

The Corporation as agent of the Issuer deems this Remarketing Circular to be final for the purposes of Securities and Exchange Commission Rule 15c2-12(b)(1) except for certain information which has been omitted in accordance with such Rule and which will be supplied with the final Remarketing Circular.

PRELIMINARY REMARKETING CIRCULAR DATED SEPTEMBER 27, 2002

**BOOK ENTRY ONLY
BANK ELIGIBLE**

MOODY'S RATING: A2

In the opinion of Bond Counsel, under existing laws, regulations and judicial decisions in effect on the date of delivery of the Bonds, and assuming continuing compliance with certain covenants made by the Issuer, the Corporation and the Lessee, interest on the Bonds is excludable from gross income for federal income tax purposes on the conditions and subject to the limitations set forth herein under "TAX TREATMENT" and is not subject to the federal alternative minimum tax on individuals and corporations. Interest on the Bonds held by corporations is includable in such corporations' adjusted current earnings and modified alternative minimum taxable income. Interest on the Bonds is also exempt from income taxation by the Commonwealth of Kentucky and the Bonds are exempt from ad valorem taxation by the Commonwealth of Kentucky and its political subdivisions (See "TAX TREATMENT" herein).

\$2,390,000*
CITY OF DANVILLE, KENTUCKY
MULTI-CITY LEASE REVENUE BONDS
(CITY OF SHELBYVILLE, KENTUCKY
WATER AND SEWER SYSTEM LEASE REVENUE REFUNDING PROJECT)
FIXED RATE SERIES 2002-A

Fixed Rate Conversion Date: October 10, 2002

Mandatory Tender or Redemption Date: July 1, as shown below

On March 9, 1989, the City of Danville, Kentucky (the "Issuer") issued \$152,975,000 Money Market Municipal Multi-City Lease Revenue Bonds (Kentucky Municipal League Pooled Lease Financing Program) Series 1989 (the "Original Bonds"). The Original Bonds are special and limited obligations of the Issuer payable from (i) unexpended 1989 Bond proceeds and investment earnings thereon and available for such payment under a Trust Indenture dated as of March 1, 1989, as amended and supplemented (the "Indenture") among the Issuer, the Kentucky Municipal Finance Corporation (the "Corporation") and Fifth Third Bank, Cincinnati, Ohio, as successor to PNC Bank, Kentucky, Inc., as trustee (the "Trustee") and (ii) payments made to the Trustee under certain lease agreements executed by participants in the pooled leasing program, as described herein. The Original Bonds are also payable from funds drawn under an irrevocable direct pay Letter of Credit issued by Marine Midland Bank, N.A.

On October 10, 2002, a portion of the Original Bonds in the amount set forth above (the "Bonds") will be converted to a Fixed Rate for the periods set forth below. The Fixed Rate for the Bonds will be determined by the Remarketing Agent in accordance with the Indenture.

The Bonds will initially be issued as book-entry bonds registered by the Bond Registrar hereinafter identified in the name of a nominee of The Depository Trust Company ("DTC"), which will act as securities depository for the Bonds. Individual purchases of such Bonds may be made in book-entry form only, in the principal amount of \$5,000 or any multiple of \$5,000. Principal of and interest on the Bonds shall be payable to DTC, which in turn will remit such principal and interest to the beneficial owners of the Bonds through DTC's participants as described in "Appendix F - Book-Entry System" attached hereto.

THE BONDS WILL BE SECURED SOLELY BY PAYMENTS TO BE MADE TO THE TRUSTEE UNDER A LEASE DATED AS OF OCTOBER 10, 2002 (THE "LEASE") BETWEEN THE CITY OF SHELBYVILLE, KENTUCKY (THE "LESSEE") AND THE CORPORATION, AS DESCRIBED HEREIN.

The Bonds will bear interest for the Fixed Rate Periods commencing October 10, 2002, at the rates, and will be subject to mandatory tender or redemption on the dates for termination of the Fixed Rate Periods, in the amounts, as follows:

<u>Due</u>	<u>Cusip #</u>	<u>Amount*</u>	<u>Rate</u>	<u>Yield</u>	<u>Due</u>	<u>Cusip#</u>	<u>Amount*</u>	<u>Rate</u>	<u>Yield</u>
7/1/03		\$240,000			7/1/08		\$270,000		
7/1/04		240,000			7/1/09		280,000		
7/1/05		250,000			7/1/10		290,000		
7/1/06		255,000			7/1/11		305,000		
7/1/07		260,000							

The Bonds will be remarketed in fully registered form in denominations of \$5,000 and integral multiples thereof. Interest on the Bonds is payable on January 1, 2003, and semiannually on each January 1 and July 1 thereafter by check or draft mailed to the Bond owners. Principal, purchase price or redemption price of the Bonds will be payable upon presentation and surrender thereof at Bank One, Kentucky, NA, Lexington, Kentucky, as Paying Agent.

THE BONDS ARE NOT SUBJECT TO OPTIONAL AND MANDATORY REDEMPTION PRIOR TO MATURITY AS DESCRIBED HEREIN.

THE BONDS ARE NOT GENERAL OBLIGATIONS OF THE ISSUER OR THE CORPORATION OR THE LESSEE, BUT ARE LIMITED OBLIGATIONS PAYABLE ONLY FROM THE SERIES TRUST ESTATE APPLICABLE TO THE BONDS AND COMPRISED OF PAYMENTS TO BE MADE BY THE LESSEE UNDER THE LEASE REFERRED TO ABOVE. THE BONDS DO NOT CONSTITUTE AN INDEBTEDNESS OR CHARGE AGAINST THE GENERAL CREDIT OR THE TAXING POWER OF THE ISSUER OR THE LESSEE, IF ANY, OR THE GENERAL CREDIT OF THE CORPORATION AND ARE NOT IN ANY WAY AN OBLIGATION, INDEBTEDNESS OR CHARGE AGAINST THE GENERAL CREDIT OR TAXING POWER OF THE COMMONWEALTH OF KENTUCKY.

Certain matters in connection with the remarketing of the Bonds are subject to the approval thereof by Wyatt, Tarrant & Combs, LLP, Louisville, Kentucky, Bond Counsel. It is expected that the remarketed Bonds will be available for delivery in definitive form on or about October 10, 2002.

*Preliminary; subject to adjustment

FIRST KENTUCKY SECURITIES CORPORATION

This Remarketing Circular does not constitute an offering of any securities other than the offering of the Bonds identified on the cover hereof. No dealer, broker, salesman or any other person has been authorized to give any information or to make any representations, other than those contained in this Remarketing Circular, in connection with the offering described herein, and, if given or made, such information or representations must not be relied upon as having been authorized by the Issuer, the Corporation, the Lessee or the Remarketing Agent. This Remarketing Circular does not constitute an offer to sell or a solicitation of an offer to buy any securities other than the securities offered hereby or any offer or solicitation of such offer of the securities offered hereby to any person in any jurisdiction where such offer or solicitation of such offer or sale of such securities would be unlawful. Neither the delivery of this Remarketing Circular nor the sale of the Bonds implies that information herein is correct as of any time subsequent to the date hereof.

Information herein has been obtained from the Issuer, the Corporation, the Lessee and other sources believed to be reliable, but the accuracy or completeness of such information is not guaranteed by, and should not be construed as a representation by, the Remarketing Agent.

The Bonds are not registered by the Issuer under the Securities Act of 1933, as amended, or any state securities laws, and are not listed on any stock or other securities exchange. Neither the Securities and Exchange Commission nor any other Federal, state, municipal or other governmental entity or agency has passed or will pass upon the adequacy of this Remarketing Circular or approved the Bonds for remarketing.

CITY OF DANVILLE, KENTUCKY

Mayor
ALEX W. STEVENS

KENTUCKY LEAGUE OF CITIES

Executive Director
SYLVIA L. LOVELY

Director of Financial & Member Services
WILLIAM HAMILTON

BOND COUNSEL

WYATT, TARRANT & COMBS, LLP
Louisville, Kentucky

TRUSTEE

FIFTH THIRD BANK
Cincinnati, Ohio

PAYING AGENT/REGISTRAR

BANK ONE, KENTUCKY, NA
Lexington, Kentucky

REMARKETING AGENT

FIRST KENTUCKY SECURITIES CORPORATION
Frankfort, Kentucky

CITY OF SHELBYVILLE, KENTUCKY

Mayor
DAVID B. EATON

City Clerk
INEZ HARRIS

Finance Director
JUDITH SMITH

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PRELIMINARY REMARKETING CIRCULAR

\$2,390,000*

CITY OF DANVILLE, KENTUCKY MULTI-CITY LEASE REVENUE BONDS (CITY OF SHELBYVILLE, KENTUCKY WATER AND SEWER SYSTEM LEASE REVENUE REFUNDING PROJECT) FIXED RATE SERIES 2002-A

INTRODUCTION

The purpose of this Remarketing Circular is to provide information in connection with the remarketing of certain obligations of the City of Danville, Kentucky (the "Issuer") designated as its Multi-City Lease Revenue Bonds (City of Shelbyville, Kentucky Water and Sewer System Lease Revenue Refunding Project) Fixed Rate Series 2002-A, in the aggregate principal amount of \$2,390,000* (the "Bonds"). The Bonds were originally issued as part of the Issuer's \$152,975,000 Money Market Municipal Multi-City Lease Revenue Bonds (Kentucky Municipal League Pooled Lease Financing Program) Series 1989 (the "Original Bonds"). The descriptions of certain documents contained herein do not purport to be comprehensive or definitive, and are qualified in their entirety by reference to the documents themselves.

This Remarketing Circular, together with the Appendices attached hereto, constitute the full and complete Remarketing Circular.

A glossary of defined terms is set forth in Appendix A hereto. All terms not defined herein shall have the meanings ascribed to them in the Indenture.

The Original Bonds, including the Bonds, were issued under a Trust Indenture dated as of March 1, 1989 (the "Original Indenture" and together with all supplements, the "Indenture"), among the Issuer, the Kentucky Municipal Financing Corporation (the "Corporation") and Fifth Third Bank, as successor to PNC Bank, Kentucky, Inc., as trustee (the "Trustee") and pursuant to the Constitution and laws of the Commonwealth of Kentucky, particularly, the provisions of § 58.010 et seq. of the Kentucky Revised Statutes, as amended.

The Original Bonds were issued to provide funds for a pooled lease financing program (the "Program") whereby participating cities and other political subdivisions in the Commonwealth of Kentucky can finance or refinance the acquisition of certain public projects intended for public and governmental purposes, by leasing such projects from the Corporation acting as the agent and instrumentality of the Issuer for purposes of the Program. Upon payment in full of all rentals and all other sums due under a particular lease with the Corporation, the Lessee acquires all right, title and interest in and to the Project financed under such lease. The Issuer, the Corporation and the Trustee entered into a Third Supplemental Indenture of Trust dated as of August 1, 1990 (the "Third Supplemental Indenture"), permitting the remarketing of certain Original Bonds, including the Bonds, as Fixed Rate Bonds without the support of the Credit Facility securing the payment of principal or purchase price of, or interest thereon. The funds made available to the Lessee hereinafter identified pursuant to the Lease hereinafter described will be used for the purpose of (1) refinancing the Project (as such term is defined herein) through the prepayment of all amounts due under a Lease Purchase Agreement dated as of November 25, 1991 (the "Prior Lease") between the Corporation as lessor and the Lessee and (2) paying the fees and costs of remarketing the Bonds.

*Preliminary. Subject to Adjustment.

THE BONDS

The Bonds being remarketed will be converted from the Money Market Municipal Rate to the Fixed Rate on the Fixed Rate Conversion Date shown on the cover hereof, and will be in denominations of \$5,000 and integral multiples thereof. The Bonds will bear interest as set forth on the cover hereof. The Bonds mature and are subject to mandatory tender or redemption on July 1 on the dates and in the amounts set forth on the cover hereof and are subject to mandatory sinking fund tender or redemption or purchase prior to maturity as described below. Reference is made to the Indenture for further details regarding the conversion of Fixed Rate Bonds to Money Market Municipal Bonds, tender provisions and redemption provisions.

Interest on each Bond not registered in Book-Entry Form to a Securities Depository shall be payable by check mailed by the Bond Registrar (which Bond Registrar shall be selected by the Issuer, at or prior to the time of sale of the Bonds) (the "Bond Registrar") to the registered holder thereof as of the Record Date, at the address shown on the registration books kept by the Bond Registrar or at such other address as is furnished to the Bond Registrar in writing by such registered holder. The principal of and premium, if any, on the Bonds not registered in Book-Entry Form to a Securities Depository shall be payable, without exchange or collection charges, in lawful money of the United States of America on their presentation and surrender as they respectively become due and payable, whether at maturity or by prior redemption or acceleration, at the principal trust office of the Bond Registrar. On request of a registered holder of at least \$1,000,000 in aggregate principal amount of the Bonds, all payments of principal of, premium, if any, or interest on the Bonds shall be paid by wire transfer in immediately available funds to an account designated by such registered holder.

