



WESTERN HILLS WATER DISTRICT

FINANCIAL STATEMENTS

JUNE 30, 2007 AND 2006

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INDEPENDENT AUDITORS' REPORT

Board of Directors
Western Hills Water District
Patterson, California

We have audited the accompanying balance sheets of the Western Hills Water District (the "District") as of June 30, 2007 and 2006 and the related statements of revenues and expenses and changes in retained earnings (deficit), and statements of cash flows for the years then ended. These financial statements are the responsibility of the District's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the State Controller's Audit Requirements for California Special Districts. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the District as of June 30, 2007 and 2006, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America, as well as accounting systems prescribed by the State Controller's office for special districts.

The accompanying financial statements have been prepared assuming the District will continue as a going concern. The District continues to experience significant losses. The operating results coupled with the bankruptcy of the project's developer (see Note 8) raise substantial doubt about the District's ability to continue as a going concern. As discussed in Note 9, the financial statements do not include adjustments that might result from the outcome of this uncertainty.

Cropper Accountancy Corporation
CROPPER ACCOUNTANCY CORPORATION

May 24, 2012

Western Hills Water District

MANAGEMENT'S DISCUSSION AND ANALYSIS

For Year Ending June 30, 2007

This section of the District's annual financial report presents our analysis of the District's financial performance during the Fiscal Year that ended on June 30, 2007. Please read it in conjunction with the Basic Financial Statements, which follow this section.

FINANCIAL HIGHLIGHTS

- The District's total assets increased by \$1.97 million, or 3.5%, to \$57.5 million.
- During the year the District's operating revenue increased by 163% to \$758 thousand, while operating expenses increased by 18.2% to \$3.3 million.
- Net assets decreased by \$1.42 million to \$(3.34) million.

OVERVIEW OF THE FINANCIAL STATEMENTS

The discussion and analysis are intended to serve as an introduction to Western Hills Water District's basic financial statements. The District's MD&A is comprised of five components: Net Assets, Financial Statements, Capital Assets, Long-Term Debt and Subsequent Event- Bankruptcy of Developer. This report also contains other supplementary information based on these statements.

BASIC FINANCIAL STATEMENTS

The Statement of Net Assets includes all of the District's assets and liabilities and provides information about the nature and amounts of investments in resources (assets) and the obligations to District creditors (liabilities). It also provides the basis for computing rate of return, evaluating the capital structure of the District and assessing the liquidity and financial flexibility of the District.

The Financial Statements of the District report information about the District using accounting methods similar to those used by private section companies. These statements offer short and long-term financial information about its activities.

Capital assets, shown in Table 3, inform our bondholders that Western Hills Water District is spending their bond money in a manner that is consistent with increasing the assets that will ensure the company's overall future health.

Long-term debt has been secured by the special assessment on all property owned in this phase. These assessments will be charged through the year 2031. Even though the bonds are not the obligation of Western Hills Water District, the District has agreed to assume the accounting responsibility for these bonds.

FINANCIAL ANALYSIS OF THE DISTRICT

One of the most important questions asked about the District's finances is, "Is the District, as a whole better off or worse off as a result of the year's activities?" You can think of the District's net assets (the difference between assets and liabilities) as one way to measure financial health or financial position. Over time, increases or decreases in the District's net assets are one indicator of whether its financial health is improving or deteriorating. However, until a startup company has stabilized, there may be mitigating factors on why net assets tend to fluctuate up and down as shown in Table 1 below.

NET ASSETS

To begin our analysis, a summary of the District's Statement of Net Assets is presented in Table 1. As can be seen from the table below, net assets decreased by \$1.42 million to \$(3.34) million in fiscal year 2007. This is down from \$(1.92) million in fiscal year 2006. This decrease is a result of the following:

1. Assets increased by \$1.97 million, primarily due to construction in progress.
2. Liabilities increased by \$3.39 million, primarily due to a \$4.36 million government loan.

TABLE 1
Condensed Statements of Net Assets
(000)

	2007	2006
Current and Other Assets	\$ 122	\$ 111
Restricted Assets	7,710	7,412
Fixed Assets	42,009	39,305
Other Assets	7,690	8,731
Total Assets	57,531	55,559
Current Liabilities	3,174	2,734
Long-Term Debt	57,697	54,745
Total Liabilities	60,871	57,479
Net Assets	\$ (3,340)	\$ (1,920)

FINANCIAL STATEMENTS

Western Hill's financial statements are extremely lopsided on the expense side. This is due to the fact that Western Hills is a very new district and has very few customers. This will be the norm until residential and commercial projects are started and completed for this district. Please see 2008's challenges at the end of this report.

