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CERTIFIED PUBLIC ACCOUNTANTS

WESTERN HILLS WATER DISTRICT

FINANCIAL STATEMENTS

JUNE 30, 2009 and 2008

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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, 2009 and 2008 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, 2009 and 2008, 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

July 31, 2012

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, 2009. 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
MANAGEMENT'S DISCUSSION AND ANALYSIS
For Year Ending June 30, 2009

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, 2009. Please read it in conjunction with the Basic Financial Statements, which follow this section.

FINANCIAL HIGHLIGHTS

- The District's total assets decreased by $2.4 million, or 4.0%, to $57.3 million.
- During the year the District's operating revenue decreased by 30.7% to $532 thousand, while operating expenses decreased by 13.6% to $2.9 million.
- Net assets decreased by $1.23 million to $(5.99) 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 $1.23 million to $(5.99) million in fiscal year 2009. This is down from $(4.77) million in fiscal year 2008. This decrease is a result of the following:

1. Assets decreased by $2.4 million, primarily due to depreciation of fixed assets and funding the current year's debt service on bonds payable.

2. Liabilities decreased by $1.15 million, primarily due to the $1.1 million principal payment on bonds payable.

TABLE 1
Condensed Statements of Net Assets
(000)

	2009	2008
Current and Other Assets	$ 2,586	$ 3,260
Restricted Assets	6,116	5,099
Fixed Assets	46,973	48,375
Other Assets	1,669	2,993
Total Assets	**57,344**	**59,727**
Current Liabilities	8,226	8,117
Long-Term Debt	55,111	56,375
Total Liabilities	**63,337**	**64,492**
Net Assets	**$ (5,993)**	**$ (4,766)**

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 2009's challenges at the end of this report.

TABLE 2
Statement of Revenues & Expenses
For the Years ended June 30, 2009 and 2008
(000)

	2009	2008	Total % Change Fav/(Unfav)
Total Revenues	$ 532	$ 768	(30.7%)
Total Operating Expenses (less depreciation)	1,770	2,234	20.7%
Net Operating Loss Before Depreciation	**$ (1,238)**	**$ (1,465)**	**15.5%**

CAPITAL ASSETS

During 2009, the District invested $7.5 million in a broad range of infrastructure including water treatment facilities, sewer line, and back up generators.

TABLE 3
Capital Assets
(000)

	2009	2008	Dollar Change	Total Percent Change
Water Treatment Facilities	$ 10,716	$ 10,712	$ 4	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	11,356	11,589	(233)	(2.01%)
Subtotal	**53,980**	**54,209**	**(229)**	**(0.4%)**
Less Accumulated Depreciation	7,007	5,834	1,173	20.1%
Net Book Value	**$ 46,973**	**$ 48,375**	**$ (1,401)**	**(2.9%)**

LONG TERM DEBT

At year-end, the District had $56.4 million in long-term debt. This is a net decrease of $1.4 million from 2008, due to bond and note payments made during the year.

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.

TABLE 4

Outstanding Debt

	Debt Balance	Average Coupon Rate
General Obligation Bonds	$52,590	6.0%
Caterpillar Note Payable	$3,848	5.97%

2009 CHALLENGES AND A LOOK AT THE FUTURE:

Western Hills Water District's assets are notably in place as of June 30, 2009.

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.

New income streams have been examined by the water district. A new water banking program with the Kern County Water Agency allowing the District to bank and sell excess water to other districts took effect in January 2010.