Principal of, premium, if any, and interest on Bonds registered in Book-Entry Form in the name of the Securities Depository or the Securities Depository Nominee shall be payable by wire transfer from the Bond Registrar to the Securities Depository or its nominee. So long as any Bonds remain Outstanding, the Bond Registrar shall keep and maintain at its principal trust office complete registration records in respect of the Bonds and shall provide for the registration of transfer and exchange of the Bonds in accordance with the terms of the Indenture, subject to such reasonable procedures and regulations as the Bond Registrar may prescribe.

Special and Limited Obligations

The Bonds are not general obligations of the Issuer, the Lessee or the Corporation but are special and limited obligations payable solely from the Series Trust Estate applicable to the Bonds. The Bonds do not constitute an indebtedness of the Issuer or the Lessee within the meaning of any constitutional or statutory debt limitation or restriction and do not constitute a pledge of the credit, revenues or taxing powers of the Issuer or the Lessee or the general credit of the Corporation.

Registration of Transfer and Exchange

Except as may be otherwise provided in the Indenture for Bonds registered in Book-Entry Form in the name of the Securities Depository or the Securities Depository Nominee, each Bond shall be transferable or exchangeable only on the presentation and surrender thereof at the principal trust office of the Bond Registrar, duly endorsed for transfer or accompanied by an assignment duly executed by the registered holder or his authorized representative.

Except as may be otherwise provided in the Indenture for Bonds registered in Book-Entry Form in the name of the Securities Depository or the Securities Depository Nominee, Bonds shall be exchangeable for a Bond or Bonds of the same maturity and interest rate and in Authorized Denominations, within a single maturity in an aggregate principal amount or amounts equal to the unpaid principal amount of the Bond or Bonds presented for exchange. The Bond Registrar shall be and is hereby authorized to authenticate, deliver and exchange Bonds in accordance herewith. Each Bond delivered in exchange for a surrendered Bond shall constitute an original contractual obligation of the Issuer and shall be entitled to the benefits and security of the Indenture to the same extent as the Bond or Bonds in lieu of which

any Bond is delivered in exchange. Any Bonds surrendered for exchange shall be cancelled by the Bond Registrar and the Bond Registrar shall maintain a complete record of all exchanges, transfers and cancellations of Bonds and shall make a report thereof to the Issuer on request.

Except as may be otherwise provided in the Indenture for Bonds registered in Book-Entry Form in the name of the Securities Depository or the Securities Depository Nominee, no service charge or other transfer fee shall be charged in connection with any transfer or exchange of a Bond. However, the registered owner of any Bond may be required to pay an amount equal to any tax or other governmental charge, if any, that may be imposed in connection with the transfer or exchange of any Bond.

The Bond Registrar shall not be required to transfer or exchange any Bond for the period beginning fifteen (15) days prior to the selection by the Bond Registrar of Bonds to be redeemed prior to maturity and ending on the date of mailing of notice of any such redemption.

On the receipt by the Issuer and the Bond Registrar of evidence satisfactory to them of the loss, theft, destruction or mutilation of any Outstanding Bonds, and of indemnity satisfactory to them, and on surrender and cancellation of such Bond if mutilated, the Issuer may execute and the Bond Registrar may authenticate and deliver, on the lapse of such period of time as they may deem advisable, a new Bond of like series, tenor and maturity bearing the same or different serial number, to be issued in lieu of such lost, stolen, destroyed or mutilated Bond. The Issuer and the Bond Registrar may require the payment of costs for each such new Bond issued, and the furnishing of indemnity satisfactory to the Issuer and the Bond Registrar. The Bond Registrar shall incur no liability for anything done by it under the foregoing procedures in the absence of gross negligence or fault.

Purchase and Redemption

Conversion of Interest Rate. The interest rate on the Bonds will automatically convert to another interest rate in the amounts and on the dates for termination of the Fixed Rate Periods set forth on the cover hereof. The Bonds are subject to mandatory tender for purchase on such Conversion Dates at a Purchase Price equal to the principal amount thereof plus accrued interest thereon. Owners of Bonds converting to another interest rate will have no option to retain the Bonds upon such conversion.

Optional Purchase. The Bonds are not subject to purchase at the option of the Corporation prior to maturity.

Securities Depository; Ownership of Bonds

As heretofore provided, the Bonds initially shall be registered in the name of the Securities Depository or the Securities Depository Nominee, and ownership thereof shall be maintained in Book-Entry Form by the Securities Depository for the account of the Agent Members thereof. Initially, the Bonds shall be registered in the name of Cede & Co., as the nominee of The Depository Trust Company ("DTC"), New York, New York. See "Appendix F - Book-Entry System" attached hereto, for further information on DTC and the book-entry system.

Except as provided below under this subheading, the Bonds may be transferred, in whole but not in part, only to the Securities Depository or the Securities Depository Nominee, or to a successor Securities Depository selected or approved by the Issuer or to a nominee of such successor Securities Depository. As to any Bond, the person in whose name the Bond shall be registered shall be the absolute owner thereof for all purposes, and payment of or on account of the principal of and premium, if any, and interest on any such Bond shall be made only to or on the order of the registered owner thereof or his legal representative.

Neither the Issuer nor the Bond Registrar shall have any responsibility or obligation with respect to [i] the accuracy of the records of the Securities Depository or any Agent Member with respect to any beneficial ownership interest in the Bonds, [ii] the delivery to any Agent Member, any beneficial owner of the Bonds or any other person,

other than the Securities Depository, of any notice with respect to the Bonds or [iii] the payment to any Agent Member, any beneficial owner of the Bonds or any other person, other than the Securities Depository, of any amount with respect to the principal, premium, if any, or interest on the Bonds.

So long as any Bonds are registered in Book-Entry Form, the Issuer and the Bond Registrar may treat the Securities Depository as, and deem the Securities Depository to be, the absolute owner of such Bonds for all purposes whatsoever, including without limitation [i] payment of principal, premium, if any, and interest on Bonds, [ii] giving notices of redemption and other matters with respect to the Bonds, [iii] registering transfers with respect to the Bonds, [iv] selection of Bonds for redemption and [v] and for purposes of obtaining consents under the Indenture. Notwithstanding the definition of the term "Bondholder" or "Holder" or "Holder of Bonds" in the Indenture, as referencing registered holders of the Bonds, the Bond Registrar shall be entitled to rely on written instructions from a majority of the beneficial owners of the Bonds with reference to consent, if any, required from registered holders pursuant to the terms of the Indenture.

If at any time the Securities Depository notifies the Issuer that it is unwilling or unable to continue as Securities Depository with respect to the Bonds, or if at any time the Securities Depository shall no longer be registered or in good standing under the Securities Exchange Act or other applicable statute or regulation and a successor Securities Depository is not appointed by the Issuer within ninety (90) days after the Issuer receives notice or becomes aware of such condition, as the case may be, then the above provisions in this subheading on the book-entry only system shall no longer be applicable and the Issuer shall execute and the Bond Registrar shall authenticate and deliver certificates representing the Bonds to the Bondholders.

ESTIMATED SOURCES AND USES OF FUNDS

The estimated sources and uses of funds are as follows:

Sources

Fixed Rate 2002-A Lease Revenue Bonds	\$
Investment Earnings or Revenues	_____
Total Sources	\$ <u> </u>

Uses

Prepayment of the Prior Lease	\$
Other Costs of Remarketing	
Remarketing Fee	_____
Total Uses	\$ <u> </u>

THE LEASE AND ADDITIONAL SECURITY FOR THE BONDS

Pursuant to the Program and the terms of the Original Indenture, the Corporation has entered into a Lease Purchase Agreement (the "Lease") with the City of Shelbyville, Kentucky (the "Lessee") to provide funds to refinance various improvements to the Lessee's water and sewer system (the "Project") through the prepayment of all amounts due under the Prior Lease.

General Provisions

The Lease provides for the payment by the Lessee of lease rental payments in amounts sufficient, together with amounts on deposit in and income from the investment of the funds and accounts established under the Indenture, to pay the principal of, premium if any, and interest on the Bonds when due. The holders of the Bonds will have a separate and distinct pledge of payments under the Lease as security for the payment of debt service on the Bonds. The amounts payable under the Lease are pledged as security for all the Bonds.

The following is a brief summary of certain provisions of the Lease. The summary does not purport to be comprehensive. All references to the Lease are qualified in their entirety by reference to the Lease, copies of which are available for review at the offices of the Trustee.

Duration of Lease Term. The Lease Term shall commence as of the date of delivery of the Bonds and shall terminate on the date of payment in full of all obligations thereunder.

Base Rentals and Additional Rentals. The Lessee shall pay from the sources provided in the Lease, Base Rentals directly to the Trustee during the Lease Term on the applicable Lease Rental Payment Date. The Lessee shall pay, from the sources specified in the Lease, Additional Rentals to the Trustee within fifteen (15) days after a written request therefor is mailed to the Lessee.

The Payments of Base Rentals shall be applied in order upon receipt thereof by the Trustee [1] to the accrued and unpaid interest component of Base Rentals; [2] to the accrued and unpaid principal component of Base Rentals; [3] to the Lessee's Proportionate Share of Program Expenses which have not been paid by Lessee or Lessor; and [4] to the accrued and unpaid Additional Rentals due from Lessee.

The payments of Additional Rentals shall be applied in order upon receipt thereof by the Trustee [1] to the accrued and unpaid Additional Rentals; and [2] the excess, if any, shall be held by the Trustee in an account for the credit of the Lessee until needed to be applied for the payment of Base Rentals or Additional Rentals coming due during the remainder of the Fiscal Year and then applied as overpayments.

Agreement To Refinance the Project and Lease It to the Lessee. The Lessee shall provide for the refinancing of the Project as the agent of the Lessor through the application of moneys to be disbursed from the Lessee Acquisition Account. The Lessee shall take possession of the Project upon delivery thereof, and Lessor agrees to lease the Project to the Lessee for the Lease Term.

Contractor's Performance and Payment Bonds; Insurance. Each Contractor entering into a construction contract relating to the Project shall be required to furnish a performance bond and a separate labor and material payment bond.

Damage, Destruction or Condemnation. If during the Lease Term [i] the Project or any portion thereof is destroyed, or damaged by fire or other casualty; [ii] title to, or the temporary or permanent use of the Project or any portion thereof or the estate of the Lessee or the Lessor in the Project or any portion thereof shall be taken under the power of eminent domain by any governmental authority; [iii] a material defect in construction of the Project shall become apparent, or [iv] title to or the use of all or any portion of the Project shall be lost by reason of a defect in title, then the Lessee shall continue to be obligated to pay Base Rentals and Additional Rentals.

Obligation of the Lessee To Repair and Replace the Project. The Lessor shall cause the Net Proceeds of any insurance policies, performance bonds, condemnation awards or Net Proceeds received as a consequence of default under a construction contract or made available by reason of any occurrence described above, to be deposited in the Lessee Acquisition Account, if received before the completion date of the Project, or, if received thereafter, to be deposited in a separate trust fund held by the Trustee. Net proceeds so deposited shall be applied to the prompt repair, restoration, modification, improvement or replacement of the Project. The balance of any such net proceeds remaining

after such repair, restoration, modification, improvement or replacement has been completed shall be applied to prepayment of the principal components of Base Rentals. Any repair, restoration, modification, improvement or replacement paid for in whole or in part from such net proceeds shall be the property of the Lessor, subject to the Lease, and shall be included as part of the Project under the Lease.

Maintenance of the Project by the Lessee. The Lessee agrees that, during the Lease Term and at its sole cost and expense, the Lessee will maintain, preserve and keep the Project or cause the Project to be maintained, preserved and kept, with the appurtenances and every part and parcel thereof, in good repair, working order and condition, and that the Lessee will from time to time make or cause to be made all necessary and proper repairs, except as otherwise provided in the Lease.

Provisions Regarding Casualty, Public Liability and Property Damage Insurance. The Lessee shall cause casualty and property damage insurance (which may be self-insurance) to be carried and maintained with respect to the Project in an amount equal to the aggregate principal components of Base Rentals then payable; or the replacement cost of the Project, whichever is greater. The Lessee shall, at its own expense, cause public liability insurance (which may be self-insurance) to be carried and maintained with respect to the Project. Such insurance shall be in amounts and with such coverages and exclusions as are customary and reasonable for the Lessee. Any self-insurance fund shall be reviewed annually by the Lessee's risk manager or an independent insurance consultant. The Lessor may rely on a certificate of the Lessee's risk manager or an independent insurance consultant (dated as of the first day of the Fiscal Year) as to the adequacy of any self-insurance fund.

No Encumbrance, Mortgage or Pledge of Project. The Lessor and the Lessee shall not permit any mechanic's or other lien to be perfected or remain against the Project. Neither the Lessor nor, except as provided above, the Lessee shall directly or indirectly create, incur, assume or suffer to exist any mortgage, pledge, lien, charge, encumbrance or claim on or with respect to the Project, except Permitted Encumbrances. The Lessee shall promptly, at its own expense, take such action as may be necessary to duly discharge any such mortgage, pledge, lien, charge, encumbrance or claim not excepted above which it shall have created, incurred or suffered to exist. The Lessor shall promptly, at its own expense, take such action as may be necessary to duly discharge any such mortgage, pledge, lien, charge, encumbrance or claim not excepted above which it shall have created, incurred or suffered to exist.

