180	171
Health and human services	22,085	23,244	1,159
Correctional programs	5,194	5,645	451
Education	39,011	37,955	(1,056)
General government:			
Tax relief	4,887	4,845	(42)
Debt service	2,090	2,090	0
Other general government	3,951	3,890	(61)
Total	**$ 78,782**	**$ 79,389**	**$ 607**

Capital Assets and Debt Administration

Capital Assets

The State of California's investment in capital assets for its governmental and business-type activities as of June 30, 2003, amounted to $24.7 billion (net of accumulated depreciation). This investment in capital assets includes land, a small portion of the state highway infrastructure, collections, buildings and other depreciable property, and construction in progress. Depreciable property includes buildings, improvements other than buildings, equipment, personal property, intangible assets, certain infrastructure assets, certain books, and other capitalized and depreciable property. The category of state highway infrastructure consists of prior year and current year additions and improvements to the State Highway System. Infrastructure assets are items that are normally immovable and of value only to the State, such as roads, bridges, streets and sidewalks, drainage systems, and lighting systems.

Table 4 presents a summary of the State of California's capital assets for governmental and business-type activities as of June 30, 2003.

Table 4

State of California's Capital Assets
Year ended June 30, 2003
(amounts in millions)

	Governmental Activities	Business-Type Activities	Total
Capital assets			
Land	$ 3,564	$ 17	$ 3,581
State highway infrastructure	403	—	403
Collections – nondepreciable	21	—	21
Buildings and other depreciable property	18,398	7,645	26,043
Less: accumulated depreciation	(7,006)	(3,064)	(10,070)
Construction in progress	3,941	776	4,717
Total	**$ 19,321**	**$ 5,374**	**$ 24,695**

The budget authorized $1.4 billion for the capital outlay program in the 2002-03 fiscal year, not including funding for transportation infrastructure. Infrastructure assets are discussed in more detail in the Required Supplementary Information that follows the notes to the financial statements. Of the $1.4 billion authorized, $24 million is from the General Fund, $466 million is from lease-revenue bonds, and $495 million is from an education bond (Proposition 47) for higher education facilities. The balance of funding is provided from various other bond funds, special funds, and reimbursements. The major capital projects authorized include:

- $536 million for numerous construction projects for the University of California, the California State University, California Community Colleges, and Hastings College of Law;
- $97 million for a four-story addition to the existing California Science Center;
- $73 million to replace the Caltrans San Diego District Office building; and
- $69 million to replace and renovate various facilities of the Department of Forestry and Fire Protection.

Additional information on the State's capital assets can be found in Note 7, Capital Assets.

Modified Approach for Infrastructure Assets

All prior year and current year additions to the state highway infrastructure are being reported using the modified approach. As allowed by the retroactive reporting provisions established by the Governmental Accounting Standards Board, infrastructure projects completed prior to July 1, 2001, are not included in this report. Retroactive reporting of the state highway infrastructure in the financial statements will occur no later than the year ending June 30, 2006.

Debt Administration

During the 2002-03 fiscal year, the State continued to implement the strategies adopted in the 2002 *Strategic Debt Management Plan*. Under this plan, the State changed how it makes payments on new general obligation bond issuances, by shifting from level principal payments to level debt service payments (principal and interest combined). In addition, the State is deferring the initial principal payments on newly issued general obligation bonds. Although intended to aid in closing the State's near-term budget shortfall, both of these practices individually will result in the primary government incurring increased interest costs in the future because of the delay in paying off outstanding principal balances.

The plan also targeted the restructuring of certain general obligation bonds to achieve one-time reductions in debt service requirements and to facilitate a faster transition to level debt service payments. There were no debt restructuring bonds issued during the year ended June 30, 2003; however, on July 1, 2003, the State issued general obligation bonds that will be used to refund $870 million of outstanding general obligation bonds. This debt restructuring will reduce debt service payments during the 2003-04 fiscal year, but it will achieve this reduction by increasing future debt service requirements.

Lastly, the plan included the issuance of variable-rate debt for a portion of the State's general obligation bond portfolio. On April 4, 2003, the State issued $1.4 billion of variable-rate general obligation bonds. This practice can be beneficial because, historically, variable-rate bonds are issued at rates below those of fixed-rate bonds. Also, when market rates fall, interest rates decrease. However, when market rates rise, so do interest payments on outstanding principal balances.

At June 30, 2003, the primary government had total bonded debt outstanding of $54.9 billion. Of this amount, $29.6 billion (53.9%) represents general obligation bonds, which are backed by the full faith and credit of the State. The current portion of general obligation bonds outstanding is $1.6 billion and the long-term portion is $28.0 billion. The remaining $25.3 billion (46.1%) of bonded debt outstanding represents revenue bonds, which are secured solely by specified revenue sources. The current portion of revenue bonds outstanding is $620 million and the long-term portion is $24.7 billion. Table 5 presents a summary of the primary government's long-term obligations as of June 30, 2003.

Table 5

State of California's Long-Term Obligations
Year ended June 30, 2003
(amounts in millions)

	Governmental Activities	Business-Type Activities	Total
Government-wide noncurrent liabilities			
General obligation bonds	$ 25,429	$ 2,610	$ 28,039
Revenue bonds	3,719	20,972	24,691
Certificates of participation and commercial paper	912	101	1,013
Capital lease obligations	3,701	—	3,701
Other noncurrent liabilities	7,896	3,347	11,243
Total noncurrent liabilities	**41,657**	**27,030**	**68,687**
Current portion of long-term obligations	3,031	1,521	4,552
Total long-term obligations	**$ 44,688**	**$ 28,551**	**$ 73,239**

The primary government's total long-term obligations increased during the year ended June 30, 2003. The main reason for the increase was the issuance of $16.6 billion in revenue bonds and $5.2 billion in general obligation bonds and the repayment of a $3.8 billion energy power loan, for a net increase of $18.0 billion. The revenue bonds issued consisted mainly of $11.6 billion in energy revenue bonds and $3.0 billion in Golden State Tobacco Securitization Corporation bonds. The general obligation bonds were issued primarily to finance the building and repair of education facilities.

Three statewide bond measures were passed by the voters in November 2002: Proposition 46, the Housing and Emergency Shelter Trust Fund Act of 2002; Proposition 47, the Kindergarten-University Public Education Facilities Bond Act of 2002; and Proposition 50, the Water Security, Clean Drinking Water, Coastal and Beach Protection Bond Act of 2002. These measures increased the authorization to issue bonds by $18.6 billion.

Additional information on the State's long-term obligations can be found in Note 10, Long-Term Obligations, and Notes 11 through 16.

Recent Economic Events and Future Budgets

Recent Economic Conditions
From July through September of 2003, employment in California continued to subside, but in October and November there was evidence that employment had at least stabilized. The Bay Area has taken the brunt of job losses in the state, having lost almost 11% of its jobs since the 2000 peak; and recovery in that high-tech region is key to the state's economic health. While job recovery is not yet evident in the Bay Area, signs of stability are emerging. Sales of electronic equipment are increasing, and information services began adding jobs in the third quarter of 2003.

The Southern California economy, with the exception of Los Angeles, has weathered this recession quite well. Los Angeles shows weakness in three key employment sectors: manufacturing, government, and motion pictures. The area's unemployment rate, at 6.5% in November 2003, is persistently higher than the state average. By contrast, the unemployment rate in Orange County in November 2003 was only 3.5% and in San Diego 4.0%. The Inland Empire (San Bernardino and Riverside counties) continued to grow in both jobs and population throughout the recession. Job growth has slowed in recent months but is still positive. Much of the recent growth in the Inland Empire is related to housing and other population service sectors.

The housing market continues to be strong as the year ends. Both Southern California and the Bay Area had the strongest November sales in 15 years. Despite the weak job market and severe housing affordability problems, November home sales produced annual price increases of 9.4% in the Bay Area and 16.7% in Southern California. The percentage of households that could afford the median-priced home in California was only 25% in October 2003, compared to 57% nationwide. In the San Diego area, the affordability index was only 12%. The High Desert region was the most affordable area, with an affordability index of 58%.

The stock market rebound that began in March 2003 seems to have given a boost to personal income; tax revenues began to exceed estimates early in the 2003-04 fiscal year. Retail sales for the 2003 Christmas season are expected to be the best in three years. Gross domestic product (GDP) growth for the nation was an impressive 8.2% in the third quarter of 2003 and, while that is expected to moderate in the fourth quarter, it is seen as a turning point in the national economy and consequently in the California economy.

California's Future Budgets

The Legislature adopted and the Governor approved California's 2003-04 budget on August 2, 2003. General Fund revenues were projected to be $74.8 billion and expenditures were projected to be $71.1 billion for the 2003-04 fiscal year. The General Fund budget continued to depend heavily on debt financing that was authorized for the 2002-03 fiscal year but had not been accomplished by June 30, 2003. A total of $14.6 billion in General Fund support was projected to be from bond sales. Specifically, this financial plan relied on the sale of $10.7 billion in fiscal recovery bonds, a $1.9 billion pension obligation bond, and a second $2.0 billion tobacco securitization revenue bond.

However, California's Constitution limits to $300,000 the amount of debt the Legislature can establish without approval of the voters. Separate lawsuits were filed against the State to block the issuance of pension obligation bonds and the fiscal recovery bonds on the grounds that these bond proposals violate the constitutional debt limit. A state trial court has declined to validate the pension obligation bonds and the State has appealed the court's decision.

The Administration continues to pursue judicial validation and is taking steps to prepare for the sale of the fiscal recovery bonds, as authorized by current law. A final decision on the bonds will be made after the March 2004 election, as explained below.

Because of the legal challenges posed, the Legislature passed and the Governor approved legislation in December 2003 that authorizes up to $15.0 billion in general obligation bonds to be placed on the March 2004 statewide primary ballot for approval by California's voters. These bonds are part of the Economic Recovery Bond Act, which is intended to finance the accumulated state budget deficit of $12.3 billion identified by the Administration.

These bonds can only be authorized if the voters approve both the Economic Recovery Bond Act and the Balanced Budget Amendment, Chapter 1, Statutes of 2003, Fifth Extraordinary Session, in the March 2004 election. The bonds are to be repaid within 15 years, beginning in the 2004-05 fiscal year, from receipts of one-quarter cent of the sales tax.

Also in December 2003, the Governor asked the Legislature to eliminate $2.0 billion of the budgetary shortfall immediately and proposed 41 specific actions to reduce programs such as transportation, resources, health and human services, education, and state agency operations.

The 2003-04 budget granted the Administration executive authority to reduce and reallocate expenditures among state operations. The Governor used this authority in issuing executive orders S-3-03 and S-4-03 to immediately place a broader hiring freeze on state departments, to prohibit departments from entering into new contracts to purchase services or equipment, and to restrict travel of state employees.

Governor's Proposed Budget for 2004-05

The Governor released his 2004-05 budget proposal on January 9, 2004. The proposal forecasts a $12.3 billion budget deficit through June 30, 2004. This estimate is $2.6 billion lower than previously identified by the Administration, due to revenue growth and expenditure reductions thus far during the 2003-04 fiscal year. The Governor proposes to address the deficit with a variety of budget solutions that include program reductions, cost shifts, loans, transfers, fee increases, and various funding shifts.

The proposed solutions will impact many program activities, including 22 categorical programs in education, health and human services, and public safety. The suspension of about $1.1 billion of

Proposition 42 gasoline sales tax transfers to the Transportation Investment Fund could also delay or end transportation-related projects.

The 2004-05 budget totals $97.2 billion, excluding federal funds and bond funds. This represents projected General Fund expenditures of $76.1 billion and special fund expenditures of $21.1 billion. Proposed General Fund expenditures are 2.4% lower than the $78.0 billion projected for the 2003-04 fiscal year.

The Legislative Analyst's Office, California's nonpartisan fiscal and policy advisor, released its assessment of the 2004-05 proposed budget on January 13, 2004. The assessment comments positively on the realistic revenue estimates and caseload assumptions but says that the plan does not fully address the State's ongoing budget problem. The Legislative Analyst's Office believes that a shortfall of approximately $6.0 billion will occur in 2005-06, barring any further budgetary actions to reduce the structural deficit. Early and decisive action by the Legislature is recommended to maximize solutions to the budget problem.

Requests for Information

This financial report is designed to provide interested parties with a general overview of the State of California's finances. Questions concerning the information provided in this report or requests for additional information should be addressed to the State Controller's Office, Division of Accounting and Reporting, P.O. Box 942850, Sacramento, California 94250.

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Basic Financial Statements

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Government-Wide Financial Statements

Statement of Net Assets

June 30, 2003
(amounts in thousands)

	Primary Government			
	Governmental Activities	**Business-Type Activities**	Total	**Component Units**
ASSETS				
Current assets:				
Cash and pooled investments	$ 14,353,687	$ 3,481,492	$ 17,835,179	$ 2,228,187
Amount on deposit with U.S. Treasury	—	2,785,111	2,785,111	—
Restricted assets:				
Cash and pooled investments	—	2,037,155	2,037,155	—
Investments	—	34,610	34,610	4,745
Due from other governments	—	54,043	54,043	—
Investments	859,147	1,420,624	2,279,771	8,644,499
Receivables (net)	7,624,395	385,973	8,010,368	3,410,357
Internal balances	138,939	(138,939)	—	—
Due from primary government	—	—	—	244,439
Due from other governments	8,947,722	250,189	9,197,911	685,974
Prepaid items	26,447	573	27,020	16,414
Food stamps	327,118	—	327,118	—
Inventories	96,303	16,271	112,574	113,766
Recoverable power costs (net)	—	1,129,000	1,129,000	—
Other current assets	139,262	1,371	140,633	98,420
Total current assets	32,513,020	11,457,473	43,970,493	15,446,801
Noncurrent assets:				
Restricted assets:				
Cash and pooled investments	—	2,106,455	2,106,455	100
Investments	—	92,200	92,200	4,749
Loans receivable	—	754,008	754,008	—
Investments	—	2,710,836	2,710,836	19,279,664
Net investment in direct financing leases	—	5,146,237	5,146,237	—
Receivables (net)	812,322	42,428	854,750	298,093
Loans receivable	1,564,142	2,943,103	4,507,245	5,948,659
Recoverable power costs (net)	—	7,568,000	7,568,000	—
Deferred charges	114,964	1,361,695	1,476,659	76,176
Capital assets:				
Land	3,564,083	16,999	3,581,082	441,318
State highway infrastructure	402,876	—	402,876	—
Collections – nondepreciable	20,623	—	20,623	224,500
Buildings and other depreciable property	18,398,445	7,645,247	26,043,692	19,946,005
Less: accumulated depreciation	(7,006,094)	(3,064,602)	(10,070,696)	(9,566,565)
Construction in progress	3,941,300	776,274	4,717,574	2,178,363
Other noncurrent assets	—	5,865	5,865	366,617
Total noncurrent assets	21,812,661	28,104,745	49,917,406	39,197,679
Total assets	**$ 54,325,681**	**$ 39,562,218**	$ 93,887,899	**$ 54,644,480**

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

	Primary Government			
	Governmental Activities	**Business-Type Activities**	Total	**Component Units**
LIABILITIES				
Current liabilities:				
Accounts payable	$ 10,963,595	$ 597,931	$ 11,561,526	$ 1,594,893
Due to component units	244,439	—	244,439	—
Due to other governments	7,313,905	231,795	7,545,700	4,058
Dividends payable	—	—	—	12,800
Deferred revenue	328,931	24,673	353,604	616,356
Tax overpayments	2,559,579	—	2,559,579	—
Deposits	60,385	2,571	62,956	925,631
Contracts and notes payable	10,988,900	81	10,988,981	2,917
Advance collections	586,059	40,152	626,211	236,573
Interest payable	419,101	196,031	615,132	136,714
Securities lending obligations	—	—	—	3,173,243
Benefits payable	—	460,205	460,205	2,187,276
Current portion of long-term obligations	3,031,338	1,521,155	4,552,493	1,630,781
Other current liabilities	689,771	252,147	941,918	1,814,720
Total current liabilities	37,186,003	3,326,741	40,512,744	12,335,962
Noncurrent liabilities:				
Loans payable	841,900	—	841,900	—
Benefits payable	—	919,935	919,935	7,918,336
Lottery prizes and annuities	—	1,992,519	1,992,519	—
Compensated absences payable	1,410,129	16,517	1,426,646	222,091
Certificates of participation, commercial paper, and other borrowings	911,906	101,528	1,013,434	353,864
Capital lease obligations	3,701,417	—	3,701,417	1,217,965
General obligation bonds payable	25,429,071	2,609,900	28,038,971	—
Revenue bonds payable	3,718,590	20,971,836	24,690,426	11,563,102
Other noncurrent liabilities	5,643,553	418,093	6,061,646	774,476
Total noncurrent liabilities	41,656,566	27,030,328	68,686,894	22,049,834
Total liabilities	**78,842,569**	**30,357,069**	109,199,638	**34,385,796**
NET ASSETS				
Investment in capital assets, net of related debt	14,180,116	1,405,232	15,585,348	7,404,623
Restricted:				
Nonexpendable	—	—	—	746,245
Expendable	5,230,983	7,925,726	13,156,709	6,924,222
Unrestricted	(43,927,987)	(125,809)	(44,053,796)	5,183,594
Total net assets	**(24,516,888)**	**9,205,149**	(15,311,739)	**20,258,684**
Total liabilities and net assets	**$ 54,325,681**	**$ 39,562,218**	$ 93,887,899	**$ 54,644,480**

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

Statement of Activities

Year Ended June 30, 2003
(amounts in thousands)

FUNCTIONS/PROGRAMS	Expenses	Program Revenues: Charges for Services	Program Revenues: Operating Grants and Contributions	Program Revenues: Capital Grants and Contributions
Primary government				
Governmental activities:				
General government	$ 8,600,789	$ 1,136,401	$ 1,095,388	$ —
Education	51,446,964	2,710,369	4,966,790	—
Health and human services	59,141,547	4,867,578	30,247,334	—
Resources	3,430,853	1,189,327	317,282	—
State and consumer services	437,134	454,051	8,229	—
Business and transportation	7,514,723	2,759,007	1,668,446	1,302,376
Correctional programs	6,681,270	12,406	105,656	—
Tax relief	3,921,433	2,216	—	—
Interest on long-term debt	1,780,748	—	—	—
Total governmental activities	142,955,461	13,131,355	38,409,125	1,302,376
Business-type activities:				
Housing Loan	206,864	189,812	—	—
Electric Power	4,985,000	4,985,000	—	—
Water Resources	739,819	693,566	—	—
Public Building Construction	347,898	317,741	—	—
State Lottery and payments for education	2,791,144	2,936,030	—	—
Unemployment Programs	10,651,949	8,230,208	—	—
High Technology Education	37,727	44,268	—	—
Toll Facilities	21,796	172	762	—
State University Dormitory Building Maintenance and Equipment	220,334	284,719	—	—
State Water Pollution Control Revolving	14,970	54,201	—	145,341
Public Employees' Benefits	1,694,231	2,066,530	—	—
Other enterprise programs	103,974	134,544	—	—
Total business-type activities	21,815,706	19,936,791	762	145,341
Total primary government	**$ 164,771,167**	**$ 33,068,146**	**$ 38,409,887**	**$ 1,447,717**
Component units:				
University of California	$ 17,629,925	$ 11,370,861	$ 3,531,343	$ —
State Compensation Insurance Fund	6,301,904	6,687,003	—	—
California Housing Finance Agency	542,789	556,574	72,571	—
Other component units	564,831	428,189	—	—
Total component units	**$ 25,039,449**	**$ 19,042,627**	**$ 3,603,914**	**$ —**

General revenues:
- Personal income taxes
- Sales and use taxes
- Corporation taxes
- Insurance taxes
- Other taxes
- Investment and interest
- Miscellaneous

Transfers

Nonoperating grants and gifts

Total general revenues and transfers

Change in net assets

Net assets, July 1, 2002 (restated)

Net assets, June 30, 2003

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

Net (Expenses) Revenues and Changes in Net Assets			
Primary Government			
Governmental Activities	Business-Type Activities	Total	Component Units
$ (6,369,000)		$ (6,369,000)	
(43,769,805)		(43,769,805)	
(24,026,635)		(24,026,635)	
(1,924,244)		(1,924,244)	
25,146		25,146	
(1,784,894)		(1,784,894)	
(6,563,208)		(6,563,208)	
(3,919,217)		(3,919,217)	
(1,780,748)		(1,780,748)	
(90,112,605)		(90,112,605)	
	$ (17,052)	(17,052)	
	—	—	
	(46,253)	(46,253)	
	(30,157)	(30,157)	
	144,886	144,886	
	(2,421,741)	(2,421,741)	
	6,541	6,541	
	(20,862)	(20,862)	
	64,385	64,385	
	184,572	184,572	
	372,299	372,299	
	30,570	30,570	
	(1,732,812)	(1,732,812)	
(90,112,605)	**(1,732,812)**	(91,845,417)	
			$ (2,727,721)
			385,099
			86,356
			(136,642)
			(2,392,908)
32,529,941	—	32,529,941	—
26,930,469	—	26,930,469	—
6,489,209	—	6,489,209	—
1,886,312	—	1,886,312	—
2,897,469	—	2,897,469	—
371,935	—	371,935	—
5,718	—	5,718	—
66,630	(66,630)	—	—
575,906	—	575,906	3,926,990
71,753,589	**(66,630)**	71,686,959	**3,926,990**
(18,359,016)	(1,799,442)	(20,158,458)	1,534,082
(6,157,872)	**11,004,591**	4,846,719	**18,724,602**
$ (24,516,888)	**$ 9,205,149**	$ (15,311,739)	**$ 20,258,684**

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

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Fund Financial Statements

Balance Sheet

Governmental Funds

June 30, 2003
(amounts in thousands)

	General	Federal	Transportation Construction	Nonmajor Governmental	Total
ASSETS					
Cash and pooled investments	$ 3,823,628	$ 848,376	$ 1,036,394	$ 8,035,639	$ 13,744,037
Investments	—	—	—	859,147	859,147
Receivables (net)	5,995,502	20,670	370,543	1,118,026	7,504,741
Due from other funds	1,107,357	242	1,023,457	1,379,388	3,510,444
Due from other governments	694,417	8,118,257	15,288	111,954	8,939,916
Food stamps	—	327,118	—	—	327,118
Interfund receivables	42,816	—	748,900	2,092,964	2,884,680
Loans receivable	109,227	41,229	—	1,389,062	1,539,518
Other assets	1,894	—	93,897	34,727	130,518
Total assets	**$ 11,774,841**	**$ 9,355,892**	**$ 3,288,479**	**$ 15,020,907**	$ 39,440,119
LIABILITIES					
Accounts payable	$ 1,592,283	$ 1,136,938	$ 463,814	$ 2,144,903	$ 5,337,938
Due to other funds	1,603,627	5,965,472	354,923	596,494	8,520,516
Due to component units	167,829	—	1	74,754	242,584
Due to other governments	4,750,718	1,311,027	244,514	1,007,646	7,313,905
Deferred revenue	—	327,118	—	1,813	328,931
Interfund payables	2,926,530	—	—	762,749	3,689,279
Tax overpayments	2,550,332	—	—	9,247	2,559,579
Deposits	794	—	10,162	48,494	59,450
Contracts and notes payable	10,965,000	—	—	2,763	10,967,763
Advance collections	54,185	1,125	4,634	271,008	330,952
Loans payable	25,000	—	—	—	25,000
Interest payable	2,428	—	—	7,033	9,461
Other liabilities	503,913	7,174	114,688	1,505,496	2,131,271
Total liabilities	**25,142,639**	**8,748,854**	**1,192,736**	**6,432,400**	41,516,629
FUND BALANCES					
Reserved for:					
Encumbrances	902,851	—	1,625,391	4,723,327	7,251,569
Interfund receivables	42,816	—	748,900	2,092,964	2,884,680
Loans receivable	109,227	41,229	—	1,389,062	1,539,518
Continuing appropriations	996,896	—	2,556,276	1,903,271	5,456,443
Unreserved, reported in:					
General Fund	(15,419,588)	—	—	—	(15,419,588)
Special revenue funds	—	565,809	(2,834,824)	(1,294,420)	(3,563,435)
Capital projects funds	—	—	—	(225,697)	(225,697)
Total fund balances (deficits)	**(13,367,798)**	**607,038**	**2,095,743**	**8,588,507**	(2,076,510)
Total liabilities and fund balances	**$ 11,774,841**	**$ 9,355,892**	**$ 3,288,479**	**$ 15,020,907**	

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

Reconciliation of the Governmental Funds Balance Sheet to the Statement of Net Assets

(amounts in thousands)

Total fund balances – governmental funds		**$ (2,076,510)**
Amounts reported for governmental activities in the Statement of Net Assets are different because:		
Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds.		18,842,388
Other long-term assets are not available to pay for current-period expenditures and, therefore, are not reported.		812,322
Internal service funds are used by management to charge the costs of certain activities, such as fleet management and management information systems, to individual funds. The assets and liabilities of the internal service funds are included in governmental activities in the Statement of Net Assets.		639,474
Deferred issue costs are reported as current expenditures in the funds. However, deferred issue costs are amortized over the life of the bonds and are included in the governmental activities in the Statement of Net Assets.		114,964
General obligation bonds totaling $27,167,011 and revenue bonds totaling $3,752,040 are not due and payable in the current period and, therefore, are not reported in the funds.		(30,919,051)
Certain long-term liabilities are not due and payable in the current period and, therefore, adjustments to these liabilities are not reported in the funds:		
Compensated absences adjustments	(1,377,903)	
Certificates of participation and commercial paper adjustments	(922,452)	
Capital lease adjustments	(3,893,254)	
Other long-term obligations	(5,736,866)	
		(11,930,475)
Net assets of governmental activities		**$ (24,516,888)**

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

Statement of Revenues, Expenditures, and Changes in Fund Balances

Governmental Funds

Year Ended June 30, 2003
(amounts in thousands)

	General	Federal	Transportation Construction	Nonmajor Governmental	Total
REVENUES					
Personal income taxes	$ 32,661,274	$ —	$ —	$ —	$ 32,661,274
Sales and use taxes	22,425,495	—	2,175,995	2,344,215	26,945,705
Corporation taxes	6,861,200	—	—	—	6,861,200
Insurance taxes	1,886,312	—	—	—	1,886,312
Other taxes	1,180,387	—	—	1,565,600	2,745,987
Intergovernmental	3,218	40,286,805	—	1,644,207	41,934,230
Licenses and permits	47,360	—	724,266	2,224,114	2,995,740
Charges for services	129,327	—	125,020	653,134	907,481
Fees	15,484	—	14	3,586,012	3,601,510
Penalties	60,808	602	—	521,976	583,386
Investment and interest	359,527	—	20,594	234,119	614,240
Other	503,105	—	54,385	2,486,085	3,043,575
Total revenues	**66,133,497**	**40,287,407**	**3,100,274**	**15,259,462**	124,780,640
EXPENDITURES					
Current:					
General government	2,409,661	1,114,089	7,147	4,512,552	8,043,449
Education	37,644,568	5,836,036	965	7,262,610	50,744,179
Health and human services	22,827,502	28,284,445	—	7,884,265	58,996,212
Resources	1,023,964	297,192	12	2,047,305	3,368,473
State and consumer services	459,975	8,229	—	472,461	940,665
Business and transportation	64,658	2,970,492	3,541,601	2,340,430	8,917,181
Correctional programs	5,715,949	106,059	—	19,095	5,841,103
Tax relief	3,897,106	—	—	—	3,897,106
Capital outlay	515,996	—	787	1,150,149	1,666,932
Debt service:					
Principal retirement	491,168	—	—	55,617	546,785
Interest and fiscal charges	1,521,021	—	583	281,774	1,803,378
Total expenditures	**76,571,568**	**38,616,542**	**3,551,095**	**26,026,258**	144,765,463
Excess (deficiency) of revenues over (under) expenditures	(10,438,071)	1,670,865	(450,821)	(10,766,796)	(19,984,823)
OTHER FINANCING SOURCES (USES)					
Proceeds from general obligation bonds, commercial paper, and capital leases	515,996	—	564	9,061,436	9,577,996
Proceeds from revenue bonds	—	—	—	3,000,000	3,000,000
Proceeds from remarketing bonds	—	—	—	275,000	275,000
Payment to remarketing agent	—	—	—	(275,000)	(275,000)
Payment to refund commercial paper	—	—	—	(3,521,900)	(3,521,900)
Transfers in	3,721,512	—	36,689	4,494,963	8,253,164
Transfers out	(2,714,350)	(1,107,799)	(38,823)	(4,209,415)	(8,070,387)
Total other financing sources (uses)	**1,523,158**	**(1,107,799)**	**(1,570)**	**8,825,084**	9,238,873
Net change in fund balances	(8,914,913)	563,066	(452,391)	(1,941,712)	(10,745,950)
Fund balances (deficits), July 1, 2002	**(4,452,885)** *	**43,972**	**2,548,134**	**10,530,219** *	8,669,440
Fund balances (deficits), June 30, 2003	**$ (13,367,798)**	**$ 607,038**	**$ 2,095,743**	**$ 8,588,507**	$ (2,076,510)

*Restated

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

Reconciliation of the Statement of Revenues, Expenditures, and Changes in Fund Balances of Governmental Funds to the Statement of Activities

(amounts in thousands)

Net change in fund balances – total governmental funds		**$ (10,745,950)**
Amounts reported for governmental activities in the Statement of Activities are different 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. This is the amount by which capital outlays exceed depreciation in the current period.		2,820,076
Revenues in the Statement of Activities that do not provide current financial resources are deferred and not reported as revenues in the funds.		32,691
Bond proceeds and other noncurrent financing instruments provide current financial resources to governmental funds by issuing debt, which increases long-term liabilities in the Statement of Net Assets. Repayment of bond principal is an expenditure in the governmental funds, but the repayment reduces long-term liabilities in the Statement of Net Assets. This is the amount by which proceeds exceed repayments.		
General obligation bonds adjustments	(4,727,965)	
Revenue bonds adjustments	(2,860,360)	
Certificates of participation and commercial paper adjustments	(382,360)	
		(7,970,685)
Some expenses reported in the Statement of Activities do not require the use of current financial resources and, therefore, are not reported as expenditures in governmental funds.		
Compensated absences	8,522	
Lease adjustments	(312,975)	
Other long-term obligations	(2,132,273)	
		(2,436,726)
Internal service funds are used by management to charge the costs of certain activities, such as fleet management and management information systems, to individual funds. The net revenue (expense) of the internal service funds is reported with governmental activities.		(58,422)
Change in net assets of governmental activities		**$ (18,359,016)**

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

Balance Sheet

Proprietary Funds

June 30, 2003
(amounts in thousands)

	Business-Type Activities – Enterprise Funds		
	Housing Loan	Electric Power	Water Resources
ASSETS			
Current assets:			
Cash and pooled investments	$ 750,512	$ —	$ 247,843
Amount on deposit with U.S. Treasury	—	—	—
Restricted assets:			
Cash and pooled investments	2,789	1,646,000	—
Investments	34,610	—	—
Due from other governments	—	—	—
Investments	—	37,000	—
Receivables (net)	11,376	—	83,411
Due from other funds	3,295	36,000	1,993
Due from other governments	—	—	16,884
Prepaid items	—	—	—
Inventories	—	—	9,267
Recoverable power costs (net)	—	1,129,000	—
Other current assets	—	—	110
Total current assets	802,582	2,848,000	359,508
Noncurrent assets:			
Restricted assets:			
Cash and pooled investments	—	1,704,000	154,558
Investments	—	—	51,712
Loans receivable	—	—	—
Investments	267,445	—	—
Net investment in direct financing leases	—	—	—
Receivables	—	—	—
Interfund receivables	—	—	91,516
Loans receivable	1,756,379	—	37,245
Recoverable power costs (net)	—	7,568,000	—
Deferred charges	18,465	—	1,277,680
Capital assets:			
Land	443	—	—
Buildings and other depreciable property	15,661	—	4,441,688
Less: accumulated depreciation	(11,732)	—	(1,489,403)
Construction in progress	—	—	142,610
Other noncurrent assets	5,607	—	—
Total noncurrent assets	2,052,268	9,272,000	4,707,606
Total assets	**$ 2,854,850**	**$ 12,120,000**	**$ 5,067,114**

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

Business-Type Activities – Enterprise Funds					Governmental Activities
Public Building Construction	**State Lottery**	**Unemployment Programs**	**Nonmajor Enterprise**	Total	**Internal Service Funds**
$ —	$ 248,510	$ 748,605	$ 1,486,022	$ 3,481,492	$ 609,656
—	—	2,785,111	—	2,785,111	—
53,877	—	—	334,489	2,037,155	—
—	—	—	—	34,610	—
—	—	—	54,043	54,043	—
—	352,926	—	1,030,698	1,420,624	—
114,899	134,515	128,886	27,785	500,872	117,667
12,277	3,705	12,439	18,568	88,277	297,257
—	—	38,970	194,335	250,189	7,806
—	492	—	81	573	26,447
—	4,902	—	2,102	16,271	96,303
—	—	—	—	1,129,000	—
—	—	—	1,261	1,371	8,733
181,053	745,050	3,714,011	3,149,384	11,799,588	1,163,869
227,867	—	—	20,030	2,106,455	—
—	—	—	40,488	92,200	—
—	—	—	754,008	754,008	—
—	2,443,391	—	—	2,710,836	—
4,731,953	—	—	414,284	5,146,237	—
—	—	42,428	—	42,428	—
—	—	—	22,644	114,160	—
—	—	—	1,149,479	2,943,103	—
—	—	—	—	7,568,000	—
57,129	270	—	8,151	1,361,695	—
—	4,923	—	11,633	16,999	231
—	146,505	9,491	3,031,902	7,645,247	1,178,115
—	(107,564)	(3,863)	(1,452,040)	(3,064,602)	(702,561)
416,014	—	—	217,650	776,274	3,060
—	—	—	258	5,865	—
5,432,963	2,487,525	48,056	4,218,487	28,218,905	478,845
$ 5,614,016	**$ 3,232,575**	**$ 3,762,067**	**$ 7,367,871**	$ 40,018,493	**$ 1,642,714**

(continued)

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

Balance Sheet (continued)

Proprietary Funds

June 30, 2003
(amounts in thousands)

	Business-Type Activities – Enterprise Funds		
	Housing Loan	Electric Power	Water Resources
LIABILITIES			
Current liabilities:			
Accounts payable	$ 138	$ 415,000	$ 34,767
Due to other funds	146	—	59,451
Due to component units	—	—	—
Due to other governments	—	—	74,954
Deferred revenue	—	—	—
Deposits	—	—	—
Contracts and notes payable	—	—	—
Advance collections	—	—	—
Interest payable	37,439	69,000	18,216
Benefits payable	—	—	—
Current portion of long-term obligations	156,205	222,000	107,631
Other current liabilities	—	—	—
Total current liabilities	193,928	706,000	295,019
Noncurrent liabilities:			
Interfund payables	—	—	—
Benefits payable	21,935	—	—
Lottery prizes and annuities	—	—	—
Compensated absences payable	—	—	—
Certificates of participation, commercial paper, and other borrowings	—	—	32,094
Capital lease obligations	—	—	—
General obligation bonds payable	1,827,290	—	777,610
Revenue bonds payable	517,665	11,414,000	2,344,884
Other noncurrent liabilities	—	—	414,513
Total noncurrent liabilities	2,366,890	11,414,000	3,569,101
Total liabilities	**2,560,818**	**12,120,000**	**3,864,120**
NET ASSETS			
Investment in capital assets, net of related debt	4,372	—	246,567
Restricted, expendable	289,660	—	956,427
Unrestricted	—	—	—
Total net assets	**294,032**	**—**	**1,202,994**
Total liabilities and net assets	**$ 2,854,850**	**$ 12,120,000**	**$ 5,067,114**

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

Business-Type Activities – Enterprise Funds					Governmental Activities
Public Building Construction	**State Lottery**	**Unemployment Programs**	**Nonmajor Enterprise**	Total	**Internal Service Funds**
$ 47,792	$ 30,638	$ 955	$ 48,875	$ 578,165	$ 198,551
81,116	209,857	69,250	52,434	472,254	348,093
—	—	—	—	—	1,855
558	—	18,132	138,151	231,795	—
—	—	—	24,673	24,673	—
—	13	—	2,558	2,571	935
—	—	—	81	81	21,137
25,617	2,047	—	12,488	40,152	255,107
57,042	—	—	14,334	196,031	—
—	—	460,205	—	460,205	—
259,502	535,500	—	240,317	1,521,155	13,459
—	—	55,187	196,960	252,147	5,797
471,627	778,055	603,729	730,871	3,779,229	844,934
—	—	—	3,787	3,787	98,050
—	—	—	898,000	919,935	—
—	1,992,519	—	—	1,992,519	—
—	—	7,639	8,878	16,517	32,226
—	—	—	69,434	101,528	—
—	—	—	—	—	6,444
—	—	—	5,000	2,609,900	—
5,073,621	—	—	1,621,666	20,971,836	—
—	—	—	3,580	418,093	21,586
5,073,621	1,992,519	7,639	2,610,345	27,034,115	158,306
5,545,248	**2,770,574**	**611,368**	**3,341,216**	30,813,344	**1,003,240**
—	43,864	5,094	1,105,335	1,405,232	478,388
68,768	462,001	3,145,605	3,003,265	7,925,726	—
—	(43,864)	—	(81,945)	(125,809)	161,086
68,768	**462,001**	**3,150,699**	**4,026,655**	9,205,149	**639,474**
$ 5,614,016	**$ 3,232,575**	**$ 3,762,067**	**$ 7,367,871**	$ 40,018,493	**$ 1,642,714**

(concluded)

Statement of Revenues, Expenses, and Changes in Fund Net Assets

Proprietary Funds

Year Ended June 30, 2003
(amounts in thousands)

	Business-Type Activities – Enterprise Funds		
	Housing Loan	Electric Power	Water Resources
OPERATING REVENUES			
Unemployment and disability insurance	$ —	$ —	$ —
Lottery ticket sales	—	—	—
Power sales	—	4,517,000	85,735
Student tuition and fees	—	—	—
Services and sales	3,625	—	603,696
Investment and interest	183,335	—	—
Rent	—	—	—
Other	299	—	—
Total operating revenues	**187,259**	**4,517,000**	**689,431**
OPERATING EXPENSES			
Lottery prizes	—	—	—
Power purchases (net of recoverable power costs)	—	4,446,000	82,617
Personal services	13,660	—	204,267
Supplies	—	—	—
Services and charges	16,975	71,000	91,528
Depreciation	1,260	—	75,698
Distributions to beneficiaries	—	—	—
Interest expense	174,969	—	—
Amortization of deferred charges	—	—	101,889
Other	—	—	—
Total operating expenses	**206,864**	**4,517,000**	**555,999**
Operating income (loss)	(19,605)	—	133,432
NONOPERATING REVENUES (EXPENSES)			
Donations and grants received	—	—	—
Grants provided	—	—	—
Investment and interest income	2,029	468,000	—
Interest expense and fiscal charges	—	(468,000)	(183,820)
Lottery payments for education	—	—	—
Other	524	—	4,135
Total nonoperating revenues (expenses)	**2,553**	**—**	**(179,685)**
Income (loss) before contributions and transfers	(17,052)	—	(46,253)
Capital contributions	—	—	—
Transfers in	—	—	—
Transfers out	—	—	—
Change in net assets	(17,052)	—	(46,253)
Total net assets, July 1, 2002	**311,084**	**—**	**1,249,247**
Total net assets, June 30, 2003	**$ 294,032**	**$ —**	**$ 1,202,994**

*Restated

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

Business-Type Activities – Enterprise Funds					Governmental Activities
Public Building Construction	**State Lottery**	**Unemployment Programs**	**Nonmajor Enterprise**	Total	**Internal Service Funds**
$ —	$ —	$ 6,430,714	$ —	$ 6,430,714	$ —
—	2,781,570	—	—	2,781,570	—
—	—	—	—	4,602,735	—
—	—	—	223,831	223,831	—
—	—	1,543,519	2,090,747	4,241,587	2,011,501
10,504	—	—	53,405	247,244	81
307,233	—	—	59,711	366,944	—
4	—	—	22,946	23,249	—
317,741	**2,781,570**	**7,974,233**	**2,450,640**	18,917,874	**2,011,582**
—	1,451,804	—	—	1,451,804	—
—	—	—	—	4,528,617	—
—	36,653	107,892	60,606	423,078	480,390
—	11,248	—	1	11,249	34,532
64,146	306,372	65,709	1,858,084	2,473,814	1,466,536
—	7,243	393	70,354	154,948	90,958
—	—	10,477,955	—	10,477,955	—
278,400	—	—	75,085	528,454	3,366
5,352	826	—	397	108,464	—
—	—	—	17,851	17,851	8,570
347,898	**1,814,146**	**10,651,949**	**2,082,378**	20,176,234	**2,084,352**
(30,157)	967,424	(2,677,716)	368,262	(1,258,360)	(72,770)
—	—	—	762	762	—
—	—	—	(602)	(602)	—
—	154,251	255,975	87,276	967,531	2,562
—	—	—	(9,830)	(661,650)	(24)
—	(976,998)	—	—	(976,998)	—
—	209	—	46,296	51,164	(172)
—	**(822,538)**	**255,975**	**123,902**	(619,793)	**2,366**
(30,157)	144,886	(2,421,741)	492,164	(1,878,153)	(70,404)
—	—	—	145,341	145,341	11,643
—	—	5,377	18,701	24,078	1,745
—	—	—	(90,708)	(90,708)	(1,406)
(30,157)	144,886	(2,416,364)	565,498	(1,799,442)	(58,422)
98,925	**317,115**	**5,567,063**	**3,461,157** *	11,004,591 *	**697,896**
$ 68,768	**$ 462,001**	**$ 3,150,699**	**$ 4,026,655**	$ 9,205,149	**$ 639,474**

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

Statement of Cash Flows

Proprietary Funds

Year Ended June 30, 2003
(amounts in thousands)

	Housing Loan	Electric Power
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from customers/employers	$ 601,631	$ 4,766,000
Receipts from interfund services provided	89	—
Payments to suppliers	(48,116)	(4,624,000)
Payments to employees	—	—
Payments for interfund services used	(2,014)	—
Payments for lottery prizes	—	—
Claims paid to other than employees	—	—
Other receipts (payments)	19,850	—
Net cash provided by (used in) operating activities	**571,440**	**142,000**
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Change in interfund payables and loans payable	(65)	(6,620,000)
Proceeds from revenue bonds	—	11,437,000
Retirement of general obligation bonds	(367,245)	—
Retirement of notes payable and commercial paper	(66,735)	(3,849,000)
Retirement of revenue bonds	(26,735)	—
Interest paid on operating debt	—	(282,000)
Transfers in	—	—
Transfers out	—	—
Grants received	—	—
Grants provided	—	—
Lottery payments for education	—	—
Other	—	352,000
Net cash provided by (used in) noncapital financing activities	**(460,780)**	**1,038,000**
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Changes in interfund payables and loans payable	—	—
Acquisition of intangible assets	—	—
Acquisition of capital assets	(71)	—
Proceeds from sale of capital assets	—	—
Proceeds from notes payable and commercial paper	—	—
Principal paid on notes payable and commercial paper	—	—
Payment of capital lease obligations	—	—
Retirement of general obligation bonds	—	—
Proceeds from revenue bonds	—	—
Retirement of revenue bonds	—	—
Interest paid	—	—
Contributed capital	—	—
Grants received	—	—
Net cash provided by (used in) capital and related financing activities	**(71)**	**—**
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of investments	(73)	(27,000)
Proceeds from maturity and sale of investments	107,965	—
Change in interfund receivables and loans receivable	—	—
Earnings on investments	—	78,000
Net cash provided by (used in) investing activities	**107,892**	**51,000**
Net increase (decrease) in cash and pooled investments	218,481	1,231,000
Cash and pooled investments at July 1, 2002	**534,820**	**2,119,000**
Cash and pooled investments at June 30, 2003	**$ 753,301**	**$ 3,350,000**

*Restated

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

	Business-Type Activities – Enterprise Funds						Governmental Activities
	Water Resources	Public Building Construction	State Lottery	Unemployment Programs	Nonmajor Enterprise	Total	Internal Service Funds
	$ 666,232	$ 506,676	$ 2,762,896	$ 8,023,003	$ 2,385,574	$ 19,712,012	$ 1,772,241
	—	—	—	—	1,882	1,971	49,224
	(203,401)	(66,712)	(312,384)	(65,710)	(1,046,053)	(6,366,376)	(1,343,568)
	(204,267)	—	(35,998)	(107,965)	(60,777)	(409,007)	(366,527)
	—	—	(5,044)	—	(4,292)	(11,350)	(86,009)
	—	—	(1,696,837)	—	—	(1,696,837)	—
	—	—	—	(11,191,523)	(898,270)	(12,089,793)	(723)
	—	(274,082)	142	13,048	(134,766)	(375,808)	30,724
	258,564	**165,882**	**712,775**	**(3,329,147)**	**243,298**	(1,235,188)	**55,362**
	—	—	—	—	(101)	(6,620,166)	(811)
	—	—	—	—	311,973	11,748,973	—
	—	—	—	—	(2,500)	(369,745)	—
	—	—	—	—	—	(3,915,735)	—
	—	—	—	—	—	(26,735)	—
	—	—	—	—	(8,049)	(290,049)	—
	—	—	—	5,377	2,424	7,801	1,745
	—	—	—	—	(39,321)	(39,321)	(1,406)
	—	—	—	—	145,929	145,929	—
	—	—	—	—	(602)	(602)	—
	—	—	(1,026,473)	—	—	(1,026,473)	—
	(6,833)	—	—	—	(44,004)	301,163	(158)
	(6,833)	—	**(1,026,473)**	**5,377**	**365,749**	(84,960)	**(630)**
	—	(61,390)	—	—	—	(61,390)	—
	—	—	—	—	—	—	(1,824)
	(37,721)	(564,585)	(15,757)	(131)	(181,744)	(800,009)	(78,134)
	—	—	59	609	136	804	721
	32,094	—	—	—	—	32,094	—
	—	—	—	—	—	—	(9,239)
	—	—	—	—	—	—	(2,901)
	(42,290)	—	—	—	—	(42,290)	—
	643,779	695,358	—	—	459,461	1,798,598	—
	(658,685)	(252,189)	—	—	(120,480)	(1,031,354)	—
	(198,653)	—	—	—	—	(198,653)	(3,366)
	—	—	—	—	—	—	11,643
	—	—	—	—	762	762	—
	(261,476)	**(182,806)**	**(15,698)**	**478**	**158,135**	(301,438)	**(83,100)**
	—	—	(66,215)	—	(150,655)	(243,943)	—
	—	13,679	350,566	3,166,422	14,137	3,652,769	—
	3,695	—	—	—	(20,200)	(16,505)	—
	6,409	—	12,827	255,975	27,848	381,059	2,622
	10,104	**13,679**	**297,178**	**3,422,397**	**(128,870)**	3,773,380	**2,622**
	359	(3,245)	(32,218)	99,105	638,312	2,151,794	(25,746)
	402,042	**284,989**	**280,728**	**649,500**	**1,202,229** *	5,473,308 *	**635,402** *
	$ 402,401	**$ 281,744**	**$ 248,510**	**$ 748,605**	**$ 1,840,541**	$ 7,625,102	**$ 609,656**

(continued)

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

Statement of Cash Flows (continued)

Proprietary Funds

Year Ended June 30, 2003
(amounts in thousands)

	Housing Loan	Electric Power
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES:		
Operating income (loss)	$ (19,605)	$ —
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities:		
Interest expense on operating debt	—	—
Depreciation	1,260	—
Accretion of capital appreciation bonds	—	—
Provisions and allowances	(5,375)	—
Accrual of deferred charges	—	—
Amortization of discounts	—	—
Amortization of deferred charges	5,826	—
Other	(2,092)	—
Change in assets and liabilities:		
Receivables	5,210	—
Due from other funds	990	(20,000)
Due from other governments	—	—
Prepaid items	—	—
Inventories	—	—
Net investment in direct financing leases	—	—
Recoverable power costs (net)	—	144,000
Other assets	8,120	—
Loans receivable	589,636	—
Accounts payable	—	18,000
Due to other funds	(2,542)	—
Due to component units	—	—
Due to other governments	—	—
Deposits	—	—
Contracts and notes payable	—	—
Advance collections	—	—
Interest payable	—	—
Other current liabilities	(7,214)	—
Deferred revenue	—	—
Benefits payable	(2,774)	—
Lottery prizes and annuities	—	—
Compensated absences payable	—	—
Capital lease obligations	—	—
Other noncurrent liabilities	—	—
Total adjustments	591,045	142,000
Net cash provided by (used in) operating activities	**$ 571,440**	**$ 142,000**
Noncash capital and related financing and investing activities		
Interest accreted on annuitized prizes	—	—
Unclaimed prizes directly transferred to Education Fund	—	—
Unrealized gain on investment	—	—
Gain on investment	—	—
Installment purchases to acquire equipment	—	—

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

Business-Type Activities – Enterprise Funds						Governmental Activities
Water Resources	**Public Building Construction**	**State Lottery**	**Unemployment Programs**	**Nonmajor Enterprise**	Total	**Internal Service Funds**
$ 133,432	$ (30,157)	$ 967,424	$ (2,677,716)	$ 368,262	$ (1,258,360)	$ (72,770)
—	—	—	—	—	—	3,366
75,698	—	7,243	393	70,354	154,948	90,958
—	3,230	—	—	4,973	8,203	—
—	—	(1,079)	—	—	(6,454)	—
—	(14,927)	(165)	—	—	(15,092)	—
—	(216)	—	—	—	(216)	—
85,822	5,352	826	—	3,236	101,062	—
—	2,765	153	—	(3,224)	(2,398)	9,044
944	137	(17,744)	(43,002)	15,704	(38,751)	(2,986)
—	(6,257)	(203)	1,384	(39,405)	(63,491)	(14,235)
—	—	—	119,183	(102,701)	16,482	(3,011)
—	—	247	—	2,936	3,183	9,916
(339)	—	(1,074)	4,132	(163)	2,556	(1,260)
—	206,375	—	—	21,962	228,337	—
—	—	—	—	—	144,000	—
(15)	—	—	—	(60)	8,045	1,693
—	—	—	—	(172,565)	417,071	—
(26,064)	7	2,828	(45)	9,886	4,612	19,082
(1,480)	252	(572)	7,109	29,302	32,069	17,821
—	—	—	—	—	—	(242)
(7,889)	(2,556)	—	654	9,881	90	—
—	—	(29)	—	(371)	(400)	(32)
—	—	—	—	(4,113)	(4,113)	—
—	(113)	205	—	1,077	1,169	3,174
—	1,990	—	—	3,586	5,576	—
(172)	—	—	(26,943)	(89,147)	(123,476)	(4,670)
—	—	—	—	3,169	3,169	—
—	—	—	(714,223)	109,375	(607,622)	—
—	—	(245,033)	—	—	(245,033)	—
(1,373)	—	(252)	(73)	(171)	(1,869)	(516)
—	—	—	—	—	—	(1,186)
—	—	—	—	1,515	1,515	1,216
125,132	196,039	(254,649)	(651,431)	(124,964)	23,172	128,132
$ 258,564	**$ 165,882**	**$ 712,775**	**$ (3,329,147)**	**$ 243,298**	$ (1,235,188)	**$ 55,362**

(concluded)

—	—	$ 172,545	—	$ —	$ 172,545	$ —
—	—	42,819	—	—	42,819	—
—	—	144,886	—	—	144,886	—
—	—	—	—	49,121	49,121	—
—	—	—	—	—	—	2,932

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

Statement of Fiduciary Net Assets

Primary Government and Component Unit Fiduciary Funds

June 30, 2003
(amounts in thousands)

	Private Purpose Trust	Pension and Other Employee Benefit Trust*	Investment Trust: Local Agency Investment	Agency
ASSETS				
Cash and pooled investments	$ 41,957	$ 989,219	$ 21,840,009	$ 4,627,256
Investments	1,030,917	340,597,891	—	—
Receivables (net)	2,951	4,454,753	80,909	278,796
Due from other funds	12,088	212,781	—	5,222,127
Due from other governments	—	180,000	—	23,538
Prepaid items	—	—	—	183
Interfund receivables	816,900	—	—	—
Loans receivable	—	—	—	33,079
Other assets	346,952	1,823,942	—	276
Total assets	**2,251,765**	**348,258,586**	**21,920,918**	**$ 10,185,255**
LIABILITIES				
Accounts payable	2,599	2,761,997	69	$ 5,536,930
Due to other funds	47	1,818	246	—
Due to other governments	—	255	98,464	3,108,640
Tax overpayments	—	—	—	2,156
Benefits payable	—	1,103,449	—	—
Deposits	346,952	—	—	914,462
Advance collections	—	78	—	11,784
Securities lending obligations	—	46,232,160	—	—
Interfund payables	—	—	—	24,624
Other liabilities	869,627	3,468,594	—	586,659
Total liabilities	**1,219,225**	**53,568,351**	**98,779**	**$ 10,185,255**
NET ASSETS				
Held in trust for pension benefits, pool participants, and other purposes	**$ 1,032,540**	**$ 294,690,235**	**$ 21,822,139**	

*Amounts include primary government Pension and Other Employee Benefit Trust Funds and fiduciary activity of the University of California Retirement System, a discretely presented component unit.

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

Statement of Changes in Fiduciary Net Assets

Primary Government and Component Unit Fiduciary Funds

Year Ended June 30, 2003
(amounts in thousands)

	Private Purpose Trust	Pension and Other Employee Benefit Trust*	Investment Trust: Local Agency Investment
ADDITIONS			
Contributions:			
Employer	$ —	$ 5,084,376	$ —
Plan member	—	5,272,913	—
Total contributions	—	10,357,289	—
Investment income:			
Net appreciation in fair value of investments	—	2,358,138	—
Interest, dividends, and other investment income	25,023	11,027,213	457,632
Less: investment expense	—	(1,866,581)	—
Net investment income	25,023	11,518,770	457,632
Receipts from depositors	442,018	—	25,075,442
Escheat income	116,486	—	—
Other	16,521	19,573	—
Total additions	**600,048**	**21,895,632**	**25,533,074**
DEDUCTIONS			
Distributions paid and payable to participants	—	12,967,806	455,677
Refunds of contributions	—	593,050	—
Administrative expense	2,810	332,813	1,955
Payments to and for depositors	74,293	359,355	22,835,052
Transfers out	116,486	—	—
Total deductions	**193,589**	**14,253,024**	**23,292,684**
Change in net assets	406,459	7,642,608	2,240,390
Net assets, July 1, 2002	**626,081**	**287,047,627**	**19,581,749**
Net assets, June 30, 2003	**$ 1,032,540**	**$ 294,690,235**	**$ 21,822,139**

*Amounts include primary government Pension and Other Employee Benefit Trust Funds and fiduciary activity of the University of California Retirement System, a discretely presented component unit.