TABLE 2
Statement of Revenues & Expenses
For the Years ended June 30, 2007 and 2006
(000)

	<u>2007</u>	<u>2006</u>	<u>Total % Change Fav/(Unfav)</u>
Total Revenues	\$ 758	\$ 288	163.0%
Total Operating Expenses (less depreciation)	<u>2,225</u>	<u>1,759</u>	<u>(26.5%)</u>
Net Operating Loss Before Depreciation	<u>\$ (1,467)</u>	<u>\$ (1,471)</u>	<u>(0.2%)</u>

CAPITAL ASSETS

During 2007, the District invested \$3.8 million in a broad range of infrastructure including water treatment facilities, and sewer line.

TABLE 3
Capital Assets
(000)

	<u>2007</u>	<u>2006</u>	<u>Dollar Change</u>	<u>Total Percent Change</u>
Water Treatment Facilities	\$ 10,704	\$ 10,704	\$ 0	0.0%
Pump Station & Well	3,058	3,058	0	0.0%
Aqueduct Turnout	746	746	0	0.0%
Wastewater Treatment Facility	28,104	28,104	0	0.0%
Other	<u>4,058</u>	<u>261</u>	<u>3,797</u>	<u>1455%</u>
Subtotal	<u>46,670</u>	<u>42,873</u>	<u>3,797</u>	<u>8.9%</u>
Less Accumulated Depreciation	<u>4,661</u>	<u>3,568</u>	<u>1,093</u>	<u>(30.6%)</u>
Net Book Value	<u>\$ 42,009</u>	<u>\$ 39,305</u>	<u>\$ 2,704</u>	<u>6.9%</u>

LONG TERM DEBT

At year-end, the District had \$59.1 million in long-term debt. This is a net increase of \$3.3 million from 2006, primarily due to a contractual agreement with Caterpillar Financial Service Corporation for \$4.358 million used to purchase five generator sets.

The District has outstanding general obligation debt stemming from Mello-Roos bonds issued in August 2001, December 2002, May 2004 and June 2005. The District's current average cost of capital is 6.0% in outstanding debt, as shown on Table 4. Amortized discount and deferred loss on refunding are not included in the outstanding bond balance shown on Table 4 below.

TABLE 4
Outstanding Debt
(000)

	<u>Debt Balance</u>	<u>Average Coupon Rate</u>
General Obligation Bonds	<u>\$ 54,745</u>	<u>6.0%</u>
Caterpillar Note Payable	<u>\$ 4,358</u>	<u>5.97%</u>

SUBSEQUENT EVENT- BANKRUPTCY OF DEVELOPER

Over the years the District has struggled to provide funding for its operating expenses and construction requirements. In the early years, the developer, Diablo Grande LP covered these shortfalls by providing cash injections and paying the District's invoices for total contributions in aid of construction of \$8.206 million. In addition, in 2002, the District was required to post a bond in the amount of \$605 thousand with the Army Corps of Engineers to comply with regulations and cover any costs due to leaking or spillage. The District did not have the money to purchase the bond so Diablo Grande LP funded the bond, which was also treated as a contribution in aid of construction.

Due to rising construction costs and litigation, both the District and Diablo Grande LP faced cash flow challenges. From 2001 to 2008 the District would borrow money from Diablo Grande LP to pay for construction costs and then pay these costs back when the money was available, and Diablo Grande LP would also borrow money from the District. In March of 2008, Diablo Grande LP filed for bankruptcy under Chapter 11. When this event happened Diablo Grande LP owed the District \$1.7 million. Due to the real estate market at the time of the bankruptcy, the District will not be able to recover this money, and has written off the full amount of the outstanding receivable as a bad debt expense in 2005.

During the bankruptcy proceedings for Diablo Grande LP, the bond with the Army Corps of Engineers was drawn into the proceedings. Since the bond was in the name of Diablo Grande LP the District had no say in the matter and was forced to write the bond off the books in 2005, with an offsetting reduction in contribution in aid of construction for Diablo Grande LP's original investment of \$605 thousand.

The District has performed a review and determined that with the write-off of the money owed by Diablo Grande LP and the forfeiture of the bond, there are no remaining ties with the now defunct company Diablo Grande LP.