Western Hill's future projects include the pump station upgrades, 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 95363-8610
Phone: (209) 892-0800   Fax: (209) 892-0858

WESTERN HILLS WATER DISTRICT

Statements of Net Assets

June 30, 2009 and 2008

ASSETS

	2009	2008
Current Assets		
Cash	$ 2,339,415	$ -
Accounts receivable	125,393	53,804
Taxes receivable	-	3,130,917
Prepaid water charges	113,606	67,716
Meter inventory	7,680	7,680
Total current assets	2,586,094	3,260,117
Assets restricted for debt service, at current values		
Federated money market trust		
U.S. Treasury Obligations	3,771,847	702,195
U.S Treasury Notes, 3.5% due 12/15/09, par $2,311,000	2,343,955	4,396,642
Total restricted assets	6,115,802	5,098,837
Deferred bond costs, net of accummulated amortization of $476,042 and $398,737 for 2009 and 2008, respectively	1,669,344	1,746,650
Fixed Assets, net of accumulated depreciation of $7,007,173 and $5,834,164 for 2009 and 2008, respectively	36,857,863	38,026,030
Construction in progress	10,115,301	10,348,759
Due from developer - Diablo Grande, LP	-	1,246,210
Total assets	$ 57,344,404	$ 59,726,603

LIABILITIES AND NET ASSETS

	2009	2008
Current Liabilities		
Outstanding checks in excess of cash	$ -	$ 93,682
Accounts payable	5,812,730	5,432,133
Accrued interest payable	1,082,466	1,098,170
Meter set deposits	4,500	4,500
Current portion of FSC gov't loan	181,561	388,659
Current portion of bonds payable	1,145,000	1,100,000
Total current liabilities	8,226,257	8,117,144
Caterpillar FSC gov't loan, net of current portion	3,666,232	3,785,188
Bonds payable, net of current portion	51,445,000	52,590,000
Total liabilities	63,337,489	64,492,332
Net Assets		
Invested in net assets, net of related debt	(9,464,629)	(9,489,058)
Restricted net assets, bond and reserve funds	4,758,173	4,699,477
Unrestricted net assets	(1,286,629)	23,852
Total net assets	(5,993,085)	(4,765,729)
Total liabilities and net assets	$ 57,344,404	$ 59,726,603

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

WESTERN HILLS WATER DISTRICT
Statements of Revenues, Expenses and Changes in Net Assets
For the Years Ended June 30, 2009 and 2008

	2009	2008
Operating Revenue		
Water revenue		
Residential	$ 247,025	$ 268,492
Golf course	125,853	309,608
Sewer and stormdrain	153,319	140,384
Winery	5,694	40,579
Other	282	885
Net water meter income	-	8,340
Total operating revenues	532,173	768,288
Operating Expenses		
Labor and related expenses	159,797	176,474
Purchased water	546,349	580,417
Waste water hauling and disposal	158,172	124,224
Water management	372,122	376,236
Fuel/power for pump	11,263	412,185
Maintenance	119,279	91,320
Contractual services	261,203	66,295
Insurance	57,943	33,536
Licenses and fees	13,761	23,068
Office expense	54,818	117,751
Depreciation	1,173,009	1,172,912
Bad debt expense	8,804	229,298
Other	6,971	2,957
Total operating expenses	2,943,491	3,406,673
Operating loss	(2,411,318)	(2,638,385)
Non-Operating Revenue (Expenses)		
Property taxes	4,434,058	4,501,100
Investment income	99,904	391,379
Other income	118,304	-
Interest on bonded indebtedness	(3,246,512)	(3,592,835)
Other interest expense	(144,486)	(9,661)
Amortization of bond expense	(77,306)	(77,483)
	1,183,962	1,212,500
Net loss	(1,227,356)	(1,425,885)
Total net assets at beginning of year	(4,765,729)	(3,339,844)
Total net assets at end of year	$ (5,993,085)	$ (4,765,729)