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

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Discretely Presented Component Units Financial Statements

Balance Sheet

Discretely Presented Component Units — Enterprise Activity

June 30, 2003
(amounts in thousands)

	University of California	State Compensation Insurance Fund	California Housing Finance Agency	Nonmajor Component Units	Total
ASSETS					
Current assets:					
Cash and pooled investments	$ 97,016	$ 411,659	$ 1,231,816	$ 487,696	$ 2,228,187
Investments	4,910,857	1,686,240	1,988,136	59,266	8,644,499
Investments – restricted	—	—	—	4,745	4,745
Receivables (net)	1,227,150	1,853,205	314,350	15,652	3,410,357
Due from primary government	242,519	—	—	1,920	244,439
Due from other governments	650,564	—	—	35,410	685,974
Prepaid items	—	15,214	793	407	16,414
Inventories	113,766	—	—	—	113,766
Other current assets	82,568	—	123	15,729	98,420
Total current assets	7,324,440	3,966,318	3,535,218	620,825	15,446,801
Noncurrent assets:					
Restricted assets:					
Cash and pooled investments	—	—	—	100	100
Investments	—	—	—	4,749	4,749
Investments	9,840,937	9,322,190	108,261	8,276	19,279,664
Receivables (net)	258,137	—	—	39,956	298,093
Loans receivable	—	—	5,827,860	120,799	5,948,659
Deferred charges	—	34,035	40,730	1,411	76,176
Capital assets:					
Land	391,029	26,430	—	23,859	441,318
Collections – nondepreciable	224,500	—	—	—	224,500
Buildings and other depreciable property	19,147,370	345,542	1,104	451,989	19,946,005
Less: accumulated depreciation	(9,286,247)	(152,609)	(630)	(127,079)	(9,566,565)
Construction in progress	2,176,894	—	—	1,469	2,178,363
Other noncurrent assets	349,995	—	16,622	—	366,617
Total noncurrent assets	23,102,615	9,575,588	5,993,947	525,529	39,197,679
Total assets	**$ 30,427,055**	**$ 13,541,906**	**$ 9,529,165**	**$ 1,146,354**	$ 54,644,480

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

	University of California	State Compensation Insurance Fund	California Housing Finance Agency	Nonmajor Component Units	Total
LIABILITIES					
Current liabilities:					
Accounts payable	$ 1,428,796	$ 108,326	$ 22,192	$ 35,579	$ 1,594,893
Due to other governments	—	—	536	3,522	4,058
Deposits	795,190	—	129,206	1,235	925,631
Dividends payable	—	12,800	—	—	12,800
Deferred revenue	616,356	—	—	—	616,356
Contracts and notes payable	—	—	—	2,917	2,917
Advance collections	—	235,755	—	818	236,573
Interest payable	—	—	135,937	777	136,714
Benefits payable	—	2,187,276	—	—	2,187,276
Securities lending obligations	2,474,772	698,471	—	—	3,173,243
Current portion of long-term obligations	1,002,674	—	625,115	2,992	1,630,781
Other current liabilities	1,297,493	491,765	102	25,360	1,814,720
Total current liabilities	7,615,281	3,734,393	913,088	73,200	12,335,962
Noncurrent liabilities:					
Benefits payable	—	7,918,336	—	—	7,918,336
Compensated absences payable	176,581	40,442	—	5,068	222,091
Certificates of participation, commercial paper, and other borrowings	353,864	—	—	—	353,864
Capital lease obligations	1,216,842	—	—	1,123	1,217,965
Revenue bonds payable	3,923,989	—	7,513,296	125,817	11,563,102
Other noncurrent liabilities	692,605	—	78,079	3,792	774,476
Total noncurrent liabilities	6,363,881	7,958,778	7,591,375	135,800	22,049,834
Total liabilities	**13,979,162**	**11,693,171**	**8,504,463**	**209,000**	34,385,796
NET ASSETS					
Investment in capital assets, net of related debt	6,844,975	219,363	474	339,811	7,404,623
Restricted:					
Nonexpendable	746,245	—	—	—	746,245
Expendable	4,118,524	1,629,372	1,024,228	152,098	6,924,222
Unrestricted	4,738,149	—	—	445,445	5,183,594
Total net assets	**16,447,893**	**1,848,735**	**1,024,702**	**937,354**	20,258,684
Total liabilities and net assets	**$ 30,427,055**	**$ 13,541,906**	**$ 9,529,165**	**$ 1,146,354**	$ 54,644,480

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

Statement of Revenues, Expenses, and Changes in Fund Net Assets

Discretely Presented Component Units – Enterprise Activity

Year Ended June 30, 2003
(amounts in thousands)

	University of California	State Compensation Insurance Fund	California Housing Finance Agency	Nonmajor Component Units	Total
OPERATING REVENUES					
Student tuition and fees	$ 1,096,613	$ —	$ —	$ —	$ 1,096,613
Grants and contracts	3,531,343	—	—	—	3,531,343
Services and sales	5,040,482	—	12,963	362,065	5,415,510
Department of Energy laboratories	4,173,017	—	—	—	4,173,017
Earned premiums (net)	—	5,359,292	—	—	5,359,292
Investment and interest	—	—	424,314	10,469	434,783
Rent	—	—	—	26,211	26,211
Other	324,899	113,810	10,285	20,712	469,706
Total operating revenues	**14,166,354**	**5,473,102**	**447,562**	**419,457**	20,506,475
OPERATING EXPENSES					
Personal services	8,186,656	344,216	14,026	108,711	8,653,609
Scholarships and fellowships	338,415	—	—	—	338,415
Supplies	1,457,562	—	—	—	1,457,562
Services and charges	270,303	35,190	60,868	262,022	628,383
Department of Energy laboratories	4,139,681	—	—	—	4,139,681
Depreciation	837,520	15,653	216	9,434	862,823
Distributions to beneficiaries	—	5,103,946	—	—	5,103,946
Interest expense	—	—	393,004	5,318	398,322
Amortization of deferred charges	—	773,115	2,104	—	775,219
Other	2,130,935	29,784	—	—	2,160,719
Total operating expenses	**17,361,072**	**6,301,904**	**470,218**	**385,485**	24,518,679
Operating income (loss)	(3,194,718)	(828,802)	(22,656)	33,972	(4,012,204)
NONOPERATING REVENUES (EXPENSES)					
Primary government and federal grants	3,024,526	—	72,571	—	3,097,097
Federal grants provided	—	—	(72,571)	—	(72,571)
Private gifts	485,242	—	—	—	485,242
Investment and interest income	558,438	1,074,743	108,994	8,732	1,750,907
Interest expense and fiscal charges	(268,853)	—	—	(2,435)	(271,288)
Other	177,412	139,158	18	(176,911)	139,677
Total nonoperating revenues	**3,976,765**	**1,213,901**	**109,012**	**(170,614)**	5,129,064
Income (loss) before contributions	782,047	385,099	86,356	(136,642)	1,116,860
Capital contributions	389,852	—	—	2,500	392,352
Permanent endowments	24,870	—	—	—	24,870
Change in net assets	1,196,769	385,099	86,356	(134,142)	1,534,082
Total net assets, July 1, 2002	**15,251,124**	**1,463,636** *	**938,346**	**1,071,496** *	18,724,602 *
Total net assets, June 30, 2003	**$ 16,447,893**	**$ 1,848,735**	**$ 1,024,702**	**$ 937,354**	$ 20,258,684

*Restated

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

Notes to the Financial Statements – Index

Notes to the Financial Statements

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying financial statements present information on the financial activities of the State of California over which the Governor, the Legislature, and other elected officials have direct or indirect governing and fiscal control. These financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP). The provisions of the following Governmental Accounting Standards Board (GASB) Statements have been implemented for the year ended June 30, 2003:

Provisions 12-15 of GASB Statement No. 38, *Certain Financial Statement Note Disclosures;*

GASB Statement No. 41, *Budgetary Comparison Schedules—Perspective Differences, an amendment of GASB Statement No. 34;* and

GASB Technical Bulletin No. 2003-1, *Disclosure Requirements for Derivatives Not Reported at Fair Value on the Statement of Net Assets.*

In addition, the State reports infrastructure assets, in the government-wide Statement of Net Assets and reports depreciation for capital assets as part of the functions' direct expenses in the Statement of Activities. The State is phasing in its reporting of state highway infrastructure, as allowed by GASB Statement No. 34. All major infrastructure assets are required to be reported no later than the fiscal year ending June 30, 2006.

A. Reporting Entity

These financial statements present the primary government of the State and its component units. The **primary government** consists of all funds, organizations, institutions, agencies, departments, and offices that are not legally separate from the State. Funds such as the Public Employees' Retirement Fund and the State Teachers' Retirement Fund are reported in the appropriate fiduciary funds. **Component units** are organizations that are legally separate from the State but for which the State is financially accountable, or for which the nature and significance of their relationship with the State is such that exclusion would cause the State's financial statements to be misleading or incomplete. The decision to include a potential component unit in the State's reporting entity is based on several criteria, including legal standing, fiscal dependency, and financial accountability. Following is information on blended and discretely presented component units of the State.

Blended component units, although legally separate entities, are in substance part of the primary government's operations. Therefore, data from these blended component units are integrated into the appropriate funds for reporting purposes.

Building authorities are blended component units because they have been created through the use of joint exercise of powers agreements with various cities to finance the construction of state buildings. The building authorities are reported as capital projects funds. As a result, the $755 million of capital lease arrangements between the building authorities and the State has been eliminated from the financial statements. Instead, only the underlying fixed assets and the debt used to acquire them are reported in the government-wide financial statements. For information on how to obtain copies of the financial statements of the building authorities, contact the State Controller's Office, Division of Accounting and Reporting, P.O. Box 942850, Sacramento, California 94250.

The Golden State Tobacco Securitization Corporation (GSTSC) is a not-for-profit corporation established through legislation in September 2002 solely for the purpose of purchasing Tobacco Settlement Revenues from the State. The five voting members of the State Public Works Board serve ex officio as the directors of the corporation. GSTSC is authorized to issue bonds necessary to provide sufficient funds for carrying out its purpose. GSTSC is reported in the combining statements in the Nonmajor Governmental Funds section as a special revenue fund. For information on how to obtain copies of the financial statements of GSTSC, contact the State Controller's Office, Division of Accounting and Reporting, P.O. Box 942850, Sacramento, California 94250.

Enterprise activity of **discretely presented component units** is reported in a separate column in the government-wide financial statements. Discretely presented component units are legally separate from the primary government and mostly provide services to entities and individuals outside the primary government. Discretely presented component units that report enterprise activity include the University of California, the State Compensation Insurance Fund (SCIF), the California Housing Finance Agency (CHFA), and nonmajor component units.

The University of California was founded in 1868 as a public, state-supported, land grant institution. It was written into the State Constitution of 1879 as a public trust to be administered by a governing board, the Regents of the University of California. The University of California is a component unit of the State because the

State appoints a voting majority of the regents and because expenditures for the support of various university programs and capital outlay are appropriated by the annual Budget Act. The University of California Retirement System, which is reported as a pension and other employee benefit trust fund, is a component of the comprehensive benefits package offered to employees of the university. Copies of the University of California's separately issued financial statements may be obtained from the University of California, Financial Management, 1111 Franklin Street, 10th Floor, Oakland, California 94607-5200.

SCIF is a self-supporting enterprise created to offer insurance protection to employers at the lowest possible cost. It operates in competition with other insurance carriers to provide services to the State, counties, cities, school districts, and other public corporations. It is a component unit of the State because the State appoints all five voting members of SCIF's governing board and has the authority to approve or modify SCIF's budget. Copies of SCIF's financial statements for the year ended December 31, 2002, may be obtained from the State Compensation Insurance Fund, 1275 Market Street, San Francisco, California 94103.

CHFA was created by the Zenovich-Moscone-Chacon Housing and Home Finance Act, as amended. CHFA's purpose is to meet the housing needs of persons and families of low and moderate income. It is a component unit of the State because the State appoints a voting majority of CHFA's governing board and has the authority to approve or modify its budget. Copies of CHFA's financial statements may be obtained from the California Housing Finance Agency, 1121 L Street, 7th Floor, Sacramento, California 95814.

State legislation created various nonmajor component units to provide certain services outside the primary government and to provide certain private and public entities with a low-cost source of financing for programs deemed to be in the public interest. The California Pollution Control Financing Authority, the San Joaquin River Conservancy, and the district agricultural associations are considered component units since they have a fiscal dependency on the primary government. The California Educational Facilities Authority is considered a component unit since its exclusion from the statements would be misleading because of its relationship with the primary government. The remaining nonmajor component units are considered component units because the majority of members of their governing boards are appointed by or are members of the primary government, the primary government can impose its will on the entity, or the entity provides a specific financial benefit to the primary government. For information on how to obtain copies of the financial statements of these component units, contact the State Controller's Office, Division of Accounting and Reporting, P.O. Box 942850, Sacramento, California 94250. The nonmajor component units are:

The *California Alternative Energy and Advanced Transportation Financing Authority*, which provides financing for alternative energy and advanced transportation technologies;

The *California Infrastructure and Economic Development Bank*, which provides financing for business development and public improvements;

The *California Pollution Control Financing Authority*, which provides financing for pollution control facilities;

The *California Health Facilities Financing Authority*, which provides financing for the construction, equipping, and acquisition of health facilities;

The *California Educational Facilities Authority*, which issues revenue bonds to finance loans for students attending public and private colleges and universities and to assist private educational institutions of higher learning in financing the expansion and construction of educational facilities;

The *California School Finance Authority*, which provides loans to school and community college districts to assist them in obtaining equipment and facilities;

The *district agricultural associations*, which exhibit all of the industries, industrial enterprises, resources, and products of the state (the district agricultural associations' financial report is as of and for the year ended December 31, 2002);

The *San Joaquin River Conservancy*, which was created to acquire and manage public lands within the San Joaquin River Parkway;

The *California Urban Waterfront Area Restoration Financing Authority*, which provides financing for coastal and inland urban waterfront restoration projects; and

The *California Consumer Power and Conservation Financing Authority*, which provides financing for projects to increase power supplies, reduce demand for energy, and improve the efficiency and environmental performance of power plants.

A **joint venture** is an entity resulting from a contractual arrangement and owned, operated, or governed by two or more participants as a separate and specific activity subject to joint control. In such an arrangement, the participants retain an ongoing financial interest or an ongoing financial responsibility in the entity. These entities are not part of the primary government or a component unit.

The State participates in a joint venture with the Capitol Area Development Authority (CADA). CADA was created in 1978 by the joint exercise of powers agreement between the primary government and the City of Sacramento for the location of state buildings and other improvements. CADA is a public entity, separate from the primary government and the city, and is administered by a board of five members: two appointed by the primary government, two appointed by the city, and one appointed by the affirmative vote of at least three of the other four members of the board. The primary government designates the chairperson of the board. Although the primary government does not have an equity interest in CADA, it does have an ongoing financial interest. Based upon the appointment authority, the primary government has the ability to indirectly influence CADA to undertake special projects for the citizenry of the participants. The primary government subsidizes CADA's operations by leasing land to CADA without consideration; however, the primary government is not obligated to do so. At June 30, 2003, CADA had total assets of $17.5 million, total liabilities of $10.3 million, and reserved and unreserved retained earnings of $60,000 and $6.2 million, respectively. Total revenues for the fiscal year were $7.3 million and expenses were $7.1 million, resulting in a net income of $232,000. Because the primary government does not have an equity interest in CADA, CADA's financial information is not included in the financial statements of this report. Separately issued financial statements may be obtained from the Capitol Area Development Authority, 1522 14th Street, Sacramento, California 95814.

A **related organization** is an organization for which a primary government is accountable because that government appoints a voting majority of the organization's governing board, but which is not financially accountable to the State.

Chapter 854 of the Statutes of 1996 created an Independent System Operator, a state-chartered, nonprofit market institution. The Independent System Operator is responsible for providing centralized control of the statewide transmission grid to ensure the efficient use and reliable operation of the transmission system. A five-member oversight board, comprised of three Governor's appointees, an appointee of the Senate Committee on Rules, and an appointee of the Speaker of the Assembly, oversees the Independent System Operator and appoints a governing board that is broadly representative of the state's electricity users and providers. The State's accountability for this institution does not extend beyond making the appointments. Because the primary government is not financially accountable for the Independent System Operator, the financial information of this institution is not included in the financial statements of this report. For information on how to obtain copies of the financial statements of the Independent System Operator, contact the State Controller's Office, Division of Accounting and Reporting, P.O. Box 942850, Sacramento, CA 94250.

The **Bay Area Toll Authority**, which is not part of the State's reporting entity, was created by the California Legislature in 1997 to administer the base $1 toll on toll revenues collected from the San Francisco Bay Area's seven state-owned toll bridges and to have program oversight related to certain bridge construction projects. Additional information on the Bay Area Toll Authority may be obtained from the Metropolitan Transportation Commission, 101 Eighth Street, Oakland, California 94607.

B. Government-Wide and Fund Financial Statements

Government-wide financial statements (the statement of net assets and the statement of activities) report information on all the nonfiduciary activities of the primary government and its component units. The primary government is reported separately from legally separate component units for which the State is financially accountable. Within the primary government, the State's governmental activities, which are normally supported by taxes and intergovernmental revenues, are reported separately from business-type activities, which rely to a significant extent on fees and charges for support. The effect of interfund activity has been removed from the statements, with the exception of amounts between governmental and business-type activities, which are presented as internal balances and transfers. Centralized services provided by the General Fund for other funds are charged as direct costs to the other funds that have received those services. Also, the General Fund recovers from the federal government the cost of centralized services provided to federal programs.

The statement of net assets reports all of the financial and capital resources of the government as a whole in a format that displays assets equaling liabilities plus net assets. The statement of activities demonstrates the degree to which the expenses of a given function are offset by program revenues. Program revenues include charges to customers who purchase, use, or directly benefit from goods, services, or privileges provided by a given function. Program revenues also include grants and contributions that are restricted to meeting the operational or capital requirements of a particular function. Taxes and other items that are not program-related are reported as general revenues.

Fund financial statements are provided for governmental funds, proprietary funds, fiduciary funds, and component units. A fund is a fiscal and accounting entity with a self-balancing set of accounts. Fund accounting segregates funds according to their intended purpose and is used to aid management in demonstrating compliance with finance-related legal and contractual provisions. The minimum number of funds is maintained consistent with legal and managerial requirements. Fiduciary funds, although excluded from the government-wide statements, are included in the fund financial statements. Major governmental and enterprise funds are reported in separate columns in the fund financial statements. Nonmajor governmental and proprietary funds are grouped into separate columns. Component unit statements, which follow the fiduciary fund statements, also separately report the major component units.

Governmental fund types are used primarily to account for services provided to the general public without charging directly for those services.

The State reports the following major governmental funds.

The *General Fund* is the main operating fund of the State. It accounts for transactions related to resources obtained and used for those services that do not need to be accounted for in another fund.

The *Federal Fund* accounts for the receipt and use of grants, entitlements, and shared revenues received from the federal government.

The *Transportation Construction Fund* accounts for gasoline taxes, bond proceeds, and other revenues that are used for highway and passenger rail construction.

Proprietary fund types focus on the determination of operating income, changes in net assets, financial position, and cash flows.

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. Operating expenses include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

For its proprietary funds, the State applies all applicable GASB pronouncements. In addition, the State applies all applicable Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principles Board (APB) Opinions, and

Committee on Accounting Procedure (CAP) Accounting Research Bulletins issued on or before November 30, 1989, unless these pronouncements conflict with or contradict GASB pronouncements. The State has elected not to apply FASB pronouncements issued after November 30, 1989, for its enterprise funds.

The State has two proprietary fund types — enterprise funds and internal service funds.

Enterprise funds record business-type activity for which a fee is charged to external users for goods and services. In addition, the State is required to report activities as enterprise funds in the context of the activity's principal revenue sources when any of the following criteria are met:

1. The activity's debt is secured solely by fees and charges of the activity;

2. There is a legal requirement to recover costs; or

3. The pricing policies of fees and charges are designed to recover costs.

The State reports the following major enterprise funds.

The *Housing Loan Fund* accounts for financing and contracts for the sale of properties to eligible California veterans.

The *Electric Power Fund* accounts for the acquisition and resale of electric power to retail end-use customers.

The *Water Resources Fund* accounts for charges to local water districts and the sale of excess power to public utilities.

The *Public Building Construction Fund* accounts for rental charges from the lease of public assets.

The *State Lottery Fund* accounts for the sale of lottery tickets and the lottery's payments for education.

The *Unemployment Programs Fund* accounts for employer and worker contributions used for payments of unemployment insurance and disability benefits.

The *nonmajor enterprise funds* account for additional operations that are financed and operated in a manner similar to private business enterprises.

Additionally, the State reports the internal service funds as a proprietary fund type with governmental activity. Internal service funds account for goods or services provided to other agencies, departments, or governments on a cost-reimbursement basis. The goods and services provided include: architectural services, construction and improvements, printing and procurement services, goods produced by inmates of state prisons, data processing services, administrative services related to water delivery, and equipment used by the Department of Transportation. Internal service funds are included in the governmental activities at the government-wide level.

Fiduciary fund types are used to account for assets held by the State. The State acts as a trustee or as an agent for individuals, private organizations, other governments, or other funds. Fiduciary funds, including fiduciary activity in discretely presented component units, are not included in the government-wide statements.

The State has the following four fiduciary fund types.

Private purpose trust funds account for all trust arrangements, other than those properly reported in pension or investment trust funds, whereby principal and income benefit individuals, private organizations, or other governments.

Pension and other employee benefit trust funds of the primary government and component units account for transactions, assets, liabilities, and net assets available for plan benefits of the retirement systems and for other employee benefit programs.

An *investment trust fund* accounts for the deposits, withdrawals, and earnings of the Local Agency Investment Fund, an external investment pool for local governments and public agencies.

Agency funds account for assets held by the State, which acts as an agent for individuals, private organizations, other governments, or other funds.

Discretely presented component units consist of certain organizations that have enterprise and fiduciary activity. The enterprise activity component units are the University of California, the State Compensation Insurance Fund, the California Housing Finance Agency, and other nonmajor component units. All the activity of the discretely presented component units, except that of the University of California Retirement System, is reported in a separate column in the government-wide financial statements and on separate pages following the fund financial statements. The University of California Retirement System is reported in the combining statements in the Pension and Other Employee Benefit Trust Funds section.

C. Measurement Focus and Basis of Accounting

The **government-wide financial statements** are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar transactions are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

The measurement focus and basis of accounting for the **fund financial statements** vary with the type of fund. **Governmental fund types** are presented using the current financial resources measurement focus. With this measurement focus, operating statements present increases and decreases in net current assets; the unreserved fund balance is a measure of available spendable resources.

The accounts of the governmental fund types are reported using the modified accrual basis of accounting. Under the modified accrual basis, revenues are recorded as they become measurable and available, and expenditures are recorded at the time the liabilities are incurred. Principal tax revenues susceptible to accrual are recorded as taxpayers earn income (personal income and corporation taxes), as sales are made (consumption and use taxes), and as the taxable event occurs (miscellaneous taxes), net of estimated tax overpayments. Other revenue sources are recorded when they are earned or when they are due, provided they are measurable and available within the ensuing 12 months.

Agency funds are custodial in nature and do not measure the results of operations. Assets and liabilities are recorded using the modified accrual basis of accounting.

Proprietary fund types, the **investment trust fund, private purpose trust funds,** and **pension and other employee benefit trust funds** are accounted for using the economic resources measurement focus.

The accounts of the proprietary fund types, the investment trust fund, the private purpose trust funds, and pension and other employee benefit trust funds are reported using the accrual basis of accounting. Under the accrual basis, most transactions are recorded when they occur, regardless of when cash is received or disbursed.

Lottery revenue and the related prize expense are recognized when sales are made. Certain prizes are payable in deferred installments.

Such liabilities are recorded at the present value of amounts payable in the future.

For purposes of the statement of cash flows, all cash and pooled investments in the State Treasurer's pooled investment program are considered to be cash and cash equivalents.

Discretely presented component units are accounted for using the economic resources measurement focus and the full accrual basis of accounting.

D. Food Stamps

In the Federal Fund, the distribution of food stamp benefits is recognized as revenues and expenditures, as required by GAAP. Revenues and expenditures are recognized when the benefits are distributed to the recipients. Food stamp balances held by the counties are reported as an asset and are offset by deferred revenue. Revenues, expenditures, and balances of food stamp benefits are measured based on face value.

E. Inventories

Inventories are primarily stated at the lower of average cost or market. In the government-wide financial statements, inventories for both governmental and business-type activities are expensed when consumed and unused inventories are reported as an asset on the statement of net assets. In the fund financial statements, governmental funds report inventories as expenditures when purchased. In proprietary fund types, inventories are expensed when consumed.

The discretely presented component units have inventory policies similar to those of the primary government.

F. Deposits and Investments

The State reports investments at fair value as prescribed by GAAP. Additional information on the State's investments can be found in Note 3, Deposits and Investments.

G. Net Investment in Direct Financing Leases

The State Public Works Board, an agency that accounts for its activities as an enterprise fund, has entered into lease-purchase agreements with various other primary government agencies, the University of California, and certain local agencies. The payments from these leases are used to satisfy the principal and interest requirements of revenue bonds issued by the State Public Works Board to finance the cost of projects such as acquisition and construction of facilities and equipment. Upon expiration of these leases, jurisdiction of the facilities and projects transfers to the primary government agency, the University of California, or the local agency. The State Public Works Board records the net investment in direct financing leases at the net present value of the minimum lease payments.

H. Deferred Charges

The deferred charges account primarily represents operating and maintenance costs and unrecovered capital costs in the enterprise fund type that will be recognized as expenses over the remaining life of long-term state water supply contracts in the Water Resources Fund. These costs are billable in future years. In addition, the account includes unbilled interest earnings on unrecovered capital costs that are recorded as deferred charges. These charges are recognized when billed in future years under the terms of water supply contracts. The deferred charges for the Public Buildings Construction Fund include bond counsel fees, trustee fees, rating agency fees, underwriting costs, insurance costs, and miscellaneous expenses. Bond issuance costs are amortized using the straight-line method over the term of the bonds. Amortization of bond issue costs during the facility construction period is capitalized and included in the construction costs. Deferred charges are also included in the Housing Loan Fund, the State Lottery Fund, and nonmajor enterprise funds. Bond discounts and issuance costs recorded as expenditures in certain capital projects and nonmajor special revenue funds are reclassified as deferred charges in the governmental activities column of the Statement of Net Assets.

I. Capital Assets

Capital assets are categorized into land, state highway infrastructure, collections, buildings and other depreciable property, and construction in progress. The buildings and other depreciable property account includes buildings, improvements other than buildings, equipment, personal property, intangible assets, certain infrastructure assets, certain books, and other capitalized and depreciable property. The category of state highway infrastructure consists of the prior and current year cost of additions and improvements to the State Highway System.

The value of the capital assets, including the related accumulated depreciation, is reported in the applicable governmental, business-type, or component unit activities columns in the government-wide Statement of Net Assets.

The primary government has a large collection of historical and contemporary treasures that have important documentary and artistic value. These assets are not capitalized or depreciated, because they are cultural resources and cannot reasonably be valued and/or the assets have inexhaustible useful lives. These treasures and works of art consist of furnishings, portraits and other paintings, books, statues, photographs, and miscellaneous artifacts.

In general, capital assets of the primary government are defined as assets that have a normal useful life of at least one year and a unit acquisition cost of at least $5,000. These assets are recorded at historical cost or estimated historical cost, including all costs related to the acquisition. Donated capital assets are recorded at the fair market value on the date the gift was received. Major capital asset outlays are capitalized as projects are constructed.

Buildings and other depreciable property are depreciated using the straight-line method with no salvage value for governmental activities. Buildings and other improvements are depreciated over 40 years. Equipment and personal property are depreciated over 5 years. Buildings and other depreciable property used by the California State University are depreciated from 3 to 45 years. Depreciable assets of business-type activities are depreciated using the straight-line method over their estimated useful or service lives, ranging from 2 to 100 years.

California has elected to use the modified approach for capitalizing the infrastructure assets of the State Highway System. By using the modified approach, the assets of the State Highway System are not depreciated and all expenditures made for those assets, except for additions and improvements, are expensed in the period incurred. Additions and improvements are capitalized.

To comply with the prospective reporting requirements of GASB Statement No. 34, all prior year and current year additions of the State Highway System are being capitalized. All costs incurred that are related to projects completed prior to July 1, 2001, will be included during the retroactive reporting phase. Retroactive reporting of the State Highway System assets will occur no later than the year ending June 30, 2006.

The capital assets of the discretely presented component units are reported at cost at the date of acquisition, or at fair market value at the date of donation in the case of gifts. They are depreciated over their estimated useful service lives.

J. Long-Term Obligations

Long-term obligations consist of certain unmatured general obligation bonds, certain unmatured revenue bonds, capital lease obligations, certificates of participation, commercial paper, the net pension obligation of the pension and other employee benefit trust funds, the liability for employees' compensated absences and workers' compensation claims, amounts owed for lawsuits, and the primary government's share of the University of California pension liability that is due in more than one year. In the government-wide financial statements, current and noncurrent obligations are reported as liabilities in the applicable governmental activities, business-type activities, and component units columns of the statement of net assets.

Bond premiums and discounts, as well as issuance costs, for business-type activities and component units are generally deferred and amortized over the life of the bonds. In these instances, bonds payable are reported net of the applicable premium or discount and bond issuance costs are reported as deferred charges. Bond premiums and discounts, as well as issuance costs, for governmental activities are expensed in the year incurred in the fund financial statements. In some cases, these costs are reported as deferred charges in the government-wide financial statements.

With approval in advance from the Legislature, certain authorities and state agencies may issue revenue bonds. Principal and interest on revenue bonds are payable from the pledged revenues of the respective funds, building authorities, and agencies. The General Fund has no legal liability for payment of principal and interest on revenue bonds. With the exception of the building authorities, which are included in the capital projects funds, and the Golden State Tobacco Securitization Corporation, which is included in the special revenue funds, the liability for revenue bonds is recorded in the respective fund.

K. Compensated Absences

The government-wide financial statements report both the current and the noncurrent liabilities for compensated absences, which are vested unpaid vacation and annual leave. However, unused sick-leave balances are not included in the compensated absences because they do not vest to employees. In the fund financial statements for governmental funds, only the amounts of compensated absences that normally would be liquidated with expendable available financial resources are accrued at year-end, such as costs of academic-year faculty. The costs of the academic-year faculty represent services rendered over a ten-month period that are paid for over a 12-month period. The balance of the amounts owed for services rendered is reported as a current liability in the General Fund. Because it is anticipated that compensated absences will not be used in excess of a normal year's accumulation, no additional liabilities are accrued. The amounts of vested unpaid vacation and annual leave accumulated by state employees are accrued in proprietary funds when incurred. In the discretely presented component units, the compensated absences are accounted for in a similar manner as the proprietary funds in the primary government.

L. Net Assets and Fund Balance

The difference between fund assets and liabilities is called "net assets" on the government-wide financial statements, the proprietary and fiduciary fund statements, and the component unit statements, and is called "fund balance" on the governmental fund statements. The government-wide financial statements have the following categories of net assets:

Investment in capital assets, net of related debt, represents capital assets, net of accumulated depreciation, reduced by outstanding principal balances of debt attributable to the acquisition, construction, or improvement of those assets.

Restricted net assets result from transactions with purpose restrictions and are designated as either *nonexpendable* or *expendable*. *Nonexpendable restricted net assets* are subject to externally imposed restrictions that must be retained in perpetuity. *Expendable restricted net assets* are subject to externally imposed restrictions that can be fulfilled by actions of the State.

Unrestricted net assets are neither restricted nor invested in capital assets, net of related debt.

In the fund financial statements, proprietary funds have similar categories of net assets. Governmental funds have two sections: *reserved and unreserved.* Part or all of the total fund balance may be reserved as a result of law or generally accepted accounting principles. Reserves represent those portions of the fund balances that are legally segregated for specific uses. The reserves of the fund balance for governmental funds are as follows:

Reserved for encumbrances represents goods and services that are ordered, but not received, by the end of the fiscal year.

Reserved for interfund receivables represents advances to other funds that do not represent expendable available financial resources.

Reserved for loans receivable represents the noncurrent portion of loans receivable that does not represent expendable available financial resources.

Reserved for continuing appropriations represents the unencumbered balance of all appropriations for which the period of availability extends beyond the period covered in the report. These appropriations are legally segregated for a specific future use.

The *unreserved* amounts represent the net of total fund balance, less reserves for governmental funds.

Fiduciary fund net assets are "amounts held in trust for benefits and other purposes."

M. Restatement of Beginning Fund Balances and Net Assets

1. Fund Financial Statements

The beginning fund balance of the **governmental funds** was reduced by a total of $2.9 billion. The General Fund's beginning fund balance was reduced by $931 million for payments to schools made during the year ended June 30, 2003, that were used to support educational programs of the previous year. The beginning fund balance of the nonmajor governmental funds was reduced by $2.0 billion primarly as a result of fund reclassifications. In particular, the reclassification of the State Water Pollution Control Program from a special revenue fund activity to an enterprise fund activity and the reclassification of the Federal Student Loan Reserve Program from a special revenue fund activity to a discretely presented component unit activity resulted in reductions to the beginning fund balance of $1.7 billion and $264 million, respectively.

The beginning net assets of the **enterprise funds** were increased by a total of $2.3 billion. Of the total increase, $1.7 billion related to the reclassification of the State Water Pollution Control Program as reported in the previous paragraph. In addition, the beginning net assets of this program were increased by $82 million because its basis of accounting was changed from modified accrual to accrual. The remaining increase of about $487 million was a result of including previously unreported capital assets in the enterprise activity of the California State University (CSU).

The presentation of **primary government and component unit – fiduciary funds** was changed to combine primary government Pension and Other Employee Benefit Trust Funds with fiduciary activity of the University of California Retirement System, a discretely presented component unit. In the previous year's report, the University of California Retirement System was reported separately. The beginning net assets of $287 billion in the Pension and Other Employee Benefit Trust Funds reflect the combination of these two activities.

Beginning net assets of the **discretely presented component units – enterprise activity** were increased by a total of $399 million. Of the total increase, $264 million was the result of the reclassification of the Federal Student Loan Reserve Program from a special revenue fund activity to a discretely presented component unit activity. The balance of the increase, $135 million, was mainly caused by changes in State Compensation Insurance Fund accounting principles.

2. Government-Wide Financial Statements

The beginning net assets of the **governmental activities** were reduced by $4.4 billion. Of this amount, $2.9 billion was the result of the restatements to the governmental fund financial statements discussed in the previous section. An additional reduction of $890 million was the result of an independent review and audit of the capital assets related to the CSU governmental activities of the prior year that was not available for inclusion in the State's financial statements until the current year. The remaining $633 million of the reduction was a result of the recognition of certain liabilities not identified in the prior year's report.

The beginning net assets of the **business-type activities** and the **component units** were restated as described in the previous section for enterprise funds and discretely presented component units – enterprise activity, respectively.

N. Guaranty Deposits

The State is custodian of guaranty deposits held to protect consumers, to secure the State's deposits in financial institutions, and to ensure payment of taxes and fulfillment of obligations to the State. Guaranty deposits of securities and other properties are not shown on the financial statements.

NOTE 2. BUDGETARY AND LEGAL COMPLIANCE

A. Budgeting and Budgetary Control

The State's annual budget is prepared primarily on a modified accrual basis for governmental funds. The Governor recommends a budget for approval by the Legislature each year. This recommended budget includes estimated revenues; however, revenues are not included in the annual budget bill adopted by the Legislature. Under state law, the State cannot adopt a spending plan that exceeds estimated revenues.

Under the State Constitution, money may be drawn from the treasury only through a legal appropriation. The appropriations contained in the Budget Act, as approved by the Legislature and signed by the Governor, are the primary sources of annual expenditure authorizations and establish the legal level of control at the appropriation level for the annual operating budget. The budget can be amended throughout the year by special legislative action, budget revisions by the Department of Finance, or executive orders by the Governor.

Amendments to the original budget for the year ended June 30 were legally made, and they had the effect of decreasing spending authority and expenditures for the year.

Appropriations are generally available for expenditure or encumbrance either in the year appropriated or for a period of three years if the legislation does not specify a period of availability. At the end of the availability period, the encumbering authority for the unencumbered balance lapses. Some appropriations continue indefinitely, while others are available until fully spent. Generally, encumbrances must be liquidated within two years from the end of the period when the appropriation is available. If the encumbrances are not liquidated within this additional two-year period, the spending authority for these encumbrances lapses.

B. Legal Compliance

State agencies are responsible for exercising basic budgetary control and ensuring that appropriations are not overspent. The State Controller's Office is responsible for overall appropriation control and does not allow expenditures in excess of authorized appropriations.

Financial activities are mainly controlled at the appropriation level but can vary, depending on the presentation and wording contained in the Budget Act. Certain items that are established at the category, program, component, or element level can be adjusted by the Department of Finance. For example, an appropriation for support may have detail accounts for personnel services, operating expenses and equipment, and reimbursements. The Department of Finance can authorize adjustments between the detail accounts but cannot increase the amount of the overall support appropriation. While the financial activities are controlled at various levels, the legal level of budgetary control, or the extent to which management may amend the budget without seeking approval of the governing body, has been established in the Budget Act at the appropriation level for the annual operating budget.

The State Compensation Insurance Fund (SCIF), a discretely presented component unit, is being excluded from the scope of this report's audit, as a result of a difference of opinion between SCIF and its independent auditor, PricewaterhouseCoopers LLP (PwC), on the amount of its benefits payable. SCIF information in this report reflects the amount adopted by its management based on a Statement of Actuarial Opinion issued by the actuarial firm of Milliman USA. PwC's estimate of the benefits payable was approximately $1.0 billion higher than that adopted by SCIF in its financial statements for the year ended December 31, 2002. This difference of opinion resulted in an adverse opinion by PwC as to the fair presentation of SCIF's statutory statements and no opinion on its statements prepared in accordance with accounting principles generally accepted in the United States of America.

NOTE 3. DEPOSITS AND INVESTMENTS

The State reports investments at fair value. State statutes authorize investments in certain types of securities. The State Treasurer administers a single pooled investment program comprising both an internal investment pool and an external investment pool (the Local Agency Investment Fund). There is a single portfolio of investments, with all participants having an undivided interest in the portfolio. Both pools are administered in the same manner, as described below. In addition, certain funds have the authority to separately invest their cash.

The State's pooled investment program and certain funds of the primary government are allowed by state statutes, bond resolutions, and investment policy resolutions to have investments in United States government securities, negotiable certificates of deposit, bankers' acceptances, commercial paper, corporate bonds, bank notes, mortgage loans and notes, other debt securities, repurchase agreements, reverse repurchase agreements, equity securities, real estate, mutual funds, and other investments.

The State Treasurer's Office administers a pooled investment program for the primary government and for certain discretely presented component units. As of June 30, the discretely presented component units' cash and pooled investments were approximately 5.1% of the State Treasurer's pooled investment portfolio. This program enables the State Treasurer's Office to combine available cash from all funds and to invest cash that exceeds current needs.

Both deposits and investments are included in the State's investment program. The State Treasurer's Office maintains cash deposits with certain banks where the income earned on the deposits compensates the banks for services and uncleared checks that are deposited in the pooled investment program's accounts.

All demand and time deposits held by financial institutions as of June 30, totaling approximately $7.2 billion, were insured by federal depository insurance or by collateral held by the State Treasurer's Office or an agent of the State Treasurer's Office in the State's name. The California Government Code requires collateral pledged for demand and time deposits to be deposited with the State Treasurer.

As of June 30, the State Treasurer's Office had amounts on deposit with a fiscal agent totaling $33 million related to principal and interest payments to bondholders. Additionally, there was $61 million in a compensating balance account with a custodial agent designed to provide sufficient earnings to cover fees for custodial services and system maintenance. Most of these deposits are insured by federal depository insurance or by collateral held by an agent of the State Treasurer's Office in the State's name.

The State Treasurer's Office reports its investments at fair value. The fair value of all securities in the State Treasurer's Office pooled investment program is based on quoted market prices. As of June 30, the average remaining life of the securities in the pooled money investment program administered by the State Treasurer's Office was approximately 227 days.

The Pooled Money Investment Board provides regulatory oversight over the State Treasurer's pooled investment program. The purpose of the board is to design an effective cash management and investment program, using all monies flowing through the State Treasurer's Office bank accounts and keeping all available funds invested consistent with the goals of safety, liquidity, and yield. The Pooled Money Investment Board is comprised of the State Treasurer as chair, the State Controller, and the Director of Finance. This board designates the amounts of temporarily idle money available for investment. The State Treasurer is charged with making the actual investment transactions for this investment program. This program is not registered with the Securities and Exchange Commission as an investment company.

The value of the deposits of the State Treasurer's pooled investment program, including the Local Agency Investment Fund, is equal to the dollars deposited in the program. The fair value of the position in the program may be greater or less than the value of the deposits, with the difference representing the unrealized gain or loss. As of June 30, this difference was immaterial to the valuation of the program. The pool is run with a "dollar-in, dollar-out" participation. There are no share-value adjustments to reflect changes in fair value.

Certain funds have elected to participate in the pooled money investment program, even though they have the authority to make their own investments. Others may be required by legislation to participate in the program. As a result, the deposits of these funds or accounts may be considered involuntary. However, they are part of the State's reporting entity. The remaining participation in the pool, the Local Agency Investment Fund, is all voluntary.

Certain funds that have deposits in the State Treasurer's pooled investment program do not receive the interest earnings on their deposits. The earnings on the investments related to those funds are legally required to be assigned to the State's General Fund. Most of the $189 million in interest revenue received by the General Fund from the pooled money investment program is earned on balances in these funds.

The State Treasurer's pooled investment program values participants' shares on an amortized cost basis. Specifically, the program distributes income to participants on a quarterly basis based on their relative participation during the quarter. This participation is calculated based on (1) realized investment gains and losses calculated on an amortized cost basis, (2) interest income based on stated rates (both paid and accrued), (3) amortization of discounts and premiums on a straight-line basis, and (4) investment and administrative expenses. This method differs from the fair value method used to value investments in these financial statements, because the amortized cost method is not designed to distribute to participants all unrealized gains and losses in the fair value of the pool's investments. Since the total difference between the fair value of the investments in the pool and the value distributed to pool participants using the amortized cost method described above is not material, no adjustment was made to the financial statements.

The State Treasurer's Office also reports participant fair value as a ratio of amortized cost on a quarterly basis. The State Treasurer's Office has not provided or obtained a legally binding guarantee to support the principal invested in the investment program.

The fair value and the ranges of interest rates and maturity dates of each major investment classification in the State Treasurer's pooled investment program are summarized in Table 1.

As of June 30, floating rate notes and asset-backed securities comprised slightly more than 2.3% of the pooled investments. For the floating-rate notes in the portfolio, the interest received by the State Treasurer's pooled investment program rises or falls as the underlying index rate rises or falls. The structure of the floating-rate notes in the State Treasurer's pooled investment program portfolio is such that it hedges the portfolio against the risk of increasing interest rates. A majority of the asset-backed securities are mortgage-backed securities. The mortgage-backed securities are called real estate mortgage investment conduits (REMICs). A REMIC is a security backed by a pool of mortgages. The REMICs in the State's portfolio have a fixed principal payment schedule.

The California Government Code allows the State Treasurer's Office to enter into repurchase agreements as part of its pooled investment program. A repurchase agreement consists of two simultaneous transactions. One is the purchase of securities by the State Treasurer's Office from a bank or dealer. The other is a commitment by the bank or dealer to repurchase the securities from the State Treasurer's Office at the same price, plus interest, at a mutually agreed-upon future date. As the investor, the State is protected by underlying specific government securities, which are pledged as collateral during the length of the investment. During the year ended June 30, the State Treasurer's Office entered into 20 repurchase agreements, with a carrying value of approximately $4.0 billion. As of June 30, the State Treasurer's Office did not have any repurchase agreements outstanding.

The California Government Code allows the State Treasurer's Office to enter into reverse repurchase agreements as part of its pooled investment program. A reverse repurchase agreement is a sale of securities with a simultaneous agreement to repurchase them in the future at the same price plus a contract rate of interest. The fair value of the securities underlying reverse repurchase agreements normally exceeds the cash received, providing the dealers a margin against a decline in fair value of the securities. If the dealers defaulted on their obligations to resell these securities to the State Treasurer's Office or provide securities or cash of equal value, the State Treasurer's pooled investment program would suffer an economic loss equal to the difference between the fair value plus the accrued interest of the underlying securities and the agreement obligation, including accrued interest. During the year ended June 30, the State Treasurer's Office entered into four reverse repurchase agreements by temporarily selling investments with a carrying value of approximately $555 million. The maturities of investments made with the proceeds from reverse repurchase agreements are matched to the maturities of the agreements. As of June 30, the State Treasurer's Office did not have any reverse repurchase agreements outstanding.

Enterprise funds, special revenue funds, fiduciary funds, and a building authority in the capital projects funds of the primary government also make separate investments, which are presented at fair value. The fiduciary funds include pension and other employee benefit trust funds of the California Public Employees' Retirement System (CalPERS) and the California State Teachers' Retirement System (CalSTRS). CalPERS and CalSTRS accounted for $285.6 billion (96%) of these separately invested funds.

CalPERS and CalSTRS exercise their authority under the State Constitution to invest in stocks, bonds, mortgages, real estate, and other investments.

The fair value of CalPERS' investments in securities is generally based on published market prices and quotations from major investment firms. Many factors are considered in arriving at fair value. In general, however, corporate bonds are valued based on yields currently available on comparable securities of issuers with similar credit ratings. Investments in certain restricted common stocks are valued at the quoted market price of the issuer's unrestricted common stock, less an appropriate discount.

CalPERS' mortgages are valued on the basis of their future principal and interest payments, discounted at prevailing interest rates for similar instruments. The fair value of real estate investments, principally rental property subject to long-term net leases, is estimated based on independent appraisals. Short-term investments are reported at market value, when available, or at cost plus accrued interest, which approximates market value when market value is not available. For investments where no readily ascertainable market value exists, management, in consultation with its investment advisors, has determined the fair values for the individual investments.

Under the State Constitution and statutory provisions governing CalPERS investment authority, CalPERS, through its outside investment managers, holds investments in futures and options and enters into forward foreign currency exchange contracts. Futures and options with a negative fair value of approximately $183 million were held for investment purposes as of June 30. Gains and losses on futures and options are determined based upon quoted market values and recorded in the statement of changes in fiduciary net assets.

Due to the level of risk associated with certain derivative investment securities, it is reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect the amounts reported in the financial statements.

Forward foreign currency exchange contracts are used primarily to hedge against changes in exchange rates related to foreign securities. As of June 30, CalPERS had approximately a negative $184 million net exposure to loss from forward foreign currency exchange transactions related to the approximately $33.0 billion international debt and equity portfolios. CalPERS could be exposed to risk if the counterparties to the contracts are unable to meet the terms of the contracts. CalPERS investment managers seek to control this risk through counterparty credit evaluations and approvals, counterparty credit limits, and exposure monitoring procedures. CalPERS anticipates that the counterparties will be able to satisfy their obligations under the contracts.

The fair value of investments for CalSTRS is generally based on published market prices and quotations from major investment firms. In the case of debt securities acquired through private placements, management computes fair value based on market yields and average maturity dates of comparable quoted securities. Mortgages are valued on the basis of future principal and interest payments, and are discounted at prevailing interest rates for similar instruments. Real estate equity investment fair value represents the most recent appraisals. Short-term investments are reported at cost or amortized cost, which approximates fair value.

Purchases and sales of debt securities, equity securities, and short-term investments by CalSTRS are recorded on the trade date. Real estate equity transactions are recorded on the settlement date.

The State Constitution, state statutes, and board policies permit CalPERS and CalSTRS to lend their securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. Third-party securities lending agents have been contracted to lend domestic and international equity and debt securities. All securities loans can be terminated on demand by the lender or the borrower. Collateral, in the form of cash or other securities, is required at 102% and 105% of the fair value of domestic and international securities loaned, respectively, for both CalPERS and CalSTRS. As of June 30, there was no credit risk of exposure to borrowers because the amount of collateral held exceeded the amounts owed by the borrowers. Collateral securities received are not permitted to be pledged or sold unless the borrower defaults. The contracts with the securities lending agents require them to indemnify CalPERS and CalSTRS if the borrowers fail to return the securities (and if the collateral is not sufficient to replace the securities loaned) or if the borrowers fail to pay for income distributions by the securities' issuers while the securities are on loan.

For CalPERS, the average terms of the overall loans managed by its five securities lending agents were 39 days, 24 days, 61 days, 14 days, and 14 days, respectively. In accordance with CalPERS investment guidelines, the cash collateral was invested in short-term investment funds that, at June 30, had weighted average maturities of 175 days, 84 days, 120 days, and 120 days, respectively, for four of the five portfolios. For one portfolio, a weighted average maturity was not applicable.

For CalSTRS, cash collateral received on each security loan was invested in short-term investments that, at June 30, had a weighted average maturity of 22 days.

As of June 30, the State, including discretely presented component units, had investments in securities lending agreements, real estate, investment contracts, mutual funds, and other investments totaling $88.8 billion. These investments are not subject to classification. All remaining investments reported as of June 30 are categorized in three categories of credit risk:

1. Insured or registered, or securities held by the State or its agent in the State's name;

2. Uninsured and unregistered, with securities held by the counterparty's trust department or by an agent in the State's name; and

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

The types of investments reported at year-end are representative of the types of investments made during the year. Furthermore, the credit risk associated with the investments reported at year-end is representative of the credit risk associated with investments made during the year.

Table 1 presents the risk categories of the primary government as of June 30.

Table 1

Schedule of Investments – Primary Government
June 30, 2003
(amounts in thousands)

	Interest Rates*	Maturity	Category 1	Category 2	Category 3	Total Fair Value**
Pooled investments* **						
U.S. government securities	0.92 – 3.02	1 day – 5 years	$ 23,135,463	$ —	$ —	$ 23,135,463
Negotiable certificates of deposit	1.02 – 1.84	1 day – 1 year	5,739,691	—	—	5,739,691
Commercial paper	1.01 – 1.76	1 day – 180 days	14,040,329	—	—	14,040,329
Corporate bonds	1.89 – 3.31	1 day – 5 years	2,266,271	—	—	2,266,271
Bank notes	1.02 – 1.84	1 day – 1 year	100,017	—	—	100,017
Total pooled investments			**45,281,771**	—	—	**45,281,771**
Separately invested funds subject to categorization						
Equity securities			125,300,016	631	—	125,300,647
Securities lending collateral			38,001,744	—	—	38,001,744
Mortgage loans and notes			20,940,250	50,002	—	20,990,252
U.S. government and agencies			7,301,772	265,356	—	7,567,128
Commercial paper			2,991,120	—	—	2,991,120
Corporate bonds			20,069,272	161,541	—	20,230,813
Other investments			6,500,223	74,414	—	6,574,637
Total separately invested funds subject to categorization			**221,104,397**	**551,944**	—	**221,656,341**
Separately invested funds not subject to categorization						
Investments held by broker-dealers under securities loans with cash collateral						37,287,156
Real estate						17,375,271
Venture capital and private equity funds						7,385,211
Investment contracts						2,729,378
Mutual funds						3,293,137
Insurance contracts						13,394
Mortgage loans						618,469
Other						6,044,664
Total separately invested funds not subject to categorization						**74,746,680**
Total investments			**$ 266,386,168**	**$ 551,944**	**$ —**	**341,684,792**
Fiduciary fund investments						
Less: investment trust fund						21,840,009
Less: private purpose trust funds						1,030,917
Less: pension and other employee benefit trust funds						290,254,687
Total government-wide investments						**28,559,179**
Less: current government-wide investments						25,756,143
Total noncurrent government-wide investments						**$ 2,803,036**

* These interest rates represent high and low monthly averages for each investment type during the year.

** Investments are reported at fair value except for $293 million for investment contracts that are reported at cost in two enterprise funds.

*** Approximately 5.1% of the pooled investments are investments of discretely presented component units. For separately invested funds of discretely presented component units, see Table 2.

The investments of the University of California, a discretely presented component unit including the University of California Retirement System (UCRS), are primarily stated at fair value. Investments authorized by the regents include equity securities, fixed-income securities, and real estate. The equity portion of the investment portfolio may include both domestic and foreign common and preferred stocks, actively managed and passive (index) strategies, along with a modest exposure to private equities. Private equities include venture capital partnerships, buy-outs, and international funds. The fixed-income portion of the investment portfolio may include both domestic and foreign securities, along with certain securitized investments, including mortgage-backed and asset-backed securities. Absolute return strategies, incorporating short sales, plus derivative or option positions to implement or hedge an investment position, are also authorized. Where donor agreements place constraints on allowable investments, assets associated with endowments are invested in accordance with the terms of the agreements.

A portion of the cash and pooled investments of the State Compensation Insurance Fund (SCIF), the California Housing Finance Agency (CHFA), and nonmajor component units is invested in the State Treasurer's pooled investment program. Additionally, state law, bond resolutions, and investment policy resolutions allow these component units to invest in U.S. government securities, state and municipal securities, commercial paper, corporate bonds, investment agreements, and other investments.

The University of California participates in a securities lending program as a means to augment income. Securities are loaned to select brokerage firms for which collateral is received in excess of the fair value of such investments during the period of the loan. Collateral may be cash or securities issued by the U.S. government or its agencies, or the sovereign or provincial debt of foreign countries. Collateral securities cannot be pledged or sold by the university unless the borrower defaults. Loans of domestic equities and all fixed-income securities are initially collateralized at 102% of the fair value of securities loaned. Loans of foreign equities are initially collateralized at 105%. All borrowers are required to provide additional collateral by the next business day if the value falls to less than 100% of the fair value of securities lent. The university receives interest and dividends during the loan period, as well as a fee from the brokerage firm, and is obligated to pay a fee and rebate to the borrower. The university receives the net investment income. Securities on loan for cash collateral are not considered to be categorized. As of June 30, the university had no credit risk exposure to borrowers because the amounts the university owed the borrowers exceeded the amounts the borrowers owed the university. The university is fully indemnified by its custodial bank against any losses incurred as a result of borrower default.

Securities loans immediately terminate upon notice by either the university or the borrower. Cash collateral is invested by the university's lending agent in a short-term investment pool in the university's name, with guidelines approved by the university. As of June 30, the securities in this pool had a weighted average maturity of 248 days.

The State Department of Insurance permits SCIF to lend a certain portion of its securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. A third-party lending agent has been contracted to lend U.S. Treasury notes and bonds. Collateral, in the form of cash and other securities, is adjusted daily and is required at approximately 102% of the fair value of securities loaned. Collateral securities received are not permitted to be pledged or sold unless the borrower defaults. The maximum loan term is one year. In accordance with SCIF's investment guidelines, cash collateral was invested in short-term investments at December 31, 2002, with maturities matching the related loans. Interest income on these investments is shared by the borrower, the third party lending agent, and SCIF.

Table 2 presents risk categories of the discretely presented component unit investments as of June 30.

Table 2

Schedule of Investments – Discretely Presented Component Units
June 30, 2003
(amounts in thousands)

	Category 1	Category 2	Category 3	Total Fair Value*
Separately invested funds subject to categorization				
Equity securities	$ 27,023,336	$ —	$ —	$ 27,023,336
Securities lending collateral	11,192,188	—	—	11,192,188
Mortgage loans and notes	3,039,544	—	—	3,039,544
U.S. government and agency securities	3,420,252	—	—	3,420,252
Commercial paper	57,794	—	—	57,794
Corporate bonds	16,810,721	—	—	16,810,721
Investment agreements	—	1,084,014	—	1,084,014
Other investments	1,580,363	—	—	1,580,363
Total separately invested funds subject to categorization	**63,124,198**	**1,084,014**	**—**	**64,208,212**
Separately invested funds not subject to categorization				
Investment agreements				949,299
Mutual funds				839,811
Investments held by broker-dealers under securities loans with cash collateral				10,837,261
Real estate				62,429
Venture capital and private equity funds				578,190
Insurance contracts				479,014
Mortgage loans				53,797
Other investments				268,848
Total separately invested funds not subject to categorization				**14,068,649**
Total investments	**$ 63,124,198**	**$ 1,084,014**	**$ —**	**78,276,861**
Less: University of California Retirement System				42,324,557
Less: University of California Retirement System securities lending transactions				8,018,647
Total enterprise activity				**27,933,657**
Less: current investments				8,649,244
Total noncurrent enterprise activity investments				**$ 19,284,413**

*Investments are reported at fair value except for $1,980,021 for investment agreements that are reported at cost.

NOTE 4. ACCOUNTS RECEIVABLE

Table 3 presents the disaggregation of accounts receivable attributable to taxes, interest expense reimbursements, lottery retailer collections, and unemployment program receipts. Other receivables are for interest, gifts, grants, various fees, penalties and other charges. The adjustment for the fiduciary funds represents amounts due from fiduciary funds that were reclassified as external receivables on the government-wide Statement of Net Assets.

Table 3

Schedule of Accounts Receivable
June 30, 2003
(amounts in thousands)

	Taxes	Reimbursement of Accrued Interest Expense	Lottery Retailers	Unemployment Programs	Other	Total
Current governmental activities						
General Fund	$ 5,594,782	$ —	$ —	$ —	$ 400,720	$ 5,995,502
Federal Fund	—	—	—	—	20,670	20,670
Transportation Construction Fund	287,763	—	—	—	82,780	370,543
Nonmajor governmental funds	269,221	—	—	—	848,805	1,118,026
Internal service funds	—	—	—	—	117,667	117,667
Adjustment:						
Fiduciary funds	—	—	—	—	1,987	1,987
Total current governmental activities	**$ 6,151,766**	**$ —**	**$ —**	**$ —**	**$ 1,472,629**	**$ 7,624,395**
Amounts not scheduled for collection during the subsequent year	**$ 812,322**	**$ —**	**$ —**	**$ —**	**$ —**	**$ 812,322**
Current business-type activities						
Housing Loan Fund	$ —	$ —	$ —	$ —	$ 11,376	$ 11,376
Water Resources Fund	—	—	—	—	83,411	83,411
Public Buildings Construction Fund	—	114,899	—	—	—	114,899
State Lottery Fund	—	—	134,515	—	—	134,515
Unemployment Programs Fund	—	—	—	128,886	—	128,886
Nonmajor enterprise funds	—	—	—	—	27,785	27,785
Adjustment:						
Account reclassification	—	(114,899)	—	—	—	(114,899)
Total current business-type activities	**$ —**	**$ —**	**$ 134,515**	**$ 128,886**	**$ 122,572**	**$ 385,973**
Amounts not scheduled for collection during the subsequent year	**$ —**	**$ —**	**$ —**	**$ 42,428**	**$ —**	**$ 42,428**

NOTE 5. RESTRICTED ASSETS

Table 4 presents a summary of the legal restrictions on assets as of June 30. The restricted assets of the primary government are in the enterprise funds.

Table 4

Schedule of Restricted Assets
June 30, 2003
(amounts in thousands)

	Cash and Pooled Investments	Investments	Due from other Governments	Loans Receivable	Total
Primary government					
Debt service	$ 1,636,602	$ 119,782	$ 54,043	$ 754,008	$ 2,564,435
Construction	236,969	—	—	—	236,969
Operations	2,256,896	—	—	—	2,256,896
Other	13,143	7,028	—	—	20,171
Total primary government	**4,143,610**	**126,810**	**54,043**	**754,008**	**5,078,471**
Discretely presented component units					
Nonmajor component units – debt service	—	9,594	—	—	9,594
Total discretely presented component units	**—**	**9,594**	**—**	**—**	**9,594**
Total restricted assets	**$ 4,143,610**	**$ 136,404**	**$ 54,043**	**$ 754,008**	**$ 5,088,065**

NOTE 6. NET INVESTMENT IN DIRECT FINANCING LEASES

The State Public Works Board, an agency that accounts for its activities as an enterprise fund, has entered into lease-purchase agreements with various other primary government agencies, the University of California, and certain local agencies. Payments from these leases will be used to satisfy the principal and interest requirements of revenue bonds issued by the State Public Works Board.

The minimum lease payments to be received by the State Public Works Board for the primary government are summarized in Table 5.

Table 5

Schedule of Minimum Lease Payments to Be Received by the State Public Works Board for the Primary Government

(amounts in thousands)

Year Ending June 30	Primary Government Agencies	University of California	Local Agencies	Total
2004	$ 412,193	$ 119,031	$ 59,020	$ 590,244
2005	429,053	117,650	58,925	605,628
2006	412,431	112,715	58,670	583,816
2007	371,403	111,449	58,085	540,937
2008	369,584	111,686	58,304	539,574
2009-2013	1,647,881	518,816	273,853	2,440,550
2014-2018	1,455,588	383,446	188,579	2,027,613
2019-2023	660,805	270,358	13,863	945,026
2024-2028	241,034	—	—	241,034
Total minimum lease payments	**5,999,972**	**1,745,151**	**769,299**	**8,514,422**
Less: unearned income	2,350,865	766,211	251,109	3,368,185
Net investment in direct financing leases	**$ 3,649,107**	**$ 978,940**	**$ 518,190**	**$ 5,146,237**

NOTE 7. CAPITAL ASSETS

Table 6 summarizes the capital activity for the primary government as of June 30. Included in the capital activity is $4.5 billion in fixed assets related to capital leases.