2008 CHALLENGES AND A LOOK AT THE FUTURE:

Western Hills Water District's assets are notably in place as of June 30, 2007. The only notable change in assets was an additional \$3.8 million in costs for the Raw Water Pump Station Upgrade/SCADA system.

Financial operations are limited due to a small customer base. At this time, the water company receives its income from two golf courses, sixty acres of grapes and residential housing.

Western Hill's future projects include the pump station upgrades, water treatment facilities upgrade and chlorination system.

All in all it will take more than 10 years for Western Hills to be even close to breaking even. Due to the Bankruptcy of the developer, it had been a concern of Western Hills that it could not pay its operating expenses since the developer had been paying the shortfall. In light of the development being sold Western Hills will continue to keep paying its bills through the assumed obligation of the new owners.

CONTACTING THE DISTRICT'S FINANCIAL MANAGER

This financial report is designed to provide our customers, investors, and creditors with a general overview of the District's finances and to demonstrate the District's accountability for the money it receives.

If you have questions about this report or need additional financial information please contact Western Hills Water District.

Western Hills Water District
c/o Charles Smith, Financial Manager
9521 Morton Davis Drive
Diablo Grande, CA 95363
Phone: (209) 892-0800 Fax: (209) 892-0858

WESTERN HILLS WATER DISTRICT

Balance Sheets

June 30, 2007 and 2006

	<u>ASSETS</u>	
	<u>2007</u>	<u>2006</u>
Current Assets		
Cash	\$ (93,682)	\$ -
Accounts receivable	53,804	41,087
Prepaid water charges	67,716	53,946
Meter inventory	<u>7,680</u>	<u>9,120</u>
Total current assets	<u>35,518</u>	<u>104,153</u>
Assets restricted for debt service, at current values		
Federated money market trust		
U.S. Treasury Obligations	702,195	3,435,675
U.S Treasury Notes, 3.5% due 12/15/09, par \$4,415,000	4,396,642	4,274,605
Accrued interest receivable	<u>-</u>	<u>-</u>
Total restricted assets	<u>5,098,837</u>	<u>7,710,280</u>
Deferred bond costs, net of accumulated amortization of \$321,253 and \$243,948 for 2007 and 2006, respectively	1,746,650	1,824,133
Fixed Assets, net of accumulated depreciation of \$4,661,252 and \$3,567,945 for 2007 and 2006, respectively	38,039,950	37,998,582
Construction in progress	2,822,803	4,009,669
Deferred reimbursable bond costs	-	117,721
Due from developer - Diablo Grande, LP	<u>1,246,210</u>	<u>6,541,232</u>
Total assets	<u>\$ 48,989,968</u>	<u>\$ 58,305,770</u>
 <u>LIABILITIES AND NET ASSETS</u>		
Current Liabilities		
Outstanding checks in excess of cash	\$ -	\$ (17,899)
Accounts payable	5,432,133	654,949
Accrued interest payable	1,098,170	1,112,157
Current portion of FSC gov't loan	0	-
Current portion of bonds payable	<u>1,055,000</u>	<u>1,020,000</u>
Total current liabilities	7,585,303	2,769,207
Caterpillar FSC gov't loan	3,785,188	4,006,874
Bonds payable, net of current portion	<u>52,635,000</u>	<u>53,725,000</u>
Total liabilities	<u>64,005,491</u>	<u>60,501,081</u>
Net Assets		
Contributed capital	8,206,193	7,601,193
Retained earnings (deficit)	<u>(11,546,037)</u>	<u>(10,125,917)</u>
Total net assets	<u>(3,339,844)</u>	<u>(2,524,724)</u>
Total liabilities and net assets	<u>\$ 60,665,647</u>	<u>\$ 57,976,357</u>

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

WESTERN HILLS WATER DISTRICT
Statements of Revenues and Expenses and Changes in Retained Earnings (Deficit)
For the Years Ended June 30, 2007 and 2006