"Permitted Encumbrances" means, as of any particular time: [a] liens for taxes and assessments not then delinquent, or liens which may remain unpaid pursuant to the provisions of the Lease; [b] the Lease; [c] any lien created by a Collateral Document; [d] utility, access and other easements and rights of way, restrictions and exceptions which do not, in the opinion of the Independent Counsel, interfere with or impair the Project; [e] any Financing Statements filed to perfect security interests; [f] such minor defects, irregularities, encumbrances and clouds on title as normally exist with respect to property of the general character of the Equipment and Improvements and as do not, in the opinion of the Independent Counsel, materially impair title to the Project; and [g] such additional liens described as an additional Permitted Encumbrance in Exhibit G of the Lease.

Conveyance of the Project. The Lessor shall convey the Project to the Lessee, if the Lessee shall have paid in full all Lease Rental Payments required hereunder for the Lease Term.

Events of Default Defined. The following shall be "Events of Default" or "Defaults" under the Lease:

- A. failure by the Lessee to pay any Base Rentals at the time specified therein;
- B. failure by the Lessee to pay any Additional Rentals or to observe and perform any covenant, condition or agreement on its part to be observed or performed, other than as referred to in A above, for a period of thirty (30) days after written notice specifying such failure and requesting that it be remedied shall have been given to the Lessee by the Lessor, unless the Lessor shall agree in writing to an extension of such time prior to its expiration; provided, however, that if such failure cannot be

corrected within the applicable period, the Lessor will not unreasonably withhold its consent to an extension of time if corrective action is instituted by the Lessee within the applicable period and diligently pursued until such failure is corrected. If, however, by reason of Force Majeure, the Lessee is unable in whole or in part to carry out any of its agreements contained in the Lease (other than its obligations contained in Section 2.1 and Article 6 thereof), the Lessee shall not be deemed in default during the continuance of such inability. The Lessee agrees, however, to remedy with all reasonable dispatch the cause or causes preventing the Lessee from carrying out such agreement, provided that the settlement of strikes and other employee-related disturbances shall be entirely within the discretion of the Lessee and the Lessee shall not be required to make settlement of strikes, lockouts and other employee-related disturbances by acceding to the demands of the opposing party or parties when such course is in its judgment unfavorable to the Lessee;

- C. a default or event of default under a Collateral Document, if any;
- D. a failure to use or apply the funds in the Lessee Acquisition Account to pay the costs of refinancing the Project or as otherwise permitted under the Lease;
- E. a breach by Lessee of the representations, covenants and warranties set forth in the Lease;
- F. the dissolution or liquidation of the Lessee, or the voluntary initiation by the Lessee of any proceeding under any federal or state law relating to bankruptcy, insolvency, arrangement, reorganization, readjustment of debt or any other form of debtor relief.
- G. Such additional events of default as may be described in Exhibit G to the Lease.

Remedies on Default. Whenever an Event of Default shall have happened and be continuing, the Trustee, on behalf of the Lessor, may, or at the request of the Owners of a majority in aggregate principal amount of the Bonds Outstanding shall, without any further demand or notice, exercise any of the remedies set forth below:

- A. The Trustee may (i) terminate the Lease and give notice to the Lessee to vacate or surrender the Project, within sixty (60) days from the date of such notice, and may proceed to repossess and liquidate or sublease the Project or any portion thereof or (ii) declare that all interest and principal components of Base Rentals and all Additional Rentals, including any prepayment premiums, are immediately due and payable.
- B. The Trustee shall be entitled to all amounts on deposit in the Lessee's Acquisition Account.
- C. The Trustee may exercise all the rights and remedies of a secured party under the Kentucky Uniform Commercial Code with respect to any personal property comprising a portion of the Project and may otherwise repossess and liquidate such property in any lawful manner.
- D. The Trustee, acting for the Lessor, may sublease the Project or any portion thereof.
- E. The Trustee, acting for the Lessor, may recover from the Lessee the Optional Prepayment Price, calculated to the date of recovery of such amount.
- F. The Trustee may sell or otherwise dispose of the Project and apply the proceeds to payment of amounts due.
- G. The Trustee may, acting for the Lessor, take whatever action at law or in equity may appear necessary or desirable to enforce its rights in and to the Project under the Lease and any Collateral Documents.

Application of Revenues and Funds and Accounts

The Lessee's water and sewer system (the "System"), more specifically described in Appendix C hereto, is operated as a water and sewer system for the security and source of payment of the Lease, the Bonds and any Parity Debt (as hereinafter described in Appendix E). The Lessee's general obligation debt, as may be outstanding from time to time, is not on a parity as to security and source of payment with the Lease or the Bonds. The Lease establishes the various funds and accounts of the System and the procedures for applying System revenues. Capitalized terms used in the following paragraphs and not defined in Appendix A are defined in the Lease.

The Revenues of the System, together with income from the Debt Service Reserve, as hereinafter defined, shall be set aside as and when received into the General Revenue Fund and shall then be expended, used and apportioned as follows:

Flow of Funds

(1) To the extent moneys are received by the Lessee representing any legislative appropriation or grant, federal or state, for purposes of deposit to the Revenue Fund, the Debt Service Fund or the Debt Service Reserve, or for the defrayal of Operation and Maintenance Costs, or for improvements, repairs or replacements to the System (from amounts in the Depreciation Fund) such funds shall be promptly transmitted by the Lessee to the appropriate depository for deposit to the fund or account so specified.

(2) The Lessee shall cause all moneys received as Revenues to be transferred from the Revenue Fund and deposited to the following accounts and funds on no less than a monthly basis (except for items FIFTH and SIXTH) in the amounts hereinafter stated and in the prescribed sequence:

FIRST: Into the Interest Account within the Debt Service Fund an amount when added to the amount then on deposit therein, equal to (i) the interest portion of Base Rentals and Lessee's Proportionate Share of Recurring Program Expenses under the Lease plus (ii) the interest on all outstanding Parity Debt accrued and unpaid in respect of the next interest payment date for such Parity Debt divided by the number of months preceding such interest payment date or to reimburse a credit provider for its direct payment of interest on System Bonds under an agreement with such credit provider.

SECOND: Into the Principal Account within the Debt Service Fund an amount when added to the amount then on deposit therein, equal to (i) the principal portion of Base Rentals and (ii) the Principal Installments on any Parity Debt accrued and unpaid in respect of the next Principal Installment Date for such Parity Debt divided by the number of months preceding such Principal Installment Date or to reimburse a credit provider for its direct payment of principal of Parity Debt under an agreement with such credit provider.

THIRD: If at any time the amount in the Debt Service Reserve is less than the Aggregate Debt Service Reserve Requirement, there shall be deposited into the Debt Service Reserve, on no less than a monthly basis, an amount equal to 1/24th of such deficiency so that the balance in the Debt Service Reserve will equal the Aggregate Debt Service Reserve Requirement in the month that is twenty-four (24) months from the month such deficiency first existed. Thereafter such monthly payments may cease for so long as the required balance in the Debt Service Reserve is maintained and such monthly payments shall resume again if at any time said balance is less than the Aggregate Debt Service Reserve Requirement and shall continue until said balance is established.

FOURTH: On or before the tenth day of each month, into the Operation and Maintenance Fund, (i) the amount of money, after adjusting for moneys then on deposit in such Fund and which are not otherwise required for the operational reserve, equal to the reasonable and necessary Operation and Maintenance costs and any Additional Rentals (the "Monthly Requirement") for the next succeeding month, plus (ii) an amount which, after taking into account the

sums then on deposit in said Fund will equal the estimated and budgeted operation and maintenance Costs for two (2) additional months, such additional sums to be held as an operational reserve and expended as required, subject to replacement in the same manner, if so expended.

FIFTH: If at any time the amount in the Depreciation Fund is less than the Depreciation Reserve Requirement, there shall be deposited into the Depreciation Fund, on no less than a monthly basis, an amount equal to 1/24th of such deficiency so that the balance in the Depreciation Fund will equal the Depreciation Reserve Requirement in the month that is twenty-four months from the month such deficiency first existed. Thereafter such monthly payments may cease for so long as the required balance in the Depreciation Fund is maintained and such monthly payments shall resume again if at any time said balance is less than the Depreciation Reserve Requirement and shall continue until said balance is established.

SIXTH: On a periodic basis, but no less frequently than annually, the revenues remaining in the General Revenue Fund at the end of the month, or, in the case of annual transfers, the preceding calendar year, after making the payments required by paragraphs FIRST to FIFTH, inclusive, hereof, including any balances to be accrued and maintained, shall be transferred to the Surplus Fund; provided that no such transfer shall be made to the Surplus Fund until the respective reserve requirements set forth in paragraphs THIRD through FIFTH have been fully funded and if such reserves are not fully funded, amounts remaining in the General Revenue Fund shall be deposited in the appropriate funds in the prescribed in order until such reserve requirements are fully funded.

Funds and Accounts

(1) Debt Service Fund.

The Debt Service Fund shall be maintained by the Lessee in the appropriate depository so long as any of the System Bonds authorized or permitted to be issued by the Lease remain outstanding; and all moneys deposited in the Debt Service Fund from time to time shall be used, disbursed and applied, and are irrevocably pledged solely for the purpose of paying the Base Rentals and the Principal Installments of, and interest on all System Bonds as may be issued and outstanding from time to time pursuant to the provisions of the Lease. Funds in the Debt Service Fund may, from time to time, at the option of the Lessee, be used and employed to purchase sufficient term System Bonds, if any be outstanding, to satisfy a sinking fund installment due within the next succeeding twelve (12) months. The Lessee shall direct the depository to, and the depository shall, pay out of the Interest Account to the Lessor and to any paying agents for any Parity Debt (a) on the day preceding each payment date, the amounts required for the payment of interest portion of Base Rentals and Program Expenses hereunder and interest on the Outstanding Bonds due on such date, and (b) on the date preceding the redemption date or date of purchase, the amounts required for the payment of accrued interest on System Bonds redeemed or purchased for retirement unless the payment of such accrued interest shall be otherwise provided for.

The Lessee shall direct the depository to, and the depository shall, pay out of moneys credited to the Principal Account to the Lessor and to the respective paying agents for any day preceding each payment date for any Base Rentals or for any Parity Debt, the amounts required for the payment of principal due on such date.

(2) Debt Service Reserve.

The Lease establishes a Debt Service Reserve as security for the payment of principal of, interest on, and redemption price, if any on System Bonds, all as more particularly described under the heading "The Lease and Additional Security for the Bonds - Security".

(3) Operation and Maintenance Fund.

The Operation and Maintenance Fund shall be used to pay Additional Rentals and the reasonable expenses of operating, maintaining and repairing the System and for paying Operation and Maintenance Costs.

(4) Depreciation Fund.

The Depreciation Fund shall be available and shall be utilized to balance depreciation, to make unforeseen major repairs and replacements of the System and to pay the costs of constructing additions, extensions, betterments and improvements to the System which will either increase income and revenues or provide a higher degree of service.

In addition, to the transfers required to be made to the Depreciation Fund from other Funds and Accounts under the provisions of the Lease, so long as the balance in the Depreciation Fund is less than the Depreciation Reserve Requirement, there shall be transferred to and deposited in such Fund any other moneys:

- (a) received by the Lessee from any other source and duly determined and ordered by the Lessee to be deposited therein, unless required to be otherwise applied as provided by the Lease,
- (b) for which the Lessee has exercised a discretion to so deposit or transfer as permitted by the Lease, and
- (c) ordered to be so deposited from the proceeds of any System Bonds.

To the extent that other moneys will not be available for the payment of Base Rentals or Principal Installments of and interest on System Bonds when due or the payment of Operation and Maintenance Costs, amounts in the Depreciation Fund shall be transferred by the Lessee, upon written direction by an authorized officer and be deposited in the Debt Service Fund or operation and Maintenance Fund, as applicable.

The depository shall from time to time pay out or permit the withdrawal of moneys from the Depreciation Fund for the purpose of making payments pursuant to paragraph (3) hereof upon receipt by said depository of written direction of an Authorized officer stating the following with respect to each payment to be made:

- (a) the fund from which the payment is to be made,
- (b) the name of the person or party to whom the payment is to be made, and
- (c) the amount to be paid.

(5) Surplus Fund.

The Surplus Fund shall be maintained by the Lessee in the appropriate depository so long as any System Bonds remain outstanding; and all moneys deposited in the Surplus Fund may be used as follows: (a) to the extent necessary from time to time monies in the Surplus Fund shall be transferred to the Debt Service Fund to permit payment of all obligations payable from such Fund without drawing on the Debt Service Reserve; (b) monies in the Surplus Fund shall be used for payment of principal of and interest on any outstanding bonds and notes issued by the Lessee to pay for costs of improving or extending the System or may be transferred to the appropriate fund or account created herein to permit such payment; and (c) monies in the Surplus Fund otherwise may be used for any other lawful municipal purpose; provided that the remaining balance in the Surplus Fund following any such withdrawal, is equal to at least 5% of the System's Revenues for the fiscal year in which the withdrawal is made.

