WESTERN HILLS WATER DISTRICT

FINANCIAL STATEMENTS

JUNE 30, 2006 AND 2005

WESTERN HILLS WATER DISTRICT

Board of Directors

Board Members	Title
Dwain Sanders	President – member
Stan Duck	Member
Webb Schaffer	Member

District Manager

Ray Madison

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Cropper Accountancy Corporation
Certified Public Accountants

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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, 2006 and 2005 and the related statements of revenues and expenses, changes in net assets, and 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, 2006 and 2005, 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 7) raise substantial doubt about the District's ability to continue as a going concern. As discussed in note 8, the financial statements do not include adjustments that might result from the outcome of this uncertainty.

Cropper Accountancy Corporation
CROPPER ACCOUNTANCY CORPORATION

April 27, 2010

Western Hills Water District
MANAGEMENT'S DISCUSSION AND ANALYSIS
For Year Ending June 30, 2006

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, 2006. Please read it in conjunction with the Basic Financial Statements, which follow this section.

FINANCIAL HIGHLIGHTS

- The District's total assets decreased by $6.5 million, or -10%, to $55.6 million.
- During the year the District's operating revenue increased by 67% to $288 thousand, while operating expenses increased by 10% to $2.8 million.
- Net assets decreased by $1.402 million to $(1.920) 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, Debt Service 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 $1.402 million to $(1.920) million in fiscal year 2006. This is down from $(.518) million in fiscal year 2005. This decrease is a result of the following:

1. Assets decreased by $6.47 million, primarily due to a $7.41 million decrease in receivables from the developer.
2. Liabilities decreased by $5.06 million, primarily due to a $4.25 million decrease in accounts payable.

TABLE 1
Condensed Statements of Net Assets
(000)

	2006	2005
Current and Other Assets	$ 111	$ 2,226
Restricted Assets	7,412	7,105
Fixed Assets	39,092	36,540
Other Assets	8,944	16,154
Total Assets	**55,559**	**62,025**
Current Liabilities	2,734	6,778
Long-Term Debt	54,745	55,765
Total Liabilities	**57,479**	**62,543**
Net Assets	**$ (1,920)**	**$ (518)**

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 2007's challenges at the end of this report.

TABLE 2
Statement of Revenues & Expenses
For the Years ended June 30, 2006 and 2005
(000)

	2006	2005	Total % Change Fav/(Unfav)
Total Revenues	$288	$172	67.0%
Total Operating Expenses (less depreciation)	1,759	1,656	(6.2%)
Net Operating Loss Before Depreciation	**$ (1,471)**	**$ (1,484)**	**0.9%**

CAPITAL ASSETS AND DEBT ADMINISTRATION

During 2006, the District invested $3.8 million in a broad range of infrastructure including water treatment facilities, sewer line, vehicles and equipment.

TABLE 3
Capital Assets
(000)

	2006	2005	Dollar Change	Total Percent Change
Water Treatment Facilities	$ 10,704	$ 10,180	$ 524	5.2%
Pump Station & Well	3,057	3,057	0	0.0%
Aqueduct Turnout	746	746	0	0.0%
Wastewater Treatment Facility	28,104	25,050	3,054	12.2%
Other	261	27	234	866.7%
Subtotal	**42,872**	**39,060**	**3,812**	**9.8%**
Less Accumulated Depreciation	3,568	2,520	1,048	(41.6%)
Net Book Value	**$ 39,304**	**$ 36,540**	**$ 2,764**	**7.6%**

LONG TERM DEBT

At year-end, the District had $55.8 million in long-term debt. This is a net decrease of $0.8 million from 2005.

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

	Debt Balance	Average Coupon Rate
General Obligation Bonds	$ 55,865	6.0%

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.

2007 CHALLENGES AND A LOOK AT THE FUTURE:

Western Hills Water District's assets are notably in place as of June 30, 2006. The only notable change in assets were an additional $3.1 million in costs for the wastewater treatment facility.

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 and water treatment facilities upgrade.