	<u>2007</u>	<u>2006</u>
Operating Revenue		
Water revenue		
Residential	\$ 219,914	\$ 96,560
Golf course	234,838	37,829
Sewer and stormdrain	129,368	106,158
Winery	13,793	556
Other	500	-
Net Water Meter Income	<u>159,401</u>	<u>47,382</u>
Total operating revenues	<u>757,814</u>	<u>288,485</u>
Operating Expenses		
Labor and related expenses	216,251	189,265
Purchased water	496,530	429,780
Waste water hauling and disposal	150,140	157,588
Water management	398,714	390,032
Fuel/power for pump	413,514	265,006
Maintenance	125,163	151,710
Contractual services	50,435	14,244
Insurance	31,829	-
Licenses and fees	8,170	45,630
Office expense	76,651	90,442
Depreciation	1,093,307	1,047,874
Bad debt expense	230,047	-
Other	<u>27,187</u>	<u>24,901</u>
Total operating expenses	<u>3,317,938</u>	<u>2,806,472</u>
Operating loss	<u>(2,560,124)</u>	<u>(2,517,987)</u>
Non-Operating Revenue (Expenses)		
Property taxes	4,663,339	4,328,741
Investment income	106,154	260,034
Interest on bonded indebtedness	(3,547,962)	(3,394,754)
Other interest expense	(4,222)	(359)
Amortization of bond expense	<u>(77,305)</u>	<u>(77,574)</u>
	<u>1,140,004</u>	<u>1,116,088</u>
Net loss	<u>(1,420,120)</u>	<u>(1,401,899)</u>
Retained earnings (deficit) at beginning of year	<u>(10,125,917)</u>	<u>(8,724,018)</u>
Retained earnings (deficit) at end of year	<u><u>\$ (11,546,037)</u></u>	<u><u>\$ (10,125,917)</u></u>

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

WESTERN HILLS WATER DISTRICT
Statements of Cash Flows
For the Years Ended June 30, 2007 and 2006

	<u>2007</u>	<u>2006</u>
Cash flows from operating activities		
Receipts from customers and users	\$ 745,097	\$ 355,227
Payments to suppliers of goods and services	2,870,263	(5,883,673)
Payments to employees and related benefits	<u>(213,759)</u>	<u>(186,773)</u>
Net cash used in operating activities	<u>3,401,601</u>	<u>(5,715,219)</u>
Cash flows from capital and related financing activities		
Bond indebtedness retired	(1,055,000)	(790,000)
Decrease (increase) in advances to developer	5,295,022	7,405,250
Proceeds from Caterpillar loan	(221,686)	-
Fixed asset additions, including construction in progress	52,191	(3,812,999)
Interest paid on bonded indebtedness	(3,561,949)	(3,434,826)
Other interest paid	(4,222)	-
Property taxes collected for debt	<u>4,663,339</u>	<u>4,328,741</u>
Net cash provided by capital and financing activities	<u>5,167,695</u>	<u>3,696,166</u>
Cash flows from investing activities		
Decrease (increase) in investments	2,611,443	1,723,613
Investment income received	106,154	258,561
Increase (decrease) in meter inventory	<u>1,440</u>	<u>-</u>
Net cash provided by (used in) investing activities	<u>2,719,037</u>	<u>1,982,174</u>
Net increase (decrease) in cash	11,288,333	(36,879)
Cash (outstanding checks in excess of cash) at beginning of year	<u>(17,945)</u>	<u>18,934</u>
Cash (outstanding checks in excess of cash) at end of year	<u><u>\$ 11,270,388</u></u>	<u><u>\$ (17,945)</u></u>
Reconciliation of Operating Loss to Net Cash		
Provided By (Used In) Operating Activities:		
Net operating loss	\$ (2,560,124)	\$ (2,518,346)
Adjustments to cash used in operating activities:		
Depreciation expense	1,093,307	1,047,874
(Increase) decrease in assets		
Accounts receivable	(12,717)	82,102
Prepaid water charges	(13,770)	(15,360)
Deferred recoverable bond costs	117,721	(58,952)
Increase (decrease) in accounts payable - operating	<u>4,777,184</u>	<u>(4,252,537)</u>
Net cash used in operating activities	<u><u>\$ 3,401,601</u></u>	<u><u>\$ (5,715,219)</u></u>

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

WESTERN HILLS WATER DISTRICT
Notes to Financial Statements
June 30, 2007 and 2006

1. Summary of Significant Accounting Policies

The accounting policies of the Western Hills Water District (the “District”) conform to accounting principles as applicable to governmental entities, which are classified as proprietary funds – business type, in the United States of America. The following is a summary of the more significant policies:

Reporting entity

For financial reporting purposes, in conformity with the Governmental Accounting Standards Board (“GASB”) Codification Section 2100, defining the governmental reporting entity, the District includes all funds that are controlled by or dependent on the Board of Directors of the District. Since no other entities are controlled by or rely upon the District, the reporting entity consists solely of the District.