Security

Pledge of Revenues. Pursuant to the Lease, the Revenues of the System are being pledged and assigned as security for the payment of the Lease Rental Payments and any additional Parity Debt. The Revenues will be subject to the lien of such pledge without any physical delivery thereof or further act, and the lien of such pledge will be valid and binding as against all persons having claims of any kind in tort, contract or otherwise against the Lessee, irrespective of whether such persons have notice thereof. The pledge created under the Lease is and shall be superior to a pledge of such Revenues securing any subordinated debt.

Nothing contained in the Lease is to be construed as limiting any authority granted to the Lessee to issue other obligations, the security and source of payment of which is subordinate and subject to the pledges and assignments for the Lease and any additional Parity Debt.

Debt Service Reserve. The Lease establishes a Debt Service Reserve. Under the provisions of the Lease, there shall be deposited to the credit of the Debt Service Reserve (a) all amounts from the Revenue Fund required to be deposited therein by the Lease, (b) all moneys received on account of or in connection with investment obligations credited to the Debt Service Reserve as herein provided, and (c) all System Bond proceeds which may be required to be deposited in the Debt Service Reserve.

The Debt Service Reserve is pledged to and shall be used for the payment of principal of, interest on, and redemption price, if any, in respect of any outstanding System Bonds, including the Base Rentals, as to which there would otherwise be a default in payment, and sums in the Debt Service Reserve shall be transferred to other funds and accounts in a timely manner upon due certification as provided below in order to effectuate the intent hereof and the purposes of the Debt Service Reserve. In the event that amounts in the Debt Service Reserve are reduced below the Aggregate Debt Service Reserve Requirement by transfer to the Debt Service Fund or as a result of a reduction in value of investments upon a determination of value in accordance with the provisions of the Lease, the deficiency in the Debt Service Reserve shall be cured from the first available Revenues as applied as provided under the heading "The Lease and Additional Security for the Bonds Application of Revenues and Funds and Accounts".

The Lessee shall cause the depository from time to time to transfer or pay out moneys in the Debt Service Reserve for the purpose of making payments and transfers to other funds and accounts pursuant to the preceding paragraph upon receipt by said depository of written direction of an authorized officer stating with respect to each payment or transfer to be made:

- (a) the account or fund to which the payment or transfer is to be made,
- (b) the purpose of the payment or transfer, and
- (c) the amount to be paid.

Any interest earned or sums realized as a result of investment of moneys in the Debt Service Reserve shall accrue to, and be a part of, said Debt Service Reserve; provided, however, that so long as the Debt Service Reserve contains the Aggregate Debt Service Reserve Requirement, any such interest earned or sums realized shall be transferred, as received, to the Revenue Fund.

In lieu of the deposit of funds in the Debt Service Reserve, the Lessee may obtain a Debt Service Reserve Guaranty. Any Debt Service Reserve Guaranty shall be considered a deposit of funds in the Debt Service Reserve equal to the Debt Service Reserve Coverage provided by the Debt Service Reserve Guaranty Agreement.

As conditions precedent to delivery of a Debt Service Reserve Guaranty, the Lessee shall obtain (i) a Debt Service Reserve Guaranty, (ii) an opinion of counsel addressed to the Lessee stating that the delivery of such

Debt Service Reserve Guaranty to the Lessee is authorized under and complies with the terms hereof, and (iii) written evidence from a Rating Agency, if the System Bonds are rated by such Rating Agency, that the Rating Agency has reviewed the proposed Debt Service Reserve Guaranty and that (x) the issuance of the Debt Service Reserve Guaranty to the Lessee and (y) if a Debt Service Reserve Guaranty is then in effect with respect to the Debt Service Reserve, the substitution of the proposed Debt Service Reserve Guaranty for the Debt Service Reserve Guaranty then in effect, will not, by itself, result in a reduction or withdrawal of its rating on the System Bonds. If the System Bonds are insured by a bond insurer, the references to Rating Agency in the prior sentence shall be read to mean such bond insurer and the substitution of the proposed Debt Service Reserve Guaranty shall not result in the cancellation of the bond insurance provided by such bond insurer.

For the purposes of the Debt Service Reserve, the capitalized terms shall have the following meanings:

"Debt Service Reserve Guarantor" means the issuer of a Debt Service Reserve Guaranty.

"Debt Service Reserve Guaranty" means a letter of credit, surety bond or similar arrangement representing the irrevocable obligation of the Debt Service Reserve Guarantor to pay to the Lessee upon request made by the Lessee up to an amount stated therein for application as provided in this Section.

"Debt Service Reserve Guaranty Agreement" means the reimbursement agreement, loan agreement or similar agreement between the Lessee and a Debt Service Reserve Guarantor with respect to repayment of amounts advanced under the Debt Service Reserve Guaranty.

"Debt Service Reserve Guaranty Coverage" means the amount available at any particular time to be paid to the Lessee under the terms of the Debt Service Reserve Guaranty.

"Debt Service Reserve Guaranty Limit" means the maximum aggregate amount available to be paid to the Lessee under the terms of a Debt Service Reserve Guaranty.

"Rating Agency" means either Moody's Investors Service, Inc. or Standard & Poor's Corporation, both corporations and organized under the laws of the States of Delaware and New York, respectively, and their successors and assigns.

Rate Covenants: Coverage: Annual Budget.

The Lessee shall at all times establish, enforce and collect rates, rentals, and charges for services rendered and facilities afforded by facilities constituting the System; and the same shall be reasonable and just, taking into account and consideration the cost and value of the System, the costs of operating the same and maintaining the same in a good state of repair, proper and necessary allowances for additions and extensions, and the amounts necessary for the orderly retirement of all System Bonds and the accruing interest thereon, and the accumulation and maintenance of reserves as provided in this Lease (but excluding depreciation expense); and such rates and charges shall be adequate to meet all such requirements as provided in the Lease, and shall, if necessary, be adjusted from time to time in order to comply therewith (subject to such regulatory approvals as may be required by law); and annual revenue from such rates, rentals and charges shall be further adequate to provide, after fulfillment of all contractual obligations required of the Lessee incident to the the Lease and any Parity Debt, including accumulation and maintenance of all reserves required by this Lease, and after payment of Operation and Maintenance Costs 1.20 times coverage of the Annual Debt Service Requirement, and shall, if necessary, be adjusted from time to time in order to comply herewith.

On or before the first day of each fiscal year, so long as the Lease has not been cancelled, the Lessee will adopt an annual budget of current expenses for the ensuing fiscal year, and will promptly file a copy of such budget, and of any amendments thereto, in the Office of the City Clerk, and will furnish copies thereof to any holder of any System Bond upon request. The term "current expenses" as herein used, includes all reasonable and necessary costs

of operating, repairing, maintaining and insuring the System, but shall exclude depreciation expense and expenditures for extensions, improvements and extraordinary repairs and maintenance, and payments into the Debt Service Fund and the Debt Service Reserve. The Lessee covenants that the current expenses incurred in any year will not exceed the reasonable and necessary amounts available therefor, and that it will not expend any amount or incur any obligations for operation, maintenance and repairs in excess of the total amount provided for current expenses in its annual budget. At the same time, and in like manner, the Lessee agrees that it will prepare an estimate of Revenues to be derived from operation of the System for such fiscal year, and to the extent that said Revenues are projected to be insufficient to meet all requirements as provided in the Lease, the Lessee covenants and agrees that it will immediately (subject to any regulatory approvals as required by law) revise its rates, rentals and charges for services rendered by the System, so that the same will be adequate to meet all of such requirements.

The Lessee shall not at any time make any reduction in any prevailing schedule of rates, rentals and charges for use of the services and facilities of the Lessee without first obtaining the written determination of an Engineer with expertise in the field of water and/or wastewater engineering, as applicable, to the effect that the proposed reduction will not adversely affect the ability of the Lessee to meet all the requirements and covenants set forth in the Lease.

Other Covenants

The Lessee further covenants, so long as the Lease is outstanding, as follows:

A. It will at all times own and operate the System as a combined and consolidated public project on a revenue-producing basis, and will permit no services to be rendered free of charge or without full compensation.

B. It will at all times maintain the System in good condition through application of Revenues accumulated and set aside for operation and maintenance as described above and will make renewals and replacements, as the same may be required, through application of Revenues accumulated and set aside into the Depreciation Fund.

C. It will perform all duties with reference to the System required by the Statutes and Constitution of Kentucky and will not sell, lease, mortgage or in any manner dispose of the system, or any part thereof except as permitted under law and the terms of the Lease.

D. Pursuant to Section 96.934 of the Kentucky Revised Statutes and other applicable legal provisions, the Lessee will cause rates and charges for water and sewer services furnished by the system to be billed simultaneously to the same customers of the System, and will provide that water and sewer service will be discontinued to any premises where there is a failure to pay any part of the charges so billed, including such penalties and fees for disconnection and/or reconnection as may be prescribed from time to time, to the greatest extent permitted by law.

Further information concerning the Lessee and the Lessee's water and sewer system is set forth in attached Appendix C. Additional information about the Lessee may be obtained from the Corporation by writing to the Kentucky League of Cities, 101 East Vine Street, Suite 600, Lexington, Kentucky 40507, Attention: Bill Hamilton, Director of Financial & Member Services.

THE INDENTURE

The Original Indenture provided that the Original Bonds were secured by a letter of credit issued by Marine Midland Bank, N.A. (the "Credit Facility"). The Third Supplemental Trust Indenture modified the Original Indenture to permit the remarketing of a portion of the Original Bonds, at a fixed rate without the benefit of the Credit Facility securing the principal or purchase price of or interest on such portion of the Original Bonds.

The following is a brief summary of certain provisions of the Indenture. The summary does not purport to be comprehensive. All references herein to the Indenture are qualified in their entirety by reference to such document, copies of which are available at the office of the Trustee.

Series Trust Estate

The Bonds will be secured by a separate and distinct Series Trust Estate created with respect to the Bonds (the "Series Trust Estate"). Nothing in the Bonds or the Third Supplemental Trust Indenture will be considered as assigning or pledging any other funds or assets of the Issuer other than the Series Trust Estate. Subject to the prior lien and security interest on the Series Trust Estate for the benefit of the Owners of the Bonds, the Series Trust Estate is also pledged on a subordinated basis as security for the payment of principal and Purchase Price of, premium, if any, and interest on the Original Bonds. The Bonds will not be secured by the Credit Facility and the provisions of the Original Indenture relating to draws on the Credit Facility or Alternate Credit Facility in order to pay principal or Purchase Price of or interest on the Original Bonds shall not apply to the Bonds.

When the Bonds are no longer Outstanding, the priority lien and security interest of the Bonds on the Series Trust Estate shall cease and be discharged.

THE BONDS ARE NOT GENERAL OBLIGATIONS OF THE ISSUER, THE LESSEE OR THE CORPORATION BUT ARE LIMITED OBLIGATIONS PAYABLE SOLELY AND ONLY FROM THE SERIES TRUST ESTATE. THE BONDS DO NOT CONSTITUTE AN INDEBTEDNESS WITHIN THE MEANING OF ANY CONSTITUTIONAL OR STATUTORY DEBT LIMITATION OR RESTRICTION.

Conversion of Original Bonds to Supplemental Bonds

Original Bonds in the aggregate principal amount of \$2,390,000* shall be converted to the Bonds pursuant to the terms and conditions and subject to the procedures set forth in the Original Indenture relating to conversion of Money Market Municipal Bonds to Fixed Rate Bonds and certain requirements set forth in the Third Supplemental Trust Indenture.

Description of the Bonds

The Bonds shall be dated the date of their conversion to Fixed Rate Bonds and will bear interest at the Fixed Rate determined as provided in the Original Indenture. The Bonds will be fully registered Fixed Rate Bonds in Authorized Denominations. The Bonds will mature as provided in the Original Indenture. Payment of the Purchase Price and principal of and interest on the Bonds shall not be secured by the Credit Facility.

Payment of Principal and Interest

The Issuer covenants that it will promptly pay the principal and Purchase Price of, and premium, if any, on the Bonds in the manner provided in the Bonds, and interest on the Bonds shall be payable on each Interest Payment Date at the rates set forth in the Lease; provided that all such payments are payable by the Issuer from the Series Trust Estate.

*Preliminary; subject to adjustment

Funds and Accounts

Creation of Funds. Under the Original Indenture the Issuer created and established the following Funds to be held by the Trustee which may be applicable to the Bonds: (a) the Debt Service Reserve Fund; (b) the Project Fund and, within the Project Fund, a Lessee Acquisition Accounts; (c) the Redemption Fund and, within the Redemption Fund, a Premium Account; and (d) the Revenue Fund and, within the Revenue Fund, a Lessee Account. Segregated accounts have been established pursuant to the Third Supplemental Trust Indenture and descriptions of such accounts are provided under the heading "Creation of Segregated Accounts."