Table 6

Schedule of Changes in Capital Assets — Primary Government
June 30, 2003
(amounts in thousands)

	Beginning Balance*	Additions	Deductions	Ending Balance
Governmental activities				
Capital assets not being depreciated:				
Land	$ 2,987,871	$ 585,830	$ 9,618	$ 3,564,083
State highway infrastructure	59,262	343,614	—	402,876
Collections	17,129	3,601	107	20,623
Construction in progress	2,622,361	1,759,930	440,991	3,941,300
Total capital assets not being depreciated	**5,686,623**	**2,692,975**	**450,716**	**7,928,882**
Capital assets being depreciated:				
Buildings and improvements	14,436,901	1,017,448	134,184	15,320,165
Infrastructure	263,962	39,305	—	303,267
Equipment and other assets	2,647,240	245,298	117,525	2,775,013
Total capital assets being depreciated	**17,348,103**	**1,302,051**	**251,709**	**18,398,445**
Less accumulated depreciation for:				
Buildings and improvements	4,524,013	471,811	141,935	4,853,889
Infrastructure	99,569	6,242	—	105,811
Equipment and other assets	1,889,065	260,324	102,995	2,046,394
Total accumulated depreciation	**6,512,647**	**738,377**	**244,930**	**7,006,094**
Total capital assets being depreciated, net	**10,835,456**	**563,674**	**6,779**	**11,392,351**
Governmental activities, capital assets, net	**$ 16,522,079**	**$ 3,256,649**	**$ 457,495**	**$ 19,321,233**
Business-type activities				
Capital assets not being depreciated:				
Land	$ 16,282	$ 822	$ 105	$ 16,999
Construction in progress	555,736	316,054	95,516	776,274
Total capital assets not being depreciated	**572,018**	**316,876**	**95,621**	**793,273**
Capital assets being depreciated:				
Buildings and improvements	6,176,809	133,515	67,925	6,242,399
Infrastructure	1,204,664	38,993	833	1,242,824
Equipment and other assets	148,859	17,467	6,302	160,024
Total capital assets being depreciated	**7,530,332**	**189,975**	**75,060**	**7,645,247**
Less accumulated depreciation for:				
Buildings and improvements	2,251,686	119,438	68,503	2,302,621
Infrastructure	621,479	19,014	—	640,493
Equipment and other assets	111,121	16,496	6,129	121,488
Total accumulated depreciation	**2,984,286**	**154,948**	**74,632**	**3,064,602**
Total capital assets being depreciated, net	**4,546,046**	**35,027**	**428**	**4,580,645**
Business-type activities, capital assets, net	**$ 5,118,064**	**$ 351,903**	**$ 96,049**	**$ 5,373,918**

*Restated

Table 7 summarizes the depreciation expense charged to the activities of the primary government as of June 30.

Table 7

Schedule of Primary Government Depreciation Expense
June 30, 2003
(amounts in thousands)

	Amount
Governmental activities	
General government	$ 88,470
Education	216,738
Health and human services	31,744
Resources	45,814
State and consumer services	28,017
Business and transportation	86,460
Correctional programs	150,176
Internal service funds (charged to the activities that utilize the fund)	90,958
Total depreciation expense – governmental activities	**738,377**
Business-type activities	
Enterprise	**154,948**
Total primary government	**$ 893,325**

Table 8 summarizes the capital activity for discretely presented component units as of June 30.

Table 8

Schedule of Changes in Capital Assets — Discretely Presented Component Units
June 30, 2003
(amounts in thousands)

	Beginning Balance	Additions	Deductions	Ending Balance
Capital assets not being depreciated:				
Land	$ 402,132	$ 46,004	$ 6,818	$ 441,318
Collections	205,388 *	21,115	2,003	224,500
Construction in progress	2,229,657	(49,641)	1,653	2,178,363
Total capital assets not being depreciated	**2,837,177**	**17,478**	**10,474**	**2,844,181**
Capital assets being depreciated:				
Buildings and improvements	11,116,517	1,569,919	23,791	12,662,645
Equipment and other depreciable assets	6,646,576 *	597,244	279,443	6,964,377
Infrastructure	290,053	29,324	394	318,983
Total capital assets being depreciated	**18,053,146**	**2,196,487**	**303,628**	**19,946,005**
Less accumulated depreciation for:				
Buildings and improvements	4,425,953	376,816	31,033	4,771,736
Equipment and other depreciable assets	4,426,768	475,775	247,999	4,654,544
Infrastructure	130,313	10,232	260	140,285
Total accumulated depreciation	**8,983,034**	**862,823**	**279,292**	**9,566,565**
Total capital assets being depreciated, net	**9,070,112**	**1,333,664**	**24,336**	**10,379,440**
Capital assets, net	**$ 11,907,289**	**$ 1,351,142**	**$ 34,810**	**$ 13,223,621**

*Restated

NOTE 8. ACCOUNTS PAYABLE

The accounts payable are amounts due to taxpayers, other governments, vendors, customers, beneficiaries, and employees related to different programs.

Table 9 presents detail of the accounts payable as of June 30.

The adjustment for the fiduciary funds represents amounts due to fiduciary funds that were reclassified as external payables on the government-wide Statement of Net Assets.

Table 9

Schedule of Accounts Payables
June 30, 2003
(amounts in thousands)

	Education	Health and Human Services	Resources	Business and Transportation	General Government and Others	Total
Governmental activities:						
General Fund	$ 708,204	$ 271,609	$ 115,699	$ 3,828	$ 492,943	$ 1,592,283
Federal Fund	150,232	626,983	59,270	235,780	64,673	1,136,938
Transportation Construction Fund	1,052	—	—	462,333	429	463,814
Nonmajor governmental funds	391,736	745,859	148,861	482,678	375,769	2,144,903
Internal service funds	—	39,982	11,312	22,391	124,866	198,551
Adjustment:						
Fiduciary funds	372,403	4,966,128	—	56,304	32,271	5,427,106
Total governmental activities	**$ 1,623,627**	**$ 6,650,561**	**$ 335,142**	**$ 1,263,314**	**$ 1,090,951**	**$ 10,963,595**
Business-type activities:						
Housing Loan Fund	$ —	$ —	$ —	$ —	$ 138	$ 138
Electric Power Fund	—	—	415,000	—	—	415,000
Water Resources Fund	—	—	34,767	—	—	34,767
Public Building Construction Fund	—	—	—	—	47,792	47,792
State Lottery Fund	—	—	—	—	30,638	30,638
Unemployment Programs Funds	—	955	—	—	—	955
Nonmajor enterprise funds	42,524	821	1,282	3,376	872	48,875
Adjustment:						
Fiduciary funds	—	19,766	—	—	—	19,766
Total business-type activities	**$ 42,524**	**$ 21,542**	**$ 451,049**	**$ 3,376**	**$ 79,440**	**$ 597,931**

NOTE 9. SHORT-TERM FINANCING

As part of its cash management program, the State regularly issues short-term obligations to meet cash flow needs. The State issues revenue anticipation notes (RANs) to partially fund timing differences between revenues and expenditures. A significant portion of the General Fund revenues are received in the later half of the fiscal year, while disbursements are paid more evenly throughout the fiscal year. If additional external cash flow borrowing is required, the State issues revenue anticipation warrants (RAWs).

The State issued a total of $12.5 billion of RANs in October and November 2002 to partially fund cash flow needs in the 2002-03 fiscal year, including the repayment of $7.5 billion in RAWs issued in June 2002. The State issued $11.0 billion of RAWs on June 18, 2003, to provide enough additional cash to pay the maturing 2002 RANs and to partially fund cash flow timing differences for the 2003-04 fiscal year.

During the 2002-03 fiscal year, the State entered into agreements with seven financial institutions to provide credit and liquidity for the RAWs, which mature on June 16, 2004.

The California Housing Finance Agency, a discretely presented component unit, entered into an agreement with a financial institution to provide a line of credit for short-term borrowings of up to $100 million. At June 30, 2003, draws totaling $12 million were outstanding.

NOTE 10. LONG-TERM OBLIGATIONS

As of June 30, the primary government had long-term obligations totaling $73.2 billion. Of that amount, $4.6 billion is due within one year and includes $934 million in outstanding commercial paper that had been scheduled to be refunded by general obligation bonds issued during the fiscal year. This commercial paper was refunded in July 2003. The other long-term obligations for governmental activities consist of $2.8 billion for workers' compensation claims, $1.4 billion for reimbursement of costs mandated by the State, $997 million for net pension obligations, $703 million owed for lawsuits, and the University of California pension liability of $87 million. The compensated absences will be liquidated by the General Fund, special revenue funds, capital projects funds, and internal service funds. Workers' compensation and capital leases will be liquidated by the General Fund, special revenue funds, and internal service funds. Loans payable, net pension obligations, lawsuits, reimbursement of costs incurred by local agencies and school districts for costs mandated by the State, and the University of California pension liability will be liquidated by the General Fund. The $418 million in other long-term obligations for business-type activities is mainly for advance collections. These other long-term obligations do not have required payment schedules, or they will be paid when funds are appropriated. The changes in the long-term obligations during the year ended June 30, 2003, are summarized in Table 10.

Table 10

Schedule of Changes in Long-Term Obligations
(amounts in thousands)

	Balance July 1, 2002	Additions	Deductions	Balance June 30, 2003	Due Within One Year	Noncurrent Liabilities
Governmental activities						
Loans payable	$ 707,805	$ 141,486	$ 7,391	$ 841,900	$ —	$ 841,900
Compensated absences payable	1,583,592	783,882	791,244	1,576,230	166,101	1,410,129
Certificates of participation and commercial paper	540,092	3,914,835	2,598,225	1,856,702	944,796	911,906
Capital lease obligations	3,597,536	515,996	207,109	3,906,423	205,006	3,701,417
General obligation bonds payable	22,110,822	5,150,784	504,235	26,757,371	1,328,300	25,429,071
Revenue bonds payable	784,015	3,000,000	31,975	3,752,040	33,450	3,718,590
Other long-term obligations	3,924,191 *	2,536,282	463,235	5,997,238	353,685	5,643,553
Total	**$ 33,248,053**	**$ 16,043,265**	**$ 4,603,414**	**$ 44,687,904**	**$ 3,031,338**	**$ 41,656,566**
Business-type activities						
Benefits payable	$ 1,087,726	$ 177,700	$ 156,099	$ 1,109,327	$ 189,392	$ 919,935
Lottery prizes and annuities	2,637,900	—	115,307	2,522,593	530,074	1,992,519
Compensated absences payable	33,281	16,474	16,996	32,759	16,242	16,517
Certificates of participation and commercial paper	3,937,426	79,880	3,915,778	101,528	—	101,528
General obligation bonds payable	3,221,310	—	412,035	2,809,275	199,375	2,609,900
Revenue bonds payable	8,900,472	13,639,940	982,504	21,557,908	586,072	20,971,836
Other long-term obligations	434,619	1,229	17,755	418,093	—	418,093
Total	**$ 20,252,734**	**$ 13,915,223**	**$ 5,616,474**	**$ 28,551,483**	**$ 1,521,155**	**$ 27,030,328**

*Restated

NOTE 11. CERTIFICATES OF PARTICIPATION

Debt service requirements for certificates of participation, which are financed by lease payments from governmental activities, are shown in Table 11. The certificates of participation were used to finance the acquisition and construction of state office buildings.

Table 11

Schedule of Debt Service Requirements for Certificates of Participation – Primary Government
(amounts in thousands)

Year Ending June 30	Principal	Interest	Total
2004	$ 10,547	$ 3,303	$ 13,850
2005	10,422	3,412	13,834
2006	10,445	3,760	14,205
2007	5,825	3,813	9,638
2008	5,637	4,006	9,643
2009-2013	28,991	19,212	48,203
2014-2018	28,620	3,203	31,823
Total	**$ 100,487**	**$ 40,709**	**$ 141,196**

Debt service requirements for certificates of participation for the University of California, a discretely presented component unit, are shown in Table 12.

Table 12

Schedule of Debt Service Requirements for Certificates of Participation – University of California – Discretely Presented Component Unit
(amounts in thousands)

Year Ending June 30	Principal	Interest	Total
2004	$ 11,975	$ 16,692	$ 28,667
2005	12,610	15,967	28,577
2006	13,245	15,323	28,568
2007	13,910	14,639	28,549
2008	14,610	13,920	28,530
2009-2013	68,455	58,169	126,624
2014-2018	68,415	40,874	109,289
2019-2023	70,925	20,586	91,511
2024-2028	25,965	8,563	34,528
2029-2033	17,925	1,812	19,737
Total	**$ 318,035**	**$ 206,545**	**$ 524,580**

NOTE 12. COMMERCIAL PAPER AND OTHER LONG-TERM BORROWINGS

The primary government has two commercial paper borrowing programs: a general obligation commercial paper program of up to $2.0 billion, and an enterprise fund commercial paper program for the Department of Water Resources of up to $100 million. Under these programs, commercial paper may be issued at prevailing rates for periods not to exceed 270 days from the date of issuance.

To provide liquidity for the programs, the State has entered into a revolving credit agreement with commercial banks.

The current agreement for the general obligation commercial paper program, effective Feburary 26, 2003, established the existing $2.0 billion limit on the amount of outstanding notes. As of June 30, 2003, the general obligation commercial paper program had $1.8 billion in outstanding commercial paper notes related to governmental activity. As of June 30, 2003, the enterprise fund commercial paper program had $32 million in outstanding notes.

The proceeds from the issuance of commercial paper are restricted primarily to construction costs of general obligation bond program projects and of certain state water projects. Because the general obligation commercial paper is retired by long-term general obligation debt, it is considered a noncurrent liability. During the fiscal year ended June 30, 2003, the primary government issued $3.9 billion in commercial paper and issued long-term general obligation bonds to refund $3.5 billion in outstanding commercial paper. However, $934 million was not refunded by June 30, 2003, so it remains as an outstanding current liability.

In June 2001, the primary government received an interim loan for $4.3 billion that was used for power purchases. The financing was structured as a term loan due to be paid on or before October 31, 2001, from the proceeds of the sale of long-term revenue bonds. Because bonds were not issued before October 31, 2001, the interim financing converted to a three-year term loan with quarterly principal and interest payments. The primary government made principal payments of $385 million during the year ended June 2003 before the balance of the loan was paid off with bond proceeds in October 2002.

The primary government has a revenue bond anticipation note (BAN) program that consists of borrowing for capital improvements on certain campuses of the California State University. As of June 30, 2003, $69 million in outstanding BANs existed in anticipation of issuing housing revenue bonds to the public.

The University of California, a discretely presented component unit, has mortgages and other borrowings consisting of contractual obligations resulting from the acquisition of land or buildings and the construction and renovation of certain facilities. The mortgages are secured by real property. Included in mortgages and other borrowings, which total approximately $167 million, are various unsecured financing agreements with commercial banks that total approximately $63 million.

The University of California established a $550 million commercial paper program with tax-exempt and taxable components. The program is supported by the legally available unrestricted investments balance in the University of California's Short-Term Investment Pool. Commercial paper has been issued to provide for interim financing of construction and related equipment and medical center working capital requirements. Commercial paper is secured by a pledge of the net revenues generated by the enterprise financed, not by any encumbrance, mortgage, or other pledge of property, and does not constitute a general obligation of the University of California. At June 30, 2003, outstanding tax-exempt and taxable commercial paper was $430 million and $120 million, respectively.

NOTE 13. LEASES

The aggregate amount of lease commitments for facilities and equipment of the primary government in effect as of June 30 was approximately $7.4 billion. This amount does not include any future escalation charges for real estate taxes and operating expenses. Primary government leases that are classified as operating leases, in accordance with the applicable standards, contain clauses providing for termination. Operating lease expenditures are recognized as incurred over the lease term. It is expected that, in the normal course of business, most of these operating leases will be replaced by similar leases.

The total present value of minimum capital lease payments for the primary government is composed of $13 million from internal service funds and $3.9 billion from other governmental activities. The additions and deductions of capital lease obligations may be found in Note 10, Long-Term Obligations. Also reported in Note 10 are the current and noncurrent portions of the capital lease obligations. Lease expenditures for the year ended June 30, 2003, amounted to approximately $804 million.

Included in the capital lease commitments are lease-purchase agreements that certain state agencies have entered into with the State Public Works Board, an enterprise fund agency, amounting to a present value of net minimum lease payments of $3.6 billion. This amount represents 93% of the total present value of minimum lease payments of the primary government. Also included in the capital lease commitments are some lease-purchase agreements to acquire equipment.

The capital lease commitments do not include $755 million of lease-purchase agreements with building authorities that are blended component units. These building authorities acquire or develop office buildings and then lease the facilities to state agencies. Upon expiration of the lease, title passes to the primary government. The costs of the buildings and the related outstanding revenue bonds and certificates of participation are reported in the government-wide statements. Accordingly, the lease receivables or capital lease obligations associated with these buildings are not included in the financial statements.

Future minimum lease commitments of the primary government are summarized in Table 13.

Table 13

Schedule of Future Minimum Lease Commitments – Primary Government
(amounts in thousands)

Year Ending June 30	Operating Leases	Capital Leases: Internal Service Funds	Capital Leases: Other Governmental Activities	Total
2004	$ 264,678	$ 4,599	$ 482,574	$ 751,851
2005	197,580	4,772	483,687	686,039
2006	134,960	1,221	445,423	581,604
2007	86,821	791	392,550	480,162
2008	70,051	791	388,761	459,603
2009-2013	140,807	3,228	1,716,112	1,860,147
2014-2018	62,531	—	1,508,140	1,570,671
2019-2023	5,774	—	708,655	714,429
2024-2028	6	—	245,819	245,825
2029-2033	3	—	—	3
2034-2038	3	—	—	3
2039-2043	3	—	—	3
2044-2048	2	—	—	2
Total minimum lease payments	$ 963,219	15,402	6,371,721	$ 7,350,342
Less: amount representing interest		2,235	2,478,465	
Present value of net minimum lease payments		$ 13,167	$ 3,893,256	

The aggregate amount of discretely presented component units' lease commitments for land, facilities, and equipment in effect as of June 30, 2003, was approximately $2.5 billion. Table 14 presents the future minimum lease commitments for the University of California and the State Compensation Insurance Fund. Operating lease expenditures for the year ended June 30, 2003, amounted to approximately $182 million for discretely presented component units.

Table 14

Schedule of Future Minimum Lease Commitments – Discretely Presented Component Units
(amounts in thousands)

Year Ending June 30	University of California Capital	University of California Operating	State Compensation Insurance Fund Operating	Total
2004	$ 150,528	$ 76,040	$ 43,060	$ 269,628
2005	139,395	66,269	39,279	244,943
2006	131,591	53,272	31,852	216,715
2007	121,142	41,988	23,001	186,131
2008	117,624	32,825	20,406	170,855
2009-2013	542,844	59,767	45,057	647,668
2014-2018	429,202	3,265	—	432,467
2019-2023	318,567	3,399	—	321,966
2024-2028	11,439	3,772	—	15,211
2029-2033	—	4,283	—	4,283
2034-2038	—	4,877	—	4,877
2039-2043	—	1,645	—	1,645
Total minimum lease payments	**1,962,332**	**$ 351,402**	**$ 202,655**	**$ 2,516,389**
Less: amount representing interest	662,773			
Present value of net minimum lease payments	**$ 1,299,559**			

NOTE 14. COMMITMENTS

As of June 30, the primary government had commitments of $3.9 billion for certain highway construction projects. These commitments are not included in the reserve for encumbrances in the Federal and Transportation Construction Funds because the future expenditures related to these commitments are expected to be reimbursed with $598 million from local governments and $3.3 billion in proceeds of approved federal grants. The ultimate liability will not accrue to the State.

The primary government had other commitments totaling $36.0 billion that are not included as a liability on the balance sheet. These commitments included loan and grant agreements that totaled approximately $3.5 billion to reimburse other entities for construction projects for school building aid and housing. The constructed assets will not belong to the primary government, whose payments are contingent upon the other entities entering into construction contracts. In addition to the loan and grant commitments, the primary government had commitments of approximately $1.2 billion for the seismic retrofit of toll bridges, $1.1 billion for the construction of water projects and the purchase of power, and $313 million for the maintenance and operation of the California State Lottery's automated gaming system and its communication systems and services. These are long-term projects, and all needs of the contracts may not have been defined. The projects will be funded with existing and future program resources or with the proceeds of revenue and general obligation bonds.

The primary government has also entered into $20.2 billion in long-term contracts to purchase power that are not included as a liability on the balance sheet of the Electric Power Fund. In addition, there are variable costs that management estimates at $9.8 billion associated with several of the contracts. Purchases will take place in the future, and the commitments will be met with future receipts from charges to residential and commercial energy users.

As of June 30, the discretely presented component units had other commitments that are not included as a liability on the balance sheet. The University of California had authorized construction projects totaling $2.9 billion. The university has also made commitments to make investments in certain investment partnerships pursuant to provisions in the partnership agreements. These commitments totaled $531 million as of June 30, 2003. Other component units had outstanding commitments to provide $471 million for loans under various housing revenue bond programs and $127 million to other governments for infrastructure improvements.

NOTE 15. GENERAL OBLIGATION BONDS

The State Constitution permits the primary government to issue general obligation bonds for specific purposes and in such amounts as approved by a two-thirds majority of both houses of the Legislature and by a majority of voters in a general or direct primary election. The debt service for general obligation bonds is appropriated from the General Fund. Under the State Constitution, the General Fund is used first to support the public school system and public institutions of higher education; it can then be used to service the debt on outstanding general obligation bonds. Enterprise funds and certain other funds reimburse the General Fund for any debt service provided on their behalf.

General obligation bonds that are directly related to, and expected to be paid from, the resources of enterprise funds are included in the accounts of such funds in the financial statements. However, the General Fund may be liable for the payment of any principal and interest on these bonds that is not met from the resources of such funds.

As of June 30, $24.9 billion of general obligation bonds had been authorized but not issued. This amount includes $13.2 billion that has been authorized by the applicable finance committee for future issuance in the form of commercial paper notes. Of this amount, $1.8 billion in general obligation indebtedness has been issued in the form of commercial paper notes but not yet retired by long-term bonds.

During the 2001-02 fiscal year, the State adopted its new *Strategic Debt Management Plan.* This plan included shifting from level principal payments to level debt service payments (principal and interest combined), deferring initial principal payments on newly issued general obligation bonds, and issuing variable-rate general obligation bonds. In April 2003, the State sold $1.4 billion of variable-rate general obligation bonds consisting of $250 million in daily rate, $650 million in weekly rate, and $500 million in auction rate. The interest rates associated with the daily rates and weekly rates are determined by the remarketing agents to be the lowest rate that would enable them to sell the bonds for delivery on the effective date of such rate at a price (without regard to accrued interest) equal to 100% of the principal amount and the interest is paid on the first business day of each calendar month. The interest rates on the auction-rate bonds are determined by the auction agent through an auction process and the interest is paid on the business day immediately following each auction rate period. Letters of credit were issued to secure payment of principal and interest on the daily and weekly variable-rate bonds. Under these letters of credit, the credit providers pay all principal and interest payments to the bondholders. The State is then required to reimburse the credit providers for the amounts paid, plus interest. There are different credit providers for each series of variable-rate bonds issued. The letter of credit initial expiration dates for the daily and weekly variable-rate bonds are April 14, 2008, and April 14, 2006, respectively.

Information on the changes in general obligation bond debt for the year ended June 30, 2003, may be found in Note 10, Long-Term Obligations.

Table 15 shows the debt service requirements for all general obligation bonds as of June 30, 2003. The estimated debt service requirements for the $1.4 billion variable-rate bonds are calculated using the actual interest rates in effect on June 30, 2003. Sinking fund deposits will be set aside in a mandatory sinking fund at the beginning of each fiscal year starting in the 2015-16 fiscal year and continuing to the 2032-33 fiscal year, based on the schedule provided in the official statement. The deposits set aside in any fiscal year, with approval of the State Treasurer and the appropriate bond finance committees, may be applied to the redemption of any other general obligation bonds then outstanding. To the extent that the deposit is not applied by January 31 of each fiscal year, the variable-rate bonds will be redeemed in whole or in part on an interest payment date in that fiscal year.

Table 15

Schedule of Debt Service Requirements for General Obligation Bonds
(amounts in thousands)

Year Ending June 30	Governmental Activities Interest	Governmental Activities Principal	Governmental Activities Total	Business-Type Activities Interest	Business-Type Activities Principal	Business-Type Activities Total
2004	$ 1,341,930	$ 1,328,300	$ 2,670,230	$ 154,920	$ 199,375	$ 354,295
2005	1,285,835	1,245,334	2,531,169	145,581	134,340	279,921
2006	1,215,109	1,171,411	2,386,520	136,015	146,955	282,970
2007	1,146,206	1,204,445	2,350,651	125,908	156,545	282,453
2008	1,079,186	1,278,203	2,357,389	115,117	152,905	268,022
2009 -2013	4,336,815	5,679,783	10,016,598	426,540	790,220	1,216,760
2014 -2018	3,143,938	3,536,375	6,680,313	243,283	612,460	855,743
2019 -2023	2,221,482	4,114,360	6,335,842	118,276	322,840	441,116
2024 -2028	1,227,892	4,016,170	5,244,062	55,489	157,890	213,379
2029 -2033	319,662	3,182,990	3,502,652	19,396	135,745	155,141
Total	**$ 17,318,055**	**$ 26,757,371**	**$ 44,075,426**	**$ 1,540,525**	**$ 2,809,275**	**$ 4,349,800**

Prior Year Defeasance: In prior years, the primary government placed the proceeds of the refunding bonds in a special irrevocable escrow trust account with the State Treasury to provide for all future debt service payments on defeased bonds. The assets of the trust accounts and the liability for defeased bonds are not included in the State's financial statements. As of June 30, the outstanding balance of general obligation bonds defeased in prior years was approximately $1.7 billion.

NOTE 16. REVENUE BONDS

Revenue bonds that are directly related to, and expected to be paid from, the resources of enterprise funds are included in the accounts of such funds. Principal and interest on revenue bonds are payable from the pledged revenues of the respective funds of the authorities and agencies listed in the next section of this note. The General Fund has no legal liability for payment of principal and interest on revenue bonds.

Revenue bonds to acquire, construct, or renovate state facilities or to refund outstanding revenue bonds in advance of maturity are issued for water resources, public building construction, and certain nonmajor enterprise funds. Revenue bonds are also issued to make loans to finance the acquisition of farms and homes by California veterans. Revenue bonds were used to repay advances from the

General Fund and loans from financial institutions that were used to finance electric power purchases for resale to utility customers.

Certain building authorities, under state law, may issue revenue bonds. These revenue bonds are in the governmental activities column of the government-wide statement of net assets. These bonds are issued for the purpose of acquiring and constructing buildings for public education purposes and for the purpose of constructing state office buildings. Leases with state agencies pay the principal and interest on the revenue bonds issued by the building authorities. The primary government has no legal liability for the payment of principal and interest on these revenue bonds.

The Golden State Tobacco Securitization Corporation (GSTSC) is authorized by state law to issue asset-backed bonds. The bonds are secured by and payable solely from Tobacco Settlement Revenue that GSTSC has purchased from the State. The primary government has no legal liability for the payment of principal and interest on these bonds. These bonds are included in the governmental activities column of the government-wide Statement of Net Assets.

The University of California, a discretely presented component unit, issues revenue bonds to finance the construction, renovation, and acquisition of certain facilities and equipment.

Under state law, the California Housing Finance Agency (CHFA), a discretely presented component unit, issues fixed- and variable-rate revenue bonds to make loans to finance housing developments and to finance the acquisition of homes by low- and moderate-income families. Variable-rate debt is typically tied to a common index such as the Bond Market Association (BMA) or the London Interbank Offered Rate (LIBOR) and is reset periodically.

Table 16 shows revenue bonds outstanding as of June 30.

Table 16

Schedule of Revenue Bonds Outstanding
June 30, 2003
(amounts in thousands)

Primary government		
Governmental activities		
Nonmajor governmental funds		
Golden State Tobacco Securitization Corporation Fund	$	3,000,000
Building authorities		752,040
Total nonmajor governmental funds		**3,752,040**
Business-type activities		
Housing Loan Fund		521,475
Electric Power Fund		11,636,000
Water Resources Fund		2,397,219
Public Building Construction Fund		5,333,123
Nonmajor enterprise funds		1,670,091
Total enterprise funds		**21,557,908**
Total primary government		**25,309,948**
Discretely presented component units		
University of California		4,019,501
California Housing Finance Agency		8,136,870
Nonmajor component units		128,507
Total discretely presented component units		**12,284,878**
Total	**$**	**37,594,826**

Table 17 shows the debt service requirements for fixed- and variable-rate bonds as of June 30, 2003. It excludes certain unamortized refunding costs, premiums, discounts, and other costs that are included in Table 16.

Table 17

Schedule of Debt Service Requirements for Revenue Bonds
(amounts in thousands)

Year Ending June 30	Primary Government: Governmental Activities Principal	Primary Government: Governmental Activities Interest*	Primary Government: Business-Type Activities Principal	Primary Government: Business-Type Activities Interest*	Discretely Presented Component Units Principal	Discretely Presented Component Units Interest*
2004	33,450	233,741	552,931	911,681	724,050	394,285
2005	35,080	232,093	815,687	888,012	606,073	366,819
2006	43,435	230,326	864,672	850,474	346,476	350,645
2007	45,640	228,178	843,915	812,438	357,932	337,568
2008	50,300	225,918	879,128	774,962	380,408	324,233
2009-2013	275,990	1,087,443	4,927,741	3,220,877	2,353,625	1,402,680
2014-2018	285,640	1,018,048	5,831,680	1,964,541	2,155,034	1,005,319
2019-2023	429,260	925,561	5,282,648	755,536	1,942,083	640,047
2024-2028	395,245	810,605	1,017,455	205,343	1,882,981	383,040
2029-2033	563,770	669,867	272,460	37,313	1,291,964	123,463
2034-2038	805,275	457,210	54,455	3,705	249,435	33,521
2039-2043	788,955	141,925	—	—	46,830	2,105
Total	**$ 3,752,040**	**$ 6,260,915**	**$ 21,342,772**	**$ 10,424,882**	**$ 12,336,891**	**$ 5,363,725**

*Includes interest on variable-rate bonds based on rates in effect on June 30, 2003.

Table 18 shows debt service requirements as of June 30, 2003, for variable-rate debt included in Table 17, as well as net swap payments, assuming that current interest rates remain the same for their term. As interest rates vary, variable-rate bond interest payments and net swap payments will vary.

Table 18

Schedule of Debt Service and Swap Requirements for Variable-Rate Revenue Bonds
(amounts in thousands)

	Primary Government				Discretely Presented Component Units			
	Business-Type Activities							
Year Ending June 30	Principal	Interest*	Interest* Rate SWAP Net	Total	Principal	Interest*	Interest* Rate SWAP Net	Total
2004	$ —	$ 15,000	$ 31,000	$ 46,000	$ 64,290	$ 41,672	$ 131,893	$ 237,855
2005	—	15,000	31,000	46,000	78,470	39,710	125,812	243,992
2006	—	15,000	31,000	46,000	84,305	37,583	119,546	241,434
2007	—	15,000	31,000	46,000	89,595	35,086	112,191	236,872
2008	—	15,000	31,000	46,000	102,630	32,189	103,518	238,337
2009-2013	658,000	71,000	148,000	877,000	545,155	122,647	393,987	1,061,789
2014-2018	772,000	21,000	44,000	837,000	588,825	74,696	238,984	902,505
2019-2023	—	—	—	—	693,195	43,197	139,484	875,876
2024-2028	—	—	—	—	698,440	22,217	72,527	793,184
2029-2033	—	—	—	—	674,735	8,640	28,613	711,988
2034-2038	—	—	—	—	67,015	1,126	3,818	71,959
Total	**$ 1,430,000**	**$ 167,000**	**$ 347,000**	**$ 1,944,000**	**$ 3,686,655**	**$ 458,763**	**$ 1,470,373**	**$ 5,615,791**

*Based on rates in effect on June 30, 2003.

Primary Government Variable Rate/Swap Disclosure

Objective: The Department of Water Resources (DWR) entered into interest-rate swap agreements with various counterparties to reduce variable-interest-rate risk for the Electric Power Fund. The swaps create a synthetic fixed rate. DWR agreed to make fixed-rate payments and receive floating-rate payments on notional amounts equal to a portion of the principal amount of this variable-rate debt.

Terms of the Agreements and Fair Value: The terms and fair values of the swap agreements entered into by DWR, all of which became effective February 1, 2003, are summarized in Table 19. The notional amounts of the swaps match the principal amounts of the associated debt. The swap agreements contain scheduled reductions to outstanding notional amounts that follow scheduled amortization of the associated debt. All swaps had a negative fair value as of June 30, 2003, because interest rates had declined. The fair values were provided by the counterparties using the par value or the marked-to-market method.

Credit Risk: As of June 30, 2003, DWR was not exposed to credit risk because the swaps had negative fair values. However, should interest rates increase and the fair values become positive, DWR would be exposed to credit risk in the amount of the swaps' fair value. DWR has a total of nine swap agreements with six different counterparties. Three swaps, approximating 35% of the total notional value, are with a counterparty that has Moody's Investors Service, Fitch Reporting, and Standard & Poor's credit ratings of Aaa, AAA, and AAA, respectively. Of the remaining swaps, two are held with a single counterparty, approximating 21% of the outstanding notional value. That counterparty has Moody's, Fitch's, and S&P credit ratings of Aa3, AA-, and A+. The remaining four swaps are with separate counterparties, all having Moody's, Fitch's, and S&P credit ratings of Aa3, AA-, and A+, or better. The credit ratings of the counterparties for the swap agreements are summarized in Table 19.

Table 19

Schedule of Terms, Fair Values, and Credit Ratings of Swap Agreements
(amounts in thousands)

Swap Termination Date	Outstanding Notional Amount at June 30, 2003	Fair Values at June 30, 2003	Fixed Rate Paid by Electric Power Fund	Variable Rate Received by Electric Power Fund	Counterparty Credit Ratings (Moody's, Fitch's, S&P)
5/1/2011	$ 94,000	$ (4,000)	2.914 %	80% of LIBOR	Aaa, AAA, AAA
5/1/2012	234,000	(11,000)	3.024	80% of LIBOR	Aaa, AAA, AAA
5/1/2013	200,000	(9,000)	3.405	BMA	Aa3, AA-, AA-
5/1/2013	100,000	(4,000)	3.405	BMA	Aa3, AA-, A+
5/1/2013	30,000	(1,000)	3.405	BMA	Aa3, AA-, A+
5/1/2014	194,000	(10,000)	3.204	80% of LIBOR	Aa1, AA, AA-
5/1/2015	174,000	(10,000)	3.280	80% of LIBOR	Aaa, AAA, AAA
5/1/2016	202,000	(11,000)	3.342	80% of LIBOR	Aa3, AA-, A+
5/1/2017	202,000	(12,000)	3.389	80% of LIBOR	Aa3, AA-, A+
Total	$ 1,430,000	$ (72,000)			

Basis Risk: DWR is exposed to basis risk on the swaps that have payments calculated on the basis of a percentage of LIBOR. The basis risk results from the fact that DWR's floating interest payments payable on the underlying debt are determined in the tax-exempt market, while the DWR floating receipts on the swaps are based on LIBOR, which is determined in the taxable market. Should the relationship between LIBOR and the tax-exempt market change and move to convergence, or should DWR's bonds trade at levels worse (higher in rate) in relation to the tax-exempt market, DWR's cost would increase. As of June 30, 2003, the variable rate on DWR's bonds ranged from 0.70% to 1.80%, while 80% of LIBOR received on the swap was equal to 0.89%.

Termination Risk: DWR's swap agreements do not contain any out-of-the-ordinary termination events that would expose it to significant termination risk. In keeping with market standards, DWR or the counterparty may terminate a swap agreement if the other party fails to perform under the terms of the contract or in the event of a significant loss of creditworthiness by the other party. DWR views the likelihood of such an event to be remote at this time. If a termination were to occur, at the time of the termination DWR would be liable for payment equal to the swap's fair value, if it had a negative fair value at that time. A termination would mean that DWR's underlying floating rate bonds would no longer be hedged and DWR would be exposed to floating rate risk, unless it entered into a new hedge.

Rollover Risk: Other than termination, there is no rollover risk associated with the swap agreements, because the agreements have termination dates and notional amounts that are tied to equivalent maturity dates and principal amounts of amortizing debt.

Discretely Presented Component Unit Variable Rate/Swap Disclosure – California Housing Finance Agency (CHFA)

Table 18 includes debt service requirements and net swap payments as of June 30, 2003, for the California Housing Finance Agency (CHFA), a discretely presented component unit. Total principal, variable interest, and interest rate net swap payments are $3.3 billion, $423 million, and $1.4 billion, respectively.

Objective: CHFA has entered into interest rate swap agreements with various counterparties to protect itself against rising rates by providing a synthetic fixed rate for a like amount of variable-rate bond obligations. All of CHFA's interest rate swap transactions are structured to pay a fixed interest rate while receiving a variable interest rate, with one exception. Specifically, two associated interest rate swaps, one for $63 million, the total amount of the bonds outstanding, and the second on $13 million of the same bonds (the second swap is not reflected in the interest rate swap table). Under the terms of the first swap, CHFA pays a fixed interest rate and receives a variable interest rate; on the second swap, it pays a variable rate of interest based on a percentage of LIBOR and receives a variable rate of interest based on BMA. Synthetic fixed rates provide CHFA with significantly lower fixed costs of funds compared to the interest rates for its fixed-rate bonds.

Terms, Fair Value, and Credit Risk: All of CHFA's notional amounts of the swaps match the principal amounts of the associated debt. CHFA has created a synthetic fixed rate by swapping a portion of its variable rate debt. CHFA did not pay or receive any cash when the swap transactions were initiated. CHFA utilizes eight counterparties for its interest rate swap transactions. Counterparties are required to collateralize their exposure to CHFA when their credit ratings fall from AA to the highest single-A category, A1/A+. CHFA is not required to provide collateralization until its ratings fall to the mid-single-A category, A2/A. CHFA's swap portfolio has an aggregate negative fair value, due to a decline in interest rates, of $410 million as of June 30, 2003. Fair values are as reported by CHFA's counterparties and are estimated using the zero-coupon method. Since CHFA's swap portfolio has an aggregate negative fair value, CHFA is not exposed to credit risk. However, should interest rates rise, the negative fair value of the swap portfolio would be reduced and could eventually become positive. At this point, CHFA would become exposed to the counterparties' credit, since the counterparties would be obligated to make payment to CHFA in the event of termination. CHFA has 73 swap transactions, with outstanding notional amounts of $3.3 billion. The Standard & Poor's credit ratings for these counterparties range from A+ to AAA; Moody's credit ratings range from Aa3 to Aaa.

Basis Risk: CHFA's swaps contain the risk that the floating rate component of the swap will not match the floating rate of the underlying bonds. This risk arises because floating rates paid by swap counterparties are based on indices that consist of market-wide averages, while interest paid on CHFA's variable-rate bonds is specific to individual issuers. CHFA's variable-rate tax-exempt bonds trade at a slight discount to the BMA index. Swaps associated with tax-exempt bonds, for which CHFA receives a variable-rate payment, are based on a percentage of LIBOR; thus CHFA is exposed to basis risk if the relationship between BMA and LIBOR converges. As of June 30, 2003, the BMA rate was 0.98%, 65% of one-month LIBOR was 0.73%, and 60% of one-month LIBOR plus 26 basis points was 0.93%.

Termination Risk: Counterparties to CHFA's interest rate swaps have termination rights that require settlement payments by either CHFA or the counterparties, based on the fair value of the swap. As of June 30, 2003, no termination events had occurred.

Rollover Risk: CHFA's swap agreements have limited rollover risk because the agreements contain scheduled reductions to outstanding notional amounts that are expected to follow scheduled and anticipated reductions in the associated bonds payable. Six swap agreements contain par termination rights to accommodate unexpected faster paydown of the associated bonds from higher rates of prepayments of the home ownership loan portfolio.

Discretely Presented Component Unit Variable Rate/Swap Disclosure – University of California (UC)

Table 18 includes debt service requirements and net swap payments as of June 30, 2003, of the University of California (UC), a discretely presented component unit. Total principal, variable interest, and interest rate net swap payments are $348 million, $35 million, and $113 million, respectively.

Objective: UC has entered into interest rate swap agreements as a means to lower borrowing costs, compared to fixed-rate bonds at the time of issuance, and to effectively change the variable interest rate on bonds to a fixed rate of 3.1%. The swaps are with three financial institutions in connection with variable-rate refunding revenue bonds associated with the UC Davis Medical Center.

Terms: The bonds and related swap agreements mature on September 1, 2026. The aggregate notional amount of swaps matches the outstanding amounts on the bonds throughout the term of the bonds. UC pays the swap counterparties a fixed payment of 3.1% and receives a variable payment computed as 67% of the 30-day LIBOR. UC believes that, over time, the variable interest rates it pays on the bonds will approximate the variable payments it receives on the interest rate swaps, leaving the fixed interest rate payment on the swaps as the net payment obligation for the transaction.

Fair Value: The swaps have an estimated negative fair value of $9.6 million as of June 30, 2003, because interest rates have decreased since the execution of the swaps. The fair value is an indication of the difference in value of the swap fixed interest payments due on the swap and swap fixed rate payments due on a swap with identical terms executed on June 30, 2003. The fair value of the interest rate swap is the estimated amount the university would have paid to terminate the swap agreement in June 30, 2003. The fair value was estimated by the financial institutions using available quoted market prices or a forecast of expected discounted future cash flows.

Basis Risk: UC is exposed to basis risk whenever the interest rates on the bonds are reset. The interest rates on the bonds are tax-exempt interest rates reset each 28 days, weekly or daily, while the variable receipt rate on the interest rate swaps is taxable (67% of the 30-day LIBOR).

Termination and Interest Rate Risk: UC is exposed to losses in the event of non-performance by counterparties or unfavorable interest rate movements. The swap may be terminated if the insurer's credit quality rating falls below A- as issued by Fitch Ratings or Standard & Poor's, thereby canceling the synthetic interest rate payments to the variable interest rates on the bonds. At termination, UC may also owe a termination payment if there is a realized loss on the fair value of the swap.

Current Year Defeasances: In October 2002, the primary government issued $171 million in Central Valley Project Water System Revenue Bonds, which were used to advance refund $164 million of outstanding bonds. The proceeds of the advance refunding were used to purchase securities that were deposited in an irrevocable trust with an escrow agent to provide for all future debt service payments on the advance refunded bonds. As a result, the advance refunded bonds are considered to be defeased and the related liabilities have been removed from the financial statements. Although the advanced refundings resulted in the recognition of an accounting loss of approximately $13 million for the 2002-03 fiscal year, the primary government effectively reduced its aggregate debt service payments by approximately $15 million over the next 20 years and obtained an economic gain of $8 million.

In May 2003, the primary government issued $439 million in Central Valley Project Water System Revenue Bonds to refund $433 million of outstanding bonds. The proceeds of the current refunding, after payment of underwriting refunding fees, other issuance costs, and deposits to a Debt Service Reserve Account, were used to refund debt that was called. Although the current refundings resulted in the recognition of an accounting loss of approximately $18 million for the 2002-03 fiscal year, the primary government effectively reduced its aggregate debt service payments by approximately $45 million over the next 22 years and obtained an economic gain of $28 million.

In December 2002, CHFA, a discretely presented component unit, issued Multifamily Housing Revenue Bonds, of which a portion of the proceeds were used to refund Multi-Unit Rental Housing Revenue Bonds. The loss from the debt refundings was deferred and will be amortized as a component of interest expense over the shorter of the term of the bonds extinguished or the term of the refunding bonds. The refunding will decrease the debt service cash outflow for Multifamily Programs by $3 million. The refunding may also result in an economic gain for Multifamily Programs of an estimated $3 million.

In March 2003, UC, a discretely presented component unit, issued $348 million variable-rate bonds to advance refund and defease $301 in million in UC Davis Medical Center Revenue Bonds. UC also entered into an interest rate swap agreement, resulting in a fixed interest rate of 3.1%. Proceeds were used to pay for issuance costs and to purchase $341 million of U.S. government securities sufficient to fund retirement of the specified obligations. The defeasance resulted in deferred financing costs of $35 million, included as an offset to the current and non-current portion of long-term debt, as appropriate, in UC's statement of net assets, and is being amortized as interest expense over the remaining life of the defeased bonds. Aggregate debt service payments were reduced by $55 million over the next 23 years and UC was able to obtain an economic gain of $42 million, based on the assumption that the variable-rate bond payments will be offset by the variable receipts under the interest rate swaps.

Prior Year Defeasances: In prior years, the primary government defeased certain bonds by placing the proceeds of new bonds in irrevocable trust accounts to provide for all future debt service requirements. Accordingly, the assets and liabilities for these defeased bonds are not included in the financial statements. As of June 30, the outstanding balance of revenue bonds defeased in prior years was approximately $938 million.

In prior years, the University of California, a discretely presented component unit, defeased certain bonds. Investments that have maturities and interest rates sufficient to fund retirement of defeased liabilities are being held in irrevocable trusts for the debt service payments. Accordingly, the assets of the trust accounts and the liabilities for the defeased bonds are not included in the State's financial statements. As of June 30, the outstanding balance of University of California revenue bonds defeased in prior years was $415 million.

NOTE 17. INTERFUND BALANCES AND TRANSFERS

A. Interfund Balances

Due from other funds and due to other funds represent short-term interfund receivables and payables resulting from the time lag between the dates that goods and services are provided and received and payments between entities are made. Table 20 presents the due from and due to other funds as of June 30, 2003.

Table 20

Schedule of Due From Other Funds and Due To Other Funds

June 30, 2003
(amounts in thousands)

	Due To					
Due From	General Fund	Federal Fund	Transportation Construction Fund	Nonmajor Governmental Fund	Housing Loan Fund	Electric Power Fund
Governmental funds						
General Fund	$ —	$ —	$ 226,650	$ 11,071	$ —	$ —
Federal Fund	666,124	—	728,093	549,511	—	—
Transportation Construction Fund	—	—	—	353,490	—	—
Nonmajor governmental funds	274,741	—	31,233	135,883	—	—
Total governmental funds	**940,865**	**—**	**985,976**	**1,049,955**	**—**	**—**
Enterprise funds						
Housing Loan Fund	120	—	—	—	—	—
Water Resources Fund	—	—	—	—	—	—
Public Building Construction Fund	23,699	—	—	—	—	—
State Lottery Fund	18	—	—	209,839	—	—
Unemployment Programs Fund	66,165	—	—	3,085	—	—
Nonmajor enterprise funds	27,923	—	16,724	638	—	—
Total enterprise funds	**117,925**	**—**	**16,724**	**213,562**	**—**	**—**
Internal service funds	**48,026**	**242**	**20,757**	**115,820**	**3,295**	**36,000**
Fiduciary funds	**541**	**—**	**—**	**51**	**—**	**—**
Total primary government	**$ 1,107,357**	**$ 242**	**$ 1,023,457**	**$ 1,379,388**	**$ 3,295**	**$ 36,000**

Due To							
Water Resources Fund	Public Building Construction Fund	Lottery Resources Fund	Unemployment Programs Fund	Nonmajor Enterprise Fund	Internal Service Funds Fund	Fiduciary Funds Fund	Total
$ —	$ —	$ —	$ —	$ 10,030	$ 74,836	$ 1,281,040	$ 1,603,627
—	—	—	5,701	—	5,221	4,010,822	5,965,472
—	—	—	—	—	1,226	207	354,923
—	243	—	—	318	31,549	122,527	596,494
—	**243**	**—**	**5,701**	**10,348**	**112,832**	**5,414,596**	**8,520,516**
—	—	—	—	—	26	—	146
—	—	—	—	—	59,451	—	59,451
—	—	—	—	—	44,776	12,641	81,116
—	—	—	—	—	—	—	209,857
—	—	—	—	—	—	—	69,250
—	—	—	—	—	24	7,125	52,434
—	**—**	**—**	**—**	**—**	**104,277**	**19,766**	**472,254**
1,993	**12,034**	**3,705**	**6,738**	**8,220**	**78,753**	**12,510**	**348,093**
—	**—**	**—**	**—**	**—**	**1,395**	**124**	**2,111**
$ 1,993	**$ 12,277**	**$ 3,705**	**$ 12,439**	**$ 18,568**	**$ 297,257**	**$ 5,446,996**	**$ 9,342,974**

Interfund receivables and payables are the result of interfund loans that are not expected to be repaid within one year. The $2.1 billion in nonmajor governmental funds payable from the General Fund is primarily the result of legislation authorizing the transfer of cash from special revenue funds to the General Fund. Table 21 presents the interfund receivables and payables as of June 30, 2003.

Table 21

Schedule of Interfund Receivables and Payables
June 30, 2003
(amounts in thousands)

	Interfund Payables						
Interfund Receivables	**General Fund**	**Transportation Construction Fund**	**Nonmajor Governmental Funds**	**Water Resources Fund**	**Nonmajor Enterprise Funds**	**Fiduciary Funds**	**Total**
Governmental funds							
General Fund	$ —	$ —	$ 2,089,430	$ —	$ 20,200	$ 816,900	$ 2,926,530
Nonmajor governmental funds	13,849	748,900	—	—	—	—	762,749
Total governmental funds	**13,849**	**748,900**	**2,089,430**	**—**	**20,200**	**816,900**	**3,689,279**
Enterprise funds	**1,343**	**—**	**—**	**—**	**2,444**	**—**	**3,787**
Internal service funds	**3,000**	**—**	**3,534**	**91,516**	**—**	**—**	**98,050**
Fiduciary funds	**24,624**	**—**	**—**	**—**	**—**	**—**	**24,624**
Total primary government	**$ 42,816**	**$ 748,900**	**$ 2,092,964**	**$ 91,516**	**$ 22,644**	**$ 816,900**	**$ 3,815,740**

Due from primary government and due to component units represent short-term receivables and payables between the primary government and component units resulting from the time lag between the dates that goods and services are provided and received and payments between entities are made. Table 22 presents the due from primary government and due to component units as of June 30, 2003.

Table 22

Schedule of Due From Primary Government and Due To Component Units

June 30, 2003
(amounts in thousands)

	Due To		
Due From	University of California	Nonmajor Component Units	Total
Governmental funds			
General Fund	$ 167,764	$ 65	$ 167,829
Transportation Construction Fund	1	—	1
Nonmajor governmental funds	74,754	—	74,754
Total governmental funds	**242,519**	**65**	**242,584**
Internal service funds	**—**	**1,855**	**1,855**
Total primary government	**$ 242,519**	**$ 1,920**	**$ 244,439**

B. Interfund Transfers

As required by law, transfers move money collected by one fund to another fund that does the disbursing. The General Fund and certain other funds transfer money to support various programs accounted for in other funds. The largest transfers from the General Fund to the nonmajor governmental funds were $1.1 billion for the support of trial courts and $928 million to replace the reduction in the vehicle license fees used to support local governments. The largest transfer from the Federal Fund to the nonmajor governmental funds was $1.1 billion for the administration of the unemployment programs. The largest transfer from the nonmajor governmental funds to the General Fund was $2.5 billion from the Golden State Tobacco Securitization Corporation to support General Fund programs. Table 23 presents the interfund transfers for the year ended June 30, 2003.

Table 23

Schedule of Interfund Transfers
June 30, 2003
(amounts in thousands)

	Transferred To		
Transferred From	**General Fund**	**Transportation Construction Fund**	**Nonmajor Governmental Funds**
Governmental funds			
General Fund	$ —	$ 2,753	$ 2,711,597
Federal Fund	—	—	1,102,422
Transportation Construction Fund	29,477	—	9,346
Nonmajor governmental funds	3,501,619	33,936	655,714
Total governmental funds	**3,531,096**	**36,689**	**4,479,079**
Enterprise funds	**73,930**	—	**14,478**
Internal service funds	—	—	**1,406**
Fiduciary funds	**116,486**	—	—
Total primary government	**$ 3,721,512**	**$ 36,689**	**$ 4,494,963**

Transferred To			
Unemployment Programs Fund	**Nonmajor Enterprise Funds**	**Internal Service Funds**	**Total**
$ —	$ —	$ —	$ 2,714,350
5,377	—	—	1,107,799
—	—	—	38,823
—	16,401	1,745	4,209,415
5,377	**16,401**	**1,745**	**8,070,387**
—	**2,300**	—	**90,708**
—	—	—	**1,406**
—	—	—	**116,486**
$ 5,377	**$ 18,701**	**$ 1,745**	**$ 8,278,987**

NOTE 18. FUND DEFICITS AND ENDOWMENTS

A. Fund Deficits

Table 24 shows the funds that had deficits at June 30, 2003.

Table 24

Schedule of Fund Deficits
June 30, 2003
(amounts in thousands)

	Governmental Funds	Internal Service Funds
General Fund	$ 13,367,798	$ —
Higher Education Construction Fund	167,404	—
All Other Capital Projects Fund	18,392	—
Architecture Revolving Fund	—	7,378
Water Resources Revolving Fund	—	12,156
Total	**$ 13,553,594**	**$ 19,534**

B. Discretely Presented Component Unit Endowments

The University of California, a discretely presented component unit, administers certain restricted nonexpendable, restricted expendable, and unrestricted endowments that are included in the related net asset categories of the government-wide and fund financial statements. As of June 30, the total fair value of restricted and unrestricted endowments was $3.3 billion and $932 million, respectively. The University of California's policy is to retain appreciation on investments with the endowment after an annual income distribution. Endowment income capitalized to endowment principal that is available to meet future funding needs upon approval by the board of regents amounted to $1.1 billion at June 30. The portion of investment returns earned on endowments and distributed each year to support current operations is based on a rate approved by the board of regents.

NOTE 19. RISK MANAGEMENT

The primary government has elected, with a few exceptions, to be self-insured against loss or liability. Generally, the exceptions are when a bond resolution or a contract requires the primary government to purchase commercial insurance for coverage against property loss or liability. There have been no significant reductions in insurance coverage from the prior year. In addition, there has been no insurance settlement in the last three years that has exceeded insurance coverage. The primary government generally does not maintain reserves. Losses are covered in the year in which the payment occurs by appropriations from each fund responsible for payment. All claim payments are on a "pay as you go" basis, with workers' compensation benefits for self-insured agencies being initially paid by SCIF. The potential amount of loss arising from risks other than workers' compensation benefits is not considered material in relation to the primary government's financial position.

The discounted liability for unpaid self-insured workers' compensation loses is estimated to be $2.8 billion as of June 30, 2003. This estimate is based on actuarial reviews of the State's employee workers' compensation program and includes indemnity payments to claimants, as well as all other costs of providing workers' compensation benefits, such as medical care and rehabilitation. The estimate also includes the liability for unpaid services fees, industrial disability leave benefits, and incurred but not reported amounts. The estimated total liability of approximately $3.5 billion is discounted to $2.8 billion, using a 4% interest rate. Of the total, $354 million is a current liability, of which $256 million is included in the General Fund, $97 million in the special revenue funds, and $1 million in the internal service funds. The remaining $2.4 billion is reported as other noncurrent liabilities in the government-wide Statement of Net Assets. Changes in claims liabilities during the year ended June 30 are shown in Table 25.

The University of California, a discretely presented component unit, is self-insured for medical malpractice, workers' compensation, employee health care, and general liability claims. These risks are subject to various claim and aggregate limits, with excess liability coverage provided by an independent insurer. Liabilities are recorded when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. These losses include an estimate for claims that have been incurred but not reported. The estimated liabilities are based upon an independent actuarial determination of the anticipated future payments, discounted at rates ranging from 5.0% to 7.5%. The other discretely presented component units do not have significant liabilities related to self-insurance. Changes in self-insurance claims liabilities for the primary government and the University of California during the fiscal year ended June 30 are reported in Table 25.

Table 25

Schedule of Changes in Self-Insurance Claims
Years Ended June 30
(amounts in thousands)

	Primary Government		University of California – Discretely Presented Component Unit	
	2003	2002	2003	2002
Unpaid claims, beginning	$ 1,931,000	$ 1,428,500	$ 453,800	$ 402,800
Incurred claims	1,298,184	829,500	299,079	262,600
Claim payments	(401,174)	(327,000)	(232,702)	(211,600)
Unpaid claims, ending	**$ 2,828,010**	**$ 1,931,000**	**$ 520,177**	**$ 453,800**

NOTE 20. NONMAJOR ENTERPRISE SEGMENT INFORMATION

Table 26 presents the condensed balance sheet, the condensed statement of revenues, expenses, and changes in net assets, and the condensed statement of cash flows for nonmajor enterprise funds. The primary sources of revenues for these funds follow.

High Technology Education: Proceeds from revenue bonds and other debt for construction and renovation of public buildings for high-technology purposes.

Toll Facilities: Toll fees collected for crossing state toll bridges, except for the fees administered by the Bay Area Toll Authority.

State University Dormitory Building Maintenance and Equipment: Charges to students for housing and parking, and student fees for campus unions and health centers.

State Water Pollution Control Revolving Fund: Interest charged on loans to communities for construction of water pollution control facilities and projects.

Public Employees' Benefits: Contributions and premiums for public employee long-term care plans, and fees for managing a deferred compensation program.

Other Enterprise Programs: All other goods or services provided to the general public on a continuing basis when all or most of the cost involved is to be financed by user charges.