Diablo Grande Community Facilities District No.1 – Bond Issues (see note 4)

In August 2001, the Western Hills Water District - Diablo Grande Community Facilities District No. 1 issued \$21,000,000; in December 2002, issued \$6,650,000; in May 2004 issued \$20,000,000; and in January 2005 issued \$9,350,000 in bonds pursuant to the Mello-Roos Community Facilities Act of 1982, as amended, for a total of \$57,000,000 as of June 30, 2007. The bonds are secured by and payable from a pledge of special taxes to be levied on approximately 5,070 acres of real property within the boundaries of the District. The Bond provisions indicate that:

“Neither the faith and credit nor the taxing power of the water district, the County of Stanislaus, the State of California or any political subdivision thereof is pledged to the payment of the bonds. The bonds do not constitute a debt of the water district within the meaning of any statutory or constitutional debt limitation.”

Although the provisions indicate the bonds are not an obligation of the Western Hills Water District, the District has assumed the responsibility of accounting for the proceeds and the future debt service. The bond proceeds funded the acquisition of water and wastewater facilities by the District. The costs of water facilities incurred in prior years were contributed to the District by Diablo Grande LP (Diablo Grande), the developer of the Diablo Grande project. The bond proceeds, net of certain costs of issuance and debt reserve requirements, have been used or set aside for current and future facility improvements.

Fund accounting classification

The financial statements of the District are presented as those of an enterprise fund under the broad category of funds called proprietary funds which also includes internal service funds. Enterprise funds account for operations that are financed and operated in a manner similar to private business enterprises – where the intent is that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered substantially through user charges. The acquisition of the physical plant facilities required to provide these goods and services, as indicated above, were initially financed by the developer, for the District, in anticipation of proceeds from the bond issue, which will further fund the additions to plant and equipment.

WESTERN HILLS WATER DISTRICT
Notes to Financial Statements
June 30, 2007 and 2006

1. Summary of Significant Accounting Policies (continued)

Basis of accounting

Enterprise funds are accounted for on the flow of economic measurement focus using the accrual basis of accounting. Revenues are recognized when they are earned, and expenses are recognized when they are incurred.

The GASB is the designated standard-setting body establishing governmental accounting and financial reporting principles.

The District follows alternative 1 of GASB 20 regarding the use of the pronouncements of the GASB and Financial Accounting Standards Board ("FASB") in its accounting. That is, the District follows (1) all GASB pronouncements and (2) FASB pronouncements, Accounting Principles Board ("APB") Opinions, and Accounting Research Bulletins ("ARB") issued on or before November 30, 1989, except those that conflict with GASB pronouncements.

Cash and cash equivalents

For the purpose of the statement of cash flows, the District considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents, including short-term certificates of deposit. To date, only cash in bank is applicable.

Investments

State statutes authorize the District to invest in obligations of the U.S. Treasury, the Local Agency Investment Fund of the State of California (LAIF), commercial paper, corporate bonds and repurchase agreements.

Fixed assets

Fixed assets are carried at historical cost or estimated historical cost if actual cost is not available. Contributed assets will be recorded at cost or estimated fair value on the date contributed.

The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend asset lives are not capitalized.

Depreciation expense is provided on a straight-line basis over 30 to 40 years depending on the category.

Operating vs. non-operating revenues

Revenues related to providing water supply to customers and users are classified as operating revenue in the Statement of Revenues and Expenses and Changes in Retained Earnings (Deficit). All other revenues, including property taxes, are classified as non-operating revenue.

WESTERN HILLS WATER DISTRICT
Notes to Financial Statements
June 30, 2007 and 2006

1. Summary of Significant Accounting Policies (continued)

Estimates in accounting

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and consequently, the reported amounts of revenues and expenses in the financial statements. The District's estimates relate primarily to estimates of useful lives of fixed assets and the determination of an allowance for uncollectible receivables (for which there are none for June 30, 2007 or 2006). Actual results could differ from these estimates.

Reclassifications

To conform to the presentation in the current year financial statements, certain items in the comparative prior year financial statements have been reclassified.