Creation of Segregated Accounts. In connection with the conversion and remarketing of the Bonds, the Trustee will create a separate series of Segregated Accounts identified by the series designation of the Bonds in [i] the Debt Service Reserve Fund, but only if a Supplemental Bond Debt Service Reserve Requirement has been established for such series of Bonds, [ii] the Redemption Fund and its Premium Account and [iii] the Revenue Fund. The Paying Agent will also create a separate Segregated Account in the Principal and Interest Account of the Paying Agent Fund.

Lease and Lessee Acquisition Account. Except as described herein, the provisions of the Original Indenture shall apply to the Lessee Acquisition Account, the Lease, and the closing of the Lease with respect to which the Bonds are being converted and remarketed except that the Lessee Acquisition Account shall constitute a part of the Series Trust Estate and the total principal component of Base Rentals to be due under such Lease shall be equal to the total principal amount of the Bonds. Notwithstanding the provisions of the Original Indenture, amounts remaining in the Lessee Acquisition Account after delivery of a completion certificate shall be used to (1) finance additional improvements to the System or (ii) pay Base Rentals next coming due and payable.

Deposit of Moneys in Funds or Accounts. All payments received by the Trustee pursuant to the Lease shall be deposited in the respective Segregated Accounts created pursuant to the Third Supplemental Trust Indenture, provided that if the deposit of any funds is not provided for in the Third Supplemental Trust Indenture, deposits shall be made in accordance with the Original Indenture.

Application of Moneys in Funds or Accounts.

A. Revenue Fund. Moneys in the Segregated Account of the Revenue Fund for a series of Supplemental Bonds will be applied on a first-in, first-out basis to make the payments specified below in the order of priority specified below; provided, however, that investment earnings on the Segregated Account of the Debt Service Reserve Fund, if any, and the Segregated Account of the Revenue Fund will be applied to such payments prior to the use of any other moneys in the Segregated Account of the Revenue Fund:

1. At such times as are necessary to pay interest on the series of Supplemental Bonds;
2. At such times as are necessary to pay Program Expenses allocable to the series of Supplemental Bonds;
3. At such times as are necessary to deposit in the Segregated Account of the Debt Service Reserve Fund, if any, for that series of Supplemental Bonds amounts sufficient to satisfy the Supplemental Bonds Debt Service Reserve Requirement, if any;
4. At such times and for such other purposes as may be authorized or permitted by the Original Indenture; and
5. All amounts remaining in a Segregated Account of the Revenue Fund after making or providing for the payments specified in 1 through 4 above (the "excess amounts") as of each March 15 and September 15, shall be returned to the Lessee.

B. Lessee Account.

1. Liquidation Proceeds and any payment by the Lessee of its Optional Prepayment Price will be deposited in the Lessee's Lessee Account in the Revenue Fund and shall constitute a part of the Series Trust Estate. All interest earnings thereon shall be transferred to the Lessee as received or applied as a part of the Optional Prepayment Price, if necessary, to fully pay all of the Lessee's obligations under the Lease.

2. On the date the Optional Prepayment Price is used to redeem Bonds or is deposited in the Revolving Fund Account, any remaining funds in the Lessee Account shall be paid to the Lessee or other person from which they were received.

Deposits of Moneys in Segregated Account of the Paying Agent Fund. The Paying Agent shall deposit any moneys for the payment of the principal of and interest on the Bonds in the Segregated Account of the Principal and Interest Account for the Bonds and shall deposit any moneys for the payment of any premium on the Bonds in a special segregated premium account to be established for such purpose in the Paying Agent Fund. The Paying Agent shall use moneys in the Segregated Principal and Interest Account for the Bonds on each Bond Payment Date for the payment of the principal of and interest on the Bonds then due and payable, whether by redemption, maturity or acceleration. The Paying Agent shall use moneys in any premium account for the payment of premium on the Bonds upon optional purchase or redemption. Upon (i) payment of all premiums due or owing as a result of an optional purchase or redemption or (ii) cancellation of such purchase or redemption, amounts remaining in the applicable premium account may be returned to the depositor of such moneys.

Moneys to be Held in Trust. All moneys required to be deposited with or paid to the Trustee or the Paying Agent for account of any fund established under any provision of the Third Supplemental Trust Indenture shall be held by the Trustee or the Paying Agent, as the case may be, in trust, and except for moneys deposited with or paid to the Trustee or the Paying Agent for the redemption of the Bonds, notice of the redemption of which has been duly given, shall, while held by the Trustee or the Paying Agent, constitute part of the Series Trust Estate and be subject to the security interest created thereby.

Investment of Funds

Any moneys transferred to and held in a Lessee Acquisition Account shall be promptly invested and reinvested as provided in the Lease by the Trustee pursuant to written directions from the Lessee, or, in the absence of such direction by the Lessee, in the sole discretion of the Trustee, which shall mature, or be subject to redemption at the option of the holder thereof, not later than the respective dates when the moneys in the Lessee Acquisition Account are expected to be required for the purposes intended. All earnings on moneys in the Lessee Acquisition Account shall be credited to that account.

Defeasance

If the Issuer pays or causes to be paid to the Owner of any Bond the principal of and interest due and payable and thereafter to become due and payable on such Bond, or any portion of such Bond in an Authorized Denomination thereof, such Bond or portion thereof will cease to be entitled to any lien, benefit or security under the Indenture. If the Issuer pays or causes to be paid the principal of and interest due and payable on all Outstanding Bonds, pays or causes to be paid all other sums payable by the Issuer, including all fees, expenses and other amounts payable to the Trustee, the Paying Agent, the Registrar, the Corporation and the Remarketing Agent, then, and in that case, the right, title and interest of the Trustee in and to the Series Trust Estate will thereupon cease, terminate and become void.

Any Bond will be deemed to be paid for all purposes of the Indenture when (a) payment of the principal of such Bond plus interest thereon to the due date thereof (whether such due date is by reason of maturity or upon redemption as provided in the Third Supplemental Trust Indenture) either (i) has been made or caused to be made in accordance with

the terms thereof, or (ii) has been provided for by irrevocably depositing with the Trustee in trust and irrevocably set aside exclusively for such payment, (1) moneys, sufficient to make such payment and/or (2) noncallable Government Obligations maturing as to principal and interest in such amount and at such time as will insure the availability of sufficient moneys to make such payment and (b) all necessary and proper fees, compensation and expenses of the Trustee, the Paying Agent, the Registrar, the Corporation and the Remarketing Agent pertaining to the Bonds with respect to which such deposit is made have been paid or the payment thereof provided for to the satisfaction of the Trustee. At such times as a Bond is deemed to be paid hereunder, as aforesaid, such Bond will no longer be secured by or entitled to the benefits of the Indenture, except for the purposes of any such payment from such moneys or Government Obligations.

Notwithstanding the foregoing paragraph, no deposit under (a)(ii) above will be deemed a payment of such Bonds as aforesaid until (a) proper notice of redemption of such Bonds has been given in accordance with the Indenture or if the Bonds are not to be redeemed within the next succeeding sixty (60) days, until the Issuer has given the Trustee, in form satisfactory to the Trustee, irrevocable instructions to notify, as soon as practicable, the Owners of the Bonds to be redeemed, that the deposit required by (a)(ii) above has been made with the Trustee and that the Bonds are deemed to have been paid in accordance with the Indenture and stating the maturity or redemption date upon which moneys are to be available for the payment of the principal of the Bonds plus interest thereon to the due date thereof, or (b) the maturity of the Bonds.

Events of Default and Remedies

In no event shall an Event of Default under the Original Indenture constitute an Event of Default under the Third Supplemental Trust Indenture unless it is also an Event of Default under the Third Supplemental Trust Indenture. In like manner, no Event of Default under the Third Supplemental Trust Indenture with respect to the Bonds will constitute an Event of Default under the Original Indenture or an Event of Default with respect to any other series of Supplemental Bonds.

Events of Default. With respect to the Bonds, each of the following events will constitute and is referred to in the Third Supplemental Trust Indenture as an "Event of Default":

1. A failure to pay interest on or principal of the Bonds when the same becomes due and payable;
2. A failure to pay an amount due in respect to the Purchase Price of the Bonds after such payment becomes due and payable;
3. Any event of default under the Lease; or
4. A failure by the Issuer to observe and perform any covenant, condition, agreement or provisions (other than as described in 1 and 2 above) contained in the Bonds or in the Third Supplemental Trust Indenture as it relates to the Bonds, 60 days after written notice specifying such failure and requesting that it be remedied, has been given to the Issuer and the Corporation by the Trustee. The Trustee may agree to an extension of such period prior to its expiration; provided, however, that the Trustee will be deemed to have agreed to an extension of such period if corrective action is initiated by the Issuer or the Corporation within such period and is being diligently pursued.

Acceleration; Other Remedies. Upon the occurrence of an Event of Default with respect to the Bonds described in paragraph 1 or 2 under Events of Default, the Trustee may declare the Bonds to be immediately due and payable, whereupon the Bonds will, without further action, become immediately due and payable, and the Trustee will give written notice thereof to the Issuer, the Corporation, the Paying Agent, and, by Mail, to all Owners of the Bonds.

The provisions of the preceding paragraph are subject to the condition that if, after the principal of the Bonds has been so declared to be due and payable, the Issuer causes to be deposited with the Trustee an amount sufficient

to pay all matured installments of interest and the principal of all the Bonds which has become due otherwise than by reason of such declaration (with interest upon such principal and, to the extent permissible by law, on overdue installments of interest, at a late payment rate) and such amount as will be sufficient to cover reasonable compensation and reimbursement of expenses payable to the Trustee and the Paying Agent, and all Events of Default, other than nonpayment of the Purchase Price or principal of Bonds which has become due as a result of said declaration, are remedied, then, in every such case, such Event of Default will be deemed waived and such declaration and its consequences rescinded and annulled. The Trustee will promptly give written notice of such waiver, rescission or annulment to the Issuer, the Corporation, the Paying Agent, and, by Mail, to all Owners of Bonds; but no such waiver, rescission and annulment will extend to or affect any subsequent Event of Default or impair any right or remedy consequent thereon.

Upon the occurrence and continuance of any Event of Default with respect to the Bonds, then and in every such case the Trustee may, upon receipt of indemnity to its satisfaction of all costs and expenses of such action, including attorneys' fees and expenses, in its own name and as the Trustee of an express trust:

(i) by mandamus, or other suit, action or proceeding at law or in equity, enforce all rights of the Owners and require the Issuer and the Corporation to carry out their agreements with or for the benefit of the Owners of the Bonds and to perform their duties under the Act and the Indenture, provided that any such remedy may be taken only to the extent permitted under the applicable provisions of the Indenture:

(ii) bring suit upon the Bonds or the Lease; or

(iii) bring an action or suit in equity to enjoin any acts or things which may be unlawful or in violation of the rights of the Owners of the Bonds.

Restoration to Former Position. If any proceeding taken by the Trustee to enforce any right under the Indenture is discontinued or abandoned for any reason, or is determined adversely to the Trustee, then the Issuer, the Trustee and the Owners will be restored to their former positions and rights hereunder, respectively, and all rights, remedies and powers of the Trustee will continue as though no such proceeding had been taken.

Owner's Right to Direct Proceedings. The Owners of a majority in principal amount of the Bonds have the right, by an instrument in writing executed and delivered to the Trustee and upon furnishing indemnity satisfactory to the Trustee for all costs and expenses of such action, including attorneys' fees and expenses, to direct the time, method and place of conducting all remedial proceedings available to the Trustee under the Indenture or exercising any trust or power conferred on the Trustee by the Indenture.

Application of Moneys. Any moneys received by the Trustee, by any receiver or by any Owner pursuant to any right given or action taken under the provisions described above, after payment of the costs and expenses of the proceedings resulting in the collection of such moneys and of the expenses, liabilities and advances incurred or made by the Trustee and the fees and expenses of the Paying Agent will be deposited in the segregated account of the Revenue Fund and all moneys so deposited in such account during the continuance of an Event of Default (other than moneys for the payment of Bonds which have matured or otherwise become payable prior to such Event of Default) will be applied in the order described in the Indenture. Whenever moneys are to be so applied, such moneys will be applied at such times as the Trustee determines, having due regard to the amount of such moneys available for application and the likelihood of additional moneys becoming available for such application in the future. Whenever the Trustee applies such funds, it will fix the date upon which such application is to be made and upon such date interest on the amounts of principal and interest to be paid on such date will cease to accrue. The Trustee will give notice of the deposit with it of any such moneys and of the fixing of any such date by Mail to all Owners of Outstanding Bonds and will not be required to make payment to any Owner until such Bond is presented to the Trustee for appropriate endorsement or for cancellation if fully paid.

Covenants of the Issuer

Payment of Principal and Interest; Pledge of Series Trust Estate; Limited Liability. The Issuer covenants that it will promptly pay the principal and Purchase Price of, premium, if any, and interest on the Bonds at the place, on the dates and in the manner provided in the Bonds, provided that all such payments are payable by the Issuer solely from the Series Trust Estate. Nothing in the Bonds or the Indenture will be considered as assigning or pledging any other funds or assets of the Issuer other than the Series Trust Estate. The Series Trust Estate is pledged and assigned as security for the equal and ratable payment of the Bonds and will be used on a first priority basis to pay the principal of and interest on the Bonds, except as may be otherwise expressly authorized in the Indenture or the Lease.