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Table 26

Nonmajor Enterprise Funds

(amounts in thousands)

Condensed Balance Sheet

June 30, 2003

	High Technology Education	Toll Facilities
Assets		
Due from other funds	$ 10,279	$ —
Due from other governments	—	—
Other current assets	32,301	45,070
Capital assets	—	533,981
Other noncurrent assets	476,654	426
Total assets	**$ 519,234**	**$ 579,477**
Liabilities		
Due to other funds	$ —	$ 16,725
Due to other governments	—	6,134
Other current liabilities	34,328	11,215
Noncurrent liabilities	357,767	—
Total liabilities	**392,095**	**34,074**
Net assets		
Investment in capital assets, net of related debt	—	533,981
Restricted	127,139	—
Unrestricted	—	11,422
Total net assets	**127,139**	**545,403**
Total liabilities and net assets	**$ 519,234**	**$ 579,477**

Condensed Statement of Revenues, Expenses, and Changes in Fund Net Assets

Year Ended June 30, 2003

	High Technology Education	Toll Facilities
Operating revenues	$ 44,268	$ —
Depreciation expense	—	(18,155)
Other operating expenses	(37,727)	(2,925)
Operating income (loss)	6,541	(21,080)
Nonoperating revenues (expenses)	—	218
Capital contributions	—	—
Transfers in	—	—
Transfers out	—	—
Change in net assets	6,541	(20,862)
Total net assets, July 1, 2002	**120,598**	**566,265**
Total net assets, June 30, 2003	**$ 127,139**	**$ 545,403**

Condensed Statement of Cash Flows

Year Ended June 30, 2003

	High Technology Education	Toll Facilities
Net cash provided (used) by:		
Operating activities	$ 35,449	$ (12)
Noncapital financing activities	—	(602)
Capital and related financing activities	(34,585)	773
Investing activities	—	172
Net increase (decrease)	**864**	**331**
Cash and pooled investments at July 1, 2002	**50,562**	**41,403**
Cash and pooled investments at June 30, 2003	**$ 51,426**	**$ 41,734**

State University Dormitory Building Maintenance and Equipment	State Water Pollution Control	Public Employees' Benefits	Other Enterprise Programs	Total
$ —	$ 2,497	$ 2,817	$ 2,975	$ 18,568
—	134,162	112,895	1,321	248,378
694,468	439,387	1,329,727	341,485	2,882,438
1,229,441	—	—	45,723	1,809,145
6,131	1,736,740	—	189,391	2,409,342
$ 1,930,040	**$ 2,312,786**	**$ 1,445,439**	**$ 580,895**	**$ 7,367,871**
$ 20,279	$ —	$ 7,115	$ 8,315	$ 52,434
—	—	131,916	101	138,151
100,134	5,731	216,677	172,201	540,286
1,034,372	311,347	898,000	8,859	2,610,345
1,154,785	**317,078**	**1,253,708**	**189,476**	**3,341,216**
525,631	—	—	45,723	1,105,335
353,106	1,995,708	189,022	338,290	3,003,265
(103,482)	—	2,709	7,406	(81,945)
775,255	**1,995,708**	**191,731**	**391,419**	**4,026,655**
$ 1,930,040	**$ 2,312,786**	**$ 1,445,439**	**$ 580,895**	**$ 7,367,871**
$ 227,847	$ 44,994	$ 2,006,341	$ 127,190	$ 2,450,640
(51,249)	—	—	(950)	(70,354)
(169,085)	(5,032)	(1,694,231)	(103,024)	(2,012,024)
7,513	39,962	312,110	23,216	368,262
56,872	(731)	60,189	7,354	123,902
	145,341	—	—	145,341
16,277	—	—	2,424	18,701
(51,387)	—	—	(39,321)	(90,708)
29,275	184,572	372,299	(6,327)	565,498
745,980	**1,811,136**	**(180,568)**	**397,746**	**3,461,157**
$ 775,255	**$ 1,995,708**	**$ 191,731**	**$ 391,419**	**$ 4,026,655**
$ 79,239	$ (162,503)	$ 250,550	$ 40,575	$ 243,298
(44,004)	449,853	—	(39,498)	365,749
191,847	—	—	100	158,135
10,241	8,523	(134,960)	(12,846)	(128,870)
237,323	**295,873**	**115,590**	**(11,669)**	**638,312**
438,587	**142,553**	**183,215**	**345,909**	**1,202,229**
$ 675,910	**$ 438,426**	**$ 298,805**	**$ 334,240**	**$ 1,840,541**

NOTE 21. NO COMMITMENT DEBT

Certain debt of the nonmajor component units is issued to finance activities such as construction of new facilities and remodeling of existing facilities, as well as acquisition of equipment. This debt is collateralized solely by the credit of private and public entities and is administered by trustees independent of the State. As of June 30, these component units had $15.8 billion of debt outstanding, which is not debt of the State.

The State has also entered into transactions that involve debt issued by four special purpose trusts that were created by one of the nonmajor component units mentioned above, the California Infrastructure and Economic Development Bank. The special purpose trusts are legally separate entities that issued long-term debt for the primary purpose of financing certain costs of assets and obligations that are recoverable by utilities through electric rate charges, but that may prevent the utilities from offering electricity at lower rates in a competitive market. As of June 30, the special purpose trusts had approximately $2.7 billion of debt outstanding. Like the debt of nonmajor component units, the debt of the special purpose trusts is not debt of the State.

In addition, the State has participated in transactions involving debt issued by the Bay Area Toll Authority, which is not part of the State's reporting entity. The debt was issued to finance improvements to existing bridges and to design and construct new bridges. As of June 30, the Bay Area Toll Authority had $700 million of debt outstanding, which is not debt of the State.

NOTE 22. CONTINGENT LIABILITIES

A. Litigation

The primary government is a party to numerous legal proceedings, many of which normally occur in governmental operations. To the extent they existed, the following were accrued as a liability in the government-wide financial statements: legal proceedings that were decided against the primary government before June 30, 2003; legal proceedings that were in progress as of June 30, 2003, and were settled or decided against the primary government as of December 19, 2003; and legal proceedings having a high probability of resulting in a decision against the primary government as of December 19, 2003, and for which amounts could be estimated. In the governmental fund financial statements, the portion of the liability that is expected to be paid within the next 12 months is recorded as a liability of the fund from which payment will be made. In the proprietary fund financial statements, the entire liability is recorded in the fund involved.

In addition, the primary government is involved in certain other legal proceedings that, if decided against the primary government, may require it to make significant future expenditures or may impair future revenue sources. Because of the prospective nature of these proceedings, no provision for the potential liability has been made in the financial statements.

Following are the more significant lawsuits pending against the primary government.

The primary government is a defendant in two actions, *Cigarettes Cheaper!, et al., v. Board of Equalization, et al., and California Assn. of Retail Tobacconists, et al., v. Board of Equalization, et al.*, that challenge the constitutionality of Proposition 10. The plaintiffs allege that Proposition 10, which increases the excise tax on tobacco products, violates 11 sections of the California Constitution and related provisions of law. The primary government filed notices of related cases. If the statute ultimately is declared unconstitutional, exposure may include the entire $750 million that is collected annually, together with interest, amounting to in excess of $4.0 billion on these collections. On November 15, 2000, the trial court ruled completely in the primary government's favor. Judgment was entered on January 9, 2001, and both plaintiff groups filed notices of appeal on time. On June 10, 2003, the Court of Appeal, Fourth Appellate District, affirmed the trial court's judgment in all respects, and on September 24, 2003, the California Supreme Court denied petitions for review. It is not known whether the appellants will file petitions for writ of certiorari in the United States Supreme Court.

The primary government is a defendant in an action, *Ronald Arnett, et al., v. California Public Employees' Retirement System (PERS); California Board of Administration of PERS; et al.*, that challenges Section 21417 of the Government Code pertaining to industrial disability retirement benefits. The plaintiffs allege that Section 21417 makes retirement decisions based upon age, in violation of the Age Discrimination in Employment Act of 1967. In August 2001, the parties entered into a partial settlement of this action that called for the formation of a class of local public entity employers to resolve state law issues regarding PERS' authority to settle this case and pass the costs on to local public entity employers. The partial settlement also contemplated a trial to determine the extent of retroactive relief, if any, due to affected workers. After additional negotiation and further litigation, the parties tentatively reached a global settlement in December 2002. The primary government agreed to uncap future industrial disability retirement benefits to affected state employees and provide for a certain level of reimbursement. In January 2003, the court approved the settlement and this litigation has ended on the merits.

The result of this litigation will impact all state public entities with individual disability retirees. At this time, the costs have not been ascertained.

The primary government is party to several lawsuits and regulatory proceedings related to the Department of Water Resources (DWR) entering into contracts and arrangements for the purchase and sale of electric power to assist in mitigating the effect of a statewide energy supply emergency. Legislation established the Department of Water Resources Electric Power Fund (Power Fund) on January 19, 2001, and subsequent legislation expanded the powers of the fund to incur debt for the purposes of the fund and to use amounts in the fund for the purchase of power. As authorized by this legislation, DWR began selling electricity to end-use customers of three companies, collectively referred to as the investor-owned utilities (IOUs) in January 2001. DWR purchases power from wholesale suppliers under long-term contracts and in short-term and spot market transactions. DWR electricity is delivered to end-use customers through the transmission and distribution systems of the IOUs, and payments from the end-use customers are collected for DWR by the IOUs pursuant to service agreements approved and/or ordered by the California Public Utilities Commission (CPUC). Legislation authorizes DWR and the CPUC to enter into an agreement with respect to charges for the purposes of the legislation to provide for recovery by DWR of its revenue requirements. DWR financed its power purchases with advances from the primary government's General Fund, loans from financial institutions, and revenues from power sales to customers. DWR is authorized to issue bonds in an amount not to exceed $13.4 billion and payable solely from the Power Fund and to deposit the proceeds of the bonds in the Power Fund for use for any of the Power Fund's purposes.

The lawsuits and regulatory proceedings include, among others, an IOU contesting DWR's determination that its revenue requirement submissions to the CPUC for calendar years 2001 and 2002 are just and reasonable. The Court found that DWR had failed to follow the California Administrative Procedures Act (APA) and ordered DWR to do so. The Court also ruled that its decision did not affect any action taken by the CPUC, including the implementation of cost recovery of DWR's calendar years 2001 and 2002 revenue requirements. This ruling was appealed and affirmed in part and reversed in part on October 2, 2003. The appellate court concluded that Chapter 4 of the 2001-02 First Extraordinary Session (Ch. 4X) does not require DWR to make a determination that its revenue requirement is just and reasonable. Neither Ch. 4X nor the APA requires a public hearing or compliance with the APA procedures. The decision of the Court of Appeal will not be final until the time for appeal passes without appeal by either party. DWR has filed its 2003 and amended 2001-2002 revenue requirements with the

CPUC. In October 2002, the IOU filed a lawsuit on the 2003 revenue requirements and the amended 2001-02 revenue requirements, claiming that DWR had not adequately followed APA requirements or DWR's own regulations and claiming that a portion of the revenue requirements was unjust and unreasonable and therefore invalid. DWR has filed a motion to stay. The impact of the appellate decision should have a favorable impact on this second case.

In another matter, two energy suppliers have petitioned the Federal Energy Regulatory Commission (FERC), contending that amounts totaling $58 million are owed by DWR for the power purchased in the last half of January 2001 by DWR on behalf of two IOUs in the California Independent System Operator (ISO) market. DWR maintains that the Power Fund has remitted the appropriate payments to the ISO for distribution to the energy suppliers. The ISO distributed the Power Fund's January payment on a pro-rata basis to all market participants for the entire month, although DWR purchased power on behalf of the two IOUs beginning in late January. As a result, energy suppliers did not receive full payment for the amounts owed them for power purchased in January by DWR on behalf of the two IOUs. On November 25, 2002, FERC issued an order finding that the ISO had misapplied the payment it received from DWR and directed the ISO to reallocate its pro-rata disbursement for the entire month of January 2001 and to disburse funds from DWR allocated for January 2001 to those that supplied power for the period of January 17-31, 2001. The ISO recently submitted a filing to FERC outlining its process of calculating the distribution of funds from DWR. Resolution of this matter is still pending at FERC.

Various actions are underway contesting certain long-term power contracts entered into by the DWR. In addition, other lawsuits and regulatory proceedings in which the primary government is a party may affect the price or supply of energy in California. In one case, the California Power Exchange Corporation (CalPX), certain IOUs, and others have brought suit against the State of California, claiming that the State's assumption of CalPX's block forward contracts after CalPX filed for bankruptcy in early 2001 was unconstitutional. The plaintiffs argue that they are entitled to damages of $1.1 billion, which is their estimation of the fair value of the block forward contracts at the time the State assumed them. Under the block forward contracts, which expired in December 2001, the Power Fund paid approximately $350 million for energy provided by the contracts. These lawsuits and regulatory proceedings could impact the revenue requirements and rate structure needed to repay debt, and the terms and conditions of the power purchase contracts. Because the legal and regulatory proceedings are in an early stage, the ultimate outcome of these matters cannot presently be determined.

The primary government is a defendant in three actions, *Fong v. Connell, Taylor v. Connell, and Harris v. Connell.* In all three actions, the plaintiffs claim that the State Controller's Office (SCO) has a constitutional and statutory duty to give notice prior to the time that the SCO sells property that has escheated to the State. Because the plaintiffs allegedly were not given notice prior to the SCO's sale of their shares of stock, they seek to recover either the current value of the stock or its value when they made their claim for its return, whichever is higher. The plaintiffs also seek to have these cases converted into class actions. Judgment in favor of the primary government has been entered in all three cases. All plaintiffs have appealed the judgments and oral arguments will be held in January 2004. An unfavorable outcome to the primary government is reasonably possible. The plaintiffs' individual damages are approximately $2 million but, if they are successful in converting these cases into class actions and if they ultimately prevail on the merits, damages would total in excess of $1.5 billion.

The primary government is a defendant in *San Diego v. Commission on State Mandates et al.*, regarding certain unreimbursed costs for the care of medically indigent adults (MIAs). In 1997, the California Supreme Court ruled that, by excluding MIAs from Medi-Cal, the State had mandated a new program on the counties. The court sent the matter back to the Commission to decide whether and by what amount San Diego had incurred costs not reimbursed by the State. San Diego later appealed an adverse decision by the Commission. On September 24, 2003, in an unpublished decision, the Court of Appeal ruled in favor of San Diego on certain of its claims and determined that the State owed the county $3.4 million for medical services rendered to MIAs during 1991 and 1992. On November 3, 2003, the State filed a Petition for Review in the California Supreme Court. On December 18, 2003, the California Supreme Court denied the State's petition. The Commission has taken the position that it would be bound to apply the holding of the San Diego case to any new claim for prospective relief brought by any county as a "test claim." Currently, there is a test claim pending before the Commission that was filed by the County of San Bernardino. Certain estimates of the annual cost of the services rendered by all counties to MIAs exceed $4.0 billion. How much of that the State will determine to be unreimbursable to the counties is unknown at this time due to "poison pill" provisions relating to certain vehicle license fee and sales tax revenue. These poison pill provisions provide that, in the event that a final appellate court decision holds that the legislation transferring financial responsibility for providing services to MIAs from the State to the counties established a reimbursable state mandate, such revenues would revert to the State.

The primary government is party to several lawsuits alleging that the gross receipts from the plaintiffs' sale of certain short-term financial instruments constitute business income and therefore must be included in the denominator of the California sales factor of the apportionment formula to be applied to the business income of the plaintiffs. The plaintiffs further contend that the exclusion is a violation of their rights under the due process and commerce clauses of the U.S. Constitution. The Franchise Tax Board maintains that, under pertinent tax statutes, the return of the original loan proceeds from a maturing debt instrument is not a "gross receipt" for sales factor purposes and thus must be excluded from the denominator of the sales factor. The board estimates that the amount at issue to all taxpayers for prior years could exceed $500 million.

The primary government is a party to the lawsuit of *County of Orange, et al., v. Orange County Assessment Appeals Board No. 3*. In June 1978, passage of Proposition 13 added an article to the State Constitution limiting property taxes to one percent of a property's assessed value and allowing for increases to a property's base value of no more than two percent per year. Base value represents the upper limitation on a property's assessed value. In November 1978, passage of Proposition 8 responded to an uncertainty on whether a property's assessed value could ever decrease to reflect "damage, destruction, depreciation, obsolescence, removal of property, or other factors." The trial court ruled that the Orange County Assessor's Office collected property taxes in amounts exceeding those allowed by the California Constitution. If the trial court ruling is upheld, overall exposure may exceed $10.0 billion, with the State's share being in excess of $4.0 billion due to the funding guarantee to public schools established by Proposition 98.

The primary government is party to 27 separate actions involving approximately 3,000 plaintiffs regarding flood litigation. These cases arose out of the February 20, 1986, breach of the south levee of the Yuba River. On September 4, 1991, the jury returned a special verdict for the State on a dangerous condition cause of action; however, the trial judge decided a cause of action for inverse condemnation against the State. The State appealed the inverse condemnation judgment on June 26, 1992, and the plaintiffs made a timely cross-appeal on the dangerous condition cause of action. The appeals were consolidated. On September 4, 1999, the court affirmed the jury verdict in favor of the State on the dangerous condition and reversed the inverse condemnation judgment against the State. The case was remanded for a new trial on the inverse condemnation cause of action only. On February 20, 2001, re-trial on the inverse action commenced and the judge's "intended decision" determined that the plaintiffs take nothing. The plaintiffs appealed, oral arguments were heard on November 19, 2003, and the plaintiffs prevailed. The State recently filed a request for reconsideration and is currently in the process of preparing a petition for review to the California Supreme Court. The range of potential damages for all of Yuba County coordinated actions is between $800 million and $1.5 billion.

The primary government is a defendant in an action, *Sanchez, et al., v. Johnson, et al.*, where a class of persons with developmental disabilities is seeking injunctive relief against the Health and Human Services Agency and the departments of Developmental Services, Mental Health, and Finance, to obtain higher funding rates for service providers. If the rates requested by the plaintiffs are awarded, costs to the State will increase by approximately $1.0 billion per year.

The University of California, the State Compensation Insurance Fund (SCIF), the California Housing Finance Agency (CHFA), and nonmajor discretely presented component units are contingently liable in connection with claims and contracts, including those currently in litigation, arising in the normal course of their activities. Although there are inherent uncertainties in any litigation, the management and the general counsel of the University of California, SCIF, and CHFA are of the opinion that the outcome of such matters either is not expected to have a material effect on the financial statements or cannot be estimated at this time.

B. Federal Audit Exceptions

The primary government receives substantial funding from the federal government in the form of grants and other federal assistance. The primary government, the University of California, and the California Housing Finance Agency (CHFA) are entitled to these resources only if they comply with the terms and conditions of the grants and contracts and with the applicable federal laws and regulations; they may spend these resources only for eligible purposes. If audits disclose exceptions, the primary government, the University of California, and CHFA may incur a liability to the federal government.

NOTE 23. PENSION TRUSTS

Three retirement systems, the California Public Employees' Retirement System (CalPERS) and the California State Teachers' Retirement System (CalSTRS), both part of the primary government, and the University of California Retirement System, a discretely presented component unit, are included in the pension and other employee benefit trust funds column of the fiduciary funds financial statements. The pension liability for all pension and other employee benefit trust funds was determined in accordance with GASB Statement No. 27, *Accounting for Pensions by State and Local*

Government Employers. The amounts of the pension liability for all pension and other employee benefit trust funds are presented in Table 28 as the net pension obligation (NPO) as of June 30. Information on the investments of the primary government and discretely presented component units is presented separately in Note 3, Deposits and Investments.

CalPERS administers five defined benefit retirement plans: the Public Employees' Retirement Fund (PERF), the Judges' Retirement Fund (JRF), the Judges' Retirement Fund II (JRF II), the Legislators' Retirement Fund (LRF), and the Volunteer Firefighters' Length of Service Award Fund (VFF). CalPERS also administers three defined contribution plans: the State Peace Officers' and Firefighters' Defined Contribution Plan Fund (SPOFF), the public employee Replacement Benefit Fund (RBF), and the public employee Supplemental Contributions Program Fund (SCPF). CalPERS issues a publicly available financial report that includes financial statements and required supplementary information for these plans. This report may be obtained by writing to the California Public Employees' Retirement System, Central Supply, P.O. Box 942715, Sacramento, California 94229.

CalPERS uses the accrual basis of accounting. Member contributions are recognized when due. The VFF, the SPOFF, and the RBF are funded only by employer contributions that are recorded when due and the employer has made a formal commitment to provide the contributions. Benefits under the defined benefit plans and refunds are recognized when due, in accordance with the terms of each plan.

CalSTRS administers three defined benefit retirement plans within the State Teachers' Retirement Plan: the Defined Benefit Program (DB Program), the Defined Benefit Supplement Program, and the Cash Balance Benefit Program. CalSTRS also offers, through a third-party administrator, a defined contribution plan that meets the requirements of Internal Revenue Code Section 403(b). The Teachers' Health Benefits Fund provides post-employment health benefits to retired members of the DB Program. CalSTRS issues a publicly available financial report that includes financial statements and required supplementary information for these plans. This report may be obtained from the California State Teachers' Retirement System, Audits Division, 7667 Folsom Boulevard, 2nd Floor, Sacramento, California 95826.

CalSTRS uses the accrual basis of accounting. Member contributions are recognized in the period in which the contributions are due. Employer and primary government contributions are recognized when due, and the employer or the primary government has made a formal commitment to provide the contributions. Benefits are recognized when due and payable, in accordance with the retirement and benefits programs.

A. Public Employees' Retirement Fund

1. Fund Information

Plan Description: CalPERS administers the PERF, which is an agent multiple-employer defined benefit retirement plan. Employers participating in the PERF include the primary government and certain discretely presented component units, 61 school employers, and 1,422 public agencies as of June 30, 2002. For reporting purposes, the financial information of the RBF is combined with the PERF.

The amount by which the actuarial accrued liability exceeded the actuarial value of assets in the PERF for the primary government and other participating agencies was $7.9 billion at June 30, 2002. This is a result of the difference between the actuarial value of assets of $156.1 billion and the actuarial accrued liability of $164.0 billion. Contributions are actuarially determined.

2. Employer's Information

Plan Description: The primary government and certain discretely presented component units contribute to the PERF. CalPERS acts as a common investment and administrative agent of the primary government and the other member agencies. The discretely presented component units' participation in the PERF is not a material portion of the program. The primary government employees served by the PERF include: first-tier and second-tier miscellaneous and industrial, California Highway Patrol, peace officers and firefighters, and other safety members. The payroll for primary government employees covered by the PERF in the year ended June 30, 2003, was approximately $12.5 billion.

All employees who work half-time or more are eligible to participate in the PERF. The PERF provides benefits based on members' years of service, age, final compensation, and benefit formula. Vesting occurs after five years, or after ten years for second-tier employees. The PERF provides death, disability, and survivor benefits. The benefit provisions are established by statute.

Funding Policy: Benefits are funded by contributions from members and the primary government and earnings from investments. Member and primary government contributions are a percentage of applicable member compensation. Member rates are defined by law and based on the primary government's benefit formula. The primary government contribution rates are determined by periodic actuarial valuations.

Employees, with the exception of employees in the second-tier plans, contribute to the fund based on the required contribution rates. The contribution rates of active plan members are based on a percentage of salary over a monthly base compensation amount of $133 to $863. Employees' required contributions vary from 1.0% to 8.0% of their salary over the base compensation amount. However, for the 2002-03 and 2003-04 fiscal years, first-tier employees are not required to contribute. Specifically, the State of California, pursuant to a memorandum of understanding with the employee unions, agreed to a temporary cessation of employee retirement contributions for the 2002-03 and 2003-04 fiscal years for miscellaneous and industrial employees. As a result, the contribution rates were reduced from the usual statutory 5% or 6% to 0%.

All of the primary government employees served by the PERF are now covered by group term life insurance. The required employer contribution rates for the primary government, without group term life insurance benefits, are shown in Table 27.

Table 27

Schedule of Required Employer Contribution Rates for the Primary Government by Member Category

Year Ended June 30, 2003

	Normal Cost	Unfunded Liability	Group Term Life Benefit	Total Rate
Miscellaneous members				
First tier	10.632 %	(3.278) %	0.059 %	7.413 %
Second tier	6.032	(3.278)	0.059	2.813
Industrial (first and second tier)	10.707	(7.924)	0.075	2.858
California Highway Patrol	16.112	6.964	0.000	23.076
Peace officers and firefighters	17.053	(3.185)	0.057	13.925
Other safety members	16.391	0.528	0.136	17.055

For the year ended June 30, 2003, the annual pension cost (APC) and the amount of contributions made by the primary government were each $1,172 million. The APC and the percentage of APC contributed for the last three years are shown in Table 28. Actuarial valuations of the PERF are performed annually. Information from the last valuation, which was performed as of June 30, 2002, is also shown in Table 28.

B. Judges' Retirement Fund

Plan Description: CalPERS administers the JRF, which is an agent multiple-employer defined benefit retirement plan. The JRF membership includes justices of the Supreme Court and courts of appeal, as well as judges of superior courts, municipal courts, and justice courts appointed or elected prior to November 9, 1994. There are 59 employers participating in the JRF for the year ended

June 30, 2003. The payroll for employees covered by the JRF for the year ended June 30, 2003, was approximately $143 million. The primary government pays the employer contributions for all employees covered by the JRF.

The JRF provides benefits based on a member's years of service, age, final compensation, and benefit formula. Vesting occurs after five years. The JRF provides death, disability, and survivor benefits. Benefits for the JRF are established by the Judges' Retirement Law.

Funding Policy: The contribution rate of active plan members is defined by law and is based on a percentage of salary over a base compensation amount. For the year ended June 30, 2003, the required member rate for the JRF was 8.0%.

The contributions of the primary government to the JRF are not actuarially determined. Contributions are determined by state statute. As of June 30, 2003, employer contributions are required to be 8.0% of applicable member compensation. Other funding to meet benefit payment requirements of the JRF is currently provided by: filing fees, which require varying amounts, depending on fee rate and number of filings; investments, which earn the current yield on short-term investments; and the primary government's balancing contributions, as required by the Judges' Retirement Law. The balancing contributions are an amount at least equal to the estimated benefits payable during the ensuing fiscal year, less the sum of the estimated member contributions during the ensuing fiscal year and net assets available for benefits at the beginning of the fiscal year ("pay as you go" basis).

The annual pension cost (APC) and the amount of employer contributions made to the JRF for the year ended June 30, 2003, were $186 million and $99 million, respectively. The net pension obligation (NPO) of the JRF at June 30, 2003, was $987 million, an increase of $88 million over last year's balance of $899 million. The APC is comprised of $190 million for the annual required contribution (ARC), $67 million for interest on the NPO, and $71 million for the adjustment to the ARC. An actuarial valuation of the JRF's assets and liabilities is made annually. The APC, the percentage of APC contributed, and the NPO for the last three years are shown in Table 28. Information on the last valuation, which was performed as of June 30, 2002, is shown in Table 28. The aggregate cost method that was used for the June 30, 2002, valuation does not identify or separately amortize the unfunded actuarial accrued liability; therefore, this liability is not shown in Table 28.

C. Judges' Retirement Fund II

Plan Description: CalPERS administers the JRF II, which is an agent multiple-employer defined benefit retirement plan. The membership of the JRF II includes justices of the same courts covered by the JRF who were appointed or elected on or subsequent to November 9, 1994. There are 59 employers participating in the JRF II. The payroll for employees covered by the JRF II for the year ended June 30, 2003, was approximately $83 million. The primary government pays the employer contributions for all employees covered by the JRF II.

The JRF II provides benefits based on a member's years of service, age, final compensation, and benefit formula. Vesting occurs after five years. The JRF II provides death, disability, and survivor benefits. Benefits for the JRF II are established by the Judges' Retirement System II Law.

Funding Policy: The required contribution rate of active plan members is defined by law and is based on a percentage of salary over a base compensation amount. For the year ended June 30, 2003, the required member rate for the JRF II was 8.0%, and the primary government's contribution rate for the JRF II was 19.23% of applicable member compensation.

Actuarial valuations for the JRF II are required to be carried out annually. The legislated primary government contribution rate is adjusted periodically as part of the annual Budget Act in order to maintain or restore the actuarial soundness of the fund.

For the year ended June 30, 2003, the annual pension cost (APC) and the amount of contributions made for the JRF II were approximately $15.9 million and $15.3 million, respectively. The APC and the percentage of APC contributed for the year ended June 30, 2003, are shown in Table 28. Information on the last valuation, which was performed as of June 30, 2002, is also shown in Table 28.

D. Legislators' Retirement Fund

Plan Description: CalPERS administers the LRF, which is a single-employer defined benefit retirement plan. The eligible membership of the LRF includes state legislators serving in the legislature prior to November 1, 1990, constitutional officers, and legislative statutory officers. The payroll for the employees covered by the LRF in 2003 was approximately $2.4 million.

The LRF provides benefits based on a member's years of service, age, final compensation, and benefit formula. Vesting occurs after five years. The plan provides death, disability, and survivor benefits. Benefits for the LRF are established by the Legislators' Retirement Law.

The LRF is currently in transition. The number of legislators eligible to participate in the LRF is declining as incumbent legislators leave office and are replaced by new legislators who are not eligible to participate in the program. Eventually, the only active members in the LRF will be approximately 16 constitutional officers (including the Insurance Commissioner and members of the Board of Equalization) and approximately 4 legislative statutory officers.

Funding Policy: The employer contribution requirements of the LRF are based on actuarially determined rates. An actuarial valuation of the LRF's assets and liabilities is required at least every two years. Member contribution rates are defined by law. For the year ended June 30, 2003, the actual contributions made by employees were approximately 0.97% of covered payroll. For the year ended June 30, 2003, there was no statutory employer contribution required for the primary government based on the June 30, 2001, valuation, and the primary government did not contribute.

The net pension obligation (NPO) of the LRF on June 30, 2003, was approximately $10.2 million. There was no annual pension cost (APC) because the annual required contribution (ARC) equaled zero and the interest on the NPO closely approximated the adjustment to the ARC. The APC, the percentage of APC contributed, and the NPO for the last three years are shown in Table 28. An actuarial valuation of the LRF's assets and liabilities is made annually. Information on the last valuation, which was performed as of June 30, 2002, is also shown in Table 28. The aggregate cost method that was used for the June 30, 2002, valuation does not identify or separately amortize the unfunded actuarial accrued liability; therefore, this liability is not shown in Table 28.

E. Volunteer Firefighters' Length of Service Award Fund

Plan Description: CalPERS administers the VFF, which is an agent multiple-employer defined benefit retirement plan. The VFF membership includes volunteer firefighters. There were 61 fire departments participating in the VFF for the year ended June 30, 2003.

The difference in the actuarial value of assets over the actuarial accrued liability of the VFF was approximately $0.14 million at June 30, 2002. This is a result of the difference between the actuarial value of assets of $2.31 million and the actuarial accrued liability of $2.45 million. Contributions are actuarially determined.

F. State Peace Officers' and Firefighters' Defined Contribution Plan Fund

Plan Description: CalPERS administers the SPOFF, which is a defined contribution pension plan. The plan is a qualified money purchase pension plan under Section 401(a) of Title 26 of the Internal Revenue Code, and it is intended to supplement the retirement benefits provided by the PERF to correctional officers employed by the State of California.

Funding Policy: Contributions to the plan are funded entirely by the primary government with a contribution rate of 2% of the employee's base pay, not to exceed contribution limits established by the Internal Revenue Code. Contribution requirements are established and may be amended through a memorandum of understanding from the State of California Department of Personnel Administration. These contributions, as well as the participant's share of the net earnings of the fund, are credited to the participant's account. For the year ended June 30, 2003, contributions by the primary government to the SPOFF were approximately $35 million.

The net earnings of the fund are allocated to the participant's account as of each valuation date, in the ratio that the participant's account balance bears to the aggregate of all participants' account balances. The benefit paid to a participant will depend only on the amount contributed to the participant's account and earnings on the value of the participant's account. Plan provisions are established by and may be amended by statute. At June 30, there were 34,176 participants.

G. State Teachers' Retirement Fund

Plan Description: CalSTRS administers the STRF, which is comprised of three programs: the Defined Benefit Program (DB Program), the Defined Benefit Supplement Program (DBS Program), and the Cash Balance Benefit Program (CBB Program). The DB, DBS, and CBB programs are cost-sharing, multiple-employer, defined benefit retirement plans that provide pension benefits to teachers and certain other employees of the California public school system.

Membership in the DB Program is mandatory for all employees meeting the eligibility requirements. The DB Program provides benefits based on a member's age, final compensation, and years of service. Vesting occurs after five years. In addition, the retirement program provides benefits to members upon disability and to survivors upon the death of eligible members. The Teachers' Retirement Law establishes the benefits for the DB Program. At June 30, 2003, the DB Program had approximately 1,200 contributing employers, approximately 538,000 plan members, and 177,000 benefit recipients. The primary government is a non-employer contributor to the DB Program. The payroll for employees covered by the DB Program in 2003 was approximately $23.4 billion.

Membership in the DBS Program is automatic for all members of the DB Program. The DBS Program provides benefits based on the balance of member accounts. Vesting occurs immediately. The Teachers' Retirement Law establishes the benefits for the DBS Program. The primary government does not contribute to the DBS Program. Assets of the DBS Program of $1.3 billion are combined with the assets of the DB and CBB Programs in the STRF.

The CBB Program is designed for employees of California public schools who are hired to perform creditable service for less than 50% of the full-time equivalent for the position. Participation in the CBB Program is optional to employers. However, if the employer elects to offer the CBB Program, each eligible employee will automatically be covered by the CBB Program unless the member elects to participate in the DB Program or an alternative plan provided by the employer within 60 days of hire. At June 30, 2003, the CBB Program had 25 contributing school districts and approximately 16,000 contributing participants. Assets of the CBB Program of $30 million are combined with the assets of the DB and DBS Programs in the STRF.

Funding Policy: DB Program benefits are funded by contributions from members, employers, the primary government, and earnings from investments. Member and employer contributions are a percentage of applicable member earnings. The Teachers' Retirement Law governs member rates, employer contribution rates, and primary government contributions.

The DB Program contribution rate of members is 6% of creditable compensation through December 31, 2010, increasing to 8% thereafter for service less than or equal to one year of creditable service per fiscal year. The employer contribution rate is 8.25% of creditable compensation for service less than or equal to one year of creditable service per fiscal year; for service in excess of one year within one fiscal year, the employer contribution rate is 0.25%. The General Fund contribution in 2001-02 and 2002-03 was 1.975% of the creditable compensation of the immediately preceding calendar year upon which members' contributions are based. Beginning in 2003-04, the General Fund contribution will be 2.017% of total creditable compensation of the fiscal year ending in the prior calendar year (i.e., the creditable compensation in 2001-02 for the 2003-04 fiscal year). This is to finance the 1998 legislated benefit increases payable under the DB Program. Up to an additional 1.505% of calendar-year creditable earnings is transferred to the DB Program to amortize the unfunded actuarial obligation and to eliminate any normal cost deficit attributable to benefits in effect as of July 1, 1990. The normal cost deficit is the difference between the normal cost rate and the member and employer contributions, which equal 16.25% of creditable compensation. Based on the most recent actuarial valuation, as of June 30, 2001, there is no normal cost deficit for benefits in effect as of July 1, 1990.

The DBS Program member contribution rate is 2% of creditable compensation for service less than or equal to one year of creditable service per fiscal year. For service in excess of one year within one fiscal year, the member contribution rate is 8% and the employer rate is 8%.

For the year ended June 30, 2003, the annual pension cost (APC) for the DB Program was approximately $2.5 billion, and the employer and primary government contributions were approximately $2.0 billion and $0.4 billion, respectively. The APC and the percentage of APC contributed for the last three years are shown in Table 28. Actuarial valuations of the DB Program are performed biennially. Information from the last valuation is shown in Table 28.

H. CalSTRS Voluntary Investment Program

Plan Description: CalSTRS administers the VIP, a 403(b) program, through a third-party administrator. The VIP is a defined contribution plan and is open to any employee who is eligible to participate. Contributions to the program are voluntary; however, the Internal Revenue Code does impose a maximum amount that can be contributed annually. At June 30, 2003, the VIP had 404 participating employers (school districts) and 3,193 plan members.

I. Teachers' Health Benefits Fund

Plan Description: CalSTRS administers the THBF, which was established pursuant to Chapter 1032, Statutes of 2000 (SB 1435), to provide the Medicare Premium Payment Program for eligible retired members of the DB Program. At June 30, 2003, there were 5,683 benefit recipients.

Funding Policy: The THBF is funded as needed by that portion of the monthly DB Program statutory employer contribution that exceeds the DB Program annual required contribution.

J. University of California Retirement System – Discretely Presented Component Unit Fiduciary Activity

The UCRS is a fiduciary activity of the University of California, a discretely presented component unit. The UCRS consists of: the University of California Retirement Plan (UCRP), a single-employer defined benefit plan funded with university and employee contributions; the Public Employees' Retirement System Voluntary Early Retirement Incentive Program (PERS-VERIP), a defined benefit plan for university employees who elected early retirement under the plan; and two defined contribution plans with several investment portfolios funded with employee non-elective and elective contributions. Most university career employees participate in the UCRS.

The UCRP provides lifetime retirement income, disability protection, death benefits, and pre-retirement survivor benefits to eligible employees of the University of California and its affiliates. Membership in the retirement plan is required for all employees appointed to work at least 50% time for a year or more. Generally, an employee must have five years of service to be entitled to plan benefits. The maximum monthly benefit is 100% of the employee's highest average compensation over a 36-month period. The amount of the pension benefit is determined by salary rate, age, and years of service credit, with certain cost-of-living adjustments.

Members' contributions to the UCRP are accounted for separately and accrue interest at 6% annually. Upon termination, members can elect a refund of their contributions plus accumulated interest. Vested terminated members who are eligible to retire can also elect a lump-sum payment equal to the present value of their accrued benefits. Either action results in the member's forfeiture of rights to further accrued benefits.

At June 30, 2003, plan membership totaled 179,636, comprised of 121,351 active members, 20,418 inactive members (terminated vested employees entitled to benefits but not yet receiving them), and 37,867 retirees and beneficiaries currently receiving benefits. The active members include 66,268 current employees who are fully vested and 55,083 nonvested current employees covered by the plan. A total of 10,844 terminated nonvested employees are not members of the plan, but are eligible for a refund.

The board of regents' (the regents) funding policy provides for actuarially determined contributions at rates that provide for sufficient assets to be available when benefits are due. The contribution rate is determined using the entry age normal actuarial funding method. The significant actuarial assumptions used to compute the actuarially determined contribution are the same as those used to compute the actuarial accrued liability.

The annually determined rates for employer contributions as a percentage of payroll are based on recommendations of the consulting actuary and on appropriations received from the primary government.

Employees may be required to contribute to the UCRP. The rate of employee contributions is established annually as a percentage of covered wages, pursuant to the regents' funding policy, recommended and certified by an enrolled, independent actuary and approved by the regents, the plan's trustee. During the year ended June 30, 2003, employee contributions to the UCRP were redirected to the University of California Defined Contribution Plan.

For the year ended June 30, 2003, there were no employer contributions, annual pension costs, or net pension obligations. The annual pension cost was equal to the actuarially determined contribution.

The actuarial value of assets was determined using techniques that smooth the effect of short-term volatility in the fair value of investments over a five-year period. The actuarial value of assets in excess of the actuarial accrued liability is being amortized as a level percentage of projected payroll on an open basis. The remaining amortization period at June 30, 2003, was eight years.

In November 2002, the regents approved a capital accumulation provision accrual credit, effective April 1, 2003. Each active member received a credit equal to 5% of eligible covered compensation earned between April 1, 2002, and March 31, 2003, plus annual interest at the assumed earnings rate of the UCRP. This plan amendment increased the actuarial accrued liability by approximately $322 million for the year ended June 30, 2003.

In January 2001, the regents approved changes to the benefit provisions that became effective January 1, 2001. These changes increased the actuarial accrued liability by approximately $800 million for the year ended June 30, 2001.

The PERS-VERIP is a defined benefit pension plan providing lifetime supplemental retirement income and survivor benefits to members of the University of California CalPERS program (UC-PERS) who elected early retirement under provisions of the plan. The university contributed to the CalPERS program on behalf of these UC-PERS members. Of 1,579 eligible employees, 879 elected to retire under this voluntary early-retirement program. The cost of contributions made to the plan is borne entirely by the university and the federal Department of Energy laboratories. Over the five-year period ended June 30, 1996, the university and the Department of Energy laboratories were required to make contributions to the plan sufficient to maintain the promised benefits and the qualified status of the plan, as determined by the plan's consulting actuary.

The University of California maintains two defined contribution plans that provide savings incentives and additional retirement security for all eligible university employees. The Defined Contribution Plan (DC Plan) accepts both after-tax and pretax contributions. Effective July 1, 2001, the regents adopted a provision for matching employer and employee contributions to the DC Plan related to certain summer session teaching or research compensation for eligible academic employees. Employer contributions to the DC Plan were $3.7 million for the year ended June 30, 2003. In addition, the university has established a Tax Deferred 403(b) Plan. There are no employer contributions to the 403(b) Plan. Participants in the DC Plan and the 403(b) Plan may direct their elective and nonelective contributions to investment funds managed by the treasurer of the regents of the university. Participants may also invest contributions in, and transfer plan accumulations to, certain external mutual funds on a custodial plan basis. The participants' interest in external mutual funds is shown separately on the statement of the plans' fiduciary net assets.

The DC Plan pretax contributions are fully vested and are mandatory for all employees who are members of the University of California Retirement Plan. Monthly employee contributions range from approximately 2% to 4% of covered wages, depending upon whether wages are above or below the Social Security wage base. The 403(b) Plan and the DC Plan after-tax options are generally available to all university employees.

Additional information on the retirement plans can be obtained from the 2002-03 annual reports of the University of California Retirement Plan, the PERS-VERIP, the DC Plan, and the 403(b) Plan.

The annual required contribution for the current year was determined as part of the June 30, 2003, actuarial valuation, which is the latest available information, using the entry age normal actuarial cost method. Significant actuarial assumptions used in the valuation are shown in Table 28. Information from the last valuation is also shown in Table 28.

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Table 28

Actuarial Information – Pension Trusts – Primary Government
June 30, 2003

	Public Employees' Retirement Fund	Judges' Retirement Fund	Judges' Retirement II Fund
Last actuarial valuation	June 30, 2002	June 30, 2002	June 30, 2002
Actuarial cost method	Individual Entry Age Normal	Aggregate Cost	Aggregate Entry Age Normal
Amortization method	Level % of Payroll, Closed	None	Level % of Payroll, Closed
Remaining amortization period	13 to 30 years	None	Average of 5 Years
Asset valuation method	Smoothed Market Value	Market Value	Smoothed Market Value
Actuarial assumption			
Investment rate of return	8.25 %	7.50 %	7.75 %
Projected salary increase	3.75 – 18.88	3.75	3.75
Includes inflation at	3.50	3.50	3.50
Post-retirement benefit increases	2 – 5	3.75	3.0
Annual pension costs (in millions)			
Year ended 6/30/01	$ 163	$ 159	$ 9.6
Year ended 6/30/02	700	164	11.1
Year ended 6/30/03	1,172	186	15.9
Percent contribution			
Year ended 6/30/01	106 %	57 %	102 %
Year ended 6/30/02	100	40	112
Year ended 6/30/03	100	53	96
Net pension obligation (in millions)			
Year ended 6/30/01	—	$ 803.0	—
Year ended 6/30/02	—	899.0	—
Year ended 6/30/03	—	987.1	—
Funding as of last valuation (in millions)			
Actuarial value – assets	$ 62,201	N/A	$ 72
Actuarial accrued liabilities (AAL) – entry age	68,854	N/A	77
Excess of actuarial value of assets over AAL (EAV) (unfunded actuarial accrued liability (UAAL))	(6,653)	N/A	(5)
Covered payroll	12,423	N/A	73
Funded ratio	90 %	N/A	94 %
EAV (UAAL as percent of covered payroll)	(54) %	N/A	(6) %

Legislators' Retirement Fund	State Teachers' Retirement Defined Benefit Program Fund	University of California Retirement Plan Fund	Voluntary Early Retirement Incentive Plan Fund
June 30, 2002	June 30, 2001	June 30, 2003	June 30, 2003
Aggregate Cost	Entry Age Normal	Entry Age Normal	Unit Credit
None	Level % of Payroll, Open	Level % of Payroll, Open	N/A
None	29 Years	8 Years	N/A
Smoothed Market Value	3-Year Asset Smoothing	Smoothed Fair Value	Fair Value
7.50 %	8.00 %	7.50 %	7.50 %
3.75	4.25	4.5 – 6.5	N/A
3.50	3.50	4.00	4.00
3.50	2.00	N/A	N/A
$ —	$ 2,035	—	—
—	2,498	—	—
—	2,545	—	—
— %	115 %	N/A	N/A
—	90	N/A	N/A
—	91	N/A	N/A
$ 10.6	—	—	—
10.2	—	—	—
10.2	—	—	—
N/A	$ 107,654	$ 41,429	$ 71.5
N/A	109,881	32,955	49.3
N/A	(2,227)	8,474	22.1
N/A	20,585	7,734	N/A
N/A	98.0 %	125.7 %	144.9 %
N/A	(10.8) %	109.6 %	N/A

NOTE 24. POST-RETIREMENT HEALTH CARE BENEFITS

Health care and dental benefits are provided by the primary government and certain discretely presented component units, to annuitants of retirement systems to which the primary government contributes as an employer. The discretely presented component units' participation in these plans is not a material portion of the program. To be eligible for these benefits, first-tier plan annuitants must retire on or after age 50 with at least five years of service, and second-tier plan annuitants must retire on or after attaining age 55 with at least 10 years of service. In addition, annuitants must retire within 120 days of separation from employment to be eligible to receive these benefits. As of June 30, approximately 115,600 annuitants were enrolled to receive health benefits and approximately 94,200 annuitants were enrolled to receive dental benefits. In accordance with the Government Code, the primary government generally pays 100% of the health insurance cost for annuitants, plus 90% of the additional premium required for the enrollment of family members of annuitants. Although the primary government generally pays 100% of the dental insurance premium for annuitants, the Government Code does not specify the primary government's contribution toward dental insurance costs. The primary government recognizes the cost of providing health and dental insurance to annuitants on a pay-as-you-go basis. The cost of these benefits for the year ended June 30 was approximately $561 million.

Also, the University of California, a discretely presented component unit, provides to retired employees certain health plan benefits in addition to pension benefits. Employees who meet specific requirements may continue their medical and dental benefits into retirement and continue to receive University of California contributions for those benefits. There are approximately 37,100 retirees currently eligible to receive such benefits. The cost of retiree medical and dental coverage is recognized when paid. The cost of providing medical and dental benefits for retirees and their families and survivors for the year ended June 30, 2003, was $149 million.

NOTE 25. SUBSEQUENT EVENTS

The following information describes significant events that occurred subsequent to June 30, 2003, but prior to the date of the auditor's report.

The primary government issued $3.5 billion in general obligation bonds to retire previously issued commercial paper, to repay internal state loans, and to finance various school, wildlife, coastal, and park projects. The primary government also issued revenue anticipation notes of $3.0 billion that are due to be redeemed in June 2004.

The California Infrastructure and Economic Development Bank issued $1.2 billion in fixed-rate revenue bonds that will be loaned to the Department of Transportation for seismic retrofit of the Bay Area toll bridges.

The California State University issued approximately $10 million in bond anticipation notes.

The State Public Works Board, an agency that accounts for its activities as an enterprise fund, issued lease revenue bonds totaling $425 million.

The Golden State Tobacco Securitization Corporation sold $2.6 billion in Enhanced Tobacco Settlement Asset-Backed Bonds.

The regents of the University of California issued approximately $1.3 billion in revenue bonds.

The Public Utilities Commission has ordered the Department of Water Resources (DWR) Electric Power Fund to decrease revenue by giving credits for DWR power charges in the monthly billings to customers of investor-owned utilities from mid-September through mid-October 2003.

In December, the Governor approved Assembly Bill 9, which authorized $15.0 billion in economic recovery bonds for the purposes of financing the accumulated state budget deficit. The bill also provided for the bonds to be secured by a pledge of revenues in the Fiscal Recovery Fund that are derived from designated sales and use taxes. However, these bonds can only be issued if the voters approve, in March 2004, both the bond issue and a balanced budget constitutional amendment.

In July 2003, Standard and Poor's lowered its rating on California's general obligation bonds from A to BBB and on General Fund lease-supported debt from A- to BBB-.

In December 2003, Moody's Investors Service lowered its rating on California's general obligation bonds from A3 to Baa1 and on the State's lease revenue bonds and General Fund-enhanced tobacco bonds from Baa to Baa2.

Additionally, in December 2003, Fitch Ratings lowered its rating on California's general obligation bonds from A to BBB and on the State's lease revenue bonds from A- to BBB.

According to SCIF's management, SCIF has engaged a third party actuarial review of the adequacy of its reserves as of September 30, 2003. SCIF has also taken a number of specific steps to improve its financial position, including significant rate increases, strict underwriting controls, and expense reductions. Also, SCIF's lawsuit against the California Department of Insurance (CDI) to determine if CDI has the authority to control operations of SCIF is continuing in the San Francisco Superior Court.

Required Supplementary Information

Schedule of Funding Progress [1]

Public Employees' Retirement Fund

(amounts in millions)

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Excess of Actuarial Value of Assets Over AAL (Unfunded Actuarial Accrued Liability (UAAL)) (a - b)	Funded Ratio (a / b)	Covered Payroll (c)	Excess (UAAL) as a Percentage of Covered Payroll ((a - b) / c)
June 30, 2000	$ 65,948	$ 59,685	$ 6,263	110.5 %	$ 11,191	56.0 %
June 30, 2001	66,976	64,567	2,409	103.7	11,905	20.2
June 30, 2002	62,201	68,854	(6,653)	90.3	12,425	(53.5)

Judges' Retirement Fund II

(amounts in thousands)

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Excess of Actuarial Value of Assets Over AAL (Unfunded Actuarial Accrued Liability (UAAL)) (a - b)	Funded Ratio (a / b)	Covered Payroll (c)	Excess (UAAL) as a Percentage of Covered Payroll ((a - b) / c)
June 30, 2000	$ 40,503	$ 41,619	$ (1,116)	97.3 %	$ 42,983	(2.6) %
June 30, 2001	55,955	60,933	(4,979)	91.8	61,547	(8.1)
June 30, 2002	71,929	76,459	(4,530)	94.1	72,804	(6.2)

State Teachers' Retirement Defined Benefit Program[2]

(amounts in millions)

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Excess of Actuarial Value of Assets Over AAL (Unfunded Actuarial Accrued Liability (UAAL)) (a - b)	Funded Ratio (a / b)	Covered Payroll (c)	Excess (UAAL) as a Percentage of Covered Payroll ((a - b) / c)
June 30, 1999	$ 90,001	$ 86,349	$ 3,652	104.2 %	$ 17,185	21.3 %
June 30, 2000	102,225	93,124	9,101	109.8	18,224	49.9
June 30, 2001	107,654	109,881	(2,227)	98.0	20,585	(10.8)

[1] Actuarial valuations for the Judges' Retirement Fund and the Legislators' Retirement Fund are performed using the aggregate actuarial cost valuation method. The schedule of funding progress is not required if the aggregate cost mentod is used.

[2] Beginning July 1, 2001, actuarial valuations are not prepared in even-numbered years. No estimation using acturial methodology is made in years between valuations.

University of California Retirement System
(amounts in millions)

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Excess of Actuarial Value of Assets Over AAL (a - b)	Funded Ratio (a / b)	Covered Payroll (c)	Excess as a Percentage of Covered Payroll ((a - b) / c)
June 30, 2001	$ 40,554	$ 27,451	$ 13,103	147.7 %	$ 6,539	200.4 %
June 30, 2002	41,649	30,100	11,549	138.4	7,227	159.8
June 30, 2003	41,429	32,955	8,474	125.7	7,734	109.6

Infrastructure Assets Using the Modified Approach

To comply with the prospective reporting requirements, all prior and current year additions to the State Highway System are being reported. The estimated budgeted preservation costs, actual preservation costs, established condition levels, and actual condition levels are not being reported because the reported infrastructure asset value is not material.

All costs incurred that are related to State Highway System projects completed prior to July 1, 2001, will be included during the retroactive reporting phase. Retroactive reporting of the State Highway System general infrastructure assets in the financial statements will occur no later than the year ending June 30, 2006. When the value of the reported infrastructure assets becomes material, the estimated budgeted preservation costs, actual preservation costs, established condition levels, and actual condition levels of the State Highway System will be included.

Budgetary Comparison Schedule

General Fund and Major Special Revenue Funds

Year Ended June 30, 2003
(amounts in thousands)

	General Fund			
	Budgeted Amounts		Actual	Variance With
	Original	Final	Amounts	Final Budget
REVENUES				
Corporation tax	—	—	$ 6,803,559	—
Intergovernmental	—	—	—	—
Cigarette and tobacco taxes	—	—	114,894	—
Inheritance, estate, and gift taxes	—	—	647,372	—
Insurance gross premiums tax	—	—	1,879,784	—
Vehicle license fees	—	—	15,500	—
Motor vehicle fuel tax	—	—	—	—
Personal income tax	—	—	32,709,761	—
Retail sales and use taxes	—	—	22,415,138	—
Other major taxes and licenses	—	—	292,602	—
Other revenues	—	—	3,667,173	—
Total revenues	**—**	**—**	**68,545,783**	**—**
EXPENDITURES				
State and consumer services	$ 474,436	$ 475,587	466,853	$ 8,734
Business and transportation	81,211	64,067	63,227	840
Resources	1,009,291	1,180,192	1,069,642	110,550
Health and human services	22,085,201	23,243,957	23,044,150	199,807
Correctional programs	5,193,724	5,644,575	5,596,504	48,071
Education	39,011,469	37,955,318	36,633,416	1,321,902
General government:				
Tax relief	4,886,858	4,845,007	4,839,322	5,685
Debt service	2,089,691	2,089,691	2,067,543	22,148
Other general government	3,950,726	3,890,198	3,783,620	106,578
Total expenditures	**$ 78,782,607**	**$ 79,388,592**	**77,564,277**	**$ 1,824,315**
OTHER FINANCING SOURCES (USES)				
Transfers from other funds	—	—	3,289,521	—
Transfers to other funds	—	—	(369,955)	—
Other additions and deductions	—	—	143,822	—
Total other financing sources (uses)	**—**	**—**	**3,063,388**	**—**
Excess of revenues and other sources over expenditures and other uses	—	—	(5,955,106)	—
Fund balances (deficits), July 1, 2002	**—**	**—**	**(1,581,130)** *	**—**
Fund balances (deficits), June 30, 2003	**—**	**—**	**$ (7,536,236)**	**—**

*Restated

Federal				Transportation Construction			
Budgeted Amounts		Actual	Variance With	Budgeted Amounts		Actual	Variance With
Original	Final	Amounts	Final Budget	Original	Final	Amounts	Final Budget
—	—	$ —	—	—	—	$ —	—
—	—	37,873,575	—	—	—	—	—
—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—
—	—	—	—	—	—	714,872	—
—	—	—	—	—	—	3,202,512	—
—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—
—	—	6	—	—	—	218,977	—
—	**—**	**37,873,581**	**—**	**—**	**—**	**4,136,361**	**—**
$ 8,229	$ 8,229	8,229	—	$ 1	$ 1	—	$ 1
2,622,614	2,622,614	2,622,614	—	2,675,015	2,546,430	2,383,367	163,063
296,988	296,988	296,988	—	12	12	12	—
26,746,819	26,746,819	26,746,819	—	—	—	—	—
105,656	105,656	105,656	—	—	—	—	—
5,916,240	5,916,240	5,916,240	—	980	980	980	—
—	—	—	—	—	—	—	—
—	—	—	—	500	500	273	227
1,131,676	1,131,676	1,131,676	—	2,444,816	2,445,457	2,444,828	629
$ 36,828,222	**$ 36,828,222**	**36,828,222**	**—**	**$ 5,121,324**	**$ 4,993,380**	**4,829,460**	**$ 163,920**
—	—	8,584,875	—	—	—	5,861,759	—
—	—	(9,625,242)	—	—	—	(6,036,043)	—
—	—	94	—	—	—	5,086	—
—	**—**	**(1,040,273)**	**—**	**—**	**—**	**(169,198)**	**—**
—	—	5,086	—	—	—	(862,297)	—
—	**—**	**5,736**	**—**	**—**	**—**	**2,532,798** *	**—**
—	**—**	**$ 10,822**	**—**	**—**	**—**	**$ 1,670,501**	**—**

Reconciliation of Budgetary Basis Fund Balances of the General Fund and the Major Special Revenue Funds and GAAP Basis Fund Balances

June 30, 2003
(amounts in thousands)

	General	Special Revenue Fund Types: Federal	Special Revenue Fund Types: Transportation Construction
Budgetary fund balance reclassified into GAAP statement fund structure	$ (7,536,236)	$ 10,822	$ 1,670,501
Basis difference:			
Interfund receivables	42,816	—	748,900
Loans receivable	109,227	41,229	—
Interfund payables	(2,109,630)	—	—
Loans payables	(25,000)	—	—
Escheat property	(816,900)	—	—
Authorized and unissued bonds	—	—	(10,565)
Accounts payables	—	—	(14,124)
Due to other funds	—	—	(325,000)
Condemnation deposits	—	—	93,897
Other	(26,893)	(15,265)	(1,435)
Timing difference:			
Federal grants	—	575,906	—
Liabilities budgeted in subsequent years	(3,005,182)	(5,654)	(66,431)
GAAP fund equity, June 30, 2003	$ (13,367,798)	$ 607,038	$ 2,095,743

Notes to the Required Supplementary Information

Budgetary Comparison Schedule

The State annually reports its financial condition based on GAAP (GAAP basis) and on the State's budgetary provisions (budgetary basis). The Budgetary Comparison Schedule, General Fund and Major Special Revenue Funds, reports the original budget, the final budget, the actual expenditures, and the variance between the final budget and the actual expenditures, using the budgetary basis of accounting.

On a budgetary basis, individual appropriations are charged as expenditures when commitments for goods and services are incurred. However, for financial reporting purposes, the State reports expenditures based on the year goods and services are received. The Budgetary Comparison Schedule includes all the current year expenditures for the General Fund and major special revenue funds and their related appropriations that are legislatively authorized annually, continually, or by project. On a budgetary basis, adjustments for encumbrances are budgeted under other general government, while the encumbrances relate to all programs' expenditures. Negative budget and expenditure amounts for other general government can result when current encumbrances are significantly higher than prior year encumbrances.