2. Cash and Investments

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

The entire cash balance (before outstanding checks) is held in one institution in the amount of \$424,501 at June 30, 2007, and is \$174,501 over the FDIC insured amount of \$250,000. The June 30, 2007 investments, which are reflected in balance sheet as assets restricted for debt services, are categorized as follows:

US Treasury Money Market Trust	\$ 3,435,675
US Treasury Notes, par \$4,415,000, 3.50%, due 12/15/09	<u>4,274,605</u>
	<u><u>\$ 7,710,280</u></u>

Credit Risk

Credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. Presented below is the minimum rating by the California Government Code and the actual rating as of the year-end for each investment type.

<u>Investment Type</u>	<u>Fair Value</u>	<u>Minimum Legal Rating</u>	<u>Not Required To Be Rated</u>	<u>Rating as of Year End</u>			
				<u>AAA</u>	<u>A</u>	<u>Unrated</u>	
US Treasury Money Market	\$ 3,435,675	N/A	\$ 3,435,675	\$ -	\$ -	\$ -	-
US Treasury Notes	4,274,605	N/A	4,274,605	-	-	-	-
Total	<u><u>\$ 7,710,280</u></u>		<u><u>\$ 7,710,280</u></u>	<u><u>\$ -</u></u>	<u><u>\$ -</u></u>	<u><u>\$ -</u></u>	<u><u>-</u></u>

WESTERN HILLS WATER DISTRICT
Notes to Financial Statements
June 30, 2007 and 2006

3. Fixed Assets

All purchased assets are valued at cost. In accordance with generally accepted accounting principles for proprietary entities, depreciation has been provided on the straight-line method over estimated useful lives of thirty to forty years.

The following reflects the changes in fixed assets for the year ended June 30, 2007:

	Balance <u>June 30, 2006</u>	Reclassifications <u>And Additions</u>	Balance <u>June 30, 2007</u>	Depreciable <u>Life in Years</u>
Water treatment facilities	\$ 10,704,148	\$ -	\$ 10,704,148	40
Pump station & well	3,057,844	-	3,057,844	30
Aqueduct turnout	745,802	-	745,802	40
Wastewater treatment facility	28,103,909	-	28,103,909	40
Storm drain outfall line	2,446	-	2,446	40
Frog pond	10,803	-	10,803	30
Other	34,882	-	34,882	3 to 30
	<u>42,659,834</u>	<u>-</u>	<u>42,659,834</u>	
Accumulated depreciation	3,567,945	1,093,307	4,661,252	
Net book value	<u>\$ 39,091,889</u>	<u>\$ (1,093,307)</u>	<u>\$ 37,998,582</u>	
Construction in progress – sewer	<u>\$ 213,310</u>	<u>\$ 3,796,359</u>	<u>\$ 4,009,669</u>	n/a

4. “Mello-Roos” Assessment District – Western Hills Water District - Diablo Grande Community Facilities District No. 1

Western Hills Water District - Diablo Grande Community Facilities District issued bonds totaling \$21,000,000 in August, 2001, followed by \$6,650,000 in December, 2002, \$20,000,000 in May 2004 and \$9,350,000 in January 2005. The total debt issued was \$57,000,000. The proceeds are to fund facility assets. Interest rates on these bonds ranged from 2.25% to 5.7%.

The changes in the District’s long-term obligations were as follows:

	Year Ended <u>June 30, 2007</u>	Year Ended <u>June 30, 2006</u>
Balance at beginning of year	\$ 55,765,000	\$ 56,555,000
Bonds issued	-	-
Principal payments	<u>(1,020,000)</u>	<u>(790,000)</u>
Balance at end of year	<u>\$ 54,745,000</u>	<u>\$ 55,765,000</u>
Due in one year	<u>\$ 1,055,000</u>	<u>\$ 1,020,000</u>

WESTERN HILLS WATER DISTRICT
Notes to Financial Statements
June 30, 2007 and 2006

4. "Mello-Roos" Assessment District - Western Hills Water District - Diablo Grande Community Facilities District No. 1 (continued)

The following is a debt service schedule to maturity:

<u>2001 Bond</u>			
Fiscal Year Ending June 30,	Interest	Principal	Total
2008	\$ 1,352,802	\$ 355,000	\$ 1,707,802
2009	1,333,628	370,000	1,703,628
2010	1,312,960	390,000	1,702,960
2011	1,290,563	415,000	1,705,563
2012	1,266,494	435,000	1,701,494
Thereafter	<u>15,280,479</u>	<u>18,380,000</u>	<u>33,660,479</u>
	<u><u>\$ 21,836,926</u></u>	<u><u>\$ 20,345,000</u></u>	<u><u>\$ 42,181,926</u></u>