Arbitrage and Tax Covenants. The Issuer and the Corporation on behalf of the Issuer will not take or permit, or omit to take or cause to be taken, any action that would adversely affect the exclusion by the Owners from federal income taxation of the interest on the Bonds and, if they should take or permit, or omit to take or cause to be taken, any such action, the Issuer and the Corporation on behalf of the Issuer will take or cause to be taken all lawful actions necessary to rescind or correct such actions or omissions promptly upon having knowledge thereof. The Issuer and the Corporation on behalf of the Issuer acknowledge that the continued exclusion of interest on the Bonds from the gross income of the Owners for federal income tax purposes depends, in part, upon compliance with the arbitrage limitations imposed by Section 148 of the Code. The Issuer and the Corporation on behalf of the Issuer covenant that they will comply with all the requirements of Section 148 of the Code, and that they will not permit at any time any of the proceeds of the Bonds or other funds under their control to be used, directly or indirectly, to acquire an asset or obligation, the acquisition of which would cause the Bonds to be "arbitrage bonds" for purposes of Section 148 of the Code.

Trustee; Paying Agent

Limitations on Liability. The Trustee and the Paying Agent will not be answerable for the default or misconduct of any agent or employee selected by them with reasonable care to perform any of the duties required under the Indenture. Neither the Trustee nor the Paying Agent will be answerable for the exercise of any discretion or power under the Indenture or for anything whatsoever in connection with the trust created thereby, except only for its own gross negligence or willful misconduct .

Compensation, Expenses and Advances. The Trustee and the Paying Agent are entitled to reasonable compensation for their services rendered (not limited by any provision of law in regard to the compensation of the trustee of an express trust) and to reimbursement for their actual out of pocket expenses (including reasonable counsel fees and expenses) reasonably incurred in connection therewith except as a result of their gross negligence or willful misconduct.

Good Faith Reliance. The Trustee and the Paying Agent are protected and will incur no liability in acting or proceeding in good faith upon any resolution, notice, telegram, telex or facsimile transmission, request, consent, waiver, certificate, statement, affidavit, voucher, bond, requisition or other paper or document which they in good faith believe to be genuine and to have been passed or signed by the proper board, body or person or to have been prepared and furnished pursuant to any of the provisions of the Indenture, the Third Supplemental Trust Indenture or the Lease, or upon the written opinion of any attorney, engineer, accountant or other expert believed by the Trustee or the Paying Agent, as the case may be, to be qualified in relation to the subject matter, and the Trustee, the Remarketing Agent, the Credit Facility Provider or the Paying Agent are under no duty to make any investigation or inquiry as to any statements contained or matters referred to in any such instrument, but may accept and rely upon the same as conclusive evidence of the trust and accuracy of such statements.

Resignation of Trustee. The Trustee may resign and be discharged of the trusts created by the Indenture by a written notice of resignation.

Removal of Trustee. The Trustee may be removed at any time by filing with the Trustee so removed, and with the Issuer, the Credit Facility Provider, the Paying Agent and the Remarketing Agent an instrument or instruments in writing, appointing a successor or an instrument or instruments in writing, consenting to the appointment by the Issuer of a successor and accompanied by an instrument of appointment by the Issuer of such successor and executed by Owners of not less than a majority in principal amount of the Bonds Outstanding.

Appointment of Successor Trustee. In case at any time the Trustee is removed, or is dissolved, or if its property or affairs are taken under the control of any state or federal court or administrative body because of insolvency or bankruptcy, or for any other reason, then a vacancy will forthwith and ipso facto exist in the office of Trustee and a successor may be appointed, and if the Trustee resigns, then a successor may be appointed, subject to the approval of the Credit Facility Provider, by the Issuer or by the Owners of not less than a majority in principal amount of Bonds Outstanding.

Every successor Trustee (a) must be a bank or trust company duly organized under the laws of the United States or any state or territory thereof and authorized by law to perform all the duties imposed upon it by the Original Indenture, (b) must (i) have a combined capital stock, surplus and undivided profits of at least \$50,000,000 as set forth in its most recent published annual report of condition or (ii) be controlled directly or indirectly through one or more subsidiaries by a bank holding company that has a combined capital and surplus of at least \$50,000,000 as set forth in its most recent published annual report of condition, have at least \$50,000,000 of trust assets under management and have a combined capital and surplus of at least \$2,000,000 as set forth in its most recent published report of condition and (c) must be qualified under the Act to perform the duties of Trustee.

Any corporation into which any Trustee under the Indenture is merged or converted or with which it is consolidated, or any corporation resulting from any merger or consolidation to which any Trustee is a party will be the successor Trustee under the Indenture.

Standard of Care. The Trustee will, during the existence of an Event of Default exercise such of the rights and powers vested in it by the Indenture and use the same degree of skill and care in such exercise as a prudent person would use and exercise under the circumstances in the conduct of his own affairs.

Intervention in Litigation of the Issuer. The Trustee may intervene on behalf of the Owners in any judicial proceeding to which the Issuer is a party and which in the opinion of the Trustee and its counsel has a substantial bearing on the interests of the Owners, and will do so, upon receipt of indemnity satisfactory to it, at the request of the Credit Facility Provider or at the request of Owners of at least 25% in principal amount of the Bonds Outstanding and if permitted by the court having jurisdiction in the premises.

Qualification of Paying Agent; Resignation; Removal. Each Paying Agent (a) must be a commercial bank or trust company duly organized under the laws of the United States of America or any state or territory thereof authorized by law to perform all the duties imposed upon it by the Indenture, and (b) must (i) have a combined capital stock surplus and undivided profits of at least \$50,000,000 as set forth in its most recent published annual report of condition or (ii) be controlled directly or indirectly through one or more subsidiaries by a bank holding company that has a combined capital and surplus of at least \$50,000,000 as set forth in its most recent published annual report of condition, have at least \$50,000,000 of trust assets under management and have a combined capital and surplus of at least \$2,000,000 as set forth in its most recent published report of condition. The Paying Agent may at any time resign and be discharged of the duties and obligations created by the Indenture by giving at least 45 days notice to the Corporation on behalf of the Issuer, the Trustee, the Remarketing Agent and the Credit Facility Provider. The Paying Agent may be removed at any time by the Corporation on behalf of the Issuer with the consent of the Credit Facility Provider and the Remarketing Agent by an instrument, signed by the Trustee and filed with the Paying Agent.

In the event of the resignation or removal of the Paying Agent, the Paying Agent will pay over, assign and deliver any moneys and any Credit Facility held by it in such capacity to its successor or, if there be no successor, to the Trustee.

If the Paying Agent resigns or is removed, or is dissolved, or if the property or affairs of the Paying Agent are taken under the control of any state or federal court or administrative body because of bankruptcy or insolvency, or for any other reason and the Trustee has not appointed a successor Paying Agent, the Trustee will ipso facto be deemed to be the Paying Agent for all purposes of the Indenture until the appointment of a Paying Agent.

Several Capacities. The same entity may serve as the Trustee and the Paying Agent and in any other combination of such capacities, to the extent permitted by law.

Modification and Amendment of Indenture

Supplemental Indentures Without Owners' Consent. The Issuer, the Corporation and the Trustee may, from time to time and at any time, without the consent of or notice to the Owners, enter into Supplemental Indentures to cure any formal defect, omission, inconsistency or ambiguity in the Indenture, to grant to or confer or impose upon the Trustee or the Paying Agent for the benefit of the Owners any additional rights, remedies, powers, authority, security, liabilities or duties which may lawfully be granted, conferred or imposed and which are not contrary to or inconsistent with the Indenture; to add to the covenants and agreements of, and limitations and restrictions upon the Issuer or the Corporation in the Indenture other covenants, agreements, limitations and restrictions; to confirm, as further assurance, any pledge under, and the subjection to any claim, lien or pledge created or to be created by, the Indenture; to authorize a different denomination or denominations of the Bonds and to make correlative amendments and modifications to the Indenture regarding exchangeability of Bonds of different denominations, redemptions of portions of Bonds of particular denominations and similar amendments and modifications of a technical nature; to comply with the requirements of the Trust Indenture Act of 1939, as from time to time amended; to evidence or give effect to the delivery of an Alternate Credit Facility; to secure or maintain a rating on the Bonds with either or both of Moody's and Standard & Poor's, provided that any such modification, amendment or supplement is not, in the judgment of the Trustee, materially adverse to the Owners; in connection with the issuance of additional Bonds or obligations; in any manner necessary, in the opinion of Bond Counsel, to preserve the exclusion of interest on the Bonds from the gross income of a recipient thereof for federal income tax purposes; to modify, amend or supplement the Indenture in such manner as to permit the qualification of the bonds for deposit with The Depository Trust Corporation or any similar depository, provided that any such modification, amendment or supplement is not, in the judgment of the Trustee, materially adverse to the Owners; to make any modifications or amendments necessary to permit the Bonds or a portion thereof to be remarketed to a purchaser, without the benefit of any Credit Facility securing the payment of principal or purchase price of or interest on the Bonds or such portion of the Bonds; and to modify, alter, amend or supplement the Indenture in any other respect which in the judgment of the Trustee is not materially adverse to the Owners.

Supplemental Indentures Requiring Owners' Consent. Except for any Supplemental Indenture entered into as described above, Owners of not less than 60% in aggregate principal amount of the Bonds Outstanding will have the right from time to time to consent to and approve the execution and delivery by the Issuer, the Corporation and the Trustee of any Supplemental Indenture deemed necessary or desirable by the Issuer for the purposes of modifying, altering, amending, supplementing or rescinding, in any particular, any of the terms or provisions contained in the Indenture. As an alternative to securing such Owners' consent, the Trustee can secure the consent of the Credit Facility Provider.

If Owners of not less than the above-specified percentage of Bonds or, in the alternative, the Credit Facility Provider, consent to and approve the execution and delivery of any Supplemental Indenture, then, with certain exceptions specified in the Indenture, no Owner will have any right to object to the execution and delivery thereof, or to object to any of the terms and provisions contained therein or the operation thereof, or in any manner to question the

propriety of the execution and delivery thereof, or to enjoin or restrain the Issuer, the Corporation or the Trustee from executing and delivering the same or from taking an action pursuant to the provisions thereof.

Effect of Supplemental Indenture. Upon the execution and delivery of such Supplemental Indenture, the Indenture will be, and be deemed to be, modified and amended in accordance therewith, and the respective rights, duties and obligations under the Indenture of the Issuer, the Trustee, the Paying Agent, the Remarketing Agent, the Corporation and all Owners will thereafter be determined, exercised and enforced under the Indenture subject in all respects to such modifications and amendments.

Consent of Lessee Required. No Supplemental Indenture which affects any rights, powers, agreements or obligations of the Lessee or requires a revision of the Lease, will become effective unless and until the Lessee consents to such Supplemental Indenture.

ABSENCE OF LITIGATION

The Issuer and the Corporation have certified as of the date hereof that there is presently no action, case, proceeding or other litigation pending or, to the best knowledge of the persons so certifying, threatened before any court or administrative agency which, if adversely determined, would materially and adversely affect the ability of the Issuer to meet its obligations under the Indenture and the other Bond documents to which the Issuer is a party or the remarketing of and security for the Bonds.

TAX TREATMENT

In the opinion of Wyatt, Tarrant & Combs, LLP, Bond Counsel, under existing law and as of the date of delivery of the Bonds, based on certain covenants, representations and certifications of the Issuer, the Corporation and the Lessee, which Bond Counsel has not independently verified, and assuming continuing compliance therewith, as set forth below, interest on the Bonds is excluded from gross income for Federal income tax purposes.

Interest on the Bonds is not an item of tax preference in determining "alternative minimum taxable income" under the Internal Revenue Code of 1986, as amended (the "Code"). However, interest on the Bonds, as well as all other interest excluded from gross income under the Code ("tax-exempt interest"), is includable in computing "adjusted current earnings" for purposes of determining the alternative minimum taxable income of a corporation.

For purposes of determining their taxable income under the Code, property and casualty insurance companies must reduce their losses incurred in any taxable year by an amount equal to 15% of the tax-exempt interest they receive or accrue during such taxable year, including interest on the Bonds.

Interest on the Bonds, as well as all other tax-exempt interest, may be taken into account in computing a foreign corporation's branch profits tax under the Code.

Recipients of Social Security benefits must include tax-exempt interest income, including interest on the Bonds, in computing their "modified adjusted gross income" for purposes of determining to what extent, if any, such benefits are includable in their gross income under the Code.

The Code generally disallows as a deduction 100% of the interest expense incurred by commercial banks, thrift institutions, and other financial institutions, to the extent such interest expense is allocable to tax-exempt obligations acquired after August 7, 1986, including the Bonds. However, the Bonds have been designated by the City of Danville, Kentucky and the City of Shelbyville, Kentucky as "qualified tax-exempt obligations" under the Code and, therefore, qualify for an exception provided under the Code from this 100% disallowance rule.