The Budgetary Comparison Schedule is not presented in this document at the legal level of budgetary control because such a presentation would be extremely lengthy and cumbersome. The State of California prepares a separate report, the *Budgetary/Legal Basis Annual Report Supplement*, which includes statements that demonstrate compliance with the legal level of budgetary control in accordance with GASB's *Codification of Governmental Accounting and Financial Reporting Standards*, Section 2400.121. The Statement of Appropriations, Expenditures, and Balances and the Comparative Statement of Actual and Budgeted Expenditures include the comparison of the annual appropriated budget with expenditures at the legal level of control. The Federal Fund, which is a major special revenue fund, and a minor program of the Highway Construction Fund are not included in the *Annual Report Supplement* statements, because they are considered fiduciary fund activities on the budgetary basis and, as a consequence, are not included in the annual appropriated budget. A copy of this report is available from the State Controller's Office, Division of Accounting and Reporting, P.O. Box 942850, Sacramento, California 94250.

Reconciliation of Budgetary Basis With GAAP Basis

The Reconciliation of Budgetary Basis Fund Balances of the General Fund and the Major Special Revenue Funds and GAAP Basis Fund Balances is presented on the previous page and is explained in the following paragraphs.

The beginning fund balances for the General Fund and the Transportation Construction Fund on the budgetary basis are restated for prior year revenue adjustments and prior year expenditure adjustments. A prior year revenue adjustment occurs when the actual amount received in the current year differs from the amount of revenue accrued in the prior year. A prior year expenditure adjustment results when the actual amount paid in the current year differs from the prior year accrual for appropriations whose ability to encumber funds has lapsed in previous periods. The beginning fund balance on a GAAP basis is not affected by these adjustments.

Basis Difference

Interfund Receivables and Loans Receivable: Loans made to other funds or to other governments are normally recorded as expenditures on the budgetary basis. However, in accordance with GAAP, these loans are recorded as assets. The adjustments related to interfund receivables caused a $43 million increase to the fund equity in the General Fund and a $749 million increase to the fund equity in the Transportation Construction Fund. The adjustments related to loans receivable caused increases of $109 million in the General Fund and $41 million in the Federal Fund.

Interfund Payables: Loans received from other funds are normally recorded as revenues on a budgetary basis. However, in accordance with GAAP, these loans are recorded as liabilities. The adjustments related to interfund payables caused a $2.1 billion decrease to fund equity in the General Fund.

Escheat Property: A liability for the estimated amount of escheat property ultimately expected to be reclaimed and paid is not reported on a budgetary basis, while it is required to be reported in the interfund payables on a GAAP basis. This adjustment caused a $817 million decrease to the General Fund balance.

Loans Payable: Loans received from outside entities and component units are normally recorded as revenues on a budgetary basis. However, in accordance with GAAP, these loans are recorded as liabilities. The adjustments related to loans payable caused a $25 million decrease to fund equity in the General Fund.

Authorized and Unissued Bonds: On a budgetary basis, general obligation bonds that are not self-liquidating are recorded as additions to the fund balance for the special revenue and capital projects funds when voters authorize the sale of bonds. However, in accordance with GAAP, only the bonds issued during the year are recorded as additions to the fund balance. The adjustments related to authorized and unissued bonds caused a $11 million decrease to the fund balance in the Transportation Construction Fund.

Accounts Payable: For the budgetary basis statements, certain funds in the Transportation Construction Fund were directed to record certain transactions on a cash basis which necessitated an accrual of accounts payable. This adjustment caused a decrease of $14 million to the fund balance.

Due to Other Funds: Loans received from other funds are normally recorded as revenues on a budgetary basis. However, in accordance with GAAP, these loans are recorded as liabilities. The adjustment related to due to other funds caused a decrease of $325 million to the fund balance in the Transportation Construction Fund.

Condemnation Deposits: Deposits for condemnation proceedings of land or other property, are recorded as expenditures on a budgetary basis. However, in accordance with GAAP, an expenditure is recognized only when an expense is incurred. An adjustment for this caused a $94 million increase to fund equity in the Transportation Construction Fund.

Other: Certain other adjustments and reclassifications are necessary to present the financial statements in accordance with GAAP. The other adjustments caused decreases to the fund equity of $27 million in the General Fund, $15 million in the Federal Fund, and $1 million in the Transportation Construction Fund.

Timing Difference

Federal Grants: On a budgetary basis, a grant received from the federal government before the close of the fiscal year was not recognized as revenue until the 2003-04 fiscal year, when it was budgeted to be spent. On a GAAP basis, all the conditions were met to recognize the grant as revenue in the 2002-03 fiscal year. The adjustment caused an increase to the Federal Fund balance of $576 million.

Liabilities Budgeted in Subsequent Years: On a budgetary basis, the primary government does not accrue liabilities for which there is no existing appropriation or no currently available appropriation. The adjustments made to account for these liabilities in accordance with GAAP caused a decrease to the fund balance of $3.0 billion in the General Fund, $6 million in the Federal Fund, and a $66 million in the Transportation Construction Fund.

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STATEMENT of GENERAL FUND CASH RECEIPTS and DISBURSEMENTS

February 2004

STEVE WESTLY
California State Controller

STEVE WESTLY
California State Controller

March 10, 2004

Users of the Statement of General Fund Cash Receipts and Disbursements

Attached are the Statements of General Fund Cash Receipts and Disbursements for the period July 1, 2003 through February 29, 2004. These statements reflect the State of California's General Fund cash position and compare actual receipts and disbursements for the 2003-04 fiscal year to cash flow estimates prepared by the Department of Finance for the 2004-05 Governor's Budget as well as the 2003-04 Budget Act. These statements are prepared in compliance with Government Code section 12461.1, as well as Item 0840-001-0001, Provision 10, of the 2003-04 Budget Act, using records compiled by the State Controller.

Attachment A compares actual receipts and disbursements to date for the 2003-04 fiscal year to cash flow estimates published in the 2004-05 Governor's Budget. The Governor's Budget cash flow reflects an expected increase of $3.1 billion in receipts, and an expected increase of $4.9 billion in disbursements from the Budget Act estimate for the 2003-04 fiscal year. These cash flow estimates are predicated on projections and assumptions made by the Department of Finance in preparation of the Governor's Budget.

Attachment B compares actual receipts and disbursements to date for the 2003-04 fiscal year to cash flow estimates prepared by the Department of Finance based upon the 2003-04 Budget Act. Prior year actual amounts are also displayed for comparative purposes.

These statements are also available on the Internet at the State Controller's website at **http://www.sco.ca.gov/ard/state/index.shtml** under the category Monthly Statement of General Fund Cash Receipts and Disbursements.

Any questions concerning this report may be directed to Vincent P. Brown, Chief Operating Officer, at (916) 552-8080.

Sincerely,

Steve Westly

STEVE WESTLY
California State Controller

300 Capitol Mall, Suite 1850, Sacramento, CA 95814 •• P.O. Box 942850, Sacramento, CA 94250
PHONE: (916) 445-2636 •• Fax: (916) 445-6379 •• Web Address: www.sco.ca.gov •• E-Mail: steve@sco.ca.gov

STATEMENT OF GENERAL FUND CASH RECEIPTS AND DISBURSEMENTS
A Comparison of Actual to 2004-05 Governor's Budget Estimates
(Amounts in thousands)
Attachment A

	July 1 through February 29 2004 Actual	Estimate (b)	Actual Over or (Under) Estimate Amount	%	2003 (a) Actual	
ENERAL FUND BEGINNING CASH BALANCE	$ **438,110**	$ **438,110**	$ -	-	$ -	
Add Receipts:						
Revenues	46,944,712	47,311,951	(367,239)	(0.8)	44,392,292	
Nonrevenues	3,370,019	1,463,591	1,906,428	130.3	9,251,420	
Total Receipts	50,314,731	48,775,542	1,539,189	3.2	53,643,712	
Less Disbursements:						
State Operations	12,286,894	12,177,412	109,482	0.9	12,952,294	(a)
Local Assistance	44,032,164	43,526,945	505,219	1.2	42,585,690	(a)
Capital Outlay	208,977	148,490	60,487	40.7	123,573	
Nongovernmental	1,980,697	(201,623)	2,182,320	-	40,231	
Total Disbursements	58,508,732	55,651,224	2,857,508	5.1	55,701,788	
Receipts Over / (Under) Disbursements	(8,194,001)	(6,875,682)	(1,318,319)	-	(2,058,076)	
Net Increase / (Decrease) in Temporary Loans	7,755,891	6,437,572	1,318,319	20.5	2,058,813	
ENERAL FUND ENDING CASH BALANCE	-	-	-	-	**737**	
Special Fund for Economic Uncertainties	-	-	-	-	-	
OTAL CASH	$ -	$ -	$ -	-	$ **737**	

ORROWABLE RESOURCES	Actual	Estimate (b)	Amount	%	2003 (a) Actual	
Available Borrowable Resources	$ 24,096,927	$ 23,215,187	$ 881,740	3.8	$ 22,413,239	
Outstanding Loans (c)	18,720,891	17,402,572	1,318,319	7.6	16,117,793	(a) (d)
Unused Borrowable Resources	$ 5,376,036	$ 5,812,615	$ (436,579)	(7.5)	$ 6,295,446	

General Note:
This report is based upon funded cash. Funded cash is cash reported to and recorded in the records of the State Controller's Office. Amounts reported as funded cash may differ from amounts in other reports to the extent there are timing differences in the recording of in-transit items.

Footnotes:
(a) The General Cash Revolving Fund (GCRF) disbursements and loans have been combined with the General Fund for reporting purposes because they represent major General Fund type activities.
(b) A Statement of Estimated Cash Flow for the 2003-04 fiscal year prepared by the Department of Finance for the 2004-05 Governor's Budget. Any projections or estimates are set forth as such and not as representations of fact.
(c) Cumulative loan balance of $18.7 billion is comprised of $4.7 billion in internal borrowing and $14.0 billion in external borrowing.
(d) Cumulative loan balance of $16.1 billion is comprised of $3.6 billion in internal borrowing and $12.5 billion in external borrowing of which $3.6 billion remains in the Special Deposit Revenue Anticipation Notes Proceeds Account.
(e) Negative balances are the result of repayments received that are greater than disbursements made.
(f) Reclassified from a Non-Governmental Cost Fund.

SCHEDULE OF CASH RECEIPTS
(Amounts in thousands)

	Month of February		July 1 through February 29				
			2004				200
	2004	2003	Actual	Estimate (b)	Actual Over or (Under) Estimate Amount	%	Act
REVENUES							
Alcoholic Beverage Excise Tax	$ 18,969	$ 19,825	$ 214,495	$ 207,265	$ 7,230	3.5	$ 2
Corporation Tax	113,563	171,130	3,271,625	3,268,320	3,305	0.1	2,7
Cigarette Tax	7,835	11,062	75,881	76,133	(252)	(0.3)	
Estate, Inheritance, and Gift Tax	29,869	90,669	394,742	391,335	3,407	0.9	6
Insurance Companies Tax	15,813	14,672	934,587	936,302	(1,715)	(0.2)	8
Personal Income Tax	1,412,540	1,291,270	23,175,875	23,484,003	(308,128)	(1.3)	21,2
Retail Sales and Use Taxes	3,303,428	3,105,774	15,510,086	15,407,273	102,813	0.7	14,8
Pooled Money Investment Interest	10,145	20,394	78,396	90,926	(12,530)	(13.8)	1
Not Otherwise Classified	109,845	47,944	3,289,025	3,450,394	(161,369)	(4.7)	3,7
Total Revenues	**5,022,007**	**4,772,740**	**46,944,712**	**47,311,951**	**(367,239)**	**(0.8)**	**44,3**
NONREVENUES							
Transfers from Special Fund for Economic Uncertainties	2,524,497	-	2,524,497	308,219	2,216,278	719.1	
Transfers from Other Funds	55,538	58,776	493,597	839,493	(345,896)	(41.2)	2,7
Transfers from Electric Power Fund	-	-	-	-	-	-	6,0
Miscellaneous	119,415	156,883	351,925	315,879	36,046	11.4	4
Total Nonrevenues	**2,699,450**	**215,659**	**3,370,019**	**1,463,591**	**1,906,428**	**130.3**	**9,2**
Total Receipts	**$ 7,721,457**	**$ 4,988,399**	**$ 50,314,731**	**$ 48,775,542**	**$ 1,539,189**	**3.2**	**$ 53,6**

See notes on page 1.

:DULE OF CASH DISBURSEMENTS
unts in thousands)

	Month of February		July 1 through February 29				2003 (a)
			2004				
					Actual Over or (Under) Estimate		
	2004	2003	Actual	Estimate (b)	Amount	%	Actual
'E OPERATIONS (e)							
slative/Judicial/Executive	$ 89,071	$ 111,129	$ 915,604	$ 900,367	$ 15,237	1.7	$ 921,845
e and Consumer Services	35,988	40,648	324,691	316,851	7,840	2.5	303,354
iness, Transportation and Housing	334	1,262	6,258	6,259	(1)	-	6,869
ɲnology, Trade and Commerce	107	2,149	6,983	5,148	1,835	35.6	15,676
ources	57,793	55,068	632,562	649,084	(16,522)	(2.5)	696,212
ironmental Protection Agency	5,989	4,119	58,927	63,023	(4,096)	(6.5)	106,129
ılth and Human Services:							
əalth Services	41,926	11,273	224,458	244,834	(20,376)	(8.3)	206,863
ental Health Hospitals	34,932	47,049	389,953	412,422	(22,469)	(5.4)	402,052
ther Health and Human Services	45,015	37,306	509,383	483,998	25,385	5.2	440,521
cation:							
niversity of California	274,911	307,478	2,305,566	2,188,188	117,378	5.4	2,354,064 (a)
:ate Universities and Colleges	179,766	115,592	1,705,496	1,704,055	1,441	0.1	1,781,238
ther Education	8,378	14,089	109,928	109,645	283	0.3	131,141
rections and Youth Authority	461,417	442,205	3,134,375	3,065,243	69,132	2.3	3,712,626
ıeral Government	88,127	100,898	802,133	774,000	28,133	3.6	808,222
ılic Employees Retirement ystem	(116,005)	(67,334)	(29,647)	(35,410)	5,763	-	(11,194)
ɔt Service	283,516	169,210	1,200,927	1,202,802	(1,875)	(0.2)	995,801
ːrest on Loans	-	10,181	(10,703)	86,903	(97,606)	(112.3)	80,875
'otal State Operations	**1,491,265**	**1,402,322**	**12,286,894**	**12,177,412**	**109,482**	**0.9**	**12,952,294**
:AL ASSISTANCE (e)							
ɔlic Schools - K-12	4,075,464	3,705,910	20,259,466	20,322,490	(63,024)	(0.3)	17,984,637 (a)
ɱmunity Colleges	248,360	252,173	1,644,613	1,588,333	56,280	3.5	1,917,377 (a)
ntributions to State Teachers' ɭetirement System	-	-	397,039	397,039	-	-	867,887
ıer Education	156,762	122,752	1,987,743	1,735,836	251,907	14.5	1,854,376
rrections and Youth Authority	27,778	20,612	108,303	108,018	285	0.3	117,842
pt. of Alcohol and Drug Program	9,617	8,587	177,734	188,781	(11,047)	(5.9)	196,342
pt. of Health Services:							
ʌledical Assistance Program	928,172	784,275	7,144,997	6,788,479	356,518	5.3	7,039,600
)ther Health Services	43,823	63,573	276,525	279,736	(3,211)	(1.1)	327,241
pt. of Developmental Services	81,909	(15,725)	1,289,501	1,141,932	147,569	12.9	1,064,822
pt. of Mental Health	(91,582)	8,266	326,118	451,952	(125,834)	(27.8)	430,061
pt. of Social Services:							
;SI/SSP/IHSS	464,401	309,411	3,819,747	3,817,707	2,040	0.1	2,962,490
;alWORKs	113,757	105,694	2,323,932	2,293,089	30,843	1.3	2,030,721
)ther Social Services	76,951	114,676	776,657	758,795	17,862	2.4	918,409
x Relief	333,400	296,572	1,515,198	1,604,305	(89,107)	(5.6)	2,961,347
hool Facility Aid Program	13,953	-	13,953	-	13,953	-	15,566
ıer Local Assistance	270,403	154,678	1,970,638	2,050,453	(79,815)	(3.9)	1,896,972
Total Local Assistance	**6,753,168**	**5,931,454**	**44,032,164**	**43,526,945**	**505,219**	**1.2**	**42,585,690**

notes on page 1.

(Continued)

SCHEDULE OF CASH DISBURSEMENTS (Continued)
(Amounts in thousands)

	Month of February		July 1 through February 29				
			2004				2003
					Actual Over or (Under) Estimate		
	2004	2003	Actual	Estimate (b)	Amount	%	Actu
CAPITAL OUTLAY	**75,299**	**17,300**	**208,977**	**148,490**	**60,487**	**40.7**	**1:**
NONGOVERNMENTAL (e)							
Transfer to Special Fund for Economic Uncertainties	2,216,000	-	2,216,000	-	2,216,000	-	
Transfer to Other Funds	7,980	50	245,119	270,090	(24,971)	(9.2)	[illegible]
Transfer to Revolving Fund	677	21,688	2,887	(2,637)	5,524	-	[illegible]
Advance:							
State-County Property Tax Administration Program	-	-	-	-	-	-	
Social Welfare Federal Fund	(45,326)	18,770	(6,850)	11,383	(18,233)	(160.2)	1:
Tax Relief and Refund Account	4,000	(200)	4,000	-	4,000	-	
Counties for Social Welfare	-	-	(480,459)	(480,459)	-	-	(24
Total Nongovernmental	**2,183,331**	**40,308**	**1,980,697**	**(201,623)**	**2,182,320**	-	**4**
Total Disbursements	**10,503,063**	**$ 7,391,384**	**$ 58,508,732**	**$ 55,651,224**	**$ 2,857,508**	**5.1**	**$ 55,70**
TEMPORARY LOANS							
Special Fund for Economic Uncertainties	241,738	$ 2,524,519	$ 2,216,023	$ 2,216,300	$ (277)	-	$
Other Internal Sources	2,539,868	1,093,274	2,539,868	1,221,272	1,318,596	108.0	66
Revenue Anticipation Warrants	-	-	-	-	-	-	(7,50
Revenue Anticipation Notes	-	(3,611,000) (d)	3,000,000	3,000,000	-	-	8,88
Net Increase / (Decrease) Loans	**2,781,606**	**$ 6,793**	**$ 7,755,891**	**$ 6,437,572**	**$ 1,318,319**	**20.5**	**$ 2,05**

See notes on page 1.

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COMPARATIVE STATEMENT OF REVENUES RECEIVED
All Governmental Cost Funds
(Amounts in thousands)

	July 1 through February 29			
	General Fund		Special Funds	
	2004	2003	2004	2003
AJOR TAXES, LICENSES, AND INVESTMENT INCOME:				
Alcoholic Beverage Excise Taxes	$ 214,495	$ 200,239	$ -	$ -
Corporation Tax	3,271,625	2,730,070	9	7
Cigarette Tax	75,881	87,345	618,153	699,379
Estate, Inheritance, and Gift Tax	394,742	633,704	-	-
Insurance Companies Tax	934,587	810,461	-	-
Motor Vehicle Fuel Tax:				
Gasoline Tax	-	-	1,888,928	1,880,365
Diesel & Liquid Petroleum Gas	-	-	346,269	323,972
Jet Fuel Tax	-	-	1,243	1,640
Vehicle License Fees	-	-	1,636,202	1,253,683
Motor Vehicle Registration and Other Fees	-	-	1,477,936	1,305,996
Personal Income Tax	23,175,875	21,282,913	213	242
Retail Sales and Use Taxes	15,510,086	14,804,178	3,276,384	3,160,909
Pooled Money Investment Interest	78,396	136,923	90	381
Total Major Taxes, Licenses, and Investment Income	**43,655,687**	**40,685,833**	**9,245,427**	**8,626,574**
IOT OTHERWISE CLASSIFIED:				
Alcoholic Beverage License Fee	1,541	1,765	27,723	23,023
Electrical Energy Tax	-	-	316,221	330,494
Private Rail Car Tax	6,636	6,340	-	-
Penalties on Traffic Violations	-	-	48,785	49,253
Health Care Receipts	9,614	4,775	-	-
Revenues from State Lands	54,525	27,387	7,904	9,218
Abandoned Property	486,762	237,381	-	-
Trial Court Revenues	26,910	173	623,593 (f)	-
Horse Racing Fees	1,547	2,623	24,192	24,668
Miscellaneous	2,701,490	3,426,015	4,137,390	3,809,081
Not Otherwise Classified	**3,289,025**	**3,706,459**	**5,185,808**	**4,245,737**
Total Revenues, All Governmental Cost Funds	**$ 46,944,712**	**$ 44,392,292**	**$ 14,431,235**	**$ 12,872,311**

See notes on page 1.

STATEMENT OF GENERAL FUND CASH RECEIPTS AND DISBURSEMENTS
A Comparison of Actual to 2003-04 Budget Act Estimates
(Amounts in thousands)
Attachment B

	July 1 through February 29				
	2004				2003 (a)
	Actual	Estimate (b)	Actual Over or (Under) Estimate Amount	%	Actual
GENERAL FUND BEGINNING CASH BALANCE	**$ 438,110**	**$ 438,110**	**$ -**	**-**	**$**
Add Receipts:					
Revenues	46,944,712	51,000,859	(4,056,147)	(8.0)	44,392,29[illegible]
Nonrevenues	3,370,019	1,318,376	2,051,643	155.6	9,251,42[illegible]
Total Receipts	50,314,731	52,319,235	(2,004,504)	(3.8)	53,643,71[illegible]
Less Disbursements:					
State Operations	12,286,894	12,115,645	171,249	1.4	12,952,29[illegible]
Local Assistance	44,032,164	41,890,875	2,141,289	5.1	42,585,69[illegible]
Capital Outlay	208,977	49,283	159,694	324.0	123,57[illegible]
Nongovernmental	1,980,697	119,744	1,860,953	1,554.1	40,231
Total Disbursements	58,508,732	54,175,547	4,333,185	8.0	55,701,78[illegible]
Receipts Over / (Under) Disbursements	(8,194,001)	(1,856,312)	(6,337,689)	-	(2,058,07[illegible]
Net Increase / (Decrease) in Temporary Loans	7,755,891	3,000,000	4,755,891	158.5	2,058,81[illegible]
GENERAL FUND ENDING CASH BALANCE	**-**	**1,581,798**	**(1,581,798)**	**(100.0)**	**737**
Special Fund for Economic Uncertainties	-	2,216,300	(2,216,300)	(100.0)	-
TOTAL CASH	**$ -**	**$ 3,798,098**	**$ (3,798,098)**	**(100.0)**	**$ 737**

BORROWABLE RESOURCES

Available Borrowable Resources	$ 24,096,927	$ 23,273,213	$ 823,714	3.5	$ 22,413,23[illegible]
Outstanding Loans (c)	18,720,891	13,965,000	4,755,891	34.1	16,117,79[illegible]
Unused Borrowable Resources	$ 5,376,036	$ 9,308,213	$ (3,932,177)	(42.2)	$ 6,295,44[illegible]

General Note:
This report is based upon funded cash. Funded cash is cash reported to and recorded in the records of the State Controller's Office. Amounts reported as funded cash may differ from amounts in other reports to the extent there are timing differences in the recording of in-transit items.

Footnotes:
(a) The General Cash Revolving Fund (GCRF) disbursements and loans have been combined with the General Fund for reporting purposes because they represent major General Fund type activities.
(b) A Statement of Estimated Cash Flow for the 2003-04 fiscal year prepared by the Department of Finance for the Budget Act of 2003. Any projections or estimates are set forth as such and not as representations of fact.
(c) Cumulative loan balance of $18.7 billion is comprised of $4.7 billion in internal borrowing and $14.0 billion in external borrowing.
(d) Cumulative loan balance of $16.1 billion is comprised of $3.6 billion in internal borrowing and $12.5 billion in external borrowing of which $3.6 billion remains in the Special Deposit Revenue Anticipation Notes Proceeds Account.
(e) Negative balances are the result of repayments received that are greater than disbursements made.

EDULE OF CASH RECEIPTS
ɔunts in thousands)

	Month of February		July 1 through February 29 2004				2003 (a)
	2004	2003	Actual	Estimate (b)	Actual Over or (Under) Estimate Amount	%	Actual
ENUES							
oholic Beverage Excise Tax	$ 18,969	$ 19,825	$ 214,495	$ 202,070	$ 12,425	6.1	$ 200,239
·poration Tax	113,563	171,130	3,271,625	2,981,030	290,595	9.7	2,730,070
arette Tax	7,835	11,062	75,881	77,452	(1,571)	(2.0)	87,345
ate, Inheritance, and Gift Tax	29,869	90,669	394,742	436,763	(42,021)	(9.6)	633,704
urance Companies Tax	15,813	14,672	934,587	930,219	4,368	0.5	810,461
·sonal Income Tax	1,412,540	1,291,270	23,175,875	22,378,968	796,907	3.6	21,282,913
ɫail Sales and Use Taxes	3,303,428	3,105,774	15,510,086	15,344,649	165,437	1.1	14,804,178
ɔled Money Investment Interest	10,145	20,394	78,396	137,137	(58,741)	(42.8)	136,923
t Otherwise Classified	109,845	47,944	3,289,025	3,174,871	114,154	3.6	3,706,459
ficit Financing Bond Proceeds	-	-	-	5,337,700	(5,337,700)	(100.0)	-
Total Revenues	**5,022,007**	**4,772,740**	**46,944,712**	**51,000,859**	**(4,056,147)**	**(8.0)**	**44,392,292**
ɿREVENUES							
ɪnsfers from Special Fund for Economic Uncertainties	2,524,497	-	2,524,497	308,219	2,216,278	719.1	-
ɪnsfers from Other Funds	55,538	58,776	493,597	710,775	(217,178)	(30.6)	2,750,005
ɪnsfers from Electric Power Fund	-	-	-	-	-	-	6,094,067
scellaneous	119,415	156,883	351,925	299,382	52,543	17.6	407,348
Total Nonrevenues	**2,699,450**	**215,659**	**3,370,019**	**1,318,376**	**2,051,643**	**155.6**	**9,251,420**
Total Receipts	**$ 7,721,457**	**$ 4,988,399**	**$ 50,314,731**	**$ 52,319,235**	**$ (2,004,504)**	**(3.8)**	**$ 53,643,712**

notes on page 1.

SCHEDULE OF CASH DISBURSEMENTS
(Amounts in thousands)

	Month of February		July 1 through February 29				
			2004				2003 (a
	2004	2003	Actual	Estimate (b)	Actual Over or (Under) Estimate Amount	%	Actual
STATE OPERATIONS (e)							
Legislative/Judicial/Executive	$ 89,071	$ 111,129	$ 915,604	$ 764,808	$ 150,796	19.7	$ 921,
State and Consumer Services	35,988	40,648	324,691	291,191	33,500	11.5	303,
Business, Transportation and Housing	334	1,262	6,258	5,798	460	7.9	6,
Technology, Trade and Commerce	107	2,149	6,983	5,343	1,640	30.7	15,
Resources	57,793	55,068	632,562	534,617	97,945	18.3	696,
Environmental Protection Agency	5,989	4,119	58,927	64,528	(5,601)	(8.7)	106,
Health and Human Services:							
Health Services	41,926	11,273	224,458	211,695	12,763	6.0	206,
Mental Health Hospitals	34,932	47,049	389,953	412,044	(22,091)	(5.4)	402,
Other Health and Human Services	45,015	37,306	509,383	421,963	87,420	20.7	440,
Education:							
University of California	274,911	307,478	2,305,566	2,070,339	235,227	11.4	2,354,
State Universities and Colleges	179,766	115,592	1,705,496	1,747,304	(41,808)	(2.4)	1,781,
Other Education	8,378	14,089	109,928	104,425	5,503	5.3	131,
Corrections and Youth Authority	461,417	442,205	3,134,375	3,511,238	(376,863)	(10.7)	3,712,
General Government	88,127	100,898	802,133	251,507	550,626	218.9	808,
Public Employees Retirement System	(116,005)	(67,334)	(29,647)	438,920	(468,567)	(106.8)	(11,1
Debt Service	283,516	169,210	1,200,927	1,210,403	(9,476)	(0.8)	995,
Interest on Loans	-	10,181	(10,703)	69,522	(80,225)	(115.4)	80,
Total State Operations	**1,491,265**	**1,402,322**	**12,286,894**	**12,115,645**	**171,249**	**1.4**	**12,952,**
LOCAL ASSISTANCE (e)							
Public Schools - K-12	4,075,464	3,705,910	20,259,466	19,867,217	392,249	2.0	17,984,
Community Colleges	248,360	252,173	1,644,613	1,573,973	70,640	4.5	1,917,
Contributions to State Teachers' Retirement System	-	-	397,039	397,040	(1)	-	867,
Other Education	156,762	122,752	1,987,743	1,675,501	312,242	18.6	1,854,
Corrections and Youth Authority	27,778	20,612	108,303	125,566	(17,263)	(13.7)	117,
Dept. of Alcohol and Drug Program	9,617	8,587	177,734	321,667	(143,933)	(44.7)	196,
Dept. of Health Services:							
Medical Assistance Program	928,172	784,275	7,144,997	7,683,775	(538,778)	(7.0)	7,039,
Other Health Services	43,823	63,573	276,525	269,808	6,717	2.5	327,2
Dept. of Developmental Services	81,909	(15,725)	1,289,501	1,586,613	(297,112)	(18.7)	1,064,
Dept. of Mental Health	(91,582)	8,266	326,118	407,530	(81,412)	(20.0)	430,
Dept. of Social Services:							
SSI/SSP/IHSS	464,401	309,411	3,819,747	3,476,934	342,813	9.9	2,962,4
CalWORKs	113,757	105,694	2,323,932	2,088,987	234,945	11.2	2,030,7
Other Social Services	76,951	114,676	776,657	911,347	(134,690)	(14.8)	918,4
Tax Relief	333,400	296,572	1,515,198	361,837	1,153,361	318.8	2,961,
School Facility Aid Program	13,953	-	13,953	11,851	2,102	17.7	15,
Other Local Assistance	270,403	154,678	1,970,638	1,131,229	839,409	74.2	1,896,
Total Local Assistance	**6,753,168**	**5,931,454**	**44,032,164**	**41,890,875**	**2,141,289**	**5.1**	**42,585,**

See notes on page 1.

(Continu

IEDULE OF CASH DISBURSEMENTS (Continued)
ounts in thousands)

	Month of February		July 1 through February 29				
			2004				2003 (a)
	2004	2003	Actual	Estimate (b)	Actual Over or (Under) Estimate Amount	%	Actual
ᵓITAL OUTLAY	**75,299**	**17,300**	**208,977**	**49,283**	**159,694**	**324.0**	**123,573**
NGOVERNMENTAL (e)							
ansfer to Special Fund for Economic Uncertainties	2,216,000	-	2,216,000	-	2,216,000	-	-
ansfer to Other Funds	7,980	50	245,119	232,384	12,735	5.5	71,680
ansfer to Revolving Fund	677	21,688	2,887	(10,328)	13,215	-	82,641
lvance:							
State-County Property Tax Administration Program	-	-	-	-	-	-	9,677
Social Welfare Federal Fund	(45,326)	18,770	(6,850)	(102,312)	95,462	-	121,677
Tax Relief and Refund Account	4,000	(200)	4,000	-	4,000	-	2,400
Counties for Social Welfare	-	-	(480,459)	-	(480,459)	-	(247,844)
Total Nongovernmental	**2,183,331**	**40,308**	**1,980,697**	**119,744**	**1,860,953**	**1,554.1**	**40,231**
Total Disbursements	**10,503,063**	**$ 7,391,384**	**$ 58,508,732**	**$ 54,175,547**	**$ 4,333,185**	**8.0**	**$ 55,701,788**
MPORARY LOANS							
pecial Fund for Economic Jncertainties	241,738	$ 2,524,519	$ 2,216,023	$ -	$ 2,216,023	-	$ - (a)
ther Internal Sources	2,539,868	1,093,274	2,539,868	-	2,539,868	-	669,813 (a)
evenue Anticipation Warrants	-	-	-	-	-	-	(7,500,000)
evenue Anticipation Notes	-	(3,611,000) (d)	3,000,000	3,000,000	-	-	8,889,000
Net Increase / (Decrease) Loans	**2,781,606**	**$ 6,793**	**$ 7,755,891**	**$ 3,000,000**	**$ 4,755,891**	**158.5**	**$ 2,058,813**

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APPENDIX B

INFORMATION CONCERNING THE DEPARTMENT AND THE FACILITIES

THE DEPARTMENT OF CORRECTIONS

General

The Department of Corrections (the "Department") is a department within the State Youth and Adult Correctional Agency.

The Youth and Adult Correctional Agency (the "Agency") provides uniform policy direction and operational control to the State correctional system. This unified and coordinated effort, at both the adult and juvenile levels, is designed to deal more effectively with the myriad of correctional issues confronting California.

The Department is responsible for incarcerating the State's most serious adult offenders and for supervising offenders released to the community on parole. As one of the largest departments in State government, the Department includes an extensive infrastructure that includes 32 institutions, 38 camps, 5 prisoner/mother facilities and a correctional training center. The Department also operates or contracts for the operation of 32 public or private community based facilities. At its current size, the Department's infrastructure includes over 3,000 structures that encompass over 36 million square feet of building space on over 24,000 acres of land statewide. The Department also leases almost two million square feet of office space.

The Department has undergone tremendous expansion over the last two decades. In 1980, the Department housed 24,569 inmates and supervised 13,962 parolees and employed about 12,000 people. As of February 18, 2004, the Department housed approximately 161,500 inmates and supervises more than 115,000 parolees, and employs almost 49,000 people. The oldest of the Department institutions, San Quentin and Folsom, were built in 1852 and 1880, respectively. Ten more prisons were added between 1933 and 1965. Beginning in the early 1980's, the Department added 21 prisons during an extensive construction program. In March 2003, a small 800 bed female institution in Stockton, California was closed due to the decreasing women felon population with the passage of Proposition 36, which diverted certain offenders into treatment facilities rather than prison.

The Department estimates that by June 30, 2004, it will house nearly 160,000 inmates. With a capacity of over 170,000, there is expected to be an excess capacity of over 10,000 beds. These population numbers do not include the effect of new programs included in the 2003 Budget Act. These programs will help reduce institution population by providing new education programs, reducing parole revocations, and placing eligible inmates into drug treatment aftercare programs. The excess beds are not distributed uniformly among custody levels and bed types. The surplus consists primarily of beds located in female institutions or beds located in converted gymnasiums and lower security level dormitory beds. However, it is anticipated that by June 30, 2004 there will be a shortage of approximately 8,700 maximum-security beds.

With the completion of California State Prison-Kern County at Delano II ("Delano II") in 2004-2005, the Department's maximum bed capacity will increase by approximately 5,000 beds. Even with full occupancy of Delano II the Department will still have a shortage of approximately 5,000 maximum-security beds. This shortage is projected to increase to over 6,200 by Fiscal Year 2008-2009. This situation necessitates the housing of these inmates in facilities that were not designed for maximum-security inmates, increasing the potential for violence.

The Department's Budget

Statewide, the Department has a total budget of approximately $5.7 billion for Fiscal Year 2003-2004.

Under the State's current budget process, appropriations for rental payments for all facility leases of the Department will be included with appropriations made for the Department's base operating budget. Annual rental payments under all facility leases of the Department securing lease revenue bonds, including the Facility Leases relating to the 2004D Bonds and the 2004E Bonds, are estimated to equal approximately $264.4 million. See "SECURITY AND SOURCES OF PAYMENT FOR EACH SERIES OF BONDS—Budgeting for Rental Payments." For more information regarding the State's budgetary process and finances, see "APPENDIX A-STATE OF CALIFORNIA-STATE FINANCES."

THE CORRECTIONS FACILITIES

California State Prison-Lassen County, Susanville

California State Prison-Lassen County, Susanville facility, also known as High Desert State Prison (HDSP), is located in Lassen County approximately 7 miles east of the City of Susanville, adjacent to the existing California Correctional Center (CCC) at Susanville. HDSP is located on approximately 387 acres.

The prison is comprised of four housing facilities inside the security perimeter, two with maximum security (Level IV) beds and two with medium security (Level III) beds. The medium security facility includes Reception beds. The maximum security facility includes Administrative Segregation beds. In addition, there is a minimum security (Level I) facility outside the security perimeter. The prison also includes wastewater ponds. Construction of HDSP was completed in January 1996. Initial inmate occupancy began in August 1995, and as of February 18, 2004, the inmate population was 4,561.

Celled housing units are provided for the Level III, IV, Reception and Administrative Segregation inmates, and dormitory housing for the Level I inmates. Each Level III and Level IV facility operates semi-autonomously and is separated from the other by fencing or buildings. However, all four facilities are contained within a double-fenced security perimeter with an electrified fence that is located between the double perimeter fences and serves as a lethal barrier and deterrent to escape.

Each of these four facilities provides food services, religious, vocational and academic programs, laundry, canteen, medical, dental, and library services. Located outside the security perimeter are prison-wide support services such as central administration, maintenance, warehousing, and visitor processing. Some services are located at, and shared with the Department's CCC. These facilities include the laundry, a firehouse, firing range, and wastewater treatment facilities.

Seismicity - Susanville

Generally, within the State, some level of seismic activity occurs on a regular basis. Periodically, the magnitude of a single seismic event can cause significant ground shaking and potential for damage to property located at or near the center of such seismic activity.

The Department has developed procedures and uses design standards, which have resulted in buildings designed to withstand earthquakes of a magnitude anticipated in the facility's location. California standards and procedures require that each project be designed and constructed to the highest seismic standards (Zone 4). The governing structural building code at the time of construction for this facility was the 1991 Uniform Building Code with 1992 California Amendments (a.k.a. California Building Code). Some of these standards and procedures are listed below.

• Detailed geotechnical reports were prepared to address the soil conditions and seismic characteristic of the site.

• Buildings are then designed and engineered to meet the highest risk of seismic activity as described in the California Building Code Seismic Zone 4.

• An independent peer review was performed during the design phase.

• Field inspections and testing were performed by certified inspectors and registered professionals during construction to insure compliance with design seismic standards.

California State Prison-Fresno County, Coalinga

The California State Prison-Fresno County, Coalinga facility, also known as Pleasant Valley State Prison (PVSP), is located in the City of Coalinga, Fresno County. PVSP is located on approximately 336 acres.

The prison is comprised of four medium security (Level III) housing facilities inside the security perimeter. One of these medium security facilities has administrative segregation beds. In addition, there is a minimum security (Level I) facility outside the security perimeter. Construction of PVSP was completed in September 1994. Initial inmate occupancy began in November 1994, and as of February 18, 2004, the inmate population was 4,889.

Celled housing units are provided for the Level III and administrative segregation inmates, and dormitory housing for the Level I inmates. Each Level III facility operates semi-autonomously and is separated from the other by fencing or buildings. However, all four facilities are contained within a double-fenced security perimeter with an electrified fence that is located between the double perimeter fences and serves as a lethal barrier and deterrent to escape.

Each of these four facilities provides food services, religious, vocational and academic programs, laundry, canteen, medical, dental, and library services. Located outside the security perimeter are prison-wide support services such as central administration, maintenance, warehousing, visitor processing, firehouse, firing range, and wastewater treatment facility.

Seismicity - Coalinga

Generally, within the State, some level of seismic activity occurs on a regular basis. Periodically, the magnitude of a single seismic event can cause significant ground shaking and potential for damage to property located at or near the center of such seismic activity.

The Department has developed procedures and uses design standards, which have resulted in buildings designed to withstand earthquakes of a magnitude anticipated in the facility's location. California standards and procedures require that each project be designed and constructed to the highest seismic standards (Zone 4). The governing structural building code at the time of construction for this facility was the 1988 Uniform Building Code with 1989 and 1990 California Amendments (a.k.a. California Building Code). Some of these standards and procedures are listed below.

• Detailed geotechnical reports were prepared to address the soil conditions and seismic characteristic of the site.

• Buildings were then designed and engineered to meet the highest risk of seismic activity as described in the California Building Code Seismic Zone 4.

• An independent peer review was performed during the design phase.

• Field inspections and testing were performed by certified inspectors and registered professionals during construction to insure compliance with design seismic standards.

APPENDIX C

SUMMARY OF CERTAIN PROVISIONS OF LEGAL DOCUMENTS

The following is a brief summary of the provisions of the primary legal documents pertaining to the Bonds. This summary is not intended to be definitive, and Bondholders should refer to the documents for the complete text thereof. Copies of the documents summarized herein are available from the State Treasurer.

I. SUMMARY OF LEGAL DOCUMENTS APPLICABLE ONLY TO 2004D BONDS

A. DEFINITIONS APPLICABLE TO 2004D BONDS

The following terms are defined in the Master Indenture, as supplemented by the Fifty-First Supplemental Indenture, and, in certain cases, used in the body of the Official Statement and have the meanings set forth below:

"Act" means the State Building Construction Act of 1955 (being Part 10b of Division 3 of Title 2 of the California Government Code, as amended) and all laws amendatory thereof or supplemental thereto.

"Additional Rental" means reasonable amounts received by the Board from the Department in each year as additional rental payments sufficient for the Board to pay all administrative costs and other expenses of the Board in connection with the Facilities.

"Annual Debt Service" means, for any Fiscal Year, the sum of (1) the interest (including any compound interest) payable on all Outstanding Bonds and Incorporated Bonds in such Fiscal Year, assuming that all Outstanding Serial Bonds and Incorporated Bonds are retired as scheduled and that all Outstanding Term Bonds and Incorporated Bonds are redeemed or paid from sinking account payments as scheduled (except to the extent that such interest is to be paid from the proceeds of sale of any Bonds), (2) the principal amount of all Outstanding Serial Bonds and Incorporated Bonds maturing by their terms in such Fiscal Year, and (3) the principal amount of all Outstanding Term Bonds and Incorporated Bonds required to be redeemed or paid in such Fiscal Year (together with the redemption premium, if any, thereon).

"Base Rental" means all amounts received by the Board from the Department as base rental payments pursuant to a Lease to be used to pay the interest on and principal of a Series of Bonds or a Related Series of Bonds.

"Board" means the State Public Works Board of the State of California, an entity of state government duly organized and validly existing under and pursuant to Part 10.5 of Division 3 of Title 2 of the California Government Code.

"Bond Insurer" means MBIA Insurance Corporation, a New York stock insurance company, or any successor thereto or assignee thereof.

"Bonds" means all lease revenue bonds of all Series authorized by and at any time Outstanding pursuant to the Master Indenture and executed, issued, and delivered in accordance with the Master Indenture. "Serial Bonds" means Bonds for which no sinking account payments are provided. "Term Bonds" means Bonds which are payable on or before their specified maturity dates from sinking account payments established for that purpose and calculated to retire such Bonds on or before their specified maturity dates.

"Bond Year" means, with respect to each Master Indenture Series of Bonds, that 12-month period commencing on each principal payment date (or for any Series of Bonds with a semi-annual principal payment date, the first principal payment date occurring within each calendar year), or the anniversary of such date, for such

Series of Bonds; provided, the first Bond Year for any Series of Bonds shall commence on the date of issuance of such Series and end on the day before the next principal payment date (or for any Series of Bonds with a semi-annual principal payment date, the first principal payment date occurring within each calendar year), or anniversary thereof.

"Business Day" means a day of the year other than a Saturday or Sunday or a day on which State of California offices or banking institutions located in the State are required or authorized to remain closed.

"Capitalized Interest Subaccount" means the subaccount of the Interest Account by that name established pursuant to the Master Indenture.

"Coalinga Facility" means the Coalinga Project and the Coalinga Site.

"Coalinga Facility Lease" means the lease of the Coalinga Facility, dated as of April 1, 2004, entered into between the Board, as lessor, and Corrections, as lessee, and as it may from time to time be amended or supplemented pursuant to its terms and the terms of the 2004D Indenture.

"Coalinga Project" means all of the buildings, structures, equipment and other facilities and related improvements and certain incidental facilities constructed on the Coalinga Site, as more particularly described in Exhibit B of the 2004D Indenture, and any and all additions, betterments, and extensions and improvements thereto. The Coalinga Project is located on the Coalinga Site.

"Coalinga Revenues" means certain proceeds of the 2004D Bonds deposited in the Interest Account, all Base Rental payments received by the Board pursuant to the Coalinga Facility Lease, and all other benefits, charges, income, proceeds, profits, receipts, rents, proceeds of insurance, and revenues derived by the Board from the ownership, operation, or use of the Coalinga Facility, including interest or profits from the investment of money in any account or fund (other than the Rebate Fund and the Reserve Fund) pursuant to the 2004D Indenture.

"Coalinga Site" means the parcel of land more particularly described in Exhibit B attached to and made a part of the Coalinga Facility Lease.

"Coalinga Transfer Agreement" means the Agreement for the Transfer of Control and Possession of State Owned Real Property, dated as of April 1, 2004, by and between Corrections, as transferor, and the Board, as transferee, as originally executed and as it may from time to time be amended or supplemented pursuant to the provisions of its terms and the 2004D Indenture.

"Construction Fund" means the fund by that name established pursuant to the Master Indenture.

"Continuing Disclosure Agreement" means any Continuing Disclosure Agreement among the Board, a Department and the State Treasurer dated the date of issuance and delivery of a Series of the Bonds.

"Corrections" means the Department of Corrections, a department within the Youth and Adult Correctional Agency of the State of California.

"Dated Date" means April 1, 2004.

"Debt Service" means, with respect to any Series of Master Indenture Series of Bonds, as appropriate, for any period of time specified, the sum of (1) the interest (including any compound interest) payable on all Outstanding Bonds during such period, assuming that all Outstanding Serial Bonds are retired as scheduled and that all Outstanding Term Bonds are redeemed or paid from sinking account payments as scheduled (except to the extent that such interest is to be paid from the proceeds of sale of any Bonds), (2) the principal amount of all

Outstanding Serial Bonds maturing by their terms during such period, and (3) the principal amount of all Outstanding Term Bonds required to be redeemed or paid during such period (together with the redemption premium, if any, thereon).

"Department" means any district, department, agency, board, commission or other entity of the State, including any other local government units authorized under the Act, that are authorized to lease Facilities from the Board pursuant to the Act and have executed and delivered a Lease.

"Event of Default" means an event defined as such under the Master Indenture.

"Facility" means either (1) a Project and a Site and/or Equipment, as the case may be, as specified in a Supplemental Indenture, or (2) any project, site and/or equipment specified in an Incorporated Indenture as a Facility for purposes of the Master Indenture.

"Facility Lease" means a lease of a Project and a Site entered into between the Board as lessor and a Department as lessee, as originally executed and as it may from time to time be amended or supplemented, as specified in a Supplemental Indenture.

"Fifty-First Supplemental Indenture" means that Fifty-First Supplemental Indenture relating to the 2004D Bonds, dated as of the Dated Date, between the Board and the State Treasurer, which is supplemental to the Master Indenture.

"Fiscal Year" means the twelve-month period terminating on June 30 of each year, or any other annual accounting period hereafter selected and designated by the Board as its Fiscal Year in accordance with applicable law.

"Governor" means the elected official holding the position of the governor of the State of California.

"Holder" or "Bondholder" means any person who shall be the registered owner of any Outstanding Bond.

"Incorporated Bonds" means any series of lease revenue bonds of the Board previously or hereafter issued other than pursuant to the Master Indenture, which the Board has elected to be secured by the Reserve Fund.

"Incorporated Indenture" means the indenture of trust pursuant to which any Incorporated Bonds were issued.

"Interest Account" means any account by that name established pursuant to the Master Indenture.

"Interest Payment Date" means, as long as any of the Bonds are Outstanding, the interest payment dates for each Series of Bonds as specified in the Supplemental Indenture therefor and which dates during each Fiscal Year are separated by a period of six months, and the interest payment dates for any Incorporated Bonds. With respect to the 2004D Bonds, "Interest Payment Date" means each June 1 and December 1, commencing June 1, 2004.

"Interim Loan" means a loan from the Pooled Money Investment Board or the general fund of the State or other source of the State to the Board, the proceeds of which were applied to the acquisition, installation, or construction of a Facility.

"Lease" means an Equipment Lease or a Facility Lease or any equipment lease or facility lease securing any Incorporated Bonds.

"Legislature" means the legislature of the State of California.

"Locality" means (i) each campus of the University of California, the California State University or a Community College, at which a Facility is located; *provided*, that any two campuses located within five miles shall be considered a single Locality; or (ii) for a Facility not located on a campus, the Locality means the area within a radius of five miles around the Facility.

"Maintenance and Operation Account" means any account by that name established pursuant to the Master Indenture.

"Master Indenture" means the indenture, dated as of April 1, 1994, between the Board and the State Treasurer relating to the Board's Lease Revenue Bonds (Series I Projects), as amended by the Tenth Supplemental Indenture, dated as of September 1, 1996, and the Forty-Second Supplemental Indenture, dated as of October 1, 2002, and as it may be further amended or supplemented from time to time.

"Maximum Aggregate Semi-Annual Debt Service" means the aggregate sum of Semi-Annual Debt Service of Bonds and Incorporated Bonds that are Outstanding for that Semi-Annual Debt Service Period in which the aggregate sum is the largest, beginning with the then current Semi-Annual Debt Service Period and ending with the Semi-Annual Debt Service Period in which the last Bonds or Incorporated Bonds are Outstanding.

"Opinion of Counsel" means a written opinion of counsel of recognized national standing in the field of law relating to municipal bonds, appointed and paid by the Board and satisfactory to and approved by the State Treasurer (who shall be under no liability by reason of such approval).

"Outstanding," when used as of any particular time with reference to Bonds, means (subject to the provisions of the Master Indenture) all Bonds except --

(1) Bonds theretofore cancelled by the State Treasurer or surrendered to the State Treasurer for cancellation;

(2) Bonds paid or deemed to have been paid within the meaning of the Master Indenture; and

(3) Bonds in lieu of or in substitution for which other Bonds shall have been executed, issued, and delivered by the Board pursuant to the Master Indenture.

"Outstanding," when used with reference to any Incorporated Bonds, shall have the meaning set forth in the respective Incorporated Indenture.

"Permitted Investments" means any of the following which at the time are legal investments under the laws of the State for moneys held under the Master Indenture and then proposed to be invested therein:

(i) bonds or interest-bearing notes or obligations of the United States, or those for which the faith and credit of the United States are pledged for the payment of principal and interest;

(ii) bonds or interest-bearing notes or obligations that are guaranteed as to principal and interest by a federal agency of the United States;

(iii) bonds of the State or bonds for which the faith and credit of the State are pledged for the payment of principal and interest;

(iv) bonds or warrants, including but not limited to revenue warrants, of any county, city, metropolitan water district, California water district, California water storage district, irrigation district in the State, municipal utility district or school district of the State;

(v) bonds, consolidated bonds, collateral trust debentures, consolidated debentures or other obligations issued by general land banks or federal intermediate credit banks established under the Federal Farm Loan Act, as amended, debentures and consolidated debentures issued by the Central Bank for Cooperatives and banks for cooperatives established under the Farm Credit Act of 1933, as amended, bonds or debentures of the Federal Home Loan Bank Board established under the Federal Home Loan Bank Act, stocks, bonds, debentures and other obligations of the Federal National Mortgage Association established under the National Housing Act, as amended, and the bonds of any federal home loan bank established under said act, obligations of the Federal Home Loan Mortgage Corporation, and bonds, notes and other obligations issued by the Tennessee Valley Authority under the Tennessee Valley Authority Act, as amended;

(vi) commercial paper rated within the top rating designation by a nationally recognized rating service and issued by corporations (1) organized and operating within the United States, (2) having total assets in excess of $500,000,000 and (3) approved by the Pooled Money Investment Board, provided, however that eligible commercial paper may not exceed 180 days' maturity, represent more than 10 percent of the outstanding paper of an issuing corporation nor exceed 30 percent of the resources of an investment program, and that at the request of the Pooled Money Investment Board, such investment shall be secured by the issuer by depositing with the State Treasurer securities authorized by Section 53651 of the California Government Code of a market value of at least 10 percent in excess of the amount of the State's investment;

(vii) bills of exchange or time drafts drawn on and accepted by a commercial bank the general obligations of which are rated within the top two rating categories by a nationally recognized rating service, otherwise known as banker's acceptances, which are eligible for purchase by the Federal Reserve System;

(viii) negotiable certificates of deposit issued by a nationally or state-chartered bank or savings and loan association or by a state-licensed branch of a foreign bank which, to the extent they are not insured by federal deposit insurance, are issued by an institution the general obligations of which are rated in one of the top two rating categories by a nationally recognized rating service;

(ix) bonds, debentures and notes issued by corporations organized and operating within the United States which securities are rated in one of the top two rating categories by a nationally recognized rating service;

(x) interest-bearing accounts in state or national banks or in state or federal savings and loan associations having principal offices in the State, the deposits of which shall be secured at all times and in the same manner as state moneys are by law required to be secured;

(xi) deposits in the Surplus Money Investment Fund referred to in Section 15487 of the California Government Code;

(xii) repurchase agreements or reverse repurchase agreements, as such terms are defined in and pursuant to the terms of Section 16480.4 of the California Government Code;

(xiii) collateralized or uncollateralized investment agreements or other contractual arrangements with corporations, financial institutions or national associations within the United States, provided that the senior long-term debt of such corporations, institutions or associations is rated within the top two rating categories by a Rating Agency;

(xiv) money market funds that invest solely in obligations described in clause (i) of this definition; or

(xv) such other investments as may be authorized by a Supplemental Indenture, provided each Rating Agency has confirmed that the use of such additional investments will not result in the reduction or withdrawal of any rating on any Outstanding Bonds.

"Policy" means the financial guaranty insurance policy issued by the Bond Insurer insuring the payment of the principal of and interest on the 2004D Insured Bonds.

"Principal Account" means any account by that name established pursuant to the Master Indenture.

"Project" means public buildings, structures, works, and related improvements which have been or will be acquired, installed, and constructed on a Site, and all additions, betterments, extensions, and improvements thereto, as specified in a Supplemental Indenture.

"Rating Agency" means each nationally recognized bond rating agency which is at any time providing a rating on any Series of Bonds.

"Rebate Fund" means the fund by that name established pursuant to the Master Indenture.

"Related Series of Bonds" means two or more Series of Bonds issued under the Master Indenture which finance the same Facility or Facilities, such that the Base Rental payments generated pursuant to the Lease(s) concerning such Facility or Facilities are the source of repayment of the several Related Series of Bonds and which are designated as Related Series of Bonds pursuant to a Supplemental Indenture.

"Reserve Fund" means the fund by that name established pursuant to the Master Indenture.

"Reserve Fund Credit Facility" means (1) a letter of credit, surety or other financial undertaking issued by a financial institution if the unsecured obligations of such financial institution have the same or higher rating than the Bonds as rated by each Rating Agency, or (2) a policy of insurance or surety bond issued by a municipal bond insurance company or similar entity, if the obligations insured by such insurance company or entity have the same or higher rating than the Bonds as rated by each Rating Agency, and, in either case, which has been delivered to the State Treasurer in accordance with the Master Indenture to satisfy all or a portion of the obligation to maintain the balance on deposit in the Reserve Fund in an amount equal to the Reserve Fund Requirement and is available to make payments with respect to all Outstanding Bonds and Incorporated Bonds, in accordance with its terms and the terms of the Master Indenture.

"Reserve Fund Requirement" means, as of any date of calculation, an amount equal to the sum of (A) the greatest of:

(1) the sum of the largest single payments of Semi-Annual Debt Service relating to the two Facilities with the largest single payment of Semi-Annual Debt Service remaining,

(2) the sum of the largest single remaining payments of Semi-Annual Debt Service attributable to all Facilities situated within that Locality in the State for which such sum is the largest,

(3) ten percent (10%) of Maximum Aggregate Semi-Annual Debt Service, or

(4) the largest payment(s) of Semi-Annual Debt Service remaining for any Interest Payment Date(s) coming due in any calendar month;

plus (B) an amount not to exceed one percent (1%) of the amount calculated under part (A) above, as determined by the State Treasurer at the time of issuance of any series of Bonds.

"Revenue Fund" means any fund by that name established pursuant to the Master Indenture.

"Semi-Annual Debt Service" means that portion of Annual Debt Service that is paid on any Interest Payment Date.

"Semi-Annual Debt Service Period" means each six-month period ending on June 30 or December 31, respectively, for so long as any Bonds or Incorporated Bonds are Outstanding.

"Series," whenever used in this Summary in the context of a "Series of Bonds," means all of the bonds issued and designated under a Supplemental Indenture as being of the same series, authenticated and delivered in a simultaneous transaction, regardless of variations in maturity, interest rate, redemption and other provisions, and any bonds thereafter authenticated and delivered upon transfer or exchange of or in lieu of or in substitution for (but not to refund) such bonds as provided in the Master Indenture.

"Sinking Account" means a subaccount of the Principal Account by that name established pursuant to the Master Indenture.

"Site" means that certain land that is described in an exhibit to a Facility Lease.

"State" means the State of California.

"State Treasurer" means the Treasurer of the State of California at his office in Sacramento, California, appointed by the Board and acting as an independent trustee and fiscal agent with the rights and obligations provided in the Master Indenture, and his successors and assigns, or any other association or corporation which may at any time be substituted in his place as provided in the Master Indenture.

"Supplemental Indenture" means any indenture then in full force and effect which has been duly executed and delivered by the Board and the State Treasurer amendatory of or supplemental to the Master Indenture; but only if and to the extent that such Supplemental Indenture is specifically authorized under the Master Indenture.

"Surplus Account" means any account by that name established pursuant to the Master Indenture.

"Tax Certificate" means the tax certificate delivered by the Board at the time of the issuance and delivery of a Series of Bonds, as the same may be amended or supplemented in accordance with its terms.

"2004D Bonds" means the State Public Works Board of the State of California Lease Revenue Bonds (Department of Corrections) 2004 Series D (California State Prison — Fresno County, Coalinga) issued by the Board under and pursuant to the 2004D Indenture.

"2004D Indenture" means the Master Indenture as supplemented by the Fifty-First Supplemental Indenture.

"2004D Insured Bonds" means the 2004D Bonds maturing on December 1, 2007 through and including December 1, 2019.

B. THE MASTER INDENTURE

The 2004D Bonds will be issued under the provisions of the Master Indenture, as supplemented by the Fifty-First Supplemental Indenture. The provisions of the Master Indenture are briefly summarized below.