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
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Diablo Grande, CA 95363
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WESTERN HILLS WATER DISTRICT
Balance Sheets
June 30, 2006 and 2005

ASSETS

	2006	2005
Current Assets		
Cash	$ -	$ 18,934
Hamilton State Bank - money market account	-	2,029,783
Accounts receivable	46,404	128,506
Prepaid water charges	50,669	35,309
Meter inventory	13,500	13,500
Total current assets	110,573	2,226,032
Assets restricted for debt service, at current values		
Federated money market trust- U.S. Treasury Obligations	3,031,982	2,430,439
U.S Treasury Notes, 3.5% due 12/15/09, par $4,415,000	4,378,259	4,378,259
Money Market Fund (C.A.M.P.)	-	295,373
Accrued interest receivable	2,230	757
Total restricted assets	7,412,471	7,104,828
Deferred bond costs, net of accummulated amortization of $243,948 and $166,464 for 2006 and 2005, respectively	1,901,438	1,979,012
Fixed Assets, net of accumulated depreciation of $3,567,945 and $2,520,071 for 2006 and 2005, respectively	39,091,889	27,683,614
Construction in progress	213,310	8,856,460
Deferred reimbursable bond costs	117,721	58,769
Due from developer - Diablo Grande, LP	6,711,484	14,116,734
Total assets	$ 55,558,886	$ 62,025,449

LIABILITIES AND NET ASSETS

	2006	2005
Current Liabilities		
Outstanding checks in excess of cash	$ 17,945	$ -
Accounts payable	570,805	4,823,342
Accrued interest payable	1,124,860	1,164,932
Current portion of bonds payable	1,020,000	790,000
Total current liabilities	2,733,610	6,778,274
Bonds payable, net of current portion	54,745,000	55,765,000
Total liabilities	57,478,610	62,543,274
Net Assets		
Contributed capital	8,206,193	8,206,193
Retained deficit	(10,125,917)	(8,724,018)
Total net assets	(1,919,724)	(517,825)
Total liabilities and net assets	$ 55,558,886	$ 62,025,449

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

WESTERN HILLS WATER DISTRICT
Statements of Revenues and Expenses
For the Years Ended June 30, 2006 and 2005

	2006	2005
Operating Revenue		
Water revenue		
Residential	$ 96,560	$ 169,875
Business	-	2,960
Golf course	37,829	5,954
Sewer and stormdrain	106,158	-
Winery	556	112
Other	-	201
Net water meter income (expense)	47,382	(6,843)
Total operating revenues	288,485	172,259
Operating Expenses		
Labor and related expenses	189,265	96,473
Purchased water	429,780	389,069
Waste water hauling and disposal	157,588	310,229
Water management	390,032	355,014
Fuel/power for pump	265,006	224,176
Maintenance	151,710	112,356
Contractural services	14,244	35,455
Licences and fees	45,630	27,516
Office expense	90,442	93,877
Depreciation	1,047,874	890,168
Other	25,260	12,286
Total operating expenses	2,806,831	2,546,619
Operating loss	(2,518,346)	(2,374,360)
Non-Operating Revenue (expenses)		
Property taxes	4,328,741	3,511,999
Investment income	260,034	83,513
Bad debt expense- developer bankruptcy	-	(1,700,153)
Interest on bonded indebtedness	(3,394,754)	(3,114,884)
Amortization of bond expense	(77,574)	(70,882)
	1,116,447	(1,290,407)
Net loss	$ (1,401,899)	$ (3,664,767)

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

WESTERN HILLS WATER DISTRICT
Statements of Changes in Net Assets
For the Years Ended June 30, 2006 and 2005

	Capital	Deficit	Totals
Balance at June 30, 2004	$ 8,811,193	$ (5,059,251)	$ 3,751,942
Net loss for year ended June 30, 2005	-	(3,664,767)	(3,664,767)
Write-off of special deposit funded by capital contribution	(605,000)	-	(605,000)
Balance at June 30, 2005	$ 8,206,193	$ (8,724,018)	$ (517,825)
Net loss for year ended June 30, 2006	-	(1,401,899)	(1,401,899)
Balance at June 30, 2006	$ 8,206,193	$ (10,125,917)	$ (1,919,724)