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, 2009 and 2008

	2009	2008
Cash flows from operating activities		
Receipts from customers and users	$ 460,584	$ 760,071
Payments to suppliers of goods and services	(1,275,978)	2,862,855
Payments to employees and related benefits	(159,797)	(176,474)
Net cash provided by (used in) operating activities	(975,191)	3,446,452
Cash flows from capital and related financing activities		
Bond indebtedness retired	(1,100,000)	(1,055,000)
Decrease in advances to developer	1,246,210	4,463,022
Payments on Caterpillar loan	(326,054)	(184,567)
Fixed asset additions, including construction in progress	228,616	(7,539,450)
Payables relief obtained from creditors	118,304	-
Interest paid on bonded indebtedness	(3,262,216)	(3,606,822)
Other interest paid	(144,486)	(9,661)
Property taxes collected for debt	7,564,975	1,370,183
Net cash provided by (used in) capital and financing activities	4,325,349	(6,562,295)
Cash flows from investing activities		
Decrease (increase) in investments	(1,016,965)	2,611,443
Investment income received	99,904	391,379
Increase in meter inventory	-	1,440
Net cash provided by (used in) operating activities	(917,061)	3,004,262
Net increase (decrease) in cash	2,433,097	(111,581)
Cash (outstanding checks in excess of cash) at beginning of year	(93,682)	17,899
Cash (outstanding checks in excess of cash) at end of year	$ 2,339,415	$ (93,682)

Reconciliation of Operating Loss to Net Cash Provided By (Used In) Operating Activities:

	2009	2008
Net operating loss	$ (2,411,318)	$ (2,638,385)
Adjustments to cash used in operating activities:		
Depreciation expense	1,173,009	1,172,912
(Increase) decrease in assets		
Accounts receivable	(71,589)	(12,717)
Prepaid water charges	(45,890)	(13,770)
Deferred recoverable bond costs	-	156,728
Increase (decrease) in liabilities		
Accounts payable	380,597	4,777,184
Meter set deposits	-	4,500
Net cash provided by (used in) operating activities	$ (975,191)	$ 3,446,452

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

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.

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, 2009 or 2008). 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 cash balance (before outstanding checks) was held in two institutions at June 30, 2009, and the total balances in one institution exceeded the FDIC insured amount of $250,000 by $2,131,611. The June 30, 2009 investments, which are reflected in balance sheet as assets restricted for debt services, are categorized as follows:

US Treasury Money Market Trust	$ 3,771,847
US Treasury Notes, par $2,311,000, 3,50%, due 12/15/09	2,343,955
	$ 6,115,802

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.

Investment Type	Fair Value	Minimum Legal Rating	Not Required To Be Rated	Rating as of Year End AAA	A	Unrated
US Treasury Money Market	$ 3,771,847	N/A	$ 3,771,847	$ -	$ -	$ -
US Treasury Notes	2,343,955	N/A	-	2,343,955	-	-
Total	$ 6,115,802		$ 3,771,847	$ 2,343,955	$ -	$ -

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, 2009:

	Balance June 30, 2008	Reclassifications & Additions	Balance June 30, 2009	Depreciable Life in Years
Water treatment facilities	$ 10,711,898	$ 4,842	$ 10,716,740	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
Back-up generators	1,192,610	-	1,192,610	15
Storm drain outfall line	2,446	-	2,446	40
Frog pond	10,803	-	10,803	30
Other	34,882	-	34,882	3 to 30
	43,860,194	4,842	43,865,036	
Accumulated depreciation	5,834,164	1,173,009	7,007,173	
Net book value	$ 38,026,030	$ (1,168,167)	$ 36,857,863	
Construction in progress	$ 10,348,759	$ (233,458)	$ 10,115,301	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, 2009	Year Ended June 30, 2008
Balance at beginning of year	$ 53,690,000	$ 54,745,000
Bonds issued	-	-
Principal payments	(1,100,000)	(1,055,000)
Balance at end of year	$ 52,590,000	$ 53,690,000
Due in one year	$ 1,145,000	$ 1,100,000

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
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
2013	1,238,686	460,000	1,698,686
2014	1,206,861	490,000	1,696,861
Thereafter	12,834,932	17,430,000	30,264,932
	$ 19,150,496	$ 19,620,000	$ 38,770,496

2002 Bond

Fiscal Year Ending June 30,	Interest	Principal	Total
2010	362,949	165,000	527,949
2011	354,780	170,000	524,780
2012	345,917	180,000	525,917
2013	336,365	190,000	526,365
2014	324,675	200,000	524,675
Thereafter	2,557,912	4,710,000	7,267,912
	$ 4,282,598	$ 5,615,000	$ 9,897,598