<u>2002 Bond</u>			
Fiscal Year Ending June 30,	Interest	Principal	Total
2008	\$ 377,030	\$ 150,000	\$ 527,030
2009	370,355	155,000	525,355
2010	362,949	165,000	527,949
2011	354,780	170,000	524,780
2012	345,917	180,000	525,917
Thereafter	<u>3,218,952</u>	<u>5,100,000</u>	<u>8,318,952</u>
	<u><u>\$ 5,029,983</u></u>	<u><u>\$ 5,920,000</u></u>	<u><u>\$ 10,949,983</u></u>

<u>2004 Bond</u>			
Fiscal Year Ending June 30,	Interest	Principal	Total
2008	\$ 1,108,275	\$ 350,000	\$ 1,458,275
2009	1,095,744	365,000	1,460,744
2010	1,081,400	375,000	1,456,400
2011	1,065,613	390,000	1,455,613
2012	1,047,200	405,000	1,452,200
Thereafter	<u>13,441,431</u>	<u>17,445,000</u>	<u>30,886,431</u>
	<u><u>\$ 18,839,663</u></u>	<u><u>\$ 19,330,000</u></u>	<u><u>\$ 38,169,663</u></u>

WESTERN HILLS WATER DISTRICT
Notes to Financial Statements
June 30, 2007 and 2006

4. “Mello-Roos” Assessment District - Western Hills Water District - Diablo Grande Community Facilities District No. 1 (continued)

	<u>2005 Bond</u>		
Fiscal Year Ending June 30,	Interest	Principal	Total
2008	\$ 477,383	\$ 200,000	\$ 677,383
2009	471,226	210,000	681,226
2010	464,236	215,000	679,236
2011	456,403	220,000	676,403
2012	447,578	235,000	682,578
Thereafter	<u>5,380,246</u>	<u>8,070,000</u>	<u>13,450,246</u>
	<u>\$ 7,697,072</u>	<u>\$ 9,150,000</u>	<u>\$ 16,847,072</u>

	<u>All Bonds</u>		
Fiscal Year Ending June 30,	Interest	Principal	Total
2008	\$ 3,315,490	\$ 1,055,000	\$ 4,370,490
2009	3,270,953	1,100,000	4,370,953
2010	3,221,545	1,145,000	4,366,545
2011	3,167,359	1,195,000	4,362,359
2012	3,107,189	1,255,000	4,362,189
Thereafter	<u>37,321,108</u>	<u>48,995,000</u>	<u>86,316,108</u>
	<u>\$ 53,403,644</u>	<u>\$ 54,745,000</u>	<u>\$ 108,148,644</u>

Reserve requirement restrictions

The provisions of the “official statements” of the bond issues require the following restrictions:

Reserve fund

The District is required to maintain an amount equal to the lesser of as of June 30, 2007:

- (a) 10% of the original principal: \$5,700,000
- (b) 100% of the maximum annual debt service on the bonds based on years ended September 1:
\$4,370,953
- (c) 125% of the average annual debt service: \$5,199,454

The purpose of this \$4,370,953 reserve is to be used for debt service, if needed. Amounts in excess of the requirement, due to interest thereon, can be transferred to the Bond Fund to be used for current debt service. When the Reserve Fund exceeds the requirement to redeem the remaining outstanding bonds such excess shall be transferred to the District to be used for any lawful purpose.

WESTERN HILLS WATER DISTRICT
Notes to Financial Statements
June 30, 2007 and 2006

4. “Mello-Roos” Assessment District - Western Hills Water District - Diablo Grande Community Facilities District No. 1 (continued)

Reserve requirement restrictions (continued)

Bond fund

The Bond Fund consists of amounts held in trust by the Fiscal Agent for payments to bond holders (debt service). Annual special taxes assessed and collected shall be set aside for the debt service. During the fiscal years through June 30, 2007 property taxes were received on assessed property totaling \$13,695,925 from inception. Debt service payments totaled \$15,800,404 in interest and principal. \$2,302,393 has been applied out of special tax fund proceeds set aside for early short-term interest payments, leaving \$13,498,011 to be paid out of the “Bond Fund.” Thus, \$197,914 of the taxes assessed remains in the Bond Fund set aside.

Special Tax Fund

An amount was provided out of the bond proceeds sufficient, when combined with interest earnings thereon and on amounts in the “Reserve Fund”, to provide for interest due in the short term through September 2, 2005, shortly after the bond issue.