Pledge of the Revenues

Pursuant to the Master Indenture, the Bonds of each Series are secured by a pledge of and charge and lien upon those certain revenues and amounts on deposit in the funds and accounts established under the Master Indenture for such Series of Bonds or Related Series of Bonds (other than amounts on deposit in the Rebate Fund) and the Reserve Fund. All such moneys are irrevocably pledged to the payment of the principal of, interest on and redemption premiums, if any, on the Series of Bonds or Related Series of Bonds to which such Revenues and amounts relate. The pledge made in the Master Indenture constitutes a first pledge of and charge and lien upon those certain Revenues (other than Revenues on deposit in the Rebate Fund) and constitutes an equal pledge on the Reserve Fund along with all other Bonds and Incorporated Bonds Outstanding.

Additional Bonds

The Master Indenture provides that the Board may at any time issue a Series of Bonds payable from the Revenues for such Series as provided in the Master Indenture and secured by a pledge of and charge and lien upon such Revenues and upon the Reserve Fund as provided in the Master Indenture, but only subject to the following specific conditions, which are conditions precedent to the issuance of any Series of Bonds:

(a) The Board shall be in compliance with all agreements and covenants contained in the Master Indenture.

(b) The issuance of such Series of Bonds shall have been authorized pursuant to the Act and shall have been provided for by a Supplemental Indenture which shall specify the following:

(1) the purpose for which such Series of Bonds are to be issued; provided that such Series of Bonds shall be applied solely for the purpose of (i) financing or refinancing the acquisition, installation and construction of any Facility or Facilities, (ii) financing or refinancing the completion of and/or acquisition, installation and construction of additions, betterments, extensions, or improvements to a Facility or Facilities which have previously been financed by the Board, (iii) refunding any Series of Bonds then Outstanding, (iv) payment of interest on any Series of Bonds during the period of construction or acquisition, (v) payment of all costs incidental to or connected with any financing described in (i), (ii) or (iii) above, and/or (vi) making deposits into the Reserve Fund;

(2) the authorized principal amount and designation of such Series of Bonds;

(3) the date and the maturity dates of and the sinking account payment dates, if any, for such Series of Bonds; provided that (i) all such Series of Bonds of like

maturity shall be identical in all respects, except as to number and denomination, (ii) serial maturities for Serial Bonds or sinking account payments for Term Bonds, or any combination thereof, shall be established to provide for the retirement of such Series of Bonds on or before their respective maturity dates;

(4) the Interest Payment Dates for such Series of Bonds; provided that the first interest payment date occurs not more than twelve months following the date of issuance of the Series of Bonds;

(5) the denomination or denominations of and method of numbering such Series of Bonds;

(6) the redemption premium, if any, and the redemption terms, if any, for such Series of Bonds;

(7) the amount, if any, to be deposited from the proceeds of sale of such Series of Bonds in the Interest Account therefor;

(8) the amount, if any, to be deposited from the proceeds of sale of such Series of Bonds or as a Reserve Fund Credit Facility in the Reserve Fund, which amount shall be the lesser of:

(a) the amount needed to bring the Reserve Fund to an amount at least equal to the Reserve Fund Requirement, as calculated by including the Series of Bonds to be issued;

(b) the maximum amount of proceeds of such Series of Bonds that may be used to fund the Reserve Fund, without violating any law or regulations governing tax-exempt bonds (and without requirement to yield restrict the Reserve Fund), as set forth in an opinion of nationally recognized bond counsel on file with the State Treasurer;

(9) the amount, if any, to be deposited from the proceeds of sale of such Series of Bonds in the funds and accounts established under the Master Indenture;

(10) the forms of such Series of Bonds;

(11) if applicable, a determination that the newly issued Bonds will be a Related Series of Bonds which will be secured on a parity with a previously issued Series, sharing *pari passu* the Base Rentals derived from the Facility or Facilities which are common to the Related Series of Bonds; and

(12) such other provisions as are necessary or appropriate and not inconsistent with the Master Indenture.

(c) The Lease or Leases relating to such Series of Bonds shall provide that the Base Rental payable by the Department thereunder shall be in an amount at least sufficient to pay the Annual Debt Service on such Series of Bonds as the same become due. A certificate of the Board to the effect that such Base Rental is consistent with the fair rental value for the Facilities relating to such Series of Bonds shall be delivered to the State Treasurer to accompany each such Lease.

Incorporated Bonds

The Board may, by written request to the State Treasurer with a copy to each Rating Agency, provide that the Reserve Fund created by the Master Indenture shall also secure other issues of lease revenue bonds of the Board, which issues of Incorporated Bonds shall be specified in a certificate of the Board filed with the State Treasurer on such date. The Board shall at such time deposit funds or a Reserve Fund Credit Facility with the State Treasurer so that the Reserve Fund equals the greater of (i) the Reserve Fund Requirement (calculated after giving effect to the inclusion of the Incorporated Bonds), or (ii) the amount of the reserve account requirement under the respective Incorporated Indenture. Thereafter, all such Incorporated Bonds as so specified will be secured by the Reserve Fund as and to the same extent as all Bonds issued under the Master Indenture. The Board shall not make any other issue of its bonds subject to the Reserve Fund if the amount to be on deposit in the Reserve Fund following implementation of the provisions of the Master Indenture relating to Incorporated Bonds will be less than the amount in the reserve account under the Incorporated Indenture immediately prior to such action.

In order to implement the provisions of the Master Indenture as to Incorporated Bonds, the Board is required in each instance to deliver to the State Treasurer the following:

(1) A certificate of the Board identifying the issue of bonds to become Incorporated Bonds, and identifying the facilities and facility and equipment leases relating thereto; identifying the Reserve Fund Requirement which would be applicable once the Incorporated Bonds become subject to the benefit of the Reserve Fund, and stating the amount, if any, to be transferred from the reserve account for the Incorporated Bonds to the Reserve Fund;

(2) A copy of the Supplemental Indenture under the Incorporated Indenture providing for the Incorporated Bonds to become subject to the Reserve Fund; and

(3) Written evidence from each Rating Agency then rating the Bonds and the Incorporated Bonds that such implementation of the provisions of the Master Indenture as to Incorporated Bonds will not result in a reduction or withdrawal of the ratings on the Incorporated Bonds or on any Bonds Outstanding under the Master Indenture.

Establishment of Funds and Accounts

The following funds and accounts are established pursuant to the Master Indenture: (1) the Construction Fund, with a special account therein for each Series of Bonds as may be specified in the Supplemental Indenture for such Series; (2) the Revenue Fund established for each Series of Bonds, containing an Interest Account (including a Capitalized Interest Subaccount therein), a Principal Account, a Maintenance and Operation Account, and a Surplus Account; (3) the Reserve Fund; and (4) the Rebate Fund.

Construction Fund. The Master Indenture provides that the State Treasurer shall apply the moneys in the Construction Fund and any account therein in the manner specified in the related Supplemental Indenture, including to repay Interim Loans and accrued interest thereon, and following such repayment, from time to time to pay (or to make reimbursement or cash advances to the Board, the Department or any other State agency, public agency or person, firm or corporation for such costs), the costs of the acquisition, construction, furnishing, equipping, financing, or refinancing of the Facilities, including payment of all costs incidental thereto or connected therewith, including, without limitation, planning, engineering, inspection, legal, State Treasurer's fees incidental thereto, and costs of issuance of the Bonds. Any moneys remaining in any account in the Construction Fund upon the completion of the Facilities to which such account relates shall be applied by the State Treasurer to offset scheduled Base Rental or in such other manner as the Board may by written request direct.

Revenue Fund. All Revenues when and as received will be deposited in the State Treasury to the credit of the Revenue Fund for the Series of Bonds or Related Series of Bonds to which such Revenues relate (except for funds deposited in the Rebate Fund). The State Treasurer shall set aside all money in a Revenue Fund in the following special accounts within such Revenue Fund for the Series of Bonds to which such Revenue Fund relates:

(a) *Interest Account*. On or before the fifteenth day of the month next preceding each Interest Payment Date for such Series in each year, the State Treasurer will set aside from the Revenue Fund for such Series of Bonds and deposit in the Interest Account therefor that amount of money which, together with any money contained therein (including any amounts available in the Capitalized Interest Subaccount), is equal to the aggregate amount of interest becoming due and payable on such Series of Bonds on the next succeeding Interest Payment Date. No deposit need be made in the Interest Account if the amount contained therein (including amounts, if any, available in the Capitalized Interest Subaccount) is at least equal to the aggregate amount of interest becoming due and payable on such Series of Bonds on such Interest Payment Date.

All money in the Interest Account will be used and withdrawn by the State Treasurer solely for the purpose of paying the interest on the Series of Bonds for which such Interest Account was established as it shall become due and payable (including accrued interest on any Bonds of such Series purchased or redeemed prior to maturity); provided that the State Treasurer, upon the written request of the Board and upon receipt of such documentation as he may require, shall withdraw from such Interest Account and pay to or upon order of the Board money sufficient to reimburse the Department for any Base Rental theretofore paid by the Department under the Lease or Leases relating to the Series of Bonds for which such Interest Account was established for that period of time during which the payment of Base Rental under such Lease or Leases is abated and for which no other money (including proceeds of the rental interruption or use and occupancy insurance required by the Master Indenture as supplemented by the appropriate Supplemental Indenture and money in the respective Principal Account and in the Reserve Fund and in the Maintenance and Operation Account and in the Surplus Account) is available.

With respect to each Series of Bonds for which proceeds of the sale thereof are required to be set aside to pay interest on the Bonds, the State Treasurer (if so instructed by the Supplemental Indenture providing for the issuance of such Series) will establish and maintain a separate subaccount within the Interest Account, designated as a Capitalized Interest Subaccount. Moneys in a Capitalized Interest Subaccount are required to be transferred by the State Treasurer and deposited in the Interest Account in the amounts and at the times specified in the Supplemental Indenture providing for the issuance of a Series of Bonds.

(b) *Principal Account*. On or before the fifteenth day of the month next preceding the scheduled principal payment date for any Serial Bonds of such Series in each year, the State Treasurer shall set aside from the Revenue Fund and deposit in the Principal Account therefor an amount of money equal to the aggregate principal amount of all Outstanding Serial Bonds maturing on such principal payment date. In addition, on or before the fifteenth day of the month next preceding the scheduled sinking account payment date for any Term Bond of such Series in each year, the State Treasurer shall set aside from the Revenue Fund for such Series of Bonds and deposit in the Principal Account therefor an amount of money equal to the aggregate amount of all sinking account payments required to be made on such date into the respective sinking accounts for all Outstanding Term Bonds of such Series.

No deposit need be made in the Principal Account for any principal payment date if the amount contained therein is at least equal to the aggregate amount of the principal of all Outstanding Serial Bonds of such Series maturing by their terms on such principal payment date plus the aggregate amount of all sinking account payments required to be made during the year ending on such principal payment date for all Outstanding Term Bonds of such Series.

The State Treasurer is required to establish and maintain within the Principal Account for each Series of Bonds a separate subaccount for the Term Bonds of such Series and maturity, with each such subaccount being designated a "Sinking Account." With respect to each Sinking Account, on each mandatory sinking account payment date established for such Sinking Account, the State Treasurer shall apply the mandatory sinking account payment required on that date to the redemption (or payment at maturity, as the case may be) of Term Bonds of the Series and the maturity for which such Sinking Account was established.

All money in the Principal Account shall be used and withdrawn by the State Treasurer solely for the purpose of paying the principal of the Series of Bonds for which such Principal Account was established as it shall become due and payable, except that any money in any Sinking Account will be used and withdrawn by the State Treasurer only to purchase or to redeem or to pay Term Bonds for which such Sinking Account was created; provided that the State Treasurer, upon the written request of the Board and upon receipt of such documentation as he may require shall withdraw from such Principal Account and pay to or upon order of the Board money sufficient to reimburse the Department for any Base Rental theretofore paid by the Department under the Lease or Leases relating to the Series of Bonds for which such Principal Account was established for that period of time during which the payment of Base Rental under such Lease or Leases is abated and for which no other money (including proceeds of rental interruption or use and occupancy insurance required by the Master Indenture as supplemented by the appropriate Supplemental Indenture and money in the Reserve Fund and in the Maintenance and Operation Account and in the Surplus Account) is available.

(c) *Reserve Fund.* On or before December 1 of each year, the State Treasurer shall set aside from each of the Revenue Funds created under the Master Indenture or an Incorporated Indenture and deposit in the Reserve Fund that amount of money which shall be required to maintain the Reserve Fund in the full amount of the Reserve Fund Requirement or such larger amount as shall be required to be maintained in the Reserve Fund by any Supplemental Indenture.

Notwithstanding any other provision of the Master Indenture, the amount required to be on deposit in the Reserve Fund shall not be less than the amount of the reserve account requirement for any series of Incorporated Bonds which has been transferred into the Reserve Fund. Notwithstanding the foregoing, there shall only be transferred to the Reserve Fund moneys from a Revenue Fund for a Series of Bonds or Incorporated Bonds if the State Treasurer had previously been required to make a transfer from the Reserve Fund to the Interest Account or Principal Account for that Series of Bonds or Incorporated Bonds. See "Reserve Fund" below.

(d) *Maintenance and Operation Account.* If at any time the Board shall operate any Facility, the State Treasurer, on or before May 15 and November 15 of each year, shall set aside from the Revenue Fund for the Series of Bonds used to finance the cost of such Facility, and deposit in the Maintenance and Operation Account all amounts which are estimated to be required to provide for all costs of maintenance and operation of such Facility during the next six months, including costs of repairs, replacements, labor costs and insurance; provided that no transfer will be made to the Maintenance and Operation Account to the extent there would be insufficient funds in the Revenue Fund after such transfer to make the necessary deposits to the Interest Account or Principal Account for such Series of Bonds during the current Bond Year.

All money in the Maintenance and Operation Account shall be disbursed by the State Treasurer only to pay such costs upon the written request of the Board; provided that the State Treasurer upon the written request of the Department and upon receipt of such documentation as he may require, shall withdraw from the Maintenance and Operation Account and pay to the Department money sufficient to reimburse the Department for any Base Rental theretofore paid by the Department under the Lease or Leases relating to the Series of Bonds for such Lease which such Maintenance and Operation Account was established for a period of time during which the payment of Base Rental under such Lease or Leases is abated and for which no other money (including proceeds of rental interruption or use and occupancy insurance which may be provided under the Supplemental Indenture and money in the Surplus Account) is available.

(e) *Surplus Account*. The State Treasurer, on or before the second Business Day following the end of each Bond Year for any Series of Bonds, will deposit in the Surplus Account all money remaining in the Revenue Fund to which such Surplus Account relates after making the deposits required by the Master Indenture to the Rebate Fund and to the Interest Account, Principal Account, Reserve Fund and Maintenance and Operation Account. On the second Business Day following the end of each Bond Year, the State Treasurer, if the Board is not then in default under the Master Indenture and if the Department is not then in default under the Lease or Leases relating to the Series of Bonds for which such Surplus Account was established, shall disburse the money in the Surplus Account to or upon the order of the Board, unless (1) the State Treasurer has not received the Base Rental due and payable in such year from the Department for deposit to the Revenue Fund, or (2) the State Treasurer, in his discretion, shall determine that any money in the Surplus Account is or will be required for the payment of the principal of or interest on such Series of Bonds on any succeeding Interest Payment Date (assuming for the purposes of such determination that the Department shall pay when due all future payments of Base Rental required by such Lease or Leases), or (3) the State Treasurer, in his discretion, shall determine that any money in the Surplus Account is or will be necessary to fund the amounts on deposit in the Reserve Fund up to an amount equal to the Reserve Fund Requirement, in which event such money shall be held in the Surplus Account for such purpose.

The Master Indenture also provides that, upon the written request of the Board and upon receipt of such documentation as the State Treasurer requires, the State Treasurer shall withdraw from the Surplus Account and pay to or upon the order of the Board that amount of money sufficient to reimburse the Department for any Base Rental theretofore paid by the Department under a Lease or Leases relating to the Series of Bonds for which the Surplus Account is established for a period of time during which the payment of the Base Rental under such Lease or Leases is abated and for which no other moneys, including proceeds of rental interruption or use and occupancy insurance which may be provided under the Supplemental Indenture, is available.

Reserve Fund

All moneys in the Reserve Fund shall be used and withdrawn by the State Treasurer for the purposes of (a) replenishing, *first*, any Interest Account under the Master Indenture or under any Incorporated Indenture or, *second*, any Principal Account under the Master Indenture or under any Incorporated Indenture in the event of any deficiency at any time in such account or (b) paying the principal of, redemption premium, if any, or interest on the Bonds of any Series or any Incorporated Bonds if no other money of the Board is lawfully available therefor (including upon acceleration of any Series of Bonds pursuant to the Master Indenture or acceleration of any Series of Incorporated Bonds pursuant to the respective Incorporated Indenture). If aggregate claims against the Reserve Fund payable on any day pursuant to the previous sentence exceed the amount then on deposit therein, then such amount in the Reserve Fund will be apportioned among each Series of Bonds (including Incorporated Bonds) in the proportion that the amount then on deposit in the Reserve Fund bears to the aggregate amount of all such claims for all such Series of Bonds (including Incorporated Bonds).

So long as the Board is not in default under the Master Indenture, any amount in the Reserve Fund in excess of the amount required to be on deposit therein may (but need not) be withdrawn from the Reserve Fund (in whole or in part) and deposited in any Revenue Fund or Construction Fund or any fund or account under an Incorporated Indenture, or otherwise disbursed, as directed by the Board; provided, that the State Treasurer, upon the written request of the Board and upon receipt of such documentation as he may require, shall withdraw from the Reserve Fund and pay to or upon order of the Board money sufficient to reimburse any Department for any

Base Rental theretofore paid by such Department under a Lease or Leases for a period of time during which the payment of Base Rental under such Lease or Leases is abated and for which no other money (including proceeds of rental interruption or use and occupancy insurance provided under any Supplemental Indenture or Incorporated Indenture and money in the Maintenance and Operation Account and in the Surplus Account) is available.

On or before December 1 of each year or at any other time after there has been any use of moneys in the Reserve Fund pursuant to the Master Indenture to replenish any Interest Account or Principal Account to pay debt service on Bonds or Incorporated Bonds or any Incorporated Bonds or Outstanding Bonds have been defeased, the State Treasurer shall determine the value of all amounts on deposit in the Reserve Fund, by determining the value of all Permitted Investments at their amortized cost (plus any accrued interest) and the value of all Reserve Fund Credit Facilities at their face value. If the State Treasurer determines that the value of amounts then on deposit in the Reserve Fund are less than the Reserve Fund Requirement, the State Treasurer shall promptly provide a written notification to the Board. All amounts on deposit in the Reserve Fund shall be invested in Permitted Investments maturing at such times as the State Treasurer, in his sole discretion, shall deem appropriate. If the Board receives a written notification from the State Treasurer pursuant to the Master Indenture, the Board shall use its best efforts to take such actions as may be necessary or appropriate in order to increase the amount on deposit in the Reserve Fund to the Reserve Fund Requirement by not later than the December 1 in the year following the year of receipt of such written notification either through the deposit of a Reserve Fund Credit Facility or a portion of the proceeds of an additional Series of Bonds or from the application of other lawfully available funds of the Board, or any combination of the foregoing, provided that the Legislature is not required to make any appropriation for this purpose but may do so. The Board is not required to provide for the financing of any facilities pursuant to the Master Indenture after the date of receipt of a notification of a deficiency in the Reserve Fund if the Board determines that another method of financing is more appropriate or cost effective.

On December 1 of each year the Board shall deliver to the State Treasurer and to each Rating Agency a certificate of the Board identifying all the Facilities then covered by all the Bonds and Incorporated Bonds then Outstanding which are secured by the Reserve Fund, and demonstrating the appropriate Reserve Fund Requirement and stating whether, as of such date, the Reserve Fund Requirement is being maintained.

In lieu of making a Reserve Fund deposit in compliance with the Master Indenture, or in replacement of moneys then on deposit in the Reserve Fund (which shall be transferred by the State Treasurer to any Revenue Fund as specified by written request of the Board), the Board may deliver to the State Treasurer a Reserve Fund Credit Facility securing an amount, plus moneys and Permitted Investments, on deposit in the Reserve Fund equal to the Reserve Fund Requirement. Such Reserve Fund Credit Facility shall have a term of no less than three years. At least one year prior to the stated expiration of a Reserve Fund Credit Facility, the Board is required to deliver to the State Treasurer a replacement Reserve Fund Credit Facility. Upon delivery of a replacement Reserve Fund Credit Facility, the State Treasurer will deliver the expiring Reserve Fund Credit Facility to or upon order of the Board. If the Board fails to deposit a replacement Reserve Fund Credit Facility with the State Treasurer, the Board must immediately seek an appropriation or otherwise obtain lawfully available funds in order to make quarterly deposits with the State Treasurer so that an amount equal to the Reserve Fund Requirement is on deposit in the Reserve Fund no later than the stated expiration date of the Reserve Fund Credit Facility. If a drawing is made on the Reserve Fund Credit Facility, the Board is required to make such payments as may be required by the terms of the Reserve Fund Credit Facility or any obligations related thereto (but no less than quarterly pro rata payments) so that the Reserve Fund Credit Facility shall, absent the deposit in the Reserve Fund of an amount sufficient to increase the balance in the Reserve Fund to the Reserve Fund Requirement, be reinstated in the amount of such drawing within one year of the date of such drawing.

Investment of Money in Funds and Accounts

Money in any fund or account established under the Master Indenture will be invested in Permitted Investments unless otherwise provided in a Supplemental Indenture. Subject to the provisions of the Master Indenture governing the Rebate Fund and any Supplemental Indenture, all interest or profits from the funds and accounts relating to a Series of Bonds and received prior to completion of the Facility or Facilities financed by such Series of Bonds may be deposited in the account for such Series within the Construction Fund (as specified in a written request of the Board) and thereafter all interest or profits will be deposited in the Revenue Fund for such Series of Bonds.

Covenants of the Board

The Master Indenture contains covenants of the Board with respect to the Bonds and the Facilities. Certain of these covenants follow. Reference is made to the full Master Indenture for a complete text of such covenants.

Punctual Payment and Performance. The Board will punctually pay the principal of, redemption premium, if any, and interest to become due on every Bond issued under the Master Indenture in strict conformity with the terms of the Master Indenture and of the Bonds, and will faithfully observe and perform all of the agreements and covenants contained in the Master Indenture and in the Bonds.

Against Encumbrances. The Board will not make any pledge of or place or permit to be placed any charge or lien upon any of the Facilities or any part thereof or upon the Revenues except as provided in the Master Indenture or in a Supplemental Indenture, and will not issue any bonds, notes or obligations payable from the Revenues or secured by a pledge of or charge or lien upon the Revenues except the Bonds and any Related Series of Bonds.

Against Sale or Other Disposition of the Facilities. The Board will not sell or otherwise dispose of any of the Facilities or any part thereof essential to their proper operation or the maintenance of the Revenues. The Board will not enter into any agreement which impairs the operation any of the Facilities or any part thereof necessary to secure adequate Revenues for the payment of the interest on, principal of, and redemption premiums, if any, on any of the Bonds and any Related Series of Bonds, or which would otherwise impair the rights of the Holders with respect to the Revenues or the operation of the Facilities. Any real or personal property constituting part of a Facility which has become nonoperative or which is not needed for the efficient and proper operation of a Facility or any material or equipment constituting part of a Facility which has become worn out may be sold at not less than the market value thereof if such sale will not reduce the Revenues related to such Facility and if the net proceeds of such sale are treated as Revenues and applied in a manner provided in the Master Indenture.

Tax Covenants, Rebate Fund. The State Treasurer shall establish and maintain a fund separate from any other fund or account established and maintained under the Master Indenture designated as the Series I Rebate Fund (the "Rebate Fund"). The State Treasurer is to create within the Rebate Fund a separate account for each Series of Bonds issued under the Master Indenture. There shall be deposited in each such account of the Rebate Fund such amounts as are required to be deposited therein pursuant to the applicable Tax Certificate related to such Series of Bonds. All money at any time deposited in the Rebate Fund shall be held by the State Treasurer in trust to the extent required to satisfy the Rebate Requirement (as defined in the Tax Certificate for each Series of Bonds), for payment to the United States of America and will not be pledged to payment of principal of or interest or redemption premium, if any, on any of the Bonds.

The Master Indenture requires that the Board and the State Treasurer not use or permit the use of any proceeds of the Bonds or any funds of the Board, directly or indirectly, in any manner, and not take or omit to take any action that would cause any of the Bonds to be treated as an obligation not described in Section 103(a) of the Internal Revenue Code (the "Code"). The Board and the State Treasurer specifically covenant to comply with the provisions and procedures of the Tax Certificates. If the Board shall provide to the State Treasurer an Opinion of Counsel to the effect that any specified action required under the Master Indenture is no longer required or that some further or different action is required to maintain the exclusion from gross income for federal income tax purposes of interest on the Bonds of any Series, the State Treasurer and the Board may conclusively rely on such opinion in complying with the requirements of the Master Indenture, and the covenants in the Master Indenture concerning compliance with the Code shall be deemed to be modified to that extent.

Maintenance and Operation of the Facilities. The Board will maintain and preserve or cause the Facilities to be maintained and preserved in good order, condition, and repair at all times and will operate or cause the Facilities to be operated in an efficient and economical manner as required by the Act.

Insurance. The following provisions shall apply only to Bonds issued pursuant to the Master Indenture and not to any Incorporated Bonds.

The Board will maintain or cause to be maintained all insurance coverage required under each Supplemental Indenture or each Lease. Each such policy of insurance must be in form reasonably satisfactory to the Board and must contain a clause making all losses payable to the Board, the State Treasurer, and the party providing such insurance, as their interests may appear, and all proceeds thereof shall be paid over to the party contractually responsible for making repairs of casualty damage or to the Board to redeem Bonds as provided in the Master Indenture.

Unless otherwise provided in a Supplemental Indenture, in the event of any damage to or destruction of a Facility caused by the perils covered by such insurance, the proceeds of such insurance will be utilized, in the discretion of the Board either (i) to redeem the Outstanding Series of Bonds (to which the damaged Facility or Facilities relates) to the extent possible, but only if the Base Rental due after such a redemption would be sufficient to pay the debt service on such Series of Bonds then remaining Outstanding in accordance with their terms, or (ii) to repair, reconstruct, or replace the Facility to the end that the Facility shall be restored to at least the same condition that it was in prior to such damage or destruction. If the Board so elects to repair, reconstruct, or replace the Facility, it shall do so with all practicable dispatch in an expeditious manner and in conformity with the law so as to complete the same as soon as possible. Any balance of such proceeds not required for such repair, reconstruction, or replacement shall be transferred to the Board and treated as Revenues and applied in the manner provided in the Master Indenture.

The Board will deliver or cause to be delivered to the State Treasurer during the month of July in each year a schedule, in such detail as the State Treasurer in his discretion may request, setting forth the insurance policies then in force pursuant to the Master Indenture and each Supplemental Indenture, the names of the insurers which have issued the policies, the amounts thereof, and the property and risks covered thereby. Each such insurance policy must require that the State Treasurer be given thirty (30) days' notice of any intended cancellation thereof or reduction of the coverage provided thereby. Delivery to the State Treasurer of the schedule of insurance policies under these provisions shall not confer responsibility upon the State Treasurer as to the sufficiency of coverage or amounts of such policies.

Unless otherwise provided in a Supplemental Indenture, as an alternative to providing any public liability and property damage insurance required by a Supplemental Indenture, the Board may cause to be provided other kinds of insurance or methods or plans of protection if and to the extent such other kinds of insurance or methods or plans of protection shall afford reasonable protection to the Board and the State Treasurer and the officers, agents, and employees of each, in light of all circumstances giving consideration to cost, availability, and plans or methods of protection adopted by other governmental entities of and within the State.

Eminent Domain. If the whole or any portion of any Facility is taken by eminent domain proceedings (or sold to a government threatening to exercise the power of eminent domain), the proceeds therefrom are required to be deposited with the State Treasurer in a special fund in trust and applied and disbursed by the State Treasurer as follows:

(a) If less than the entire Facility shall have been so taken and the remainder is usable for purposes substantially similar to those for which it was constructed, and if the portion taken is replaced by a facility of equal or greater utility and of equal or greater fair rental value within or adjacent to such remainder, the State Treasurer will disburse such proceeds to the party that incurred the expense of making such replacement; but if no such replacement is made, the State Treasurer will apply such proceeds to redeem all or a portion of that Series of Bonds relating to such Facility pursuant to the Master Indenture and the Supplemental Indenture relating to such Series of Bonds.

(b) If less than the entire Facility shall have been so taken and the remainder is not usable for purposes substantially similar to those for which it was constructed, or if the entire Facility shall have been so taken, the State Treasurer will apply such proceeds, together with any other money then available to him for such purpose, for the payment of the entire amount of principal then due or to become due upon all of that Series of Outstanding Bonds relating to such Facility, together with the interest thereon so as to enable the Board to retire all of the Bonds then Outstanding by redemption or by payment at maturity; except that if such proceeds, together with any other money then lawfully available to it for such purpose, are insufficient to provide for the foregoing purpose, the State Treasurer will apply such proceeds in accordance with the Master Indenture so far as the same may be applicable.

The proceeds of eminent domain proceedings with respect to a Facility related to any Incorporated Bonds will be governed by the provisions of the Incorporated Indenture.

Leases. The Board will at all times maintain and vigorously enforce all its rights under the Leases and will promptly collect all rents and charges due for the use and occupancy of the Facilities as the same become due under the Leases, and will promptly and vigorously enforce its rights against any tenant or other person who does not pay such rents or charges as they become due under the Leases. The Board will not permit anything to be done or omit to do anything where such act or omission would or might be a ground for cancellation or termination of any Lease by the lessee thereunder. The Board may only agree to alter or modify a Lease with the written consent of the State Treasurer, who shall give such consent only if (i) in his opinion, such alterations or modifications will not result in any material impairment of the security given for the payment of the Series of Bonds related to such Lease, or (ii) the State Treasurer first obtains the consent of the Holders of at least sixty percent (60%) in aggregate principal amount of the Series of Bonds then Outstanding to such alterations or modifications in the Lease(s) relating to such Series of Bonds, exclusive of Bonds disqualified in accordance with the Master Indenture; or (iii) such alterations or modifications will facilitate the refunding or defeasance of any of the Bonds; provided that no such alterations or modifications shall materially alter or impair the obligation of the Board to pay the principal of, redemption premium, if any, or interest on any Bonds without the written consent of the Holders of all such Bonds so affected.

Prosecution and Defense of Suits. The Board will promptly, upon the request of the State Treasurer, from time to time take or cause to be taken such action as may be necessary or proper to remedy or cure any defect in or cloud upon the title to the Facilities, and will prosecute or cause to be prosecuted all such suits, actions and other proceedings as may be appropriate for such purpose and shall indemnify and hold the State Treasurer harmless from all loss, cost, damage and expense, including attorney's fees, which he may incur by reason of any such defect, cloud, suit, action or proceeding.

Amendments

The Master Indenture and the rights and obligations of the Board and of the Holders of the Bonds of any Series may be amended at any time by a Supplemental Indenture. Such amendments will become binding when the written consent of the Holders of 60% in aggregate principal amount of the Bonds of such Series then Outstanding, exclusive of Bonds disqualified as provided in the Master Indenture, are filed with the State Treasurer. No such amendment shall (1) extend the maturity of or reduce the interest rate on or otherwise alter or impair the obligation of the Board to pay the interest on, principal of, or redemption premium, if any, on any Bond at the time and place and at the rate and in the currency provided in the Master Indenture without the express written consent of the Holder of such Bond, or (2) permit the creation by the Board of any pledge of or charge or lien upon the Revenues or Reserve Fund as provided in the Master Indenture superior to or on a parity with the pledge, charge and lien created by the Master Indenture for the benefit of the Bonds of the affected Series, or (3) reduce the percentage of Bonds required for the written consent to any such amendment, or (4) modify any rights or obligations of the State Treasurer without his prior written assent thereto.

If any amendment shall not materially adversely affect the interest of the Holders and the holders of any Incorporated Bonds, then the Master Indenture and the rights and obligations of the Board and of the Holders may also be amended at any time by a Supplemental Indenture which will become binding upon execution and delivery thereof without the consent of any Holders, but only to the extent permitted by law and after receipt of an approving Opinion of Counsel and only for any one or more of the following purposes:

(a) to add to the agreements and covenants required in the Master Indenture to be performed by the Board other agreements thereafter to be performed by the Board, or to surrender any right or power reserved to or conferred on the Board in the Master Indenture;

(b) to make such provisions for the purpose of curing any ambiguity, inconsistency or omission, or of correcting, curing, or supplementing any defective provision contained in the Master Indenture or in regard to questions arising under the Master Indenture which the Board may deem desirable or necessary and not inconsistent with the Master Indenture;

(c) to provide for the issuance of any Series of Bonds and to provide the terms of such Series of Bonds and the funds and accounts therefor, subject to the conditions and upon compliance with the procedure set forth in the Master Indenture;

(d) to modify the book-entry provisions of the Master Indenture or to allow for a substitute depository;

(e) to facilitate the refunding or defeasance of any of the Bonds pursuant to the Master Indenture;

(f) to provide for compliance with any future laws or regulations concerning provision of financial information or other notices to Bondholders;

(g) to facilitate the obtaining of any insurance policy or letter of credit securing any Series of Bonds;

(h) to obtain or maintain a rating on any Series of Bonds from a Rating Agency;

(i) to modify, amend or supplement the Master Indenture in such manner as to permit the qualification thereof 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;

(j) to provide any additional procedures, covenants, or agreements to maintain the exclusion from gross income for federal income tax purposes of the interest on the Bonds, including the amendment of any Tax Certificate; or

(k) to modify, amend, or supplement the Master Indenture to allow for the appointment of a successor trustee.

Events of Default

Except as otherwise provided in a Supplemental Indenture, the following events shall be events of default under the Master Indenture with respect to a particular Series of Bonds:

(1) default in the due and punctual payment of the interest on any Bond of such Series when and as the same shall become due and payable; or

(2) default in the due and punctual payment of the principal of or redemption premium, if any, on any Bond of such Series when and as the same shall become due and payable, whether at maturity or by redemption;

The following events shall be events of default with respect to all Outstanding Bonds:

(1) default by the Board in the performance of any of the other agreements or covenants required in the Master Indenture to be performed by the Board, and such default shall have continued for a period of 60 days after the Board shall have been given notice in writing of such default by the State Treasurer; or

(2) the filing by the Board of a petition or answer seeking arrangement or reorganization under the federal bankruptcy laws or any other applicable law of the United States of America or any state therein, or the approval by a court of competent jurisdiction of a petition filed with or without the consent of the Board seeking arrangement or reorganization under the federal bankruptcy laws or any other applicable law of the United States of America or any state therein, or the assumption under the provisions of any other law for the relief or aid of debtors by any court of competent jurisdiction of custody or control of the Board or of the whole or any substantial part of its property.

Acceleration of Maturities

If an Event of Default has occurred and is continuing, the State Treasurer may, and upon the written request of the Holders of not less than 25% in aggregate principal amount of the affected Series of Bonds then Outstanding shall, by notice in writing to the Board, declare the principal of all Bonds of such Series then Outstanding and the interest accrued thereon to be due and payable immediately, and upon any such declaration the same shall become due and payable.

This provision, however, is subject to the following conditions: if, (i) at any time after the principal of the affected Series of Bonds then Outstanding shall have been so declared due and payable and before any judgment or decree for the payment of the money due shall have been obtained or entered, and (ii) if each of the following conditions has occurred or will occur: (a) the Board shall deposit with the State Treasurer a sum sufficient to pay all matured interest on all the affected Series of Bonds and all principal of such Bonds matured prior to such declaration, with interest at the rate borne by such Bonds on such overdue interest and principal, and the reasonable expenses of the State Treasurer, and (b) any and all other defaults known to the State Treasurer (other than in the payment of interest on and principal of the Bonds due and payable solely by reason of such declaration) shall have been made good or cured to the satisfaction of the State Treasurer or provision deemed by the State Treasurer to be adequate shall have been made therefor, then and in every such case the Holders of not less than 25% in aggregate principal amount of such affected Series of Bonds then Outstanding, by written notice to the Board and to the State Treasurer, may on behalf of the Holders of all the Bonds then Outstanding rescind and annul such declaration and its consequences; but no such rescission and annulment will extend to or will affect any subsequent default or will impair or exhaust any right or power consequent thereon.

Application of Funds Upon Acceleration

All moneys in the accounts, subaccounts, and funds established under the Master Indenture that relate to such a Series of Bonds for which an event of default has occurred, and moneys available in the Reserve Fund, upon the date of the declaration of acceleration by the State Treasurer following an event of default and all Revenues relating to such Series of Bonds (other than Revenues on deposit in the Rebate Fund) thereafter received by the Board will be transmitted to the State Treasurer and will be applied by the State Treasurer in the following order:

First, to the payment of the costs and expenses of the Holders in providing for the declaration of such event of default, including reasonable compensation to their accountants and counsel, and to the payment of the costs and expenses of the State Treasurer, if any, in carrying out the provisions of the Master Indenture, including reasonable compensation to his accountants and counsel; and

Second, upon presentation of the several Bonds, and the stamping thereon of the amount of the payment if only partially paid or upon the surrender thereof if fully paid, to the payment of the whole amount then owing and unpaid upon the Bonds for interest and principal, with interest on the overdue interest and principal at the rate borne by such Bonds, and in case such money is insufficient to pay in full the whole amount so owing and unpaid upon the Bonds, then to the payment of such interest, principal, and interest on overdue interest and principal without preference or priority among such interest, principal, and interest on overdue interest and principal ratably to the aggregate of such interest, principal, and interest on overdue interest and principal.

Other Remedies of Holders

Any Holder shall have the right for the equal benefit and protection of all Holders similarly situated:

(a) by mandamus or other suit or proceeding at law or in equity to enforce his or her rights against the Board or any member, officer, or employee of the Board, and to compel the Board or any such member, officer, or employee to perform and carry out their duties under the Act and the agreements and covenants with the Holders contained in the Master Indenture;

(b) by suit in equity to enjoin any acts or things which are unlawful or violate the rights of the Holders; or

(c) by suit in equity upon the happening of an event of default to require the Board and its members, officers, and employees to account as the trustee of an express trust.

Remedies Not Exclusive

No remedy in the Master Indenture conferred upon or reserved to the Holders or the State Treasurer is intended to be exclusive of any other remedy, and each such remedy is cumulative and is in addition to every other remedy given under the Master Indenture or now or hereafter existing at law or in equity or by statute or otherwise and may be exercised without exhausting and without regard to any other remedy conferred by the Act or any other law, including the rights and remedies conferred pursuant to Section 15841 of the California Government Code.

Defeasance

If the Board shall pay or cause to be paid or there shall otherwise be paid to the Holders of all Outstanding Bonds of any Series the principal of, interest on, and redemption premium, if any, on the Bonds at the times and in the manner provided in the Master Indenture and in the Bonds, then the Holders of the Bonds will cease to be entitled to the pledge of and charge and lien upon the Revenues as provided in the Master Indenture, and the agreements, covenants, and other obligations of the Board to the Holders of such Bonds under the Master Indenture will cease, terminate, and become void, discharged, and satisfied; provided however, that the following agreements, covenants, and obligations shall not be discharged and satisfied until such Bonds are paid in full: (i) the obligation of the State Treasurer to pay or cause to be paid to the Holders of the Bonds of such Series all sums due with respect to the Bonds of such Series from such moneys or investments that may have been set aside for such purposes in accordance with the Master Indenture; (ii) the obligation of the State Treasurer to register, transfer, and exchange Bonds pursuant to the Master Indenture; (iii) the obligation of the Board to pay the amounts owing to the State Treasurer under the Master Indenture; and (iv) the obligation of the Board to comply with the tax covenants contained in the Master Indenture. If the Board shall discharge the Bonds of any Series as previously described, the State Treasurer will execute and deliver to the Board all such instruments as may be necessary or desirable to evidence such discharge and satisfaction, and the State Treasurer will pay over or deliver to the Board all money or securities held by him pursuant to the Master Indenture which are not required for the payment of the interest on and principal of and redemption premium, if any, on the Bonds.

Any Outstanding Bonds of any Series will, prior to the maturity date or redemption date thereof, be deemed to have been paid within the meaning of and with the effect expressed in the preceding paragraph if, in addition to other requirements, in the case of such Bonds to be redeemed prior to maturity, the Board shall have given to the State Treasurer irrevocable instructions to mail a notice of redemption of such Bonds and there shall have been deposited with the State Treasurer either (1) money in an amount which shall be sufficient and/or (2) Permitted Investments of the type described in clause (i) or clause (ii) of the definition of Permitted Investments and which are not subject to redemption prior to maturity except by the holder thereof (including any such Permitted Investments issued or held in book-entry form on the books of the Department of the U.S. Treasury) or tax-exempt securities rated AAA or its equivalent by a Rating Agency, the interest and principal of which when paid will provide money which, together with the money, if any, deposited with the State Treasurer at the same time, shall 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 redemption premium, if any, on such Bonds.

C. THE FIFTY-FIRST SUPPLEMENTAL INDENTURE

The provisions of the Fifty-First Supplemental Indenture (relating to the 2004D Bonds) are briefly summarized in the herein.

Creation of Subaccounts

Pursuant to the Fifty-First Supplemental Indenture, there will be created accounts or subaccounts relating to the 2004D Bonds in the following funds and accounts created under the Master Indenture: Construction Fund, including the Costs of Issuance Account therein, Revenue Fund, including the Interest Account, Principal Account, Maintenance and Operation Account, and Surplus Account therein, and Rebate Fund.

Pledge of Revenues for the 2004D Bonds; Payment Dates

The 2004D Bonds are secured by a first pledge of and charge and lien upon the Coalinga Revenues generated by the Coalinga Facility Lease, equally with any Related Series of Bonds, and a first pledge of amounts on deposit in the funds and accounts established under the 2004D Indenture or the indenture for a Related Series of Bonds (other than amounts on deposit in the Rebate Fund) and a pledge of the Reserve Fund. All such moneys are irrevocably pledged to the payment of the principal of, interest on, and redemption premium, if any, on the 2004D Bonds. The pledge made in the 2004D Indenture shall constitute a first pledge of and charge and lien upon the Coalinga Revenues and amounts on deposit in the funds and accounts established pursuant to the Fifty-First Supplemental Indenture (except the Rebate Fund), equally for the benefit of all 2004D Bonds Outstanding and shall constitute an equal pledge on the Reserve Fund along with all other Bonds and Incorporated Bonds Outstanding.

If an Interest Payment Date or other date on which interest or principal on the 2004D Bonds is due falls on a day that is not a Business Day, payment shall be made on the next succeeding Business Day and no additional interest shall accrue on the 2004D Bonds for the period after the date on which such interest or principal was due.

Insurance

The Board has covenanted to maintain or cause to be maintained fire, lightning and extended coverage insurance on the Coalinga Facility and rental interruption and use and occupancy insurance of the type required by the Coalinga Facility Lease. See "THE FACILITY LEASES – Insurance" below.

In the event that the Board or Corrections receives any proceeds of any fire, lightning and extended coverage insurance, or in the event that the Board or Corrections receives any title insurance proceeds related to the Coalinga Facility, the proceeds of such insurance shall be utilized, in the discretion of the Board, either (i) to redeem the outstanding 2004D Bonds, to the extent possible and in accordance with the provisions of the 2004D Indenture, but only if the Base Rental payments due after such redemption would be sufficient to retire the 2004D Bonds then outstanding in accordance with their terms, or (ii) to repair, reconstruct or replace the Coalinga Facility to the end that the Coalinga Facility shall be restored to at least the same condition that it was in prior to such damage or destruction. If the Board so elects to repair, reconstruct or replace the Coalinga Facility, it will do so with all practicable dispatch in an expeditious manner and in conformity with the law so as to replace the same as soon as possible. Any balance of such proceeds not required for such repair, reconstruction or replacement shall be transferred to the Board and treated as Revenues and applied in the manner provided in the 2004D Indenture.

Bond Insurance Provisions

Under the Fifty-First Supplemental Indenture, the Bond Insurer has certain rights with respect to the 2004D Insured Bonds, including rights to consent to or require actions under some circumstances and rights to notices and information. The Indenture provides that the Bond Insurer shall at all times be deemed the exclusive owner of the 2004D Insured Bonds for the purposes of exercising all rights and privileges and for all approvals, consents, waivers or the institution of any action required of the Holders of the 2004D Insured Bonds. Upon the occurrence and continuance of an event of default with respect to the 2004D Insured Bonds, the Bond Insurer is entitled to control and direct the enforcement of all rights and remedies granted to the Holders of the 2004D Insured Bonds under the Indenture or the State Treasurer for the benefit of the Holders of the 2004D Insured Bonds under the Indenture, including, without limitation: (i) the right to accelerate the principal of the 2004D Insured Bonds and (ii) the right to annul any declaration of acceleration of the 2004D Insured Bonds and to approve all waivers of events of default with respect to the 2004D Insured Bonds; provided, however, that the Bond Insurer shall have no greater rights upon the occurrence and continuance of an event of default with respect to the 2004D Bonds than it would have if it were the holder of all of the 2004D Insured Bonds then outstanding.

D. THE COALINGA TRANSFER AGREEMENT

The Coalinga Transfer Agreement is being entered into with respect to the Coalinga Site. Under the terms of the Coalinga Transfer Agreement, the Department transfers to the Board control and possession of the Coalinga Site. Once control and possession has vested in the Board pursuant to the Coalinga Transfer Agreement, the Board possesses a real estate interest in the Coalinga Site, which then enables it to lease the Coalinga Facility to the Department pursuant to the terms of the Coalinga Facility Lease.

Term

The term of the Coalinga Transfer Agreement shall commence on the date of issuance of the 2004D Bonds and shall end on December 1, 2019, unless such term is extended or sooner terminated as hereinafter provided. If on December 1, 2019 any Bonds or other indebtedness of the Board incurred to pay for the Coalinga Project shall not be fully paid and retired, then the term of the Coalinga Transfer Agreement shall be extended until ten (10) days after all Bonds and other indebtedness of the Board incurred for such purposes shall be fully paid and retired, except that the term of the Coalinga Transfer Agreement shall in no event be extended beyond December 1, 2029. If prior to December 1, 2029, all Bonds and other indebtedness of the Board incurred to pay for the Project shall be fully paid and retired, the term of the Coalinga Transfer Agreement shall end ten (10) days thereafter.

Amendment

The Coalinga Transfer Agreement may only be amended by a written instrument duly authorized and executed by the Department and the Board; provided, however, that no such amendment shall materially adversely affect the owners of the Coalinga Bonds.

II. SUMMARY OF LEGAL DOCUMENTS APPLICABLE ONLY TO 2004E BONDS

A. DEFINITIONS APPLICABLE TO 2004E BONDS

The following terms are defined in the 2004E Indenture and, in certain cases, used in the body of the Official Statement and have the meanings set forth below:

"Act" means the State Building Construction Act of 1955 (being Part 10b of Division 3 of Title 2 of the California Government Code, as amended), and all laws amendatory thereof or supplemental thereto.

"Additional Bonds" means all lease revenue bonds of the Board authorized by and at any time Outstanding pursuant to the Indenture and executed, issued and delivered in accordance with the 2004E Indenture.

"Annual Debt Service" means, for any Fiscal Year, the sum of (1) the interest (including any compound interest) payable on all Outstanding Bonds in such Fiscal Year, assuming that all Outstanding Serial Bonds are retired as scheduled and that all Outstanding Term Bonds are redeemed or paid from sinking account payments as scheduled (except to the extent that such interest is to be paid from the proceeds of sale of any Bonds), (2) the principal amount of all Outstanding Serial Bonds maturing by their terms in such Fiscal Year, and (3) the principal amount of all Outstanding Term Bonds required to be redeemed or paid in such Fiscal Year (together with the redemption premium, if any, thereon).

"Authorized Denominations" means $5,000 and any integral multiple thereof, or any other amount specified in the Supplemental Indenture authorizing the issuance thereof.

"Base Rental" means all amounts received by the Board from the Department as base rental payments pursuant to the Susanville Facility Lease to be used to pay the interest on and principal of the Bonds.

"Board" means the State Public Works Board of the State of California, an entity of state government duly organized and validly existing under and pursuant to Chapter 2 of Part 10.5 of Division 3 of Title 2 of the California Government Code.

"Bond Insurer" means XL Capital Assurance Inc., a New York stock insurance company, or any successor thereto or assignee thereof.

"Bonds" means the 1993D Susanville Bonds, the 2001 Series A Bonds, the 2004E Bonds and all Additional Bonds authorized by and at any time Outstanding pursuant to the Indenture.

"Business Day" means a day of the year other than a Saturday or Sunday or a day on which State of California offices or banking institutions located in the State are required or authorized to remain closed.

"Certificate of the Board" means an instrument in writing signed by the Chair or the Administrative Secretary or Assistant Administrative Secretary of the Board, or by any other officer of the Board duly authorized by the Board for that purpose.

"Construction Fund" means the "California State Prison – Lassen County, Susanville Construction Fund" established pursuant to the Indenture.

"Continuing Disclosure Agreement" means that certain Continuing Disclosure Agreement among the Board, the Department and the State Treasurer dated the date of issuance and delivery of the 2004E Bonds.

"Department" means the Department of Corrections of the State of California, a department within the Youth and Adult Correctional Agency of the State of California.

"Financial Newspaper" means The Wall Street Journal or The Bond Buyer or any other newspaper or journal printed in the English language publishing financial news and selected by the State Treasurer, whose decision shall be final and conclusive.

"Fiscal Year" means the twelve-month period terminating on June 30 of each year, or any other annual accounting period selected and designated by the Board as its Fiscal Year in accordance with applicable law.

"Holder" or "Bondholder" means any person who shall be the registered owner of any Outstanding Bond.

"Incorporated Bonds" means any series of lease revenue bonds of the Board issued other than pursuant to the Master Indenture, which the Board has elected to be secured by the Reserve Fund.

"Indenture" means the Indenture, dated as of October 1, 2002, between the Board and the State Treasurer, as originally executed and as it may from time to time be amended or supplemented by all Supplemental Indentures executed pursuant to the provisions thereof.

"Independent Certified Public Accountant" means any certified public accountant or firm of such accountants duly licensed and entitled to practice and practicing as such under the laws of the State, appointed and paid by the Board and satisfactory to and approved by the State Treasurer (who shall be under no liability by reason of such approval), and who, or each of whom --

(1) is in fact independent and not under the domination of the Board;

(2) does not have a substantial financial interest, direct or indirect, in the operations of the Board; and

(3) is not connected with the Board as a member, officer or employee of the Board, but who may be regularly retained to audit the accounting records of and make reports thereon to the Board.

"Information Services" means one or more services designated in the Indenture which provide information with respect to called bonds, or such services as the Board may designate in a Certificate of the Board delivered to the State Treasurer.

"Interest Account" means the account by that name established pursuant to the Indenture.

"Interest Payment Date" means, as long as any of the Bonds are Outstanding, June 1, 2004 and each December 1 and June 1 thereafter.

"Interim Loan" means the loan from the Pooled Money Investment Account, the proceeds of which were applied to the design, installation or construction of the Project.

"Maintenance and Operation Account" means any account by that name established pursuant to the Indenture.

"Master Indenture" means the indenture, dated as of April 1, 1994, between the Board and the State Treasurer, as originally executed and as it may from time to time be amended or supplemented by all supplemental indentures executed pursuant to the provisions thereof.

"1993D Susanville Bonds" means the Board's Lease Revenue Bonds (Department of Corrections) 1993 Series D (California State Prison – Lassen County, Susanville).

"Opinion of Counsel" means a written opinion of counsel of recognized national standing in the field of law relating to municipal bonds, appointed and paid by the Board and satisfactory to and approved by the State Treasurer (who shall be under no liability by reason of such approval).

"Outstanding," when used as of any particular time with reference to Bonds, means (subject to the provisions of the Indenture) all Bonds except --

(1) Bonds theretofore cancelled by the State Treasurer or surrendered to the State Treasurer for cancellation;

(2) Bonds paid or deemed to have been paid within the meaning of the Indenture; and

(3) Bonds in lieu of or in substitution for which other Bonds shall have been executed, issued and delivered by the Board pursuant to the Indenture.

"Permitted Investments" means any of the following which at the time are legal investments under the laws of the State for moneys held under the Indenture and then proposed to be invested therein:

(a) bonds or interest-bearing notes or obligations of the United States, or those for which the faith and credit of the United States are pledged for the payment of principal and interest;

(b) bonds or interest-bearing notes or obligations that are guaranteed as to principal and interest by a federal agency of the United States;

(c) bonds of the State or bonds for which the faith and credit of the State are pledged for the payment of principal and interest;

(d) bonds or warrants, including but not limited to revenue warrants, of any county, city, metropolitan water district, California water district, California water storage district, irrigation district in the State, municipal utility district or school district of the State;

(e) bonds, consolidated bonds, collateral trust debentures, consolidated debentures or other obligations issued by general land banks or federal intermediate credit banks established under the Federal Farm Loan Act, as amended, debentures and consolidated debentures issued by the Central Bank for Cooperatives and banks for cooperatives established under the Farm Credit Act of 1933, as amended, bonds or debentures of the Federal Home Loan Bank Board established under the Federal Home Loan Bank Act, stocks, bonds, debentures and other obligations of the Federal National Mortgage Association established under the National Housing Act, as amended, and the bonds of any federal home loan bank established under said act, obligations of the Federal Home Loan Mortgage Corporation, and bonds, notes and other obligations issued by the Tennessee Valley Authority under the Tennessee Valley Authority Act, as amended;

(f) commercial paper rated within the top rating designation by a nationally recognized rating agency and issued by corporations (1) organized and operating within the United States, (2) having total assets in excess of $500,000,000 and (3) approved by the Pooled Money Investment Board, provided, however that eligible commercial paper may not exceed 180 days' maturity, represent more than 10 percent of the outstanding paper of an issuing corporation nor exceed 30 percent of the resources of an investment program, and that at the request of the Pooled Money Investment Board, such investment shall be secured by the issuer by depositing with the State Treasurer securities authorized by Section 53651 of the California Government Code of a market value of at least 10 percent in excess of the amount of the State's investment;

(g) bills of exchange or time drafts drawn on and accepted by a commercial bank the general obligations of which are rated within the top two rating categories by a nationally recognized rating agency, otherwise known as banker's acceptances, which are eligible for purchase by the Federal Reserve System;

(h) negotiable certificates of deposit issued by a nationally or state-chartered bank or savings and loan association or by a state-licensed branch of a foreign bank which, to the extent they are not insured by federal deposit insurance, are issued by an institution the general obligations of which are rated in one of the top two rating categories by a nationally recognized rating agency;

(i) bonds, debentures and notes issued by corporations organized and operating within the United States which securities are rated in one of the top two rating categories by a nationally recognized rating agency;

(j) interest-bearing accounts in state or national banks or in state or federal savings and loan associations having principal offices in the State, the deposits of which shall be secured at all times and in the same manner as state moneys are by law required to be secured;

(k) deposits in the Surplus Money Investment Fund referred to in Section 15487 of the California Government Code;

(l) repurchase agreements or reverse repurchase agreements, as such terms are defined in and pursuant to the terms of Section 16480.4 of the California Government Code;

(m) collateralized or uncollateralized investment agreements or other contractual arrangements with corporations, financial institutions or national associations within the United States, provided that the senior long-term debt of such corporations, institutions or associations is rated within the top two rating categories by a nationally recognized rating agency; or

(n) money market funds that invest solely in obligations described in clause (a) of this definition.

"Policy" means the municipal bond insurance policy issued by the Bond Insurer insuring the payment of the principal of and interest on the 2004E Insured Bonds.

"Principal Account" means any account by that name established pursuant to the Indenture. Within the Principal Account, the State Treasurer shall establish and maintain: (a) a Principal Subaccount, and (b) a separate subaccount for the Term Bonds of each series and maturity designated as provided in the Indenture.

"Rebate Fund" means the fund by that name established pursuant to the Indenture.

"Reserve Fund" means the fund by that name established pursuant to the Master Indenture.

"Revenue Fund" means any fund by that name established pursuant to the Indenture.

"Revenues" means certain proceeds of the Bonds deposited in the Interest Account, all Base Rental payments received by the Board pursuant to the Susanville Facility Lease and all other benefits, charges, income, proceeds, profits, receipts, rents, proceeds of insurance and revenues derived by the Board from the ownership, operation or use of the Susanville Facility, including interest or profits from the investment of money in any account or fund (other than the Rebate Fund) pursuant to the Indenture.

"Securities Depositories" means: The Depository Trust Company, 711 Stewart Avenue, Garden City, New York 11530, Fax-(516) 227-4039 or 4190, and such other securities depositories as the Board may designate from time to time.

"State" means the State of California.

"State Treasurer" means the Treasurer of the State of California at his office in Sacramento, California, appointed by the Board in the Indenture and acting as an independent trustee and fiscal agent with the rights and obligations provided in the Indenture, and his successors and assigns, or any other association or corporation which may at any time be substituted in his place as provided in the Indenture.

"Supplemental Indenture" means any indenture then in full force and effect which has been duly executed and delivered by the Board and the State Treasurer amendatory of or supplemental to the Indenture; but only if and to the extent that such Supplemental Indenture is specifically authorized under the Indenture.

"Surplus Account" means the account by that name established pursuant to the Indenture.

"Susanville Facility" means the Susanville Project and the Susanville Site.

"Susanville Facility Lease" means that certain lease of the Susanville Facility described therein originally executed October 1, 1993, as amended by a First Amendment to Facility Lease, dated as of March 1, 2001, and by a Second Amendment to Facility Lease, dated as of March 1, 2002, and by a Third Amendment to Facility Lease, dated as of April 1, 2004, each entered into between the Board as lessor and the Department as lessee, and as it may from time to time be further amended or supplemented pursuant to the provisions hereof and thereof.

"Susanville Project" means all of the buildings, structures, equipment and other facilities and related improvements and certain incidental facilities constructed on the Susanville Site, as more particularly described in Exhibit B of the 2004E Indenture, and any and all additions, betterments, and extensions and improvements thereto. The Susanville Project is located on the Susanville Site.