2004 Bond

Fiscal Year Ending June 30,	Interest	Principal	Total
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
2013	1,026,450	425,000	1,451,450
2014	1,004,575	450,000	1,454,575
Thereafter	11,410,406	16,570,000	27,980,406
	$ 16,635,644	$ 18,615,000	$ 35,250,644

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
2010	464,236	215,000	679,236
2011	456,403	220,000	676,403
2012	447,578	235,000	682,578
2013	437,658	240,000	677,658
2014	426,750	250,000	676,750
Thereafter	4,515,840	7,580,000	12,095,840
	$ 6,748,465	$ 8,740,000	$ 15,488,465

All Bonds

Fiscal Year Ending June 30,	Interest	Principal	Total
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
2013	3,039,159	1,315,000	4,354,159
2014	2,962,861	1,390,000	4,352,861
Thereafter	31,319,090	46,290,000	77,609,090
	$ 46,817,203	$ 52,590,000	$ 99,407,203

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, 2009:

(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: $4,366,545
(c) 125% of the average annual debt service: $5,402,565

The purpose of this $4,366,545 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, 2009 property taxes were received on assessed property totaling $22,631,083 from inception. Debt service payments totaled $24,561,848 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 $22,239,455 to be paid out of the "Bond Fund." Thus, $391,628 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, 2009, the reserve requirements were as follows:

Reserve Fund	$	4,366,545
Bond Fund		391,628
Total reserve requirement	$	4,758,173
Funds set aside for debt service at June 30, 2009	$	6,115,802

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 $4,173,847 was originally payable in 102 equal monthly installments at 5.97% interest. The original agreement was amended on May 28, 2009 and again on June 15, 2012 to revise the payment schedule.

5. Caterpillar Note Payable (continued)

The following is a debt service schedule to maturity for the Caterpillar note payable, including the effect of both amendments:

Fiscal Year Ending June 30,	Interest	Principal	Total
2010	$ 238,439	$ 181,561	$ 420,000
2011	226,542	193,458	420,000
2012	196,366	182,008	378,374
2013	206,693	244,437	451,130
2014	190,325	260,805	451,130
Thereafter	785,920	2,785,524	3,571,444
	$ 1,844,285	$ 3,847,793	$ 5,692,078

6. Retained Earnings (Deficit) and Capital

The District's assets are substantially in place as of June 30, 2009. However, the operations including water revenue will not be fully realized until the development is completed. At June 30, 2009, 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 former Developer, which was owned by two corporations and a limited liability company. All of the property in the District is currently owned by the successor Developer, World International LLC. The former Developer had contributed $8,206,193 to the District to acquire property and fund the deficit operation to date. As of June 30, 2009 and 2008, the balance due from the former Developer was $0 and $1,246,210, respectively.

World International LLC – the successor Developer, which acquired the property contained in the District through the bankruptcy proceedings of Diablo Grande LP. As of June 30, 2009 and 2008, the balance due to the successor Developer was $1,630,554 and $0, respectively.

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.

8. Bankruptcy of Developer

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 former Developer, the District determined that $1,700,153 of the outstanding receivable from Diablo Grande, LP was uncollectible, and 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 was forfeited through bankruptcy proceedings. The write-off of these special deposits was 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.

Due to the liquidity problems created by the bankruptcy of the Developer, the District sought and obtained relief from various creditors during the year ended June 30, 2009. The relief obtained from creditors resulted in a total reduction in outstanding payables of $449,762, of which $331,458 of the decrease in payables was recorded as a reduction in construction in progress, since the related invoices had been capitalized as construction in progress in prior years. The remaining $118,304 of the decrease in payables was recorded as other income.

9. Payables Concentration

Of the total accounts payable balance at June 30, 2009 of $5,812,730, there was $4,000,626 payable to Veolia Water and $1,630,554 payable to World Industries LLC. Of the total accounts payable balance at June 30, 2008 of $5,432,133, there was $4,000,626 payable to Veolia Water.

10. 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.

11. Subsequent Events

Subsequent events have been evaluated through July 31, 2012, which is the date the financial statements were available to be issued.