Tax-exempt interest income, including interest on the Bonds, is taken into account in determining whether certain taxpayers are denied the earned income credit under the Code by reason of having excessive investment income.

The Code requires gain on the sale or other disposition of tax-exempt obligations acquired after April 30, 1993, including the Bonds, to be included in gross income as ordinary income, and not as capital gain, to the extent of accrued market discount. Accrued market discount in the case of tax-exempt obligations, such as the Bonds, originally issued at a price equal to their principal amount is generally equal to the difference, if any, between such principal amount and the price at which the taxpayer purchased such obligations in the secondary market.

In the opinion of Bond Counsel, under the laws of the Commonwealth as presently enacted and construed, the Bonds are exempt from ad valorem taxation, and the interest thereon is exempt from income taxation, by the Commonwealth and all of its political subdivisions and taxing authorities.

For the purpose of rendering its opinion described above, Bond Counsel will assume compliance by the Issuer, the Corporation and the Lessee with the requirements of the Code that must be met subsequent to the delivery of the Bonds in order that interest thereon be and remain excluded from gross income for Federal income tax purposes. Failure to comply with such requirements could cause the interest on the Bonds to be included in gross income for Federal income tax purposes retroactive to the date of delivery of the Bonds. The Issuer, the Corporation and the Lessee have covenanted to comply with such requirements.

Purchasers of the Bonds should consult their own tax advisors for a further description of the Federal income tax rules mentioned above and for an analysis of the effect on their individual tax situations of their ownership of and receipt of interest on the Bonds.

LEGAL MATTERS

Certain legal matters incident to the remarketing, sale and delivery of the Bonds are subject to the unqualified approving opinion of Wyatt, Tarrant & Combs, LLP, Louisville, Kentucky, as Bond Counsel. The proposed form of opinion of Bond Counsel is included herein as APPENDIX B. Bond Counsel is not undertaking any responsibility for the accuracy or completeness of any disclosure or information contained in this Remarketing Circular respecting the Lessee, the Project, or litigation.

RATING

Moody's Investors Service has assigned the rating of "A2" to the Bonds. Any desired explanation of the significance of such rating should be obtained from Moody's Investors Service. There is no assurance that a particular rating will pertain for any given period of time or that it will not be lowered or withdrawn entirely if, in the judgment of the rating service, circumstances so warrant. Any downward revision or withdrawal of any such rating could have an adverse effect on the market price of the Bonds.

THE REMARKETING AGENT

First Kentucky Securities Corporation, Frankfort, Kentucky, is acting as Remarketing Agent for the Issuer in connection with the remarketing of the Bonds and will receive a remarketing fee in an amount equal to ____% of the aggregate principal amount of the Bonds, payable only from the proceeds of the Bonds, when, as and if remarketed.

MISCELLANEOUS

This Remarketing Circular is made available in connection with the remarketing of the Bonds and may not be reproduced or used, in whole or in part, for any other purpose. Any statement in this Remarketing Circular involving matters of opinion, whether or not expressly so stated, are intended as such and not as representations of fact. This Remarketing Circular is not to be construed as a contract or agreement between the Issuer and the purchasers or Owners of any of the Bonds.

This Remarketing Circular has been duly approved by the Corporation as Agent for the Issuer.

APPENDIX A

Glossary of Terms

GLOSSARY OF TERMS

In addition to the words and terms elsewhere defined in this Remarketing Circular, the following words and terms as used in this Remarketing Circular shall have the following meanings unless the context or use indicates another or different meanings or intent:

"Act" means Kentucky Revised Statutes Chapter 96 and the acts amendatory thereof or supplemental thereto.

"Additional Rentals" means any expenses of the Lessor in connection with the Lease and the Project and any taxes or any other expenses, including, but not limited to, licenses, permits, state and local sales and use or ownership taxes or property taxes which the Lessor may pay with respect to the Project and any Program Expenses not included in Base Rentals.

"Aggregate Debt Service Reserve Requirement" means the lessor of (i) the maximum Annual Debt Service Requirement in any succeeding year (ii) 10% of the proceeds of any issue of System Bonds or (iii) 125% of the average Annual Debt Service Requirement.

"Annual Budget" means the annual budget prepared by the Lessee on or before the first day of each Fiscal Year.

"Annual Debt Service Requirement" means, at any given time of determination, the maximum amount of Principal Installments and interest coming due on all system Bonds outstanding in any year (including Base Rentals under the Lease); provided, however, if the terms of any System Bonds are such that interest thereon for any future period of time is to be calculated at a variable rate, then interest on such System Bonds for such period shall be computed by assuming that the rate of interest applicable to such period is equal to the rate of interest (calculated in the manner in which the rate of interest for such period is to be calculated) which would have been in effect for the 12 months immediately preceding the date of calculation; provided further that if more than 25% of the Principal Installments of any series of System Bonds come due in any year, the Annual Debt Service Requirement for such System Bonds will be calculated as if such System Bonds were amortized on the basis of approximate level debt service over the term of such System Bonds.

"Agent Member" means a member of, or participant in, the Securities Depository.

"Authorized Denomination" means with respect to the Bonds, \$5,000 or any integral multiple thereof.

"Base Rentals" means the payments by the Lessee for and in consideration of the right to use and the option to purchase the Project during the Lease Term and shall be composed of (i) scheduled payments of principal, (ii) scheduled payments of interest on the Supplemental Bonds and (iii) Lessee's Proportionate Share of recurring Program Expenses.

"Bond Payment Date" means any Interest Payment Date and any other date on which the principal of or interest on the Bonds is to be paid to the Owners thereof, whether upon redemption, at maturity or upon acceleration of maturity of the Bonds.

"Bonds" means the \$_____ City of Danville, Kentucky Multi-City Lease Revenue Bonds

(City of Shelbyville, Kentucky Water and Sewer System Lease Revenue Refunding Project) Fixed Rate Series 2002-A Bonds issued pursuant to the Indenture.

"Book-Entry Form" means, with respect to the Bonds, a form or system, as applicable, under which (i) the ownership of beneficial interests in Bonds and bond service charges may be transferred only through a book entry and (ii) physical Bond certificates in fully registered form are registered only in the name of a Securities Depository or its nominee as Holder, with the physical Bond certificates in the custody of a Securities Depository.

"Business Day" means any day other than (i) a day on which banking institutions in New York, New York or the cities in which the Trustee, the Paying Agent or the Remarketing Agent have their respective principal offices are authorized to close or (ii) a day on which the New York Stock Exchange is closed.

"Code" means the Internal Revenue Code of 1986, as amended. Each reference to a section of the Code herein will be deemed to include the United States Treasury Regulations proposed or in effect with respect thereto and applicable to the Bonds or the use of the proceeds thereof.

"Collateral Document" means any letter of credit, mortgage, escrow agreement, guarantee, security agreement, pledge agreement or other document or agreement, if any, securing the Lease or granting a lien on or a security interest in the Project or executed in connection with the Lease of the Project.

"Consulting Engineer of National Recognition" means and refers to an Engineer or a firm of Engineers, who, by virtue of experience, reputation and ability, bear a reputation in the field of sanitary engineering which is nationally recognized and known, and upon whose professional judgment sophisticated investors rely in connection with securities which are issued for water purposes.

"Conversion" means the conversion of the interest rate on the Bonds from one interest rate mode to another interest rate mode in accordance with the provisions of the Indenture or the conversion of the Bonds from one Fixed Rate to another Fixed Rate.

"Conversion Date" means the date on which a Conversion occurs.

"Corporation" means the Kentucky Municipal Finance Corporation, an agency and instrumentality of the Issuer which will be the Lessor under the Lease.

"Correlative Leases" means Leases as to which the interest rate component of Base Rentals will be determined in part on the interest rate of certain Fixed Rate Bonds.

"Costs" means with respect to the Project all or any part of the cost of construction, installation and acquisition of all land, buildings, structures, machinery and equipment as may be applicable; finance charges, extensions, enlargements, additions, replacements, renovations and improvements, engineering, financial and legal services relating to the Project; plans, specifications, studies, surveys, estimates of cost of revenue, administrative expenses, expenses necessary or incidental to determining the feasibility or practicability of constructing the Project; and such other expenses as the Corporation determines may be necessary or incidental to the construction, installation and acquisition of the Project, its financing of interest during construction (not to exceed three (3) years), installation or acquisition and the placing of the Project in operation.

"Debt Service Reserve Fund" means, except as otherwise described under the heading "THE LEASE AND ADDITIONAL SECURITY FOR THE BONDS", the Debt Service Reserve Fund created under the Original Indenture as security for the Original Bonds, a portion of which may be transferred to a Segregated Account as security for Supplemental Bonds. Further information regarding a requirement for a reserve fund, if any, is described under the heading "THE LEASE AND ADDITIONAL SECURITY FOR THE BONDS."

"Default" and "Event of Default" means any occurrence or event specified as an Event of Default in the Third Supplemental Indenture.

"Depository" means one or more commercial banks or trust companies having the same qualifications required for a Paying Agent pursuant to the Indenture.

"Fiscal Year" means the period from and including July 1 through and including the following June 30, unless a different fiscal year shall have been adopted by the Lessee in accordance with the Lease.

"Fixed Rate" means an interest rate which is fixed and nonvariable for a period of at least one (1) year established in accordance with the Indenture.

"Fixed Rate Bonds" means Supplemental Bonds bearing interest at a Fixed Rate.

"Fixed Rate Conversion Date" means the effective date of a Fixed Rate established in accordance with the terms of the Indenture.

"Fixed Rate Period" means the period during which the Bonds bear interest at the Fixed Rate.

"Governing Body" means the City Council of the Lessee.

"Government Obligations" means (a) direct obligations of the United States of America for the payment of which the full faith and credit of the United States of America is pledged and (b) obligations issued by a person controlled or supervised by and acting as an instrumentality of the United States of America, the payment of the principal of, premium if any, and interest on which is fully guaranteed as a full faith and credit obligation of the United States of America (including any securities described in (a) or (b) issued or held in book-entry form on the books of the Department of Treasury of the United States of America), which obligations, in either case, are not subject to redemption prior to maturity at less than par at the option of anyone other than the holder.

"Indenture" means the Trust Indenture dated as of March 1, 1989, as supplemented from time to time.

"Interest Payment Date" means (i) in the case of the Bonds, the dates set forth on the cover of this Remarketing Circular, (ii) any Conversion Date, and (iii) any date on which the Bonds are purchased or deemed purchased pursuant to the Indenture or any Redemption Date for the Bonds.

"Lease" means the Correlative Lease dated as of the remarketing and conversion of the Supplemental Bonds, between the Corporation and the Lessee, as from time to time amended or supplemented.

"Lease Rental Payment Date" means (i) the 15th day of December and June with respect to the

interest component of Base Rentals; (ii) with respect to the principal component of the Lease, the 15th day of each June of each Fiscal Year, commencing June 15, 2003; and (iii) with respect to Additional Rentals fifteen (15) days after written request for such payment.

"Lease Rental Payments" means Base Rentals and Additional Rentals and any payment of the Optional Prepayment Price.

"Lease Term" means the date commencing with the delivery of the Bonds and terminating on the date of payment of all obligations thereunder, unless earlier terminated by the Lessee at its option or as otherwise terminated pursuant to the Lease.

"Lessee" means the City of Shelbyville, Kentucky, a municipal corporation and a political subdivision of the Commonwealth.

"Liquidation Proceeds" means amounts received by the Trustee in connection with enforcement of any of the remedies under the Lease, after the occurrence of an "Event of Default."

"Mail" means mail by first class postage.

"Optional Prepayment Price" means the amount as computed by the Lessor which the Lessee may, in its discretion, pay under the Lease in order to prepay in full its obligations under the Lease, which amount shall be equal to the unpaid principal component of Base Rentals increased by the sum of (a) the amount of any due or past due Lease Rental Payments together with interest on such past due Lease Rental Payments to the date of such prepayment, (b) an estimated amount equal to all interest, Program Expenses and Additional Rentals which would have been due between the date of the prepayment by the Lessee and the date on which the prepayment will be used to redeem Bonds or is deposited in the Revolving Fund Account, it being understood that all investment earnings on the Optional Prepayment Price, other than on past-due Lease Rental Payments, will be paid to the Lessee as received or applied, if necessary, as a part of the Optional Prepayment Price and any excess payment under this subpart (b) shall be paid to the Lessee on the date the prepayment is used to redeem Bonds or is deposited in the Revolving Fund Account and (c) the premium, if any, payable on any Bonds to be redeemed or purchased on account of the payment of such Optional Prepayment Price.

"Original Bonds" means Original Bonds other than Bonds being converted and remarketed as Supplemental Bonds. Accordingly, Original Bonds includes Bonds that were previously Supplemental Bonds that have been converted from Supplemental Bonds and remarketed as Original Bonds.

"Owner" or "Owners" means the person or persons in whose name any Bond is registered on the books of the Issuer maintained by the Registrar.