"Susanville Site" means those parcels of land underlying the Susanville Facility more particularly described in Exhibit B attached to and made a part of the Susanville Facility Lease.

"Susanville Site Lease" means the Site Lease, dated as of October 1, 1993, by and between the Department, as lessor, and the Board, as lessee, as originally executed and as it may from time to time be amended or supplemented pursuant to the provisions of its terms and the 2004E Indenture.

"Tax Certificate" means the tax certificate delivered by the Board at the time of the issuance and delivery of a Series of Bonds, as the same may be amended or supplemented in accordance with its terms.

"Term Bonds" means Bonds which are payable on or before their specified maturity dates from sinking account payments established for that purpose and calculated to retire such Bonds on or before their specified maturity dates.

"Trustee" means the entity then acting as independent trustee and fiscal agent for the Bonds, originally being the State Treasurer, or such other person as may be appointed in accordance with the Indenture.

"2001 Series A Bonds" means the Board's Lease Revenue Refunding Bonds (Department of Corrections) 2001 Series A (California State Prison – Lassen County, Susanville).

"2004E Bonds" means the Board's Lease Revenue Refunding Bonds (Department of Corrections) 2004 Series E (California State Prison – Lassen County, Susanville).

"2004E Indenture" means the Indenture, dated as of October 1, 1993, between the Board and the State Treasurer, as supplemented from time to time.

"2004E Insured Bonds" means the 2004E Bonds maturing on June 1, 2007 through and including June 1, 2018.

"2004E Revenues" means certain proceeds of the 2004E Bonds deposited in the Interest Account, all Base Rental payments received by the Board pursuant to the Susanville Facility Lease, and all other benefits, charges, income, proceeds, profits, receipts, rents, proceeds of insurance, and revenues derived by the Board from the ownership, operation, or use of the Susanville Facility, including interest or profits from the investment of money in any account or fund (other than the Rebate Fund and the Reserve Fund) pursuant to the 2004E Indenture.

"Written Request of the Board" means an instrument in writing signed by the Chair, the Administrative Secretary of the Board or the Assistant Administrative Secretary of the Board, or by any other officer of the Board duly authorized by the Board for that purpose.

B. 2004E INDENTURE

The 2004E Bonds will be issued under the provisions of the 2004E Indenture, as supplemented by the Third Supplemental Indenture. The 2004E Bonds issued thereunder are secured on a parity with the 1993D Susanville Bonds and the 2001 Series A Bonds and any Additional Bonds that may be issued thereunder in the future.

Pledge of the Revenues

Pursuant to the Indenture, the Bonds are secured by a pledge of and charge and lien upon those certain revenues and amounts on deposit in the funds and accounts established under the Indenture for the Bonds (other than amounts on deposit in the Rebate Fund) and by the Reserve Fund as and to the extent set forth in the Master Indenture. All Revenues and amounts on deposit in the funds and accounts established under the Indenture (other than amounts on deposit in the Rebate Fund) are irrevocably pledged to the payment of the interest on and principal of and redemption premium, if any, on the Bonds as provided in the Indenture, and the Revenues shall not be used for any other purpose while any of the Bonds remain outstanding; provided, however, that out of the

Revenues there may be allocated such sums for such purposes as are expressly permitted by the Indenture to be allocated from the Revenue Fund. The pledge made in the Indenture constitutes a first pledge of and charge and lien upon the Revenues (other than Revenues on deposit in the Rebate Fund) for the payment of the principal of and redemption premium, if any, and interest on the Bonds.

Additional Bonds

The Indenture provides that the Board may at any time issue Additional Bonds payable from the Revenues and secured by a pledge of and charge and lien upon such Revenues as provided in the Indenture, but only subject to the following specific conditions, which are made conditions precedent to the issuance of any Additional Bonds:

(a) The Board shall be in compliance with all agreements and covenants contained in the Indenture.

(b) The issuance of such Additional Bonds shall have been authorized pursuant to the Act and shall have been provided for by a Supplemental Indenture which shall specify the following:

(1) The purpose for which such Additional Bonds are to be issued; provided that such Additional Bonds shall be applied solely for the purpose of (i) financing or refinancing the acquisition, installation and construction of additions, betterments, extensions or improvements to the Susanville Facility, including payment of all costs incidental to or connected with such financing, making deposits to the Reserve Fund, and/or (ii) refunding any Bonds then Outstanding, including payment of all costs incidental to or connected with such refunding so long as such refunding results in debt service savings, when compared to the remaining debt service on the Bonds;

(2) The authorized principal amount and designation of such Additional Bonds;

(3) The date and the maturity dates of and the sinking account payment dates, if any, for such Additional Bonds; provided that (i) each such maturity date shall fall on a June 1, (ii) all such Additional Bonds of like maturity shall be identical in all respects, except as to number and denomination, (iii) serial maturities for Serial Bonds or sinking account payments for Term Bonds, or any combination thereof, shall be established to provide for the retirement of such Additional Bonds on or before their respective maturity dates, and (iv) the Annual Debt Service for each Fiscal Year after the issuance of such Additional Bonds shall be as nearly equal as practicable, taking into account the useful life of the additions or improvements, if any, to the Susanville Facility so financed;

(4) The Interest Payment Dates for such Additional Bonds;

(5) The denomination or denominations of and method of numbering such Additional Bonds;

(6) The redemption premium, if any, and the redemption terms, if any, for such Additional Bonds;

(7) The amount, if any, to be deposited from the proceeds of sale of such Additional of Bonds in the Interest Account;

(8) The amount, if any, to be deposited from the proceeds of sale of such Additional Bonds in the Reserve Fund;

(9) The amount, if any, to be deposited from the proceeds of sale of such Additional Bonds in the Construction Fund;

(10) The forms of such Additional Bonds; and

(11) Such other provisions as are necessary or appropriate and not inconsistent with the Indenture.

Additional Bonds shall not be issued on other than a fixed interest rate basis and shall not be subject to interest rate swaps, hedges or other derivative products having the effect of modifying a fixed rate of interest.

(c) The Susanville Facility Lease shall have been amended so as to modify the Base Rental payable by the Department thereunder by an amount at least sufficient to pay the interest on and principal of such Additional Bonds as the same become due and accompanied by a certificate of the Department to the effect that such Base Rental is not less than the fair rental value for the Susanville Facility.

Nothing contained in the Indenture shall limit the issuance of any lease revenue bonds of the Board payable from the Revenues and secured by a pledge of and charge and lien upon the Revenues if after the issuance and delivery of such lease revenue bonds none of the Bonds theretofore issued under the Indenture will be Outstanding.

Establishment of Funds and Accounts

The following funds and accounts are established pursuant to the Indenture: (1) the Construction Fund; (2) the Revenue Fund established for the Bonds, containing an Interest Account (in which there shall be established a Capitalized Interest Subaccount), a Principal Account (in which there shall be established a Principal Subaccount), a Maintenance and Operation Account, and a Surplus Account; and (3) the Rebate Fund.

Revenue Fund. All Revenues when and as received shall be received by the Board in trust under the Indenture for the benefit of the Holders of the Bonds and shall be deposited when and as received by the Board in the Revenue Fund. All Revenues shall be accounted for through and held in trust in the Revenue Fund, and the Board shall have no beneficial right or interest in any of the Revenues except only as provided in the Indenture. All Revenues, whether received by the Board in trust or deposited with the State Treasurer as provided in the Indenture, shall nevertheless be allocated, applied and disbursed solely to the purposes and uses set forth in the Indenture and as shall be specified in the Supplemental Indenture for each Series of Bonds, and shall be accounted for separately and apart from all other accounts, funds, money or other resources of the Board.

Moneys in the Revenue Fund shall be set aside by the State Treasurer in the following respective special accounts within the Revenue Fund:

(1) Interest Account,

(i) Capitalized Interest Subaccount;

(2) Principal Account,

(i) Principal Subaccount,

(3) Maintenance and Operation Account, and

(4) Surplus Account.

Interest Account. On or before the fifteenth day of the month next preceding each Interest Payment Date, the State Treasurer shall set aside from the Revenue Fund and deposit in the Interest Account therefor that amount of money which, together with any money contained therein, is equal to the aggregate amount of interest becoming due and payable on all Outstanding Bonds on such Interest Payment Date. No deposit need be made in the Interest Account if the amount contained therein is at least equal to the aggregate amount of interest becoming due and payable on all Outstanding Bonds on such Interest Payment Date.

All money in the Interest Account shall be used and withdrawn by the State Treasurer solely for the purpose of paying the interest on the Bonds as it shall become due and payable (including accrued interest on any Bonds purchased or redeemed prior to maturity); provided that the State Treasurer, upon the Written Request of the Department and upon receipt of such documentation as he may require, shall withdraw from such Interest Account and pay to or upon order of the Department money sufficient to reimburse the Department for any Base Rental theretofore paid by the Department under the Susanville Facility Lease for that period of time during which the payment of Base Rental under the Susanville Facility Lease is abated and for which no other money (including proceeds of the rental interruption or use and occupancy insurance required by the Indenture and money in the Principal Account and in the Reserve Fund and in the Maintenance and Operation Account and in the Surplus Account) is available.

Principal Account. On or before the earlier of November 15 or the date thirty (30) days after the Budget Act for the applicable fiscal year is enacted by the State, the State Treasurer shall set aside from the Revenue Fund and deposit in the Principal Subaccount an amount of money equal to one-half (1/2) the aggregate principal amount of all Outstanding Serial Bonds maturing on the next succeeding June 1; on or before the earlier of November 15 or the date thirty (30) days after the Budget Act for the applicable fiscal year is enacted by the State, beginning in 2012, the State Treasurer shall set aside from the Revenue Fund and deposit in the Principal Subaccount an amount of money equal to one-half (1/2) the aggregate amount of all sinking account payments required to be made on the next succeeding June 1 into the respective sinking accounts for all Outstanding Term Bonds. On or before May 15 of each year, the State Treasurer shall set aside from the Revenue Fund and deposit in the Principal Account an amount of money equal to one-half (1/2) the aggregate principal amount of all Outstanding Serial Bonds maturing on the next succeeding June 1; on or before May 15 of each year, beginning on May 15, 2013, the State Treasurer shall set aside from the Revenue Fund and deposit in the Principal Account an amount of money equal to one-half (1/2) the aggregate amount of all sinking account payments required to be made on the next succeeding June 1 into the respective sinking accounts for all Outstanding Term Bonds. On May 15 of each year, after the deposit required by the preceding sentence has been made, the State Treasurer shall set aside from the Principal Subaccount and deposit into the Principal Account that amount of money which, together with any money contained therein, is equal to the aggregate principal amount of all sinking account payments required to be made on the next succeeding June 1 into the respective sinking fund accounts for all Outstanding Term Bonds and that amount of money which, together with any money contained therein, is equal to the aggregate principal amount of all Outstanding Serial Bonds maturing on such June 1 for application as provided in this Indenture.

No deposit need be made in the Principal Account (including any amounts in the Principal Subaccount) if the amount contained therein is at least equal to the aggregate amount of the principal of all Outstanding Serial Bonds maturing by their terms on such June 1 plus the aggregate amount of all sinking account payments required to be made during the year ending on such principal payment date for all Outstanding Term Bonds. Similarly, the deposit required to be made to the Principal Account may be reduced to the extent that such deposit, together with any amounts in the Principal Subaccount, including investment earnings thereon, is equal to the aggregate amount of the principal of all Outstanding Serial Bonds maturing by their terms on such June 1 plus the aggregate amount of all sinking account payments required to be made on such June 1 for all Outstanding Term Bonds.

The State Treasurer is required to establish and maintain within the Principal Account a separate subaccount for the Term Bonds of each series and maturity, designated as the "____ Series ____ Sinking Account" (the "Sinking Account"), inserting therein the Series and maturity (if more than one such account is established for such series) designation of such Bonds. With respect to each Sinking Account, on each mandatory sinking account payment date established for such Sinking Account, the State Treasurer shall apply the mandatory sinking account payment required on that date to the redemption (or payment at maturity, as the case may be) of Term Bonds of the series and maturity for which such Sinking Account was established, upon the notice and in the manner provided in the Indenture and in the Supplemental Indenture; provided that, at any time prior to giving such notice of such redemption, the State Treasurer may apply moneys in such Sinking Account to the purchase of Term Bonds of such series and maturity at public or private sale, as and when and at such prices (including brokerage and other charges, but excluding accrued interest, which is payable from the Interest Account) as shall be determined by the State Treasurer, except that the purchase price (excluding accrued interest) shall not exceed the redemption price that would be payable for such Bonds upon redemption by application of such mandatory sinking account payment. If, during the twelve-month period immediately preceding said mandatory sinking account payment date, the State Treasurer has purchased Term Bonds of such series and maturity with moneys in such Sinking Account, such Bonds so purchased shall be applied, to the extent of the full principal amount thereof, to reduce the next succeeding mandatory sinking account payment.

All money in the Principal Account (including any amounts in the Principal Subaccount) shall be used and withdrawn by the State Treasurer solely for the purpose of paying the principal of the Bonds as they shall become due and payable, except that any money in any Sinking Account shall be used and withdrawn by the State Treasurer only to purchase or to redeem or to pay Term Bonds for which such Sinking Account was created; provided that the State Treasurer, upon the Written Request of the Board and upon receipt of such documentation as he may require, shall withdraw from such Principal Account and pay to the Department money sufficient to reimburse the Department for any Base Rental theretofore paid by the Department under the Susanville Facility Lease for that period of time during which the payment of Base Rental under the Susanville Facility Lease is abated and for which no other money (including proceeds of the rental interruption or use and occupancy insurance required by the Indenture and money in the Reserve Fund and in the Maintenance and Operation Account and in the Surplus Account) is available.

Maintenance and Operation Account. During any period when the Board shall operate the Susanville Facility, the State Treasurer, on or before May 15 and November 15 of each year, shall set aside from the Revenue Fund and deposit in the Maintenance and Operation Account all amounts which shall be estimated to be required to provide for the payment of all costs of maintenance and operation of the Susanville Facility during the next six months, including costs of repairs and replacements, labor costs and insurance.

All money in the Maintenance and Operation Account shall be disbursed by the State Treasurer only to pay such costs upon the Written Request of the Board; provided that the State Treasurer upon the written request of the Department and upon receipt of such documentation as he may require, shall withdraw from the Maintenance and Operation Account and pay to the Department money sufficient to reimburse the Department for any Base Rental theretofore paid by the Department under the Susanville Facility Lease for a period of time during which the payment of Base Rental under such Susanville Facility Lease is abated and for which no other money (including proceeds of the rental interruption or use and occupancy insurance which may be provided under the Supplemental Indenture (pursuant to the provisions of the Indenture) and money in the Surplus Account) is available.

Surplus Account. The State Treasurer, on or before May 15 of each year, shall deposit in the Surplus Account all money remaining in the Revenue Fund after the deposits required by the Indenture have been made. On June 2 of each year, the State Treasurer, if the Board is not then in default under the Indenture and if the Department are not then in default under the Susanville Facility Lease, shall disburse the money in the Surplus Account to the Department unless (1) the State Treasurer has not received all of the Base Rental due and payable in such year from the Department for deposit to the Revenue Fund, or (2) the State Treasurer, in his discretion, shall determine that any money in the Surplus Account is or will be required for the payment of the principal of or interest on such the Bonds on any succeeding Interest Payment Date (assuming for the purpose of such determination that the Department shall pay when due all future payments of Base Rental required by the

Susanville Facility Lease), or (3) the State Treasurer, in his discretion, shall determine that any money in the Surplus Account is or will be necessary to fund the amounts on deposit in the Reserve Fund up to an amount equal to the Reserve Fund Requirement, in which event such money shall be held in the Surplus Account for such purpose; provided that the State Treasurer, upon the Written Request of the Board and upon receipt of such documentation as he may require, shall withdraw from the Surplus Account and pay to the Department money sufficient to reimburse the Department for any Base Rental theretofore paid by the Department under the Susanville Facility Lease for a period of time during which the payment of Base Rental under the Susanville Facility Lease is abated and for which no other money (including proceeds of the rental interruption or use and occupancy insurance which may be provided under the provisions of the Indenture) is available.

Reserve Fund. As and to the extent provided in the Master Indenture, the State Treasurer shall maintain and hold the Reserve Fund, which shall secure all Bonds issued under the Master Indenture and any Incorporated Bonds under the Master Indenture as and to the extent set forth in the Master Indenture.

If amounts in the Interest Account or the Principal Account are insufficient to pay the principal of, redemption premium, if any, or interest on the Bonds and, if no other money of the Board is lawfully available therefor, then amounts shall be drawn from the Reserve Fund in accordance with the provisions of the Master Indenture and be deposited to the Interest Account and Principal Account under the Indenture. See "THE MASTER INDENTURE — Reserve Fund" herein.

Deposit and Investment of Money in Accounts and Funds

All money held by the State Treasurer in any of the accounts or funds established under the Indenture shall be invested in Permitted Investments. Subject to the provisions of the Indenture, all interest or profits from the funds or accounts relating to the Bonds shall be deposited in the Revenue Fund.

Covenants of the Board

The Indenture contains covenants of the Board with respect to the Bonds and the Susanville Facility. Certain of these covenants follow. Reference is made to the full Indenture for a complete text of such covenants.

Punctual Payment and Performance. The Board will punctually pay the principal of, redemption premium, if any, and interest to become due on 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 contained in the Indenture and in the Bonds.

Against Encumbrances. The Board will not make any pledge of or place or permit to be placed any charge or lien upon any of the Susanville Facility or any part thereof or upon any of the Revenues except as provided in the Indenture, and will not issue any bonds, notes or obligations payable from the Revenues or secured by a pledge of or charge or lien upon the Revenues except the Bonds.

Against Sale or Other Disposition of the Susanville Facility. The Board will not sell or otherwise dispose of any of the Susanville Facility or any part thereof essential to its proper operation or to the maintenance of any of the Revenues. The Board will not enter into any agreement which impairs the operation of any of the Susanville Facility or any part thereof necessary to secure adequate Revenues for the payment of the interest on and principal of and redemption premium, if any, on any of the Bonds, or which would otherwise impair the rights of the Holders with respect to the Revenues or the operation of the Susanville Facility. Any real or personal property constituting part of the Susanville Facility which has become nonoperative or which is not needed for the efficient and proper operation of the Susanville Facility or any material or equipment constituting part of the Susanville Facility which has become worn out may be sold at not less than the market value thereof if such sale will not reduce the Revenues related to the Susanville Facility and if the net proceeds of such sale are treated as Revenues and applied in the manner provided in the Indenture.

Tax Covenants; Rebate Fund. The State Treasurer shall establish and maintain a fund separate from any other fund or account established and maintained under the Indenture designated as the Rebate Fund (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. All money at any time deposited in the Rebate Fund shall be held by the State Treasurer in trust, to the extent required to satisfy the applicable Rebate Amount (as defined in the Tax Certificate), for payment to the United States of America.

The Board and the State Treasurer shall not use or permit the use of any proceeds of the Bonds of any series or any funds of the Board, directly or indirectly, in any manner, and shall not take or omit to take any action that would cause any of the Bonds to be treated as an obligation not described in Section 103(a) of the Internal Revenue Code. The Board and the State Treasurer specifically covenant to comply with the provisions and procedures of the Tax Certificate.

If the Board shall provide to the State Treasurer an Opinion of Counsel to the effect that any specified action required under the Indenture is no longer required or that some further or different action is required to maintain the exclusion from gross income for federal income tax purposes of interest on the Bonds of any series, the State Treasurer and the Board may conclusively rely on such Opinion of Counsel in complying with the requirements of this section, and the covenants under the Indenture shall be deemed to be modified to that extent.

Maintenance and Operation of the Susanville Facility. The Board will maintain and preserve or cause to be maintained and preserved the Facility in good order, condition and repair at all times and will operate the Susanville Facility or cause the Susanville Facility to be operated in an efficient and economical manner as a fully equipped and operational state correctional facility.

Payment of Claims. The Board will pay and discharge or cause to be paid and discharged any and all lawful claims for labor, materials or supplies which, if unpaid, might become a legal charge or lien upon the Susanville Facility or the Revenues or any part thereof or upon any funds under the control of the Board or the State Treasurer superior to or on a parity with the charge and lien upon the Revenues securing the Bonds, or which might impair the Revenues as security of the Bonds.

Payment of Taxes and Compliance with Governmental Regulations. The Board will pay and discharge or cause to be paid and discharged all applicable taxes, assessments and other governmental charges that may be levied, assessed or charged upon the Susanville Facility or any part thereof or upon the Revenues or any part thereof promptly as and when the same shall become due and payable. The Board will duly observe and conform with all valid applicable regulations and requirements of any governmental authority relative to the operation of the Susanville Facility or any part thereof, but the Board shall not be required to comply with any such regulations or requirements so long as the application or the validity thereof shall be contested in good faith.

Insurance. The Board shall maintain or cause to be maintained fire, lightning and extended coverage insurance on the Susanville Facility in an amount equal to one hundred percent (100%) of the then current replacement cost of the Susanville Facility (excluding the then value of the Susanville Site as unimproved) (except that such insurance may be subject to deductible clauses of not to exceed $500,000 for any one loss), and earthquake insurance (if available on the open market from reputable insurance companies at a reasonable cost) on any structure comprising part of the Facility in an amount equal to the full insurable value of such structure or the principal amount of all Outstanding Bonds, whichever is less (except that such insurance may be subject to a deductible clause of not to exceed $500,000). The extended coverage endorsement shall, as nearly as practicable, cover loss or damage by explosion, windstorm, riot, aircraft, vehicle damage, smoke, vandalism and malicious mischief and such other hazards as are normally covered by such endorsement. Each such policy of insurance shall be in form reasonably satisfactory to the Board and shall contain a clause making all losses payable to the Board, the State Treasurer and the Department, as their interests may appear, and all proceeds thereof shall be paid over to the party contractually responsible for making repairs of casualty damage or to the Board to redeem the Bonds as provided the Indenture.

In the event of any damage to or destruction of the Susanville Facility caused by the perils covered by such insurance, the proceeds of such insurance shall be utilized, in the discretion of the Board, either (i) to redeem Outstanding Bonds to the extent possible and in accordance with the provisions of the Indenture, but only if the Base Rental payments due after such a redemption would be sufficient to retire the Bonds then Outstanding in accordance with their terms, or (ii) for the repair, reconstruction or replacement of the Susanville Facility to the end that the Susanville Facility shall be restored to at least the same condition that they were in prior to such damage or destruction. If the Board so elects to repair, reconstruct or replace the Susanville Facility, it shall do so with all practicable dispatch in an expeditious manner and in conformity with the law so as to complete the same as soon as possible. Any balance of such proceeds not required for such repair, reconstruction or replacement shall be transferred to the Board and treated as Revenues and applied in the manner provided in the Indenture.

The Board shall maintain or cause to be maintained by the Department rental interruption or use and occupancy insurance to cover loss, total or partial, of the use of the Susanville Facility as a result of any of the hazards covered by the insurance required by the Indenture in an amount not less than the amount of Base Rental due pursuant to the Susanville Facility Lease for any period of two (2) consecutive years. Any such insurance policy shall be in form satisfactory to the Board and shall contain a loss payable clause making any loss thereunder payable to the State Treasurer as his interests appear. Any proceeds of such insurance shall be used by the State Treasurer to reimburse the Department for any rental theretofore paid by the Department under the Susanville Facility Lease for a period of time during which the payment of rental thereunder is abated, and any proceeds of such insurance not so used shall be applied as provided in the Indenture to the extent required to pay Annual Debt Service on the Bonds.

The Board will deliver or cause to be delivered to the State Treasurer in the month of July in each year a schedule, in such detail as the State Treasurer in his discretion may request, setting forth the insurance policies then in force pursuant to the Indenture, the names of the insurers which have issued the policies, the amounts thereof and the property and risks covered thereby. Each such insurance policy shall require that the State Treasurer be given thirty (30) days' notice of any intended cancellation thereof or reduction of the coverage provided thereby. Delivery to the State Treasurer of the schedule of insurance policies under the provisions of the Indenture shall not confer responsibility upon the State Treasurer as to the sufficiency of coverage or amounts of such policies. If so requested in writing by the State Treasurer, the Department shall also deliver or cause to be delivered to the State Treasurer duplicate originals or certified copies of each insurance policy described in such schedule.

The Department Budgets. The Board will supply to the State Treasurer, as soon as practicable after the beginning of each Fiscal Year of the Department, a Certificate of the Board certifying that the Department has made adequate provision in its annual budget for such Fiscal Year for the payment of all rentals due under the Susanville Facility Lease in such Fiscal Year. If in the opinion of the State Treasurer the amounts so budgeted are not adequate for the payment of all rentals due under the Susanville Facility Lease in such Fiscal Year, the Board will take such action as may be necessary and within its power to cause such annual budget to be amended, corrected or augmented so as to include therein the amounts required to be paid by the Department in such Fiscal Year for the payment of all rentals due under the Susanville Facility Lease in such Fiscal Year, or otherwise to cause the Base Rentals to be appropriated and paid, and will notify the State Treasurer of the proceedings then taken or proposed to be taken by the Board.

Susanville Facility Lease and Other Documents. The Board will at all times maintain and vigorously enforce all its rights under the Susanville Facility Lease and will promptly collect all rents and charges due for the use and occupancy of the Susanville Facility as the same become due under the Susanville Facility

Lease, and will promptly and vigorously enforce its rights against any tenant or other person who does not pay such rents or charges as they become due under the Susanville Facility Lease. The Board will not do or permit anything to be done, or omit or refrain from doing anything, in any case where any such act done or permitted to be done, or any such omission of or refraining from action, would or might be a ground for cancellation or termination of the Facility Lease by the lessee thereunder. Except for an amendment to the Susanville Facility Lease to permit the issuance of Additional Bonds in accordance with the Indenture, without the written consent of the state treasurer, the Board will not alter or modify or agree or consent to alter or modify the Susanville Facility Lease, but with the written consent of the State Treasurer, the Board may consent to alterations or modifications thereof. The State Treasurer shall give such written consent only if (i) in the opinion of the State Treasurer, such alterations or modifications will not result in any material impairment of the security given by the Indenture or the Susanville Facility Lease, or intended to be given for the payment of the Bonds, or (ii) the State Treasurer first obtains the written consent of the Holders of at least sixty percent (60%) in aggregate principal amount of the Bonds then Outstanding, exclusive of any Bonds disqualified as provided in the Indenture; provided that no such alterations or modifications shall alter or impair the obligation of the Board to pay the interest on or principal of or redemption premium, if any, on any Bonds without the written consent of the Holders of all such Bonds so affected.

Other Liens. The Board will keep the Susanville Facility free from judgments, mechanics' and materialmen's liens (except those arising from the acquisition and construction of the Susanville Facility) and free from all liens, claims, demands and encumbrances of whatsoever prior nature or character to the end that the security for the Bonds provided in the Indenture will at all times be maintained and preserved free from any claim or liability which, in the judgment of the State Treasurer (and its determination thereof shall be final), might embarrass or hamper the Board in conducting its business or operating the Susanville Facility, and the State Treasurer at his option (after first giving the Board ten (10) days' written notice to comply therewith and failure of the Board to so comply within such period) may defend against any and all actions or proceedings in which the validity hereof is or might be questioned, or may pay or compromise any claim or demand asserted in any such action or proceeding; provided, however, that, in defending such actions or proceedings or in paying or compromising such claims or demands, the State Treasurer shall not in any event be deemed to have waived or released the Board from liability for or on account of any of its agreements and covenants contained herein, or from its liability hereunder to defend the validity hereof and the pledge of and charge and lien upon the Revenues made herein and to perform such agreements and covenants.

Prosecution and Defense of Suits. The Board will promptly, upon request of the State Treasurer, from time to time take or cause to be taken such action as may be necessary or proper to remedy or cure any defect in or cloud upon the title to the Susanville Facility, whether now existing or developing, and shall prosecute or cause to be prosecuted all such suits, actions and other proceedings as may be appropriate for such purpose and shall indemnify and hold the State Treasurer harmless from all loss, cost, damage and expense, including attorney's fees, which it may incur by reason of any such defect, cloud, suit, action or proceeding.

Eminent Domain. If the whole or any portion of the Susanville Facility shall be taken by eminent domain proceedings (or sold to a governmental entity threatening to exercise the power of eminent domain), the proceeds therefrom shall be deposited with the State Treasurer in a special fund in trust and shall be applied and disbursed by the State Treasurer as follows:

If less than the entirety of the Susanville Facility shall have been so taken and the remainder is usable for purposes as a state correctional facility, and if the portion taken is replaced by a facility of equal or greater utility and of equal or greater fair rental value within or adjacent to such remainder, the State Treasurer shall disburse such proceeds to the party that incurred the expense of making such replacement; but if no such replacement is made, the State Treasurer shall apply such proceeds to redeem Bonds pursuant to the Indenture.

If less than the entirety of the Susanville Facility shall have been so taken and the remainder is not usable as a state correctional facility, the State Treasurer shall apply such proceeds to redeem Bonds. If all of the Susanville Facility shall have been so taken, the State Treasurer shall apply such proceeds, together with any other money then available to him for such purpose, for the payment of the entire amount of principal then due or to become due upon all of the Outstanding Bonds, together with the interest thereon so as to enable the Board to retire all of such Bonds then Outstanding by redemption or by payment at maturity; except that if such proceeds, together with any other money then lawfully available to him for such purpose, are insufficient to provide for the foregoing purpose, the State Treasurer shall apply such proceeds to the payment of such amounts ratably without preference of interest over principal or principal over interest.

Further Assurances. Whenever and so often as requested to do so by the State Treasurer or any Holder, the Board will promptly execute and deliver or cause to be executed and delivered all such other and further assurances, documents or instruments, and promptly do or cause to be done all such other and further things as may be necessary or reasonably required in order to further and more fully vest in the Holders all rights, interests, powers, benefits, privileges and advantages conferred or intended to be conferred upon them by the Indenture.

Continuing Disclosure. The Board and the State Treasurer on behalf of the State covenant and agree that they will comply with and carry out all of the provisions of the Continuing Disclosure Agreement. Notwithstanding any other provision of the Indenture, failure of the Board, the Department or the State Treasurer to comply with the Continuing Disclosure Agreement shall not be considered an Event of Default and shall not be deemed to create any monetary liability on the part of them or the State to any other persons, including any Bondholder or Beneficial Owner; however, any Bondholder or Beneficial Owner may take such actions as may be necessary and appropriate, including seeking mandate or specific performance by court order, to cause the Board or the State Treasurer, as the case may be, to comply with its obligations under the Indenture. For purposes of this paragraph, "Beneficial Owner" means any person which has or shares the power, directly or indirectly, to make investment decisions concerning ownership of any Bonds (including persons holding Bonds through nominees, depositories or other intermediaries).

Amendments

The Indenture and the rights and obligations of the Board and of the Holders of the Bonds may be amended at any time by a Supplemental Indenture. Such amendments shall become binding when the written consents of the Holders of sixty percent (60%) in aggregate principal amount of the Bonds then Outstanding, exclusive of Bonds disqualified as provided in the Indenture, are filed with the State Treasurer. No such amendment shall (1) extend the maturity of or reduce the interest rate on or otherwise alter or impair the obligation of the Board to pay the principal of, redemption premium, if any, or interest on any Bond at the time and place and at the rate and in the currency provided in the Indenture without the express written consent of the Holder of such Bond, or (2) permit the creation by the Board of any pledge of or charge or lien upon the Revenues as provided in the Indenture superior to or on a parity with the pledge, charge and lien created by the Indenture for the benefit of the Bonds, or (3) reduce the percentage of Bonds required for the written consent to any such amendment, or (4) modify any rights or obligations of the State Treasurer without his prior written assent thereto.

The Indenture and the rights and obligations of the Board and of the Holders may also be amended at any time by a Supplemental Indenture which shall become binding upon execution and delivery thereof without the consent of any of the Holders, but only to the extent permitted by law and after receipt of an approving Opinion of Counsel and only for any one or more of the following purposes:

(a) to add to the agreements and covenants required in the Indenture to be performed by the Board other agreements and covenants thereafter to be performed by the Board which shall not materially adversely affect the interests of the Holders, or to surrender any right or power reserved to or conferred on the Board pursuant to the terms of the Indenture;

(b) to make such provisions for the purpose of curing any ambiguity, inconsistency or omission, or of correcting, curing or supplementing any defective provision contained in the Indenture or in regard to questions arising under the Indenture which the Board may deem desirable or necessary and not inconsistent with the Indenture;

(c) to provide for the issuance of any Additional Bonds and to provide the terms of such Additional Bonds and the funds and accounts therefor, subject to the conditions and upon compliance with the procedure set forth in the Indenture; or

(d) to incorporate provisions of the Master Indenture relating to Reserve Fund.

Events Of Default

The following events shall be events of default with respect to the Bonds:

(a) if default shall be made in the due and punctual payment of the interest on any Bond when and as the same shall become due and payable; or

(b) if default shall be made in the due and punctual payment of the principal of or redemption premium, if any, on any Bond when and as the same shall become due and payable, whether at maturity as therein expressed or by proceedings for redemption; or

(c) if default shall be made by the Board in the performance of any of the other agreements or covenants required in the Indenture to be performed by the Board, and such default shall have continued for a period of sixty (60) days after the Board shall have been given notice in writing of such default by the State Treasurer or the Insurer, or

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

Acceleration of Maturities

Upon the occurrence and continuance of an event of default, the State Treasurer may, or upon the written request of the Holders of not less than twenty-five percent (25%) in aggregate principal amount of the Bonds then Outstanding shall, by notice in writing to the Board, declare the principal of all of the Bonds then Outstanding and the interest accrued thereon to be due and payable immediately, and upon any such declaration the same shall become due and payable, anything contained in the Indenture or in the Bonds to the contrary notwithstanding.

This provision, however, is subject to the following condition that if, at any time after the principal of the Bonds then Outstanding shall have been so declared due and payable and before any judgment or decree for the payment of the money due shall have been obtained or entered. The Board shall deposit with the State Treasurer a sum sufficient to pay all matured interest on all the Bonds and all principal of such Bonds matured prior to such declaration, with interest at the rate borne by such Bonds on such overdue interest and principal, and the reasonable expenses of the State Treasurer, and any and all other defaults known to the State Treasurer (other than in the payment of interest on and principal of the Bonds due and payable solely by reason of such declaration) shall have been made good or cured to the satisfaction of the State Treasurer or provision deemed by the State Treasurer to be adequate shall have been made therefor, then and in every such case the Holders of not less than twenty-five percent (25%) in aggregate principal amount of Bonds then Outstanding, by written notice to the Board and to the State Treasurer, may on behalf of the Holders of all such Bonds then Outstanding rescind and annul such declaration and its consequences; but no such rescission and annulment shall extend to or shall affect any subsequent default or shall impair or exhaust any right or power consequent thereon.

Application of Funds Upon Acceleration

All moneys in the accounts and funds established under the Indenture, and moneys available in the Reserve Fund, upon the date of the declaration of acceleration by the State Treasurer as provided in the Indenture and all Revenues (other than Revenues on deposit in the Rebate Fund) thereafter received by the Board under the Indenture shall be transmitted to the State Treasurer and shall be applied by the State Treasurer in the following order:

First, to the payment of the costs and expenses of the Holders in providing for the declaration of such event of default, including reasonable compensation to their accountants and counsel, and to the payment of the costs and expenses of the State Treasurer, if any, in carrying out the provisions of Indenture relating to such default, including reasonable compensation to its accountants and counsel; and

Second, upon presentation of the several Bonds, and the stamping thereon of the amount of the payment if only partially paid or upon the surrender thereof if fully paid, to the payment of the whole amount then owing and unpaid upon the Bonds for interest and principal, with interest on the overdue interest and principal at the rate borne by such Bonds and in case such money shall be insufficient to pay in full the whole amount so owing and unpaid upon the Bonds, then to the payment of such interest, principal and interest on overdue interest and principal without preference or priority among such interest, principal and interest on overdue interest and principal ratably to the aggregate of such interest, principal and interest on overdue interest and principal.

Other Remedies of Holders

Any Holder shall have the right for the equal benefit and protection of all Holders similarly situated:

(a) by mandamus or other suit or proceeding at law or in equity to enforce his or his rights against the Board or any member, officer or employee of the Board, and to compel the Board or any such member, officer or employee to perform, and carry out his or his duties under the Act and the agreements and covenants with the Holders contained in the Indenture;

(b) by suit in equity to enjoin any acts or things which are unlawful or violate the rights of the Holders; or

(c) by suit in equity upon the happening of an event of default to require the Board and its members, officers and employees to account as the trustee of an express trust.

Remedies Not Exclusive

No remedy conferred in the Indenture upon or reserved to the Holders or the State Treasurer is intended to be exclusive of any other remedy, and each such remedy shall be cumulative and shall be in addition to every other remedy given under the Indenture or now or later existing at law or in equity or by statute or otherwise and may be exercised without exhausting and without regard to any other remedy conferred by the Act or any other law.

Defeasance

(a) If the Board shall pay or cause to be paid or there shall otherwise be paid to the Holders of all Outstanding Bonds the principal thereof and the redemption premium, if any, and the interest thereon at the times and in the manner stipulated in the Indenture and therein, then the Holders of such Bonds shall cease to be entitled to the pledge of and charge and lien upon the Revenues as provided in the Indenture, and the agreements, covenants and other obligations of the Board to the Holders of such Bonds under the Indenture shall thereupon cease, terminate and become void and be discharged and satisfied; provided, however, that the following agreements, covenants and other obligations shall not be discharged and satisfied until such Bonds are paid in full: (i) the obligation of the State Treasurer to pay or cause to be paid to the Holders of the Bonds all sums due with respect to the Bonds from such moneys or investments that may have been set aside for such purposes in accordance with the Indenture; (ii) the obligation of the State Treasurer to register, transfer and exchange Bonds; (iii) the obligation of the Board to pay the amounts owing to the State Treasurer under the Indenture, and (iv) the obligation of the Board to comply with tax covenants set forth in the Indenture. If the Board shall discharge the Bonds, as provided above, the State Treasurer shall execute and deliver to the Board all such instruments as may be necessary or desirable to evidence such discharge and satisfaction, and the State Treasurer shall pay over or deliver to the Board all money or securities held by him pursuant to the Indenture which are not required for the payment of the principal of, redemption premium, if any, and interest on such Bonds (except amounts then on deposit in the Rebate Fund).

(b) Any Outstanding Bonds shall, prior to the maturity date or redemption date thereof, be deemed to have been paid within the meaning of and with the effect expressed in the preceding paragraph if: (1) in case any of such Bonds are to be redeemed on any date prior to their maturity date, the Board shall have given to the State Treasurer, in form satisfactory to him, irrevocable instructions to mail a notice of redemption of such Bonds in accordance with the provisions of the Indenture; (2) there shall have been deposited with the State Treasurer either (i) money in an amount which shall be sufficient and/or; (ii) Permitted Investments of the type described in clause (i) or clause (ii) of the definition of Permitted Investments and which are not subject to redemption prior to maturity except by the holder thereof (including any such Permitted Investments issued or held in book-entry form on the books of the Department of the Treasury of the United States of America) or tax-exempt securities rated AAA or its equivalent by a nationally recognized rating agency, including Standard & Poor's Corporation, Moody's Investors Service and Fitch Investors Service, Inc. if each is then rating the Bonds, the interest on and principal of which when paid will provide money which, together with the money, if any, deposited with the State Treasurer at the same time, shall 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 redemption premium, if any, on such Bonds; and (3) in the event such Bonds are not by their terms subject to redemption within the next succeeding sixty (60) days, the Board shall have given the State Treasurer, in form satisfactory to him, irrevocable instructions to mail, as soon as practicable, a notice to the Holders of such Bonds that the deposit required by clause (2) above has been made with the State Treasurer 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 redemption premium, if any, on such Bonds.

Bond Insurance Provisions

The Bond Insurer has certain rights under the Indenture with respect to the 2004E Insured Bonds, including rights to consent to or require actions under some circumstances and rights to notices and information. The Indenture provides that the Bond Insurer shall at all times be recognized as the exclusive owner of each 2004E Insured Bond for purposes of exercising all rights and privileges available to the Holders of the 2004E Insured Bonds. Upon the occurrence and continuance of an event of default with respect to the 2004E Insured Bonds, the Bond Insurer is entitled to control and direct the enforcement of all rights and remedies granted to the Holders of the 2004E Insured Bonds under the Indenture or the State Treasurer for the benefit of the Holders of the 2004E Insured Bonds under the Indenture, including, without limitation: (i) the right to accelerate the principal of the 2004E Insured Bonds and (ii) the right to annul any declaration of acceleration of the 2004E Insured Bonds and to approve all waivers of events of default with respect to the 2004E Insured Bonds; provided, however, that the Bond Insurer shall have no greater rights upon the occurrence and continuance of an event of default with respect to the 2004E Insured Bonds than it would have if it were the Holder of all of the 2004E Insured Bonds then Outstanding.

C. THE SUSANVILLE SITE LEASE

A Site Lease has been entered into with respect to the Susanville Facility. The Susanville Site Lease is by and between the Board and Corrections. Under the Susanville Site Lease, the lease to the Board from Corrections is subject to any conditions, reservations, and easements of record.

Terms

The Susanville Site Lease has commenced and will end on June 1, 2018, unless such term is extended or sooner terminated as provided in this paragraph. If, on June 1, 2018, any Bonds or other indebtedness of the Board incurred to pay for the Susanville Project is not fully paid and retired, then the term of the Susanville Site Lease shall be extended until 10 days after all Bonds shall be fully paid and retired, except that the term of the Susanville Site Lease shall in no event be extended beyond October 1, 2028. If prior to October 1, 2028 all Bonds incurred to pay for the Susanville Project are fully paid and retired, the term of the Susanville Site Lease shall end 10 days thereafter or ten (10) days after written notice by the Department to the Board, whichever is earlier.

Purpose

The Board shall use the Susanville Site solely for the purpose of constructing the Susanville Project thereon and leasing the Susanville Site and the Susanville Project constructed thereon to the Department pursuant to the Susanville Facility Lease and for such purposes as may be incidental thereto; provided, that in the event of default by the Department under the Susanville Facility Lease, the Board may exercise the remedies provided in the Susanville Facility Lease.

Assignments and Subleases

Unless the Department is in default under the Susanville Facility Lease, the Board shall not assign its rights under the Susanville Site Lease or sublet the Susanville Site without the prior written consent of the Department.

III. THE FACILITY LEASES FOR 2004D BONDS AND 2004E BONDS

A Facility Lease is being entered into with respect to each of the Coalinga Facility and the Susanville Facility. Corrections will execute the Coalinga Facility Lease and the Third Amendment to Facility Lease for the Susanville Facility, amending, in part, the Susanville Facility Lease. Except as specified below, the Coalinga Facility Lease and the Susanville Facility Lease are substantially identical. The general terms of the Facility Leases are summarized below. Each Facility Lease is by and between the Board, as lessor, and Corrections, as lessee.

In the following summary, the term "Department" refers to Corrections, the term "Bonds" refers to the 2004D Bonds or 2004E Bonds, as applicable, the term "Facility" refers to the Coalinga Facility or the Susanville Facility, as applicable, and the term "Project" refers to the Coalinga Project or the Susanville Project, as applicable.

Purpose and Term

The Board leases the Facility to the Department on the terms and conditions set forth in the Facility Lease and subject to all easements, encumbrances and restrictions of record. The Department agrees and covenants during the term of the Facility Lease that, except as provided therein, it will use the Facility only to afford the public the benefits contemplated by the Act and by the Facility Lease and so as to permit the Board to carry out its agreements and covenants contained in the Indenture and further agrees that it will not abandon the Facility.

The term of the Coalinga Facility Lease will commence on the date of issuance of the 2004D Bonds and shall end on December 1, 2019, unless such term is extended or sooner terminated as provided in the Coalinga Facility Lease. If on December 1, 2019 the 2004D Bonds, or other indebtedness of the Board incurred to pay for the Coalinga Project, shall not have been fully paid and retired, or if the rental payable under the Coalinga Facility Lease shall have been abated at any time and for any reason, then the term of the Coalinga Facility Lease shall be extended until the date upon which all the 2004D Bonds and other indebtedness of the Board incurred for such purposes shall have been fully paid and retired, except that the term of the Coalinga Facility Lease shall in no event be extended beyond December 1, 2029. If prior to December 1, 2029, the 2004D Bonds and other indebtedness of the Board incurred to pay for the Coalinga Project shall have been fully paid and retired, or the Coalinga Transfer Agreement shall have been terminated, then the term of the Coalinga Facility Lease shall end simultaneously therewith.

The term of the Susanville Facility Lease commenced on the date of issuance and initial delivery of the 1993D Susanville Bonds and shall end on June 1, 2018, unless such term is extended or sooner terminated as provided in the Susanville Facility Lease. If on June 1, 2018, all Bonds related to the Susanville Facility shall not have been fully paid and retired, or if the rental payable under the Susanville Facility Lease shall have been abated at any time and for any reason, then the term of the Susanville Facility Lease shall be extended until ten (10) days after all Bonds shall have been fully paid and retired and the Indenture shall be discharged by its terms, except that the term of the Susanville Facility Lease shall in no event be extended beyond October 1, 2028. If prior to October 1, 2028, all Bonds related to the Susanville Facility shall have been fully paid and retired and the Indenture shall be discharged by its terms, then the term of the Susanville Facility Lease shall end simultaneously therewith.

Rental

The Department agrees to pay to the Board, its successors or assigns, without deduction or offset of any kind, as rental for the use and occupancy of the Facility, the following amounts at the following times:

(a) *Base Rental*. In order to pay the principal of and interest on the Bonds, subject to the provisions of paragraph (g) below, the Department shall pay to the Board Base Rental under the Facility Lease in the semiannual installments set forth therein. Such Base Rental shall be due and payable on or before May 15 and November 15 in each year through November 15, 2019 in the case of the Coalinga Facility Lease and May 15, 2018 in the case of the Susanville Facility Lease, except that portion of the Base Rental due under the Susanville Facility Lease on November 15 which is required to be paid into the Principal Subaccount under the 2004E Indenture shall be paid on the earlier of November 15 or the date 30 days after the Budget Act for the applicable fiscal year. If any date for the payment of Base Rental is not a Business Day, such Base Rental shall be paid on the next succeeding Business Day. The payments of the Base Rental due on May 15 and November 15 of a calendar year as set forth in the Facility Lease shall be for the right to the use and occupancy of the Facility for the preceding six month period.

(b) *Additional Rental*. The Department shall pay to or upon the order of the Board as Additional Rental such reasonable amounts in each year as shall be required by the Board for the payment of all administrative costs and other expenses of the Board in connection with the Facility, including all expenses, compensation and indemnification of the State Treasurer payable by the Board under the Indenture, fees of accountants, fees of the Attorney General or attorneys, litigation costs, insurance premiums and all other necessary costs of the Board and the State Treasurer or charges required to be paid by them in order to comply with the terms of the Act, the Indenture, the Facility Lease or the Bonds. Such Additional Rental shall be billed by the Board or the State Treasurer from time to time, together with a statement certifying that the amount so billed has been paid by the Board or by the State Treasurer on behalf of the Board for one or more of the items above described, or that such amount is then payable by the Board or the State Treasurer on behalf of the Board for such items. Amounts so billed shall be due and payable by the Department within thirty (30) days after receipt of the bill by the Department.

(c) Such payments of Base Rental and Additional Rental for each rental payment period during the term of the Facility Lease shall constitute the total rental for such rental payment period, and shall be paid by the Department in each rental payment period for and in consideration of the right to the use and occupancy, and the continued quiet enjoyment, of the Facility during each such rental payment period for which such rental is paid. The parties to the Facility Lease have agreed and determined that the amount of such total rental does not exceed the fair rental value of the Facility. In making such determination, consideration has been given to the costs of the acquisition or construction, as applicable, of the Facility to be financed or refinanced by the Board with the proceeds of the Bonds, other obligations of the parties under the Facility Lease, the uses and purposes which may be served by the Facility and the benefits therefrom which will accrue to the Department and the general public.

(d) Each installment of rental payable under the Facility Lease shall be paid in lawful money of the United States of America to or upon the order of the Board in Sacramento, California, or such other place as the Board shall designate. Any such installment of rental which shall not be paid when due shall bear interest at the legal rate of interest per annum at which judgments for money in the State bear interest from the date when the same is due until the same shall be paid. Notwithstanding any dispute between the Board and the Department, the Department shall make all rental payments when due without deduction or offset of any kind and shall not withhold any rental payments pending the final resolution of such dispute.

(e) The Department covenants to take such action as may be necessary to include or cause to be included all such rental payments due under the Facility Lease in that portion of the budget of the State related to the Department and to make or cause to be made the necessary annual allocations for all such rental payments. The Department will furnish to the Board and the State Treasurer copies of that portion of the budget of the State related to the Department that contains the appropriation to pay rent under the Facility Lease, within ten (10) days after the Governor submits the budget to the State Legislature. The Department further covenants to take all actions necessary and appropriate to assist in implementing the procedure contained in California Government Code Section 15848 for making rental payments under the Facility Lease if the required rental payments have not been included in the annual budget adopted by the State or the State is operating without a budget. The covenants on the part of the Department contained in the Facility Lease shall be deemed to be and shall be construed to be ministerial, non-discretionary duties imposed by law and it shall be the duty of each and every public official of the Department to take such action and do such things as are required by law in the performance of the official duty of such officials to enable the Department to carry out and perform the agreements and covenants in the Facility Lease agreed to be carried out and performed by the Department.

(f) All rental payments received shall be applied first to the Base Rental due and thereafter to all Additional Rental due, but no such application of any payments which are less than the total rental due and owing shall be deemed a waiver of any default.

(g) The rental shall be abated proportionately during any period in which, by reason of any damage or destruction (other than by eminent domain), or title defect in the Site, there is substantial interference with the use and occupancy of the Facility or any portion thereof by the Department. Such abatement shall continue for the period commencing with such damage or destruction or title defect and ending when such use and occupancy are restored. The Department waives the benefits of California Civil Code Sections 1932(2) and 1933(4) and any and all other rights to terminate the Facility Lease by virtue of any such damage or destruction.

Financing the Project

The Board agrees to use the proceeds of the Bonds to finance and refinance the costs of the construction of the applicable Project and certain related costs (or for making reimbursements to the Board or any other state agency, public agency, person, firm or corporation for such costs theretofore paid by him, her or it), including all costs incidental to or connected with such construction, and to pay for the costs of issuance related to the Bonds.

Maintenance, Utilities, Taxes and Assessments

(a) During such time as the Department is in possession of the Facility, all maintenance and repair, both ordinary and extraordinary, of the Facility shall be the sole responsibility of the Department, which shall at all times maintain or otherwise arrange for the maintenance of the Facility in good condition, and the Department shall pay for or otherwise arrange for the payment of all utility services supplied to the Facility and shall pay for or otherwise arrange for the payment of the costs of the repair and replacement of the Facility resulting from ordinary wear and tear or want of care on the part of the Department or any other cause and shall pay for or otherwise arrange for the payment of all insurance policies required to be maintained with respect to the Facility.

(b) The Department shall also pay to the Board or upon the order of the Board, as Additional Rental such amounts, if any, in each year as shall be required by the Board for the payment of all taxes and assessments of any type or nature assessed or levied by any governmental agency or entity having power to levy taxes or assessments charged to the Board or the State Treasurer affecting or relating to the Facility or the respective interests or estates therein, or the amount of rentals received by the Board under the Facility Lease.

Changes to the Facility

At its sole cost and expense, the Department shall have the right during the term of the Facility Lease to make additions, betterments, extensions or improvements to the Facility or to attach fixtures, structures or signs to the Facility if such additions, betterments, extensions or improvements or fixtures, structures or signs are necessary or beneficial for the use of the Facility by the Department; provided, however, that any such changes to the Facility shall be made in a manner that does not result in an abatement of Base Rental.

Insurance

(a) (1) The Board shall maintain or cause to be maintained by the Department fire, lightning and extended coverage insurance on the Facility in an amount equal to one hundred percent (100%) of the then current replacement cost of the Facility, excluding the then value of the unimproved portions of the Site (except that such insurance may be subject to deductible clauses of not to exceed Two Million Five Hundred Thousand Dollars ($2,500,000) for any one loss as to the Coalinga Facility and Five Hundred Thousand Dollars ($500,000) for any one loss as to the Susanville Facility), and earthquake insurance (if such insurance is available on the open market from reputable insurance companies at a reasonable cost) on any structure comprising part of the Facility in an amount equal to the full insurable value of such structure or the principal amount of all Outstanding Bonds, whichever is less (except that such insurance may be subject to a deductible clause of not to exceed Two Million Five Hundred Thousand Dollars ($2,500,000) for any one loss as to the Coalinga Facility and Five Hundred Thousand Dollars ($500,000) for any one loss as to the Susanville Facility). The extended coverage endorsement shall, as nearly as practicable, cover loss or damage by explosion, windstorm, riot, aircraft, vehicle damage, smoke, vandalism and malicious mischief and such other hazards as are normally covered by such endorsement. Each such policy of insurance shall be in a form reasonably satisfactory to the Board and shall contain a clause making all losses payable to the Board, the State Treasurer and the Department, as their interests may appear, and all proceeds thereof shall be paid over to the party contractually responsible for making repairs of casualty damage or to the Board to redeem the Bonds as provided in the Facility Lease.

(2) In the event of any damage to or destruction of the Facility caused by the perils covered by such insurance, the proceeds of such insurance shall be utilized, in the discretion of the Board, either (i) to redeem Outstanding Bonds to the extent possible and in accordance with the provisions of the Indenture, but only if the Base Rental payments due after such a redemption would be sufficient to retire the Bonds then Outstanding in accordance with their terms, or (ii) for the repair, reconstruction or replacement of the Facility to the end that the Facility shall be restored to at least the same condition that it was in prior to such damage or destruction. Under the Coalinga Facility Lease, if the Board so elects to repair, reconstruct or replace the Facility, it shall do so with all practicable dispatch in an expeditious manner and in conformity with the law so as to complete the same as soon as possible. Any balance of such proceeds not required for such repair, reconstruction or replacement shall be transferred to the Board and treated as Revenues and applied in the manner provided in the Indenture.

(b) The Board shall maintain or cause to be maintained by the Department with respect to the Coalinga Facility rental interruption or use and occupancy insurance to cover loss, total or partial, of the use of the Coalinga Facility as a result of any of the hazards covered by the insurance required by subsection (a) of this section in an amount not less than the succeeding two (2) consecutive years' Base Rental. Alternatively, the Board will maintain or cause to be maintained by the Board or the Department with respect to the Coalinga Facility rental interruption or use and occupancy insurance under a blanket or umbrella or similar type of policy to cover loss, total or partial, of the use of all of the Coalinga Facility as a result of the hazards covered by the insurance required by paragraph (a) above in an amount not less than the succeeding two (2) consecutive years' Base Rental. The Department will maintain or cause to be maintained rental interruption or use and occupancy insurance on the Susanville Facility to cover loss, total or partial, of the use of the Susanville Facility as a result of the hazards covered by the insurance required by subsection (a) of this section in an amount not less than the total Base Rental payable by the Department under the Susanville Facility Lease for any period of at least two (2) consecutive years. Any such insurance policy shall be in form satisfactory to the Board in the case of the Coalinga Facility and the State Treasurer in the case of the Susanville Facility and shall contain a loss payable clause making any loss therein payable to the State Treasurer. Any proceeds of such insurance shall be used by the State Treasurer to reimburse the Department for any rental theretofore paid by the Department under the Facility Lease for a period of time during which the payment of rental is abated, and any proceeds of such insurance not so used shall be applied as provided in the Indenture to the extent required to pay annual debt service on the Bonds or shall be applied as provided in the Indenture to the extent required to pay administrative costs of the Board in connection with the Facility.

(c) The Department will deliver or cause to be delivered to the State Treasurer in the month of July in each year a schedule, in such detail as the State Treasurer in his discretion may request, setting forth the insurance policies then in force pursuant to the Facility Lease, the names of the insurers which have issued the policies, the amounts thereof and the property and risks covered thereby. Each such insurance policy shall require that the State Treasurer be given thirty (30) days notice of any intended cancellation thereof or reduction of the coverage provided thereby. Delivery to the State Treasurer of the schedule of insurance policies under the provisions of the Facility Lease shall not confer responsibility upon the State Treasurer as to the sufficiency of coverage or amounts of such policies. If so requested in writing by the State Treasurer, the Department shall also deliver or cause to be delivered to the State Treasurer duplicate originals or certified copies of each insurance policy described in such schedule.

Breach

(a) If the Department shall fail to pay any rental payable under the Facility Lease when the same becomes due and payable, time being expressly declared to be of the essence of the Facility Lease, or the Department shall fail to keep, observe or perform any other term, covenant or condition contained in the Facility Lease to be kept or performed by the Department for a period of sixty (60) days after notice of the same has been given to the Department by the Board or the State Treasurer plus such additional time as may be reasonably required in the sole discretion of the State Treasurer to correct any of the same, or upon the happening of any of the events specified in subsection (b) below, the Department shall be deemed to be in default under the Facility Lease and it shall be lawful for the Board to exercise any and all remedies available pursuant to law or granted pursuant to the Facility Lease. Upon any such default, the Board, in addition to all other rights and remedies it may have at law, shall have the option to do any of the following:

(1) To terminate the Facility Lease in the manner provided therein on account of default by the Department, notwithstanding any re-entry or re-letting of the Facility as provided for in subparagraph (2) below, and to re-enter the Facility and remove all persons in possession thereof and all personal property whatsoever situated upon the Facility and place such personal property in storage in any warehouse or other suitable place. In the event of such termination, the Department agrees to immediately surrender possession of the Facility, without let or hindrance, and to pay the Board all damages recoverable at law that the Board may incur by reason of default by the Department, including, without limitation, any costs, loss or damage whatsoever arising out of, in connection with, or incident to any such re-entry upon the Facility and removal and storage of such property by the Board or its duly authorized agents in accordance with the provisions of the Facility Lease. Neither notice to pay rent or to deliver up possession of the Facility given pursuant to law nor any entry or re-entry by the Board nor any proceeding in unlawful detainer, or otherwise, brought by the Board for the purpose of effecting such re-entry or obtaining possession of the Facility nor the appointment of a receiver upon initiative of the Board to protect the Board's interest under the Facility Lease shall of themselves operate to terminate the Facility Lease, and no termination of the Facility Lease on account of default by the Department shall be or become effective by operation of law or acts of the parties to the Facility Lease, or otherwise, unless and until the Board shall have given written notice to the Department of the election on the part of the Board to terminate the Facility Lease. The Department covenants and agrees that no surrender of the Facility or of the remainder of the term of the Facility Lease nor any termination of the Facility Lease shall be valid in any manner or for any purpose whatsoever unless stated or accepted by the Board by such written notice.