Improvement Fund

The remaining proceeds of the bond issue after allowing for costs of issuance were set aside to reimburse improvement costs of \$17,106,638 (2001 issue), \$5,493,887 (2002 issue), \$17,483,719 (2004 issue), and \$8,026,517 (2005 issue).

At June 30, 2007, the reserve requirements were as follows:

Reserve Fund	\$ 4,370,953
Bond Fund	197,914
Total reserve requirement	<u>\$ 4,568,867</u>
 Funds set aside for debt service at June 30, 2007	 <u>\$ 7,710,280</u>

The indebtedness will be retired over a thirty-year period from assessed parcel taxes on the properties being developed, through the District.

5. Caterpillar Note Payable

In June of 2007, the District entered into a note agreement with Caterpillar Financial Services Corporation with the proceeds used for the purchase of five Caterpillar generator sets. The total amount borrowed under this agreement of \$4,358,414 is payable in 114 equal monthly installments at 5.97% interest.

WESTERN HILLS WATER DISTRICT
Notes to Financial Statements
June 30, 2007 and 2006

5. Caterpillar Note Payable (continued)

The following is a debt service schedule to maturity for the Caterpillar note payable:

Fiscal Year Ending June 30,	Interest	Principal	Total
2008	\$ 250,681	\$ 351,540	\$ 602,221
2009	229,110	373,111	602,221
2010	206,216	396,005	602,221
2011	181,917	420,304	602,221
2012	156,127	446,094	602,221
Thereafter	<u>338,638</u>	<u>2,371,360</u>	<u>2,709,998</u>
	<u>\$ 1,362,689</u>	<u>\$ 4,358,414</u>	<u>\$ 5,721,103</u>

6. Retained Earnings (Deficit) and Capital

The District's assets are substantially in place as of June 30, 2007. However, the operations including water revenue will not be fully realized until the development is completed. At June 30, 2007, the primary customers were the 2 golf courses, clubhouse/restaurant, vineyard and the first phase of residential development homeowners. The development plan includes a hotel, single family homes, condos and public facilities. Until it comes to fruition, the water revenue will not cover expenses. It is anticipated, but not guaranteed, that the deficit will be funded by the developer.

7. Related Parties

Diablo Grande LP– the Developer, which is owned by two corporations and a limited liability company. All of the property in the District is currently owned by the Developer. The Developer has contributed \$8,206,193 to the District to acquire property and fund the deficit operation to date. As of June 30, 2007 and 2006, the balance due from the Developer was \$5,709,232 and \$6,711,484, respectively. These balances are net of \$1,700,153 that was deemed uncollectible upon the subsequent filing for Chapter 11 reorganization bankruptcy by the Developer (see Note 8).

Oak Flat Golf Company, LLC – The Oak Flat Golf Company, LLC (“OFGC”) is managed by one of the corporations which is a partner in the Developer (Diablo Grande, Inc.). It is owned by four individuals and a Corporation. OFGC currently operates two golf courses.

GBC Corporation – The GBC Corporation operates the clubhouse and restaurant adjacent to the two golf courses. It is owned by an individual who is also the President of Western Hills Water District.

WESTERN HILLS WATER DISTRICT
Notes to Financial Statements
June 30, 2007 and 2006

8. Subsequent Event

On March 10, 2008 Diablo Grande, LP filed for Chapter 11 reorganization bankruptcy, and the assets of the company were eventually sold to World International LLC for \$21,025,000 on October 7, 2008. As a result of this bankruptcy filing of the Developer, the District has determined that \$1,700,153 of the outstanding receivable from Diablo Grande, LP is uncollectible, and has recognized this expense in the Statement of Revenues and Expenses for the year ended June 30, 2005. In addition, \$682,052 in special deposits that were held through Diablo Grande has been forfeited through bankruptcy proceedings. The write-off of these special deposits has been recognized as a \$605,000 reduction in contributed capital on the Statement of Changes in Net Assets and a \$77,052 decrease in investment income on the Statement of Revenues and Expenses for the year ended June 30, 2005. Subsequent events have been evaluated through May 24, 2012, which is the date the financial statements were available to be issued.

9. Going Concern

Continued operating losses coupled with the bankruptcy of the Developer raise doubts about the District's ability to continue as a going concern. The District's management is working with the new owner of the development to promote the completion of the development resulting in sales of homes which will provide property tax revenues necessary to repay the outstanding bonds and cover operating costs of the District.