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, 2006 and 2005

		2006		2005
Cash flows from operating activities				
Receipts from customers and users	$	355,227	$	178,690
Payments to suppliers of goods and services		(5,883,673)		(1,715,460)
Payments to employees and related benefits		(186,773)		(96,473)
Net cash used in operating activities		(5,715,219)		(1,633,243)
Cash flows from capital and related financing activities				
Bond indebtedness retired		(790,000)		(445,000)
Bond indebtedness issued		-		9,350,000
Bond issuance costs		-		(327,535)
Decrease (increase) in advances to developer		7,405,250		(315,131)
Fixed asset additions, including construction in progress		(3,812,999)		(4,579,310)
Interest paid on bonded indebtedness		(3,434,826)		(2,701,066)
Property taxes collected for debt		4,328,741		3,511,999
Net cash provided by capital and financing activities		3,696,166		4,493,957
Cash flows from investing activities				
Decrease in due from Fountainhead		-		500,000
Decrease (increase) in investments		1,723,613		(3,544,475)
Investment income received		258,561		191,005
Increase (decrease) in meter inventory		-		6,644
Net cash provided by (used in) operating activities		1,982,174		(2,846,826)
Net increase (decrease) in cash		(36,879)		13,888
Cash at beginning of year		18,934		5,046
Cash (outstanding checks in excess of cash) at end of year	$	(17,945)	$	18,934
Reconciliation of Operating Loss to Net Cash Used in Operating Activities				
Net operating loss	$	(2,518,346)	$	(2,374,360)
Adjustments to cash used in operating activities:				
Depreciation expense		1,047,874		890,168
(Increase) decrease in assets				
Accounts receivable		82,102		(20,353)
Prepaid water charges		(15,360)		13,992
Deferred recoverable bond costs		(58,952)		(58,769)
Increase (decrease) in accounts payable - operating		(4,252,537)		(83,921)
Net cash used in operating activities	$	(5,715,219)	$	(1,633,243)

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

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)

Western Hills Water District - Diablo Grande Community Facilities District No. 1 has issued bonds pursuant to the Mello-Roos Community Facilities Act of 1982, as amended, as follows: $21,000,000 in August 2001, $6,650,000 in December 2002, $20,000,000 in May 2004, and $9,350,000 in January 2005; for a total of $57,000,000 as of June 30, 2006. 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 by the District of water and wastewater facilities. 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.

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 Deficit. All other revenues, including property taxes, are classified as non-operating revenue.

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 useful lives of its fixed assets and the determination of an allowance for uncollectible receivable balances (for which there are none for June 30, 2006 or 2005). Actual results could differ from these estimates.

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 in one institution in the amount of $6,456 at June 30, 2006 and is entirely insured under FDIC. The June 30, 2006 investments, which are reflected in balance sheet as assets restricted for debt services, are categorized as follows:

US Treasury Money Market Trust	$ 3,031,982
US Treasury Notes, par $4,415,000, 3.50%, due 12/15/09	4,378,259
	$ 7,410,241

Credit Risk

Credit risk is the risk that an issue 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.

Investment Type	Fair Value	Minimum Legal Rating	Not Required To Be Rated	Rating as of Year End AAA	Rating as of Year End A	Rating as of Year End Unrated
US Treasury Money Market	$ 3,031,982	N/A	$ 3,031,982	$ -	$ -	$ -
US Treasury Notes	4,378,259	N/A	4,378,259	-	-	-
Total	$ 7,410,241		$ 7,410,241	$ -	$ -	$ -

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, 2006:

	Balance June 30, 2005	Reclassifications And Additions	Transferred Assets	Balance June 30, 2006	Depreciable Life in Years
Water Treatment Facilities	$ 10,179,797	$ 524,351	$ -	$ 10,704,148	40
Pump station & well	3,057,844	-	-	3,057,844	30
Aqueduct turnout	745,802	-	-	745,802	40
Wastewater treatment facility	16,193,110	11,910,799	-	28,103,909	40
Storm drain outfall line	2,446	-	-	2,446	40
Frog pond	10,803	-	-	10,803	30
Other	13,882	21,000	-	34,882	3 to 30
	30,203,684	12,456,150	-	42,659,834	
Accumulated depreciation	2,520,070	1,047,875	-	3,567,945	
Net book value	$ 27,683,614	$ 11,408,275	$ -	$ 39,091,889	
Construction in progress – sewer	$ 8,856,460	$ 213,310	$ (8,856,460)	$ 213,310	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 June 30, 2006	Year Ended June 30, 2005
Balance at beginning of year	$ 56,555,000	$ 47,650,000
Bonds issued	-	9,350,000
Principal payments	(790,000)	(445,000)
Balance at end of year	$ 55,765,000	$ 56,555,000
Due in one year	$ 1,020,000	$ 790,000

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:

2001 Bond

Fiscal Year Ending June 30,	Interest	Principal	Total
2007	$ 1,370,408	$ 335,000	$ 1,705,408
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
Thereafter	16,546,973	18,815,000	35,361,973
	$ 23,207,334	$ 20,680,000	$ 43,887,334

2002 Bond

Fiscal Year Ending June 30,	Interest	Principal	Total
2007	$ 383,118	$ 145,000	$ 528,118
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
Thereafter	3,564,869	5,280,000	8,844,869
	$ 5,413,101	$ 6,065,000	$ 11,478,101

2004 Bond

Fiscal Year Ending June 30,	Interest	Principal	Total
2007	$ 1,119,063	$ 340,000	$ 1,459,063
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
Thereafter	14,488,630	17,850,000	32,338,630
	$ 19,958,725	$ 19,670,000	$ 39,628,725

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

2005 Bond

Fiscal Year Ending June 30,	Interest	Principal	Total
2007	$ 483,008	$ 200,000	$ 683,008
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
Thereafter	5,827,824	8,305,000	14,132,824
	$ 8,180,080	$ 9,350,000	$ 17,530,080

All Bonds

Fiscal Year Ending June 30,	Interest	Principal	Total
2007	$ 3,355,596	$ 1,020,000	$ 4,375,596
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	3,167,358	1,195,000	4,362,358
Thereafter	40,428,298	50,250,000	90,678,298
	$ 56,759,240	$ 55,765,000	$ 112,524,240

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, 2006:

(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: $4,375,596
(c) 125% of the average annual debt service: $5,409,819

The purpose of this $4,375,596 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.

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, 2006 property taxes were received on assessed property totaling $11,572,371 from inception. Debt service payments totaled $11,424,809 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 $9,122,416 to be paid out of the "Bond Fund". Thus, $2,449,955 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, 2006, the reserve requirements were as follows:

Reserve Fund	$	4,375,596
Bond Fund		2,449,955
Total reserve requirement	$	6,825,551
Funds set aside for debt service at June 30, 2006	$	7,410,241

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

5. Retained Deficit and Capital

The District's assets are substantially in place as of June 30, 2006. However, the operations including water revenue will not be fully realized until the development is completed. At June 30, 2006, the primary customers were the 2 golf courses, clubhouse/restaurant and vineyard and the beginning of homeowners. The development plan includes a hotel, single family homes, condos and public facilities. Until they come to fruition, the water revenue will not cover expenses. It is anticipated, but not guaranteed, that the deficit will be funded by the developer.

6. Related Parties

Diablo Grande LP – All of the property in the District was originally owned by the Developer. When the Developer filed for bankruptcy in 2008 (see note 7), the remaining assets were acquired by the new owner. The Developer contributed $8,206,193 to the District to acquire property and fund the deficit operation to date.

Funds have been advanced between the District and the Developer to cover construction costs since 2001. As of June 30, 2006 and 2005, the balance due from the Developer was $6,711,484 and $14,116,734, 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 7).

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.

7. 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 April 27, 2010, which is the date the financial statements were available to be issued.

8. 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.