(2) Without terminating the Facility Lease, (i) to collect each installment of rent as it becomes due and enforce any other term or provision of the Facility Lease to be kept or performed by the Department, or (ii) to exercise any and all rights of entry and re-entry upon the Facility. If the Board does not elect to terminate the Facility Lease in the manner provided for in subparagraph (1) hereof, the Department shall remain liable and agrees to keep or perform all covenants and conditions under the Facility Lease contained to be kept or performed by the Department, and, if the Facility is not re-let, to pay the full amount of the rent to the end of the term of the Facility Lease or, if the Facility is re-let, to pay any deficiency in rent that results therefrom; and further agrees to pay such rent and/or rent deficiency punctually at the same time and in the same manner as provided in the Facility Lease for the payment of rent therein, notwithstanding the fact that the Board may have received in previous years or may receive thereafter in subsequent years rental in excess of the rental specified in the Facility Lease, and notwithstanding any entry or re-entry by the Board or suit in unlawful detainer or otherwise, brought by the Board for the purpose of effecting such re-entry or obtaining possession of the Facility. Should the Board elect to re-enter as under the Facility Lease provided, the Department irrevocably appoints the Board as the agent and attorney-in-fact of the Department to re-let the Facility, or any part thereof, from time to time, either in the Board's name or otherwise, upon such terms and conditions and for such use and period as the Board may deem advisable and to remove all persons in possession thereof and all personal property whatsoever situated upon the Facility and to place such personal property in storage in any warehouse or other suitable place for the Department, for the account of and at the expense of the Department, and the Department exempts and agrees to save harmless the Board from any costs, loss or damage whatsoever arising out of, in connection with, or incident to any such re-entry upon and re-letting of the Facility and removal and storage of such property by the Board or its duly authorized agents in accordance with the provisions contained in the Facility Lease except for any such costs, loss or damage resulting from the intentional or negligent actions of the Board or its agents. The Department agrees that the terms of the Facility Lease constitute full and sufficient notice of the right of the Board to re-let the Facility in the event of such re-entry without effecting a surrender of the Facility Lease, and further agrees

that no acts of the Board in effecting such re-letting shall constitute a surrender or termination of the Facility Lease irrespective of the use or the term for which such re-letting is made or the terms and conditions of such re-letting, or otherwise, but that, on the contrary, in the event of such default by the Department, the right to terminate the Facility Lease shall vest in the Board to be effected in the sole and exclusive manner provided for in subparagraph (1) hereof. The Department further waives the right to any rental obtained by the Board in excess of the rental specified in the Facility Lease and conveys and releases such excess to the Board as compensation to the Board for its services in re-letting the Facility. The Department further agrees to pay the Board the cost of any alterations or additions to the Facility necessary to place the Facility in condition for re-letting immediately upon notice to the Department of the completion and installation of such additions or alterations.

The Department waives any and all claims for damages caused or which may be caused by the Board in re-entering and taking possession of the Facility as under the Facility Lease provided and all claims for damages that may result from the destruction of or injury to the Facility and all claims for damages to or loss of any property belonging to the Department, or any other person, that may be in or upon the Facility, except in the case of the Coalinga Facility for such claims resulting from the intentional or negligent actions of the Board or its agents.

Upon the occurrence of an event of default, payments of Base Rental may not be accelerated.

Each and all of the remedies given to the Board under the Facility Lease or by any law now or hereafter enacted are cumulative and the single or partial exercise of any right, power or privilege under the Facility Lease shall not impair the right of the Board to other or further exercise thereof or the exercise of any or all other rights, powers or privileges. The term "re-let" or "re-letting" as used in this section shall include, but not be limited to, re-letting by means of the operation or other utilization by the Board of the Facility. If any statute or rule of law validly shall limit the remedies given to the Board under the Facility Lease, the Board nevertheless shall be entitled to whatever remedies are allowable under any statute or rule of law.

If the Board shall prevail in any action brought to enforce any of the terms and provisions of the Facility Lease, the Department agrees to pay a reasonable amount as and for attorney's fees incurred by the Board in attempting to enforce any of the remedies available to the Board under the Facility Lease, whether or not a lawsuit has been filed and whether or not any lawsuit culminates in a judgment.

(b) In addition to any default resulting from breach by the Department of any term or covenant of the Facility Lease, if (1) the interest of the Department in the Facility Lease or any part thereof be assigned, sublet or transferred without the written consent of the Board, either voluntarily or by operation of law, or (2) the Department or any assignee shall file any petition or institute any proceedings under any act or acts, state or federal, dealing with or relating to the subject of bankruptcy or insolvency or under any amendment of such act or acts, either as a bankrupt or as an insolvent or as a debtor or in any similar capacity, wherein or whereby the Department asks or seeks or prays to be adjudicated a bankrupt, or is to be discharged from any or all of the debts or obligations of the Department, or offers to the Department's creditors to effect a composition or extension of time to pay the Department's debts, or asks, seeks or prays for a reorganization or to effect a plan of reorganization or for a readjustment of the Department's debts or for any other similar relief, or if any such petition or if any such proceedings of the same or similar kind or character be filed or be instituted or taken against the Department, or if a receiver of the business or of the property or assets of the Department shall be appointed by any court, except a receiver appointed at the instance or request of the Board, or if the Department shall make a general or any assignment for the benefit of the Department's creditors, or (3) the Department shall abandon the Facility, then the Department shall be deemed to be in default under the Facility Lease.

(c) The Board shall in no event be in default in the performance of any of its obligations under the Facility Lease unless and until the Board shall have failed to perform such obligations within sixty (60) days or such additional time as is reasonably required to correct any such default after notice by the Department to the Board properly specifying wherein the Board has failed to perform any such obligation.

Eminent Domain

If the whole or any portion of the Facility shall be taken by eminent domain proceedings (or sold to a governmental entity threatening to exercise the power of eminent domain), the proceeds therefrom shall be deposited with the State Treasurer in a special fund in trust and shall be applied and disbursed by the State Treasurer as follows:

(a) If less than the entire Facility shall have been so taken and the remainder is usable for purposes substantially similar to those for which it was constructed, then the Facility Lease shall continue in full force and effect as to such remainder and (i) if the portion taken is replaced by a facility of equal or greater utility within or adjacent to such remainder, the State Treasurer shall disburse such proceeds to the party that incurred the expense of making such replacement and there shall not be any abatement of rental under the Facility Lease, or (ii) failing the making of such replacement, there shall be a partial abatement of rental under the Facility Lease and the State Treasurer shall apply such proceeds as specified in the Indenture.

(b) If less than the entire Facility shall have been so taken and the remainder is not usable for purposes substantially similar to those for which it was constructed, or if the entire Facility shall have been so taken, then the term of the Facility Lease shall cease as of the day that possession shall be so taken, and the State Treasurer shall apply such proceeds, together with any other money then available to it for such purpose, for the payment of the entire amount of principal then due or to become due upon all outstanding Bonds, together with the interest thereon so as to enable the Board to retire all of the Bonds then outstanding by redemption or by payment at maturity; except that if such proceeds, together with any other money, then lawfully available to it for such purpose, are insufficient to provide for the foregoing purpose, the State Treasurer shall apply such proceeds in accordance with the provisions of the Indenture so far as the same may be applicable.

Liens

In the event the Department shall at any time during the term of the Facility Lease cause any additions, betterments, extensions or improvements to the Facility to be constructed or materials to be supplied in or upon the Facility, the Department shall pay or cause to be paid when due all sums of money that may become due, or purporting to be due for any labor, services, materials, supplies or equipment furnished or alleged to have been furnished to or for the Department in, upon or about the Facility and shall keep the Facility free of any and all mechanics' or materialmen's liens or other liens against the Facility or the Board's interest therein. In the event any such lien attaches to or is filed against the Facility or the Board's interest therein, the Department shall cause each such lien to be fully discharged and released at the time the performance of any obligation secured by any such lien matures or becomes due, except that if the Department desires to contest any such lien it may do so. If any such lien shall be reduced to final judgment and such judgment or such process as may be issued for the enforcement thereof is not promptly stayed, or if so stayed and such stay thereafter expires, the Department shall forthwith pay or cause to be paid and discharged such judgment. The Department agrees to and shall, to the maximum extent permitted by law, indemnify and hold the Board, the State Treasurer, and their members, directors, agents, successors and assigns harmless from and against and defend each of them against any claim, demand, loss, damage, liability or expense (including attorneys' fees) as a result of any such lien or claim of lien against the Facility or the Board's interest therein.

Quiet Enjoyment

The parties to the Facility Lease mutually covenant that the Department, so long as it keeps and performs the agreements and covenants contained in the Facility Lease and is not in default thereunder, shall at all times during the term of the Facility Lease peaceably and quietly have, hold and enjoy the Facility without suit, trouble or hindrance from the Board.

Status of Private Activity Use of the Facility

The Department covenants and agrees to provide updated information to the Board and the State Treasurer annually regarding the private activity use of each component of the Facility. The information that must be updated annually is set forth in the Tax Certificate that was executed and delivered by the Board upon the initial issuance of the Bonds.

Continuing Disclosure

The Department covenants and agrees that it will cooperate with the Board and the State Treasurer to comply with and carry out all of the provisions of the Continuing Disclosure Agreement, and will provide all information reasonably requested by the Board or the State Treasurer regarding the Facility in connection with continuing disclosure obligations. Notwithstanding any other provision of the Facility Lease, failure of the Department to comply with the Continuing Disclosure Agreement shall not be considered an event of default under the Facility Lease and shall not be deemed to create any monetary liability on the part of the Board, the Department or the State Treasurer to any other persons, including the owners of the Bonds; however, the State Treasurer may (and, at the request of the owners of at least twenty-five percent (25%) aggregate principal amount of outstanding Bonds, shall), or any owner of the Bonds may, take such actions as may be necessary and appropriate, including seeking specific performance by court order, to cause the Department to comply with its obligations under this paragraph.

Law Governing

The Facility Lease shall be governed exclusively by its provisions and by the laws of the State as the same from time to time exist. Any action or proceeding to enforce or interpret any provision of the Facility Lease shall be brought, commenced or prosecuted in Sacramento County, California.

Net Lease

The Facility Lease shall be deemed and construed to be a "net lease" and the Department agrees that the rentals provided for therein shall be an absolute net return to the Board, free and clear of any expenses, charges or set-offs whatsoever.

Amendment

Except as may be necessary to provide for the issuance of an additional Series of Bonds in accordance with the 2004D Indenture, the Board will not alter or modify or agree or consent to alter or modify the Coalinga Facility Lease without the written consent of the Bond Insurer and the State Treasurer; the Board may, however, consent to other alterations or modifications thereof, including, among other things, for the purpose of disposing of a portion of the Site as permitted by the 2004D Indenture, with the written consent of the Bond Insurer and the State Treasurer, but only so long as (1) such alterations or modifications, in the opinion of the State Treasurer, will not result in any material impairment of the security given or intended to be given therein or in the 2004D Indenture for the payment of the Bonds, or (2) if the State Treasurer first obtains the written consent of the Holders of at least sixty percent (60%) in aggregate principal amount of the 2004D Bonds then Outstanding to such alterations or modifications (exclusive of the Holders of 2004D Bonds disqualified as provided in the 2004D Indenture); provided that no such alterations or modifications shall alter or impair the obligation of the Board to pay the interest on or principal of or redemption premium, if any, on any 2004D Bonds without the written consent of the Holders of all 2004D Bonds so affected.

Except as may be necessary to provide for the issuance of Additional Bonds in accordance with the 2004E Indenture, the Board will not alter or modify or agree or consent to alter or modify the Susanville Facility Lease without the written consent of the State Treasurer and the Bond Insurer for the 2004E Bonds; the

Board may, however, consent to other alterations or modifications with the written consent of the State Treasurer, but only so long as (1) such alterations or modifications, in the opinion of the State Treasurer, will not result in any material impairment of the security given or intended to be given herein or in the 2004E Indenture for the payment of the Bonds outstanding under the 2004E Indenture, (2) such amendments shall not materially adversely affect Ambac Assurance Corporation (the bond insurer for the 2001 Series A Bonds), or (3) if the State Treasurer first obtains the written consent of the Holders (as defined in the 2004E Indenture) of at least sixty percent (60%) in aggregate principal amount of the Bonds then Outstanding to such alterations or modifications (exclusive of the Holders of Bonds disqualified as provided in the 2004E Indenture); provided that no such alterations or modifications shall alter or impair the obligation of the Board to pay the interest on or principal of or redemption premium, if any, on any Bonds without the written consent of the Holders of all Bonds so affected.

Tax Covenants

The Department covenants that it will not use or permit any use of the Facility, and shall not take or permit to be taken any other action or actions, which would cause any Bond to be a "private activity bond" within the meaning of Section 141 of the Internal Revenue Code of 1986, as amended, and any applicable regulations promulgated from time to time therein.

APPENDIX D

SUMMARY OF CERTAIN PROVISIONS OF THE CONTINUING DISCLOSURE AGREEMENTS

Selected provisions of the Continuing Disclosure Agreements are briefly summarized below.

Definitions

Pursuant to each Continuing Disclosure Agreement (each, a "Disclosure Agreement" and collectively, the "Disclosure Agreements"), to be executed and delivered by and among the Board, the Department and the State Treasurer, acting as trustee, the following additional definitions will apply:

"Annual Report" means the Annual Report filed by the State Treasurer pursuant to, and as described in, the Disclosure Agreement.

"Bonds" means the 2004D Bonds and the 2004E Bonds.

"Listed Events" means any of the events listed below under "Reporting of Significant Events."

"National Repository" means any Nationally Recognized Municipal Securities Information Repository certified by the Securities and Exchange Commission to be the recipient of information of the nature of the Annual Reports required by the Disclosure Agreement.

"Official Statement" means the Official Statement relating to the Bonds, dated March 24, 2004.

"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 within the State created for the purpose of receiving information of the nature of the Annual Reports or reports of material events required by the Disclosure Agreement. As of the date of the Disclosure Agreement, there is no State Repository.

Provision of Annual Reports

On behalf of the State, the State Treasurer shall, not later than April 1 of each year in which each Series of Bonds are Outstanding commencing with the report for the 2003-2004 fiscal year to be filed on April 1, 2005, provide an Annual Report consistent with the requirements of the Disclosure Agreement to each Repository, with a copy to the Administrative Secretary of the Board; provided that the audited financial statements of the State may be submitted separately from the balance of the Annual Report and later than the date required above for the filing of the Annual Report if they are not available by that date. If the State's fiscal year changes, it shall give notice of such change in the same manner as for a Listed Event. The State Treasurer shall make a copy of any Annual Report available to any person who requests a copy at a cost not exceeding the reasonable cost of duplication and delivery.

If in any year, the State Treasurer does not transmit the Annual Report to each Repository by the time specified above, the State Treasurer shall instead file a notice with each Repository stating that the Annual Report has not been timely completed and, if known, stating the date by which the State Treasurer expects to file the Annual Report. The giving of a notice shall not excuse failure to file the Annual Report.

The Board and the Department shall each (i) provide to the State Treasurer not later than March 1 of each fiscal year, commencing with information to be provided on March 1, 2005 for fiscal year 2003-2004, any information requested by the State Treasurer in connection with the Annual Report; and (ii) provide at any other time in the year any information requested by the State Treasurer with respect to other disclosure obligations.

Content of Annual Reports

The Annual Report shall contain or incorporate by reference the following:

(1) The audited General Purpose Financial Statements of the State for the fiscal year ended on the previous June 30, prepared in accordance with generally accepted accounting principles promulgated to apply to government entities from time to time by the Governmental Accounting Standards Board. If the State's audited financial statements are not available by the time the Annual Report is required to be filed pursuant to the Disclosure Agreement, 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.

(2) Financial information relating to the State's General Fund budget for the fiscal year ended on the previous June 30 and for the fiscal year in which the Annual Report is issued, which information shall describe the sources of revenues, the principal categories of expenditures, and changes in fund balances and include a summary of expected State revenues and budgeted expenditures and significant assumptions relating to revenue and expenditure expectations, including updating the tables entitled: "Summary of State Revenues and Expenditures" and "Revenue and Expenditure Assumptions" appearing under the caption "APPENDIX A-THE STATE OF CALIFORNIA-CURRENT STATE BUDGET" in the Official Statement.

(3) Information concerning the total amount of the State's authorized and outstanding debt, long-term lease obligations, and other long-term liabilities as of the end of the most recent June 30, which debt is supported by payments from the State's General Fund and which includes short-term debt. Such information shall include schedules of debt service for outstanding general obligation bonds and lease-purchase debt. This shall be accomplished by updating the tables titled "State Public Works Board of the State of California Lease Revenue Bonds Secured by the Master Indenture Reserve Fund" appearing under the caption "THE STATE PUBLIC WORKS BOARD" in the Official Statement and the following tables which appear in "APPENDIX A-THE STATE OF CALIFORNIA-STATE DEBT TABLES": "Authorized and Outstanding General Obligation Bonds"; "Outstanding State Debt"; "Schedule of Debt Service Requirements for General Fund General Obligation Bonds"; "Schedule of Debt Service Requirements for Enterprise Fund General Obligation Bonds"; "Schedule of Debt Service Requirements for Lease-Purchase Debt"; "State Public Works Board and Other Lease-Purchase Financing Outstanding Issues"; and "State Agency Revenue Bonds and Conduit Financing".

(4) A statement confirming that the insurance required by the Facility Leases is in effect or, if insurance is not in effect, naming the reason therefor.

The Annual Report may consist of one or more documents. Any or all of the items listed above may be included in the Annual Report by reference to other documents which have been filed by the State with each of the Repositories, including any final official statement (in which case such final official statement must also be available from the Municipal Securities Rulemaking Board). The State Treasurer shall clearly identify in the Annual Report each such document so included by reference.

Reporting of Significant Events

Any of the following events shall be considered a "Listed Event":

(1) principal and interest payment delinquencies;
(2) non-payment related defaults;
(3) modifications to rights of Bondholders;
(4) optional, contingent, or unscheduled bond calls;
(5) defeasances;
(6) rating changes;
(7) adverse tax opinions or events affecting the tax-exempt status of the Bonds;
(8) unscheduled draws on debt service reserves reflecting financial difficulties;
(9) unscheduled draws on credit enhancements reflecting financial difficulties;
(10) substitution of credit or liquidity providers, or their failure to perform;
(11) release, substitution, or sale of property securing repayment of the Bonds; or
(12) any event which causes a Facility not to be available for beneficial use or occupancy by the Department.

Whenever the State Treasurer obtains knowledge of the occurrence of a Listed Event which is material under applicable federal securities laws, the State Treasurer shall timely file a notice of each such occurrence, if material, with the Municipal Securities Rulemaking Board and each Repository, with a copy to the Administrative Secretary of the Board.

Termination of Reporting Obligation

The State's obligations under the Disclosure Agreement shall terminate upon the maturity, legal defeasance, prior redemption, or acceleration of all of the Outstanding Bonds. If such termination occurs prior to the final maturity of the Bonds, the State Treasurer shall give notice of such termination in the same manner as for a Listed Event above.

Dissemination Agent

The State Treasurer may, from time to time, appoint or engage a Dissemination Agent to assist in carrying out the obligations under the 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 State Treasurer shall be the Dissemination Agent. The initial Dissemination Agent shall be the State Treasurer.

Amendment; Waiver

Notwithstanding any other provision of the Disclosure Agreement, the Board, each Participating Agency and the State Treasurer may amend or waive any provision of the Disclosure Agreement provided that the following conditions are satisfied:

(1) If the amendment or waiver relates to the provisions of Sections 3(a), 4 or 5(a) of the Disclosure Agreement, it may only be made in connection with a change in circumstances that arises from a change in legal requirements, change in law, or change in the identity, nature, or status of an obligated person with respect to the Bonds, or the type of business conducted;

(2) The undertaking, as amended or taking into account such waiver, would, in the opinion of nationally recognized bond counsel, have complied with the requirements of the Rule at the time of the original

issuance of the Bonds, after taking into account any amendments or interpretations of the Rule, as well as any change in circumstances; and

(3) The amendment or waiver either (i) is approved by the Holders of the Bonds in the same manner as provided in the related Indenture for amendments to such Indenture with the consent of Holders or (ii) does not, in the opinion of nationally recognized bond counsel, materially impair the interests of the Holders or Beneficial Owners of the Bonds.

Additional Information

Nothing in the Disclosure Agreement shall be deemed to prevent the Board, the Department or the State Treasurer from disseminating any other information, using the means of dissemination set forth in the 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 the Disclosure Agreement. If the Board, the Department or the State Treasurer 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 the Disclosure Agreement, neither the Board nor the Department nor the State Treasurer shall have any obligation under the Disclosure Agreement to update such information or include it in any future Annual Report or notice of occurrence of a Listed Event.

Default

In the event of a failure of the Board, the State Treasurer or the Department to comply with any provision of the Disclosure Agreement, the State Treasurer may (and, at the request of the Holders or Beneficial Owners of at least 25% aggregate principal amount of Outstanding Bonds, shall) or any Holder or Beneficial Owner of the Bonds may take such actions as may be necessary and appropriate, including seeking mandate or specific performance by court order, to cause the Board, the State Treasurer or the Department, as the case may be, to comply with its obligations under the Disclosure Agreement. A default under the Disclosure Agreement shall not be deemed an event of default under the related Indenture, and the sole remedy under the Disclosure Agreement in the event of any failure of the Board, the State Treasurer or the Department to comply with the Disclosure Agreement shall be an action to compel performance.

Beneficiaries

The Disclosure Agreement shall inure solely to the benefit of the Holders and Beneficial Owners from time to time of the Bonds, and shall create no rights in any other person or entity (except the right of the State Treasurer or any Bondholder or Beneficial Owner to enforce the provisions of the Disclosure Agreement on behalf of the Bondholders). The Disclosure Agreement is not intended to create any monetary rights on behalf of any person based upon the Rule.

APPENDIX E

DTC AND THE BOOK-ENTRY SYSTEM

THE INFORMATION IN THIS SECTION CONCERNING THE DEPOSITORY TRUST COMPANY, NEW YORK, NEW YORK ("DTC") AND DTC'S BOOK-ENTRY ONLY SYSTEM HAS BEEN OBTAINED FROM SOURCES THAT THE BOARD, THE STATE TREASURER AND THE UNDERWRITERS BELIEVE TO BE RELIABLE, BUT THE BOARD, THE STATE TREASURER AND THE UNDERWRITERS TAKE NO RESPONSIBILITY FOR THE ACCURACY HEREOF. THE BENEFICIAL OWNERS SHOULD CONFIRM THE FOLLOWING INFORMATION WITH DTC OR THE DTC PARTICIPANTS (AS HEREINAFTER DEFINED).

DTC will act as securities depository for the Bonds. The Bonds will be executed and delivered as fully registered bonds registered in the name of Cede & Co. (DTC's partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully registered Bond certificate will be executed and delivered for each maturity date of the Bonds for each Series, each in the aggregate principal amount of such Series due on such maturity date, 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, 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, (respectively, "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 the Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Bonds on DTC's records. The ownership interest of each actual purchaser of each 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 Bonds are to be accomplished by entries made on the books of Direct and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in the Bonds, except in the event that use of the book-entry system for the Bonds is discontinued.

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

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. Beneficial Owners of the Bonds may wish to take certain steps to augment the transmission to them of notices of significant events with respect to the Bonds, such as redemptions, tenders, defaults, and proposed amendments to the Bond documents. For example, Beneficial Owners of the Bonds may wish to ascertain that the nominee holding the Bonds for their benefit has agreed to obtain and transmit notices to Beneficial Owners. In the alternative, Beneficial Owners may wish to provide their names and addresses to the registrar and request that copies of the notices be provided directly to them.

Redemption notices shall be sent to DTC. The conveyance of notices and other communications by DTC to DTC Participants, by DTC Participants to Indirect Participants and by DTC Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. Any failure of DTC to advise any DTC Participant, or of any DTC Participant or Indirect Participant to notify a Beneficial Owner, of any such notice and its content or effect will not affect the validity of the redemption of the Bonds called for redemption or of any other action premised on such notice. Redemption of portions of the Bonds by the City will reduce the outstanding principal amount of Bonds held by DTC. In such event, DTC will implement, through its book-entry system, a redemption by lot of interests in the Bonds held for the account of DTC Participants in accordance with its own rules or other agreements with DTC Participants and then DTC Participants and Indirect Participants will implement a redemption of the Bonds for the Beneficial Owners. Any such selection of Bonds to be redeemed will not be governed by the Indenture and will not be conducted by the Board or the State Treasurer.

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

The Board and the State Treasurer may decide to discontinue use of the system of book-entry only transfers through DTC (or a successor securities depository). In that event, Bond certificates will be printed and delivered to DTC. DTC may discontinue providing its services as securities depository with respect to the Bonds at any time by giving reasonable notice to the Board or the State Treasurer. Under such circumstances, in the event that a successor securities depository is not obtained, Bond certificates are required to be printed and delivered.

SO LONG AS CEDE & CO. IS THE REGISTERED HOLDER OF THE BONDS, AS NOMINEE OF DTC, REFERENCES HEREIN TO THE HOLDERS OR HOLDERS OF THE BONDS (OTHER THAN UNDER THE CAPTION "TAX MATTERS" HEREIN) SHALL MEAN CEDE & CO. AND SHALL NOT MEAN THE BENEFICIAL OWNERS OF THE BONDS.

NONE OF THE STATE TREASURER, THE BOARD OR THE UNDERWRITERS HAS ANY RESPONSIBILITY OR OBLIGATION TO DTC DIRECT PARTICIPANTS, TO INDIRECT PARTICIPANTS, OR TO ANY BENEFICIAL OWNER WITH RESPECT TO (I) THE ACCURACY OF ANY RECORDS MAINTAINED BY DTC, ANY DTC DIRECT PARTICIPANT, OR INDIRECT PARTICIPANT, (II) THE DELIVERY OF ANY NOTICE THAT IS PERMITTED OR REQUIRED TO BE GIVEN TO THE HOLDERS OF THE BONDS UNDER THE RELATED INDENTURE, (III) THE SELECTION BY DTC OR ANY DTC DIRECT PARTICIPANT OR INDIRECT PARTICIPANT OF ANY PERSON TO RECEIVE PAYMENT IN THE EVENT OF A PARTIAL REDEMPTION OF THE BONDS, (IV) THE PAYMENT BY DTC OR ANY DTC DIRECT PARTICIPANT OR INDIRECT PARTICIPANT OF ANY AMOUNT WITH RESPECT TO THE PRINCIPAL OR REDEMPTION PREMIUM, IF ANY, OR INTEREST DUE WITH RESPECT TO THE BONDS, (V) ANY CONSENT GIVEN OR OTHER ACTION TAKEN BY DTC AS THE REGISTERED HOLDER OF BONDS, OR (VI) ANY OTHER MATTER.

THE STATE TREASURER, SO LONG AS A BOOK-ENTRY ONLY SYSTEM IS USED FOR THE BONDS, WILL SEND ANY NOTICE OF REDEMPTION OR OTHER NOTICES ONLY TO DTC. ANY FAILURE OF DTC TO ADVISE ANY DTC DIRECT OR INDIRECT PARTICIPANT, OR OF ANY DTC DIRECT OR INDIRECT PARTICIPANT TO NOTIFY ANY BENEFICIAL OWNER, OF ANY NOTICE AND ITS CONTENT OR EFFECT WILL NOT AFFECT THE VALIDITY OR SUFFICIENCY OF THE PROCEEDINGS RELATING TO THE REDEMPTION OF THE BONDS CALLED FOR REDEMPTION OR OF ANY OTHER ACTION PREMISED ON SUCH NOTICE.

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APPENDIX F

PROPOSED FORMS OF FINAL LEGAL OPINIONS OF THE ATTORNEY GENERAL AND BOND COUNSEL

Form Of Opinion Of The Attorney General

The Attorney General will deliver separate opinions for the 2004D Bonds and the 2004E Bonds which will be identical other than in the specific references to each Series and will be in substantially the following form:

[Closing Date]

State Public Works Board of the
State of California
Sacramento, California

State Public Works Board of the State of California
Lease Revenue Refunding Bonds
(Department of Corrections)
2004 Series _
([Project Name])
Final Opinion

Ladies and Gentlemen:

We have acted as counsel in connection with the issuance by the State Public Works Board of the State of California (the "Board") of $ aggregate principal amount of State Public Works Board of the State of California Lease Revenue Refunding Bonds (Department of Corrections) 2004 Series __ ([Project Name]) (the "Bonds"), issued pursuant to Part 10b of Division 3 of Title 2 of the Government Code of the State of California.

[The 2004D Bonds are being issued pursuant to the terms of an Indenture, dated as of April 1, 1994, as amended by the Tenth Supplemental Indenture dated as of September 1, 1996 and the Forty-Second Supplemental Indenture dated as of October 1, 2002 (collectively, the "Master Indenture"), as supplemented by a Fifty-First Supplemental Indenture, dated as of April 1, 2004 (the "Series D Supplemental Indenture" and together with the Master Indenture, the "Indenture"), each by and between the Board and the State Treasurer, as trustee (the "State Treasurer").]

[The 2004E Bonds are being issued pursuant to the terms of an Indenture, dated as of October 1, 1993 (the "Original Indenture"), as supplemented by a First Supplemental Indenture dated as of May 1, 1997, a Second Supplemental Indenture dated as of March 1, 2001 (the "Second Supplemental Indenture"), and a Third Supplemental Indenture dated as of April 1, 2004 (the Original Indenture and the foregoing Supplemental Indentures relating to the 2004E Bonds being herein collectively referred to as the "Indenture"), each by and between the Board and the State Treasurer, as trustee. Pursuant to the Original Indenture, the Board has previously issued its Lease Revenue Bonds (Department of Corrections) 1993 Series D (California State Prison - Lassen County, Susanville), in an aggregate principal amount of $318,295,000 (the "1993D Susanville Bonds"). Pursuant to the Second Supplemental Indenture, the Board issued its Lease Revenue Refunding Bonds (Department of Corrections) 2001 Series D (California State Prison – Lassen County, Susanville) in an aggregate principal amount of $87,795,000 (the "2001A Susanville Bonds"). The 2004E Bonds are issued on a parity with that portion of the 1993D Susanville Bonds which will remain outstanding after the refunding of the Prior Bonds, and with the 2001A Susanville Bonds.]

The Indenture provides that the Bonds are issued to provide funds to (i) refund certain bonds previously issued by the Board (the “Prior Bonds”) for the benefit of the Department of Corrections of the State of California (the "Department") the proceeds of which were used to finance and refinance the costs of construction of certain correctional facilities of the Department, (ii) make a deposit to the Master Indenture Reserve Fund, and (iii) pay the costs of issuance of the Bonds. Capitalized terms not otherwise defined herein shall have the meanings ascribed thereto in the Indenture.

In such connection, we have reviewed the Indenture, [the Site Lease,] the Facility Lease, opinions of counsel to the Department, the Board and others, and such other documents, opinions and matters to the extent we deemed necessary to render the opinions set forth herein. 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 Department, the Board and the State Treasurer. 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 above.

Certain agreements, requirements and procedures contained or referred to in the Indenture, the Facility Lease, 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 if any such change occurs or action is taken or omitted upon the advice or approval of counsel other than ourselves.

The opinions expressed herein are based on an analysis of existing laws, regulations, rulings and court decisions and cover certain matters not directly addressed by such authorities. Such opinions may be affected by actions taken or omitted or events occurring after the date hereof. We have not undertaken to determine, or to inform any person, whether any such actions are taken or omitted or events do occur or any other matters come to our attention after the date hereof, and we disclaim any obligation to update this opinion. Furthermore, we have assumed compliance with all covenants and agreements contained in the Indenture and the Facility Lease.

In addition, we call attention to the fact that the rights and obligations under the Bonds, the Indenture and the Facility Lease 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 governmental entities in the State of California. We express no opinion with respect to any indemnification, contribution, penalty, choice of law, choice of forum or waiver provisions contained in the foregoing documents, nor do we express any opinion with respect to the state or quality of title to or interest in any of the real or personal property described in the Facility Lease or the Indenture, or the accuracy or sufficiency of the description of any such property contained therein. 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 limited obligations of the Board.

2. The Indenture has been duly executed and delivered by, and constitutes the valid and binding agreement of, the parties thereto. The Indenture creates a valid pledge, to secure the payment of the principal of, and interest on, the Bonds, of the Revenues and any other amounts (including proceeds of the sale of the Bonds) held by the State Treasurer in any of the funds and accounts established pursuant to the Indenture, except the

Rebate Fund, subject to the provisions of the Indenture permitting the application thereof for the purposes and on the terms and conditions set forth in the Indenture.

3. The Facility Lease has been duly authorized, executed and delivered by, and constitutes the valid and binding agreement of, the parties thereto. The obligation of the Department to pay Base Rental during the terms of the Facility Lease constitutes a valid and binding obligation of the Department. Such Base Rental payable by the Department to the Board under the terms of the Facility Lease, and subject to the terms and conditions set forth therein, constitutes the primary source of funds of the Board for payment of the principal of, redemption premium, if any, and interest on, the Bonds, and such rental is payable only from funds of the Department legally available therefor.

4. The Bonds are not a lien or charge upon the funds or property of the Board except to the extent of the aforementioned pledge. Neither the faith and credit nor the taxing power of the State of California or of any political subdivision thereof is pledged to the payment of the principal of, redemption premium, if any, or interest on, the Bonds. The Bonds are not a debt of the Board, the Department or the State of California within the meaning of any constitutional or statutory debt limit or restriction and the State of California is not liable for payment thereof.

Sincerely,

Deputy Attorney General

For BILL LOCKYER
Attorney General

FORM OF OPINION OF BOND COUNSEL

__________, 2004

State Public Works Board of the
State of California
Sacramento, California

Re: *$186,110,000 State Public Works Board of the State of California Lease Revenue Refunding Bonds (Department of Corrections) 2004 Series D (California State Prison – Fresno County, Coalinga)*

$93,975,000 State Public Works Board of the State of California Lease Revenue Refunding Bonds (Department of Corrections) 2004 Series E (California State Prison – Lassen County, Susanville)

Ladies and Gentlemen:

We have acted as Bond Counsel in connection with the issuance by the State Public Works Board of the State of California (the "Board") of $186,110,000 aggregate principal amount of the Board's Lease Revenue Refunding Bonds (Department of Corrections) 2004 Series D (California State Prison – Fresno County, Coalinga) (the "2004D Bonds") and the $93,975,000 aggregate principal amount of the Board's Lease Revenue Refunding Bonds (Department of Corrections) 2004 Series E (California State Prison – Lassen County, Susanville) (the "2004E Bonds") (collectively, the "Bonds").

The 2004D Bonds are being issued pursuant to an indenture dated as of April 1, 1994, as amended by the Tenth Supplemental Indenture dated as of September 1, 1996 and the Forty-Second Supplemental Indenture dated as of October 1, 2002 (collectively, the "Master Indenture"), as supplemented by a Fifty-First Supplemental Indenture dated as of April 1, 2004 (together with the Master Indenture, the "2004D Indenture"), each by and between the State Public Works Board of the State of California (the "Board") and the State Treasurer, as trustee. The 2004D Bonds are payable, in part, from Base Rental payments made by the Department of Corrections (the "Department") pursuant to the terms of a facility lease dated as of April 1, 2004 (the "2004 D Facility Lease") by and between the Department and the Board.

The 2004E Bonds are being issued pursuant to the terms of an indenture dated as of October 1, 1993 (the "Original Series E Indenture"), as supplemented by a First Supplemental Indenture dated as of May 1, 1997, a Second Supplemental Indenture dated as of March 1, 2001 and a Third Supplemental Indenture dated as of April 1, 2004 (the Original Series E Indenture and the foregoing Supplemental Indentures being herein collectively referred to as the "2004E Indenture"), each by and between the Board and the State Treasurer, as trustee. The 2004D Indenture and the 2004E Indenture are collectively referred to herein as the "Indentures". The 2004E Bonds are payable, in part, from Base Rental payments made by the Department pursuant to the terms of a facility lease dated as of October 1, 1993 by and between the Department and the Board, as amended by the First Amendment to Facility Lease dated as of March 1, 2001, the Second Amendment to Facility Lease dated as of March 1, 2002 and the Third Amendment to Facility Lease dated as of April 1, 2004 (together with the 2004D Facility Lease, the "Facility Leases"). Unless otherwise defined herein, or the context otherwise requires, capitalized terms used herein shall have the meanings ascribed to them in the Indentures.

The Bonds are dated as of April 1, 2004, have been issued for the purposes set forth in the Indentures in fully registered form, bear interest from their dated date at the rates described in, and mature and are subject to redemption prior to maturity in the manner and upon the terms and conditions as set forth in, the Indentures.

The description of the Bonds and other statements concerning the terms and conditions of the issuance of the Bonds set forth herein do not purport to set forth all of the terms and conditions of the Bonds or of any other document relating to the issuance of the Bonds, but are intended only to identify the Bonds and to describe briefly certain features thereof. This opinion shall not be deemed or treated as an offering circular, prospectus or official statement, and is not intended in any way to be a disclosure document used in connection with the sale or delivery of the Bonds.

In rendering the opinions set forth below, we have examined certified copies of the proceedings of the Board, and other information submitted to us relative to the issuance and sale by the Board of the Bonds. We have examined originals, or copies identified to our satisfaction as being true copies, of the Indentures, the Facility Leases, the Transfer Agreement, the Site Lease and the Tax Certificate relating to the Bonds, the resolution of the Board adopted on March 15, 2004, opinions of counsel to the Department and the Board, certificates of the Department, the State Treasurer, the Board and others, and such other documents, agreements, opinions and matters as we have considered necessary or appropriate under the circumstances to render the opinions set forth herein.

We have assumed the genuineness of all documents and signatures presented to us, the authenticity of documents submitted as originals and the conformity to originals of documents submitted as copies. 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 preceding paragraphs of this opinion. Furthermore, we have assumed compliance with all covenants and agreements contained in the Indentures, the Facility Leases, the Transfer Agreement, the Site Lease 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 the 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 Indentures, the Facility Leases, the Transfer Agreement, the Site Lease and the Tax Certificate may be limited by bankruptcy, insolvency, reorganization, arrangement, fraudulent conveyance, moratorium and other laws relating to or affecting creditors' rights, by the application of equitable principles and the exercise of judicial discretion in appropriate cases and by the limitations on legal remedies against public agencies in the State of California.

We express no opinion herein with respect to any indemnification, contribution, choice of law, choice of forum, penalty or waiver provisions contained in the foregoing documents, nor do we express any opinion with respect to the state or quality of title to any of the real or personal property described in the Facility Leases, the Transfer Agreement or the Site Lease, or the accuracy or sufficiency of the description of any such property contained therein. 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.

We are admitted to the practice of law only in the State of California and our opinion is limited to matters governed by the laws of the State of California and federal income tax law. We assume no responsibility with respect to the applicability or the effect of the laws of any other jurisdiction.

Based on and subject to the foregoing, and in reliance thereon and on all matters of fact as we deem relevant under the circumstances, and upon consideration of applicable laws, we are of the opinion that:

1. The Bonds constitute the valid and binding limited obligations of the Board.

2. The Indentures have been duly authorized, executed and delivered by, and constitute valid and binding obligations of, the Board. Each Indenture creates a valid pledge, to secure the payment of the principal of and interest on the related series of Bonds issued thereunder, of the Revenues and any other amounts (including proceeds of the sale of such Bonds) held by the State Treasurer in any of the funds and accounts

established pursuant to such Indenture, except the Rebate Fund, subject to the provisions of the Indenture permitting the application thereof for the purposes and on the terms and conditions set forth in the Indenture. The 2004E Bonds are secured on a parity under the 2004E Indenture with the 1993 Series D Bonds and the 2001 Series A Bonds previously issued under the 2004E Indenture.

3. The Facility Leases, the Transfer Agreement and the Site Lease have been duly authorized and executed by the Board and the Department and constitute valid and binding agreements of the parties thereto. The obligation of the Department to pay Base Rental during the term of the Facility Leases constitutes a valid and binding obligation of the Department. The Base Rental payable by the Department to the Board under the terms of the Facility Lease related to a series of the Bonds, subject to the terms and conditions set forth therein, constitutes the primary source of funds of the Board for payment of the principal of, redemption premium, if any, and interest on such series of the Bonds, and such Base Rental is payable only from funds of the Department legally available therefor.

4. The Bonds are not a lien or charge upon the funds or property of the Board except to the extent of the aforementioned pledge under the Indentures. Neither the faith and credit nor the taxing power of the State of California or of any political subdivision thereof is pledged to the payment of the principal of, redemption premium, if any, or interest on the Bonds. The Bonds are not a debt of the Board or the State of California within the meaning of any constitutional or statutory debt limit or restriction, and the State is not liable for payment thereof.

5. Under existing statutes, regulations, rulings and judicial decisions, interest (and original issue discount) on the Bonds is excluded from gross income for federal income tax purposes and is not an item of tax preference for purposes of calculating the federal alternative minimum tax imposed on individuals and corporations; however, it should be noted that, with respect to corporations, such interest (and original issue discount) will be included as an adjustment in the calculation of alternative minimum taxable income, which may affect the alternative minimum tax liability of corporations. The foregoing opinion is subject to the condition that the Board and the Department comply with all requirements of the Internal Revenue Code of 1986, as amended (the "Code"), that must be satisfied subsequent to the issuance of the Bonds to assure that such interest (and original issue discount) will not become includable in gross income for federal income tax purposes. Failure to comply with such requirements of the Code might cause interest (and original issue discount) on the Bonds to be included in gross income for federal income tax purposes retroactive to the date of issuance of the Bonds. The Board and the Department have covenanted to comply with all such requirements.

6. Interest (and original issue discount) on the Bonds is exempt from State of California personal income tax.

7. The difference between the issue price of a Bond (the first price at which a substantial amount of the Bonds of a maturity are to be sold to the public) and the stated redemption price at maturity with respect to such Bond constitutes original issue discount. Original issue discount accrues under a constant yield method, and original issue discount will accrue to a Bond owner before receipt of cash attributable to such excludable income. The amount of original issue discount deemed received by a Bond owner will increase the Bond owner's basis in the applicable Bond. Original issue discount that accrues for the Bond owner is excluded from the gross income of such owner for federal income tax purposes, is not an item of tax preference for purposes of calculating the federal alternative minimum tax imposed on individuals or corporations (as described in paragraph 5 above) and is exempt from State of California personal income tax.

8. The amount by which a Bondholder's original basis for determining loss on sale or exchange in the applicable Bond (generally, the purchase price) exceeds the amount payable on maturity (or on an earlier call date) constitutes amortizable Bond premium, which must be amortized under Section 171 of the Code; such amortizable Bond premium reduces the Bondholder's basis in the applicable Bond (and the amount of tax-exempt interest received), and is not deductible for federal income tax purposes. The basis reduction as a result of the amortization of Bond premium may result in a Bondholder realizing a taxable gain when a Bond is sold

by the holder for an amount equal to or less (under certain circumstances) than the original cost of the Bond to the holder.

Except as set forth in paragraphs 5, 6, 7 and 8 above, we express no opinion as to any tax consequences related to the Bonds. Other provisions of the Code may give rise to adverse federal income tax consequences to particular Bondholders. The scope of this opinion is limited to matters addressed above and no opinion is expressed hereby regarding other federal tax consequences that may arise due to ownership of the Bonds.

Certain agreements, requirements and procedures contained or referred to in the Indentures, the Facility Leases, the Transfer Agreement, the Site Lease and the Tax Certificate relating to the Bonds 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. We express no opinion herein as to the exclusion from gross income for federal income tax purposes of interest (or original issue discount) on the Bonds if any such change occurs or action is taken or omitted upon the advice or approval of counsel other than Stradling Yocca Carlson & Rauth, a Professional Corporation.

The opinions expressed herein are based on an analysis of existing laws, regulations, rulings and court decisions and cover certain matters not directly addressed by such authorities. Such opinions may be affected by actions taken or omitted or events occurring after the date hereof. We have not undertaken to determine, or to inform any person, whether any such actions are taken or omitted or events do occur, and we disclaim any obligation to update this opinion. Our engagement as Bond Counsel terminates upon the issuance of the Bonds.

The scope of our engagement in relation to the issuance of the Bonds has been limited solely to the examination of facts and law incident to rendering the opinions expressed herein. We have not been engaged or undertaken to review, confirm or verify, and therefore express no opinion herein as to, the accuracy, completeness, fairness or sufficiency of any of the statements in the Official Statement or any exhibits or appendices thereto or any other offering material relating to the Bonds. In addition, we have not been engaged to and therefore express no opinion as to the compliance by the Board or the underwriters with any federal or state statute, regulation or ruling with respect to the sale or distribution of the Bonds.

Respectfully submitted,

STRADLING YOCCA CARLSON & RAUTH, a Professional Corporation

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APPENDIX G

SPECIMENS OF BOND INSURANCE POLICIES OF MBIA INSURANCE CORPORATION AND XL CAPITAL ASSURANCE INC.

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Specimen of Bond Insurance Policy of
MBIA Insurance Corporation

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FINANCIAL GUARANTY INSURANCE POLICY

MBIA Insurance Corporation
Armonk, New York 10504

Policy No. [NUMBER]

MBIA Insurance Corporation (the "Insurer"), in consideration of the payment of the premium and subject to the terms of this policy, hereby unconditionally and irrevocably guarantees to any owner, as hereinafter defined, of the following described obligations, the full and complete payment required to be made by or on behalf of the Issuer to [PAYING AGENT/TRUSTEE] or its successor (the "Paying Agent") of an amount equal to (i) the principal of (either at the stated maturity or by any advancement of maturity pursuant to a mandatory sinking fund payment) and interest on, the Obligations (as that term is defined below) as such payments shall become due but shall not be so paid (except that in the event of any acceleration of the due date of such principal by reason of mandatory or optional redemption or acceleration resulting from default or otherwise, other than any advancement of maturity pursuant to a mandatory sinking fund payment, the payments guaranteed hereby shall be made in such amounts and at such times as such payments of principal would have been due had there not been any such acceleration); and (ii) the reimbursement of any such payment which is subsequently recovered from any owner pursuant to a final judgment by a court of competent jurisdiction that such payment constitutes an avoidable preference to such owner within the meaning of any applicable bankruptcy law. The amounts referred to in clauses (i) and (ii) of the preceding sentence shall be referred to herein collectively as the "Insured Amounts." "Obligations" shall mean:

[PAR]
[LEGAL NAME OF ISSUE]

Upon receipt of telephonic or telegraphic notice, such notice subsequently confirmed in writing by registered or certified mail, or upon receipt of written notice by registered or certified mail, by the Insurer from the Paying Agent or any owner of an Obligation the payment of an Insured Amount for which is then due, that such required payment has not been made, the Insurer on the due date of such payment or within one business day after receipt of notice of such nonpayment, whichever is later, will make a deposit of funds, in an account with U.S. Bank Trust National Association, in New York, New York, or its successor, sufficient for the payment of any such Insured Amounts which are then due. Upon presentment and surrender of such Obligations or presentment of such other proof of ownership of the Obligations, together with any appropriate instruments of assignment to evidence the assignment of the Insured Amounts due on the Obligations as are paid by the Insurer, and appropriate instruments to effect the appointment of the Insurer as agent for such owners of the Obligations in any legal proceeding related to payment of Insured Amounts on the Obligations, such instruments being in a form satisfactory to U.S. Bank Trust National Association, U.S. Bank Trust National Association shall disburse to such owners, or the Paying Agent payment of the Insured Amounts due on such Obligations, less any amount held by the Paying Agent for the payment of such Insured Amounts and legally available therefor. This policy does not insure against loss of any prepayment premium which may at any time be payable with respect to any Obligation.

As used herein, the term "owner" shall mean the registered owner of any Obligation as indicated in the books maintained by the Paying Agent, the Issuer, or any designee of the Issuer for such purpose. The term owner shall not include the Issuer or any party whose agreement with the Issuer constitutes the underlying security for the Obligations.

Any service of process on the Insurer may be made to the Insurer at its offices located at 113 King Street, Armonk, New York 10504 and such service of process shall be valid and binding.

This policy is non-cancellable for any reason. The premium on this policy is not refundable for any reason including the payment prior to maturity of the Obligations.

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

IN WITNESS WHEREOF, the Insurer has caused this policy to be executed in facsimile on its behalf by its duly authorized officers, this [DAY] day of [MONTH, YEAR].

MBIA Insurance Corporation

SPECIMEN

President

Assistant Secretary

STATEMENT OF INSURANCE

MBIA Insurance Corporation (the "Insurer") has issued a policy containing the following provisions, such policy being on file at [INSERT NAME OF TRUSTEE OR PAYING AGENT, INCLUDING CITY, STATE].

The Insurer, in consideration of the payment of the premium and subject to the terms of this policy, hereby unconditionally and irrevocably guarantees to any owner, as hereinafter defined, of the following described obligations, the full and complete payment required to be made by or on behalf of the Issuer to [INSERT NAME OF TRUSTEE OR PAYING AGENT] or its successor (the "Paying Agent") of an amount equal to (i) the principal of (either at the stated maturity or by any advancement of maturity pursuant to a mandatory sinking fund payment) and interest on, the Obligations (as that term is defined below) as such payments shall become due but shall not be so paid (except that in the event of any acceleration of the due date of such principal by reason of mandatory or optional redemption or acceleration resulting from default or otherwise, other than any advancement of maturity pursuant to a mandatory sinking fund payment, the payments guaranteed hereby shall be made in such amounts and at such times as such payments of principal would have been due had there not been any such acceleration); and (ii) the reimbursement of any such payment which is subsequently recovered from any owner pursuant to a final judgment by a court of competent jurisdiction that such payment constitutes an avoidable preference to such owner within the meaning of any applicable bankruptcy law. The amounts referred to in clauses (i) and (ii) of the preceding sentence shall be referred to herein collectively as the "Insured Amounts." "Obligations" shall mean: [INSERT LEGAL TITLE OF BONDS, CENTERED AS FOLLOWS:]

[$ PAR AMOUNT]
[ISSUER]
[DESCRIPTION OF BONDS]

Upon receipt of telephonic or telegraphic notice, such notice subsequently confirmed in writing by registered or certified mail, or upon receipt of written notice by registered or certified mail, by the Insurer from the Paying Agent or any owner of an Obligation the payment of an Insured Amount for which is then due, that such required payment has not been made, the Insurer on the due date of such payment or within one business day after receipt of notice of such nonpayment, whichever is later, will make a deposit of funds, in an account with U.S. Bank Trust National Association, in New York, New York, or its successor, sufficient for the payment of any such Insured Amounts which are then due. Upon presentment and surrender of such Obligations or presentment of such other proof of ownership of the Obligations, together with any appropriate instruments of assignment to evidence the assignment of the Insured Amounts due on the Obligations as are paid by the Insurer, and appropriate instruments to effect the appointment of the Insurer as agent for such owners of the Obligations in any legal proceeding related to payment of Insured Amounts on the Obligations, such instruments being in a form satisfactory to U.S. Bank Trust National Association, U.S. Bank Trust National Association shall disburse to such owners or the Paying Agent payment of the Insured Amounts due on such Obligations, less any amount held by the Paying Agent for the payment of such Insured Amounts and legally available therefor. This policy does not insure against loss of any prepayment premium which may at any time be payable with respect to any Obligation.

As used herein, the term "owner" shall mean the registered owner of any Obligation as indicated in the books maintained by the Paying Agent, the Issuer, or any designee of the Issuer for such purpose. The term owner shall not include the Issuer or any party whose agreement with the Issuer constitutes the underlying security for the Obligations.

Any service of process on the Insurer may be made to the Insurer at its offices located at 113 King Street, Armonk, New York 10504 and such service of process shall be valid and binding.

This policy is non-cancellable for any reason. The premium on this policy is not refundable for any reason including the payment prior to maturity of the Obligations.

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

MBIA INSURANCE CORPORATION

Specimen of Bond Insurance Policy of XL Capital Assurance Inc.

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XL CAPITAL ASSURANCE

1221 Avenue of the Americas
New York, New York 10020
Telephone: (212) 478-3400

MUNICIPAL BOND INSURANCE POLICY

ISSUER: [ ] **Policy No:** [ ]

BONDS: [ ] **Effective Date:** [ ]

XL Capital Assurance Inc. (XLCA), a New York stock insurance company, in consideration of the payment of the premium and subject to the terms of this Policy (which includes each endorsement attached hereto), hereby agrees unconditionally and irrevocably to pay to the trustee (the "Trustee") or the paying agent (the "Paying Agent") (as set forth in the documentation providing for the issuance of and securing the Bonds) for the benefit of the Owners of the Bonds or, at the election of XLCA, to each Owner, that portion of the principal and interest on the Bonds that shall become Due for Payment but shall be unpaid by reason of Nonpayment.

XLCA will pay such amounts to or for the benefit of the Owners on the later of the day on which such principal and interest becomes Due for Payment or one (1) Business Day following the Business Day on which XLCA shall have received Notice of Nonpayment (provided that Notice will be deemed received on a given Business Day if it is received prior to 10:00 a.m. Pacific time on such Business Day; otherwise it will be deemed received on the next Business Day), but only upon receipt by XLCA, in a form reasonably satisfactory to it, of (a) evidence of the Owner's right to receive payment of the principal or interest then Due for Payment and (b) evidence, including any appropriate instruments of assignment, that all of the Owner's rights with respect to payment of such principal or interest that is Due for Payment shall thereupon vest in XLCA. Upon such disbursement, XLCA shall become the owner of the Bond, any appurtenant coupon to the Bond or the right to receipt of payment of principal and interest on the Bond and shall be fully subrogated to the rights of the Owner, including the Owner's right to receive payments under the Bond, to the extent of any payment by XLCA hereunder. Payment by XLCA to the Trustee or Paying Agent for the benefit of the Owners shall, to the extent thereof, discharge the obligation of XLCA under this Policy.

In the event the Trustee or Paying Agent has notice that any payment of principal or interest on a Bond which has become Due for Payment and which is made to an Owner by or on behalf of the Issuer of the Bonds has been recovered from the Owner pursuant to a final judgment by a court of competent jurisdiction that such payment constitutes an avoidable preference to such Owner within the meaning of any applicable bankruptcy law, such Owner will be entitled to payment from XLCA to the extent of such recovery if sufficient funds are not otherwise available.

The following terms shall have the meanings specified for all purposes of this Policy, except to the extent such terms are expressly modified by an endorsement to this Policy. "Business Day" means any day other than (a) a Saturday or Sunday or (b) a day on which banking institutions in the State of California, the State of New York or the Insurer's Fiscal Agent are authorized or required by law or executive order to remain closed. "Due for Payment", when referring to the principal of Bonds, is when the stated maturity date or a mandatory redemption date for the application of a required sinking fund installment has been reached and does not refer to any earlier date on which payment is due by reason of call for redemption (other than by application of required sinking fund installments), acceleration or other advancement of maturity, unless XLCA shall elect, in its sole discretion, to pay such principal due upon such acceleration; and, when referring to interest on the Bonds, is when the stated date for payment of interest has been reached. "Nonpayment" means the failure of the Issuer to have provided sufficient funds to the Trustee or Paying Agent for payment in full of all principal and interest on the Bonds which are Due for Payment. "Notice" means telephonic or telecopied notice, subsequently confirmed in a signed writing, or written notice by registered or certified mail, from an Owner, the Trustee or the Paying Agent to XLCA which notice shall specify (a) the person or entity making the claim, (b) the Policy Number, (c) the claimed amount and (d) the date such claimed amount became Due for Payment. "Owner" means, in respect of a Bond, the person or entity who, at the time of Nonpayment, is entitled under the terms of such Bond to payment thereof, except that "Owner" shall not include the Issuer or any person or entity whose direct or indirect obligation constitutes the underlying security for the Bonds.

XLCA may, by giving written notice to the Trustee and the Paying Agent, appoint a fiscal agent (the "Insurer's Fiscal Agent") for purposes of this Policy. From and after the date of receipt by the Trustee and the Paying Agent of such notice, which shall specify the name and notice address of the Insurer's Fiscal Agent, (a) copies of all notices required to be delivered to XLCA pursuant to this Policy shall be simultaneously delivered to the Insurer's Fiscal Agent and to XCLA and shall not be deemed received until received by both and (b) all payments required to be made by XLCA under this Policy may be made directly by XLCA or by the Insurer's Fiscal Agent on behalf of XLCA. The Insurer's Fiscal Agent is the agent of XLCA only and the Insurer's Fiscal Agent shall in no event be liable to any Owner for any act of the Insurer's Fiscal Agent or any failure of XLCA to deposit or cause to be deposited sufficient funds to make payments due hereunder.

Except to the extent expressly modified by an endorsement hereto, (a) this Policy is non-cancelable by XLCA, and (b) the Premium on this Policy is not refundable for any reason. This Policy does not insure against loss of any prepayment or other acceleration payment which at any time may become due in respect of any Bond, other than at the sole option of XLCA, nor against any risk other than Nonpayment. This Policy sets forth the full undertaking of XLCA and shall not be modified, altered or affected by any other agreement or instrument, including any modification or amendment thereto.

IN THE EVENT THAT XLCA WERE TO BECOME INSOLVENT, ANY CLAIMS ARISING UNDER THIS POLICY ARE NOT COVERED BY THE CALIFORNIA GUARANTY INSURANCE FUND SPECIFIED IN ARTICLE 12119(b) OF THE CALIFORNIA INSURANCE CODE.

In witness whereof, XLCA has caused this Policy to be executed on its behalf by its duly authorized officers.

SPECIMEN	**SPECIMEN**
Name:	Name:
Title:	Title:

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