"Parity Debt" means Parity Debt issued under the provisions of the Lease.

"Paying Agent" means Bank One, Kentucky, NA or any other or additional paying agent designated pursuant to the Indenture.

"Principal Installment" means, as of any date of calculation and with respect to any System Bonds, so long as any System Bonds are outstanding, System Bonds maturing and System Bonds subject to mandatory redemption in such period.

"Principal Payment" means a payment of principal of a Bond at maturity.

"Principal Prepayment" means any payment or recovery of the principal component of any Lease Rental Payment which is received more than one month in advance of its scheduled due date, including the portion of any Liquidation Proceeds or Optional Prepayment Price representing such amount.

"Program" means the program of the Issuer described in this Remarketing Circular with respect to the issuance by the Issuer of its Money Market Municipal Multi-City Lease Revenue Bonds (Kentucky Municipal League Pooled Lease Financing Program), Series 1989 pursuant to which the Projects for the Lessees are being financed or refinanced from the proceeds of the Bonds and being leased to the Lessees pursuant to the Leases.

"Program Expenses" means the expenses and fees of the Lessor and the Administrator relating to the Program and/or the Supplemental Bonds; the cost of issuance of the Supplemental Bonds; the fees and expenses of the Issuer, the Trustee, and the Paying Agent relating to the Program and/or the Supplemental Bonds; the fees and expenses of the Remarketing Agents for remarketing the Supplemental Bonds and such other fees and expenses in connection with the Program and/or the Supplemental Bonds as the Lessor and the Administrator may in good faith determine are allocable to the Correlative Lease.

"Project" means property the Costs of which are financed or refinanced, or the Costs of which are reimbursed, as a result of the Lease.

"Purchase Date" means (i) any Business Day on which Bonds are subject to mandatory purchase pursuant to the Indenture, and (ii) in the case of an optional purchase of Bonds, the dates established for such optional purchase as described in the Indenture.

"Purchase Price" means 100% of the principal amount of and premium, if any, on Bonds tendered for purchase pursuant to the Indenture plus accrued interest, if any, to the Purchase Date.

"Record Date" means the fifteenth day of the month next preceding an Interest Payment Date.

"Redemption Date" means the date upon which Bonds are to be called for redemption pursuant to the Indenture.

"Redemption Price" means, with respect to any Bond, the principal amount thereof plus the applicable premium, if any, payable upon redemption thereof.

"Registrar" means the Paying Agent and any other or additional entity appointed by the Issuer or the Trustee to act as registrar for the Bonds.

"Revenue Fund" means the General Revenue Fund created by the Lease.

"Revenues" means the totality of all water and sewer service rates, rentals and charges of any and all types and varieties imposed, enforced and collected by the Lessee for any services rendered by the works and facilities of the Lessee which it relates to the System, together with other income received by the Lessee, if any, from any agency of government, both federal and state, as representing income or operating subsidies, as distinguished from capital grants, to the extent not otherwise required to be treated and applied.

"Revolving Fund Account" means the account created under the Original Indenture which account is not pledged to the Bonds or the Series Trust Estate.

"Securities Depository" means any securities depository that is a "clearing corporation" within the meaning of the New York Uniform Commercial Code and a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act, operating and maintaining, with its participants or otherwise, a Book-Entry System to record ownership of beneficial interests in bonds and bond service charges, and to effect transfers of bonds in Book-Entry Form, and means, initially, The Depository Trust Company (a limited purpose trust company), New York, New York.

"Securities Depository Nominee" means any nominee of a Securities Depository and shall initially mean Cede & Co., New York, New York, as nominee of The Depository Trust Company.

"Segregated Accounts" means the separate accounts to be established pursuant to the Third Supplemental Indenture and pledged as security for a series of the Supplemental Bonds.

"Series Trust Estate" means, while a series of Supplemental Bonds is Outstanding, all right, title and interest of the Issuer and the Corporation in and to (i) the Correlative Lease with respect to such series of Supplemental Bonds, (ii) the Supplemental Credit Support, if any, (iii) the Lease Rental Payments due under the Correlative Lease, (iv) the Collateral Documents, if any and (v) all moneys and securities, including earnings thereon, held in the Lessee Acquisition Account and the Lessee Account of the Lessee under the Correlative Lease and in any of the Segregated Accounts or other accounts that may be created with respect to such series of Supplemental Bonds and pledged as security therefor.

"State" means the Commonwealth of Kentucky.

"Supplemental Bonds" means Fixed Rate Bonds issued pursuant to the Indenture which are secured only by a Series Trust Estate, including the Bonds.

"Supplemental Bonds Debt Service Reserve Requirement" means an amount that may be required to be deposited and maintained in a Segregated Account of the Debt Service Reserve Fund, if any, or that may be required pursuant to a Correlative Lease to be deposited and maintained in another account or accounts as a Debt Service Reserve Fund for Supplemental Bonds; all as may be described under the heading "The Lease."

"Supplemental Credit Support" means an instrument, such as an irrevocable letter of credit, policy of bond insurance, credit facility, bond or guarantee issued by one or more financial institutions or insurance companies which provides security for the payment of the principal of and interest on a series of Supplemental Bonds when due and may include payment of the redemption price of the Supplemental Bonds.

"Undelivered Bonds" means those Bonds not delivered to the Paying Agent on any Redemption or Purchase Date relating to such Bonds.

APPENDIX B

Form of Bond Counsel Opinion

_____, 2002

City of Danville, Kentucky
City Hall
455 West Main Street
Danville, Kentucky 40422

Re: \$_____,000
City of Danville, Kentucky Multi-City Lease Revenue Bonds
(City of Shelbyville, Kentucky Water and Sewer System Lease Revenue
Refunding Project) Fixed Rate Series 2002-A

Ladies and Gentlemen:

We have acted as bond counsel in connection with the conversion and remarketing on the date hereof of a portion of the "City of Danville, Kentucky Money Market Municipal Multi-City Lease Revenue Bonds (Kentucky Municipal League Pooled Lease Financing Program), Series 1989" dated on original issuance as of March 1, 1989 and originally issued in the aggregate principal amount of \$152,975,000 (the "Original Bonds") to a Fixed Rate Series of Supplemental Bonds (as defined in the Indenture hereinafter identified) that is designated as the "City of Danville, Kentucky, Multi-City Lease Revenue Bonds (City of Shelbyville, Kentucky Water and Sewer System Lease Revenue Refunding Project) Fixed Rate Series 2002-A" (the "Supplemental Bonds"). The Supplemental Bonds are dated on their conversion and remarketing as of even date herewith. They are being converted and remarketed in the aggregate principal amount of \$_____,000.

The Supplemental Bonds are issued and secured under and pursuant to an ordinance of the City of Danville, Kentucky (the "Issuer") duly enacted on March 7, 1989 (the "Bond Ordinance") and a trust indenture dated as of March 1, 1989 (the "Indenture") among the Issuer, the Kentucky Municipal Finance Corporation (the "Corporation") and Fifth Third Bank, as successor to Citizens Fidelity Bank and Trust Company, as trustee (the "Trustee"), as amended and supplemented by a _____ supplemental trust indenture dated as of _____ (the "Supplemental Indenture") among the Issuer, the Corporation and the Trustee as approved pursuant to an ordinance of the Issuer duly enacted on September __, 2002 (the "Supplemental Ordinance"). Capitalized terms not otherwise defined herein are used as defined in the Indenture or the Supplemental Indenture.

The Supplemental Bonds are being converted and remarketed for the purpose of refinancing a project for the benefit of the City of Shelbyville, Kentucky (the "Lessee") pursuant to a fixed rate lease purchase agreement dated as of even date herewith (the "Lease") between the Corporation, acting as an agency and instrumentality of the Issuer, as lessor, and the Lessee. The obligation of the Lessee to make rental payments under the Lease is on a parity, as to security and source of payment, with the outstanding Certificates of Participation, City of Shelbyville, Kentucky (Water and Sewer Revenue Refunding and Improvement Project), Series 1998A and other Parity Obligations that may from time to time be issued and outstanding under the Lease.

In our capacity as bond counsel we have examined such documents, records of the Issuer, the Lessee and the Corporation, and other instruments as we have deemed necessary to enable us to express

the opinions set forth below, including original counterparts or certified copies of [i] the Bond Ordinance, [ii] the Supplemental Ordinance, [iii] the Indenture, [iv] the Supplemental Indenture, [v] the Lease, and [vi] documents that are included in the record of proceedings for the original issuance of the Original Bonds (the foregoing documents sometimes are collectively referred to herein as the "Lease Documents"). We have also examined one of the Supplemental Bonds as executed by the Issuer and authenticated by the Registrar. We have assumed that all of the other Supplemental Bonds have been similarly executed and authenticated.

We have relied upon the genuineness, accuracy and completeness of all documents, records and other instruments examined. We have relied upon and assumed the accuracy of and continued compliance with the covenants, representations, warranties and certifications of the parties as contained in the records of proceedings for the original issuance of the Original Bonds and the conversion and remarketing on the date hereof of the Supplemental Bonds. Except as expressly stated below, we have assumed that all parties had the requisite power and authority to enter into and perform all obligations of all documents to which they are parties. Except as expressly stated below, we have assumed the due authorization by all requisite action, and execution and delivery by such parties of such documents and the validity and binding effect thereof.

We have relied upon the opinion dated as of even date herewith of Edward D. Hays, Esq., City Attorney of the Issuer, and Frank Chuppe, Esq., City Attorney of the Lessee, as to the due authorization, execution, delivery, validity and binding effect of documents to which the Issuer and the Lessee, respectively, are parties.

Except as stated in paragraph 7 below, we express our opinion only with respect to the laws of the Commonwealth of Kentucky (the "Commonwealth") as enacted and construed on the date hereof.

Based on the foregoing, and in reliance thereon, and on the basis of our examination of such other matters of fact and questions of law as we have deemed relevant in the circumstances, it is our opinion that:

1. The Issuer is a municipal corporation and political subdivision of the Commonwealth, duly organized and validly existing under the laws of the Commonwealth, with full power and authority to cause the Supplemental Bonds to be converted and remarketed on the date hereof.

2. The Corporation is a nonprofit corporation duly organized and validly existing in good standing under the laws of the Commonwealth as an agency and instrumentality of the Issuer, with full power and authority to execute and deliver the Lease Documents to which it is a party.

3. The Lessee is a municipal corporation and political subdivision of the Commonwealth, duly organized and validly existing under the laws of the Commonwealth, with full power and authority to execute and deliver the Lease Documents to which it is a party.

4. Each of the Lease Documents to which it is a party has been duly authorized, executed and delivered by the Issuer, the Corporation and the Lessee, respectively, and is the valid and binding limited obligation thereof, enforceable in accordance with its terms.

5. All right, title and interest of the Corporation in and to the amounts payable under the Lease have been validly assigned to the Trustee.

6. The conversion and remarketing on the date hereof of the Supplemental Bonds have been duly authorized by the Issuer. The Supplemental Bonds have been duly executed and delivered by the Issuer and authenticated by the Registrar and are the valid and binding special and limited obligations of the Issuer enforceable in accordance with their terms, payable solely from the revenues and other moneys pledged pursuant to the Supplemental Indenture, entitled to the benefit and security of the Supplemental Indenture.

7. Under existing statutes, regulations and judicial decisions and as of the date hereof, the interest on the Supplemental Bonds is excludable from gross income for federal income tax purposes. Section 1317(44) of the Tax Reform Act of 1986, as amended by Section 1013(g)(41) of the Technical and Miscellaneous Revenue Act of 1988, specifically exempts the Supplemental Bonds from the arbitrage rebate requirement of Section 148(f) of the Internal Revenue Code of 1986, as amended (the "Code") and the limitation of Section 148(c)(2) of the Code on the temporary period for pooled financings. Under existing statutes, regulations and judicial decisions and as of the date hereof, the execution and delivery of the Lease Documents will not adversely affect the exclusion of the interest on the Original Bonds from gross income for federal income tax purposes (including interest on the Original Bonds accruing at the "Bank Rate" and the "Default Rate" as those terms are defined in the Reimbursement Agreement).

8. Under the laws of the Commonwealth as presently enacted and construed and as of the date hereof, the Supplemental Bonds are exempt from ad valorem taxation, and the interest thereon is exempt from income taxation, by the Commonwealth and all of its political subdivisions and taxing authorities. Under the laws of the Commonwealth as presently enacted and construed and as of the date hereof, the execution and delivery of the Lease Documents will not adversely affect the exemption of the Original Bonds from ad valorem taxation, or the exemption of the interest thereon from income taxation, by the Commonwealth and all of its political subdivisions and taxing authorities.

9. The Lease Documents do not contravene any restrictions on indebtedness applicable to the Lessee under the Constitution and laws of the Commonwealth.

For the purpose of rendering the opinions in paragraph 7 above, we have relied on and assumed compliance by the Issuer, the Corporation, the Lessee and the other Participants (as defined in the Indenture) with the requirements of the Code that must be met subsequent to the original issuance of the Original Bonds and subsequent to the conversion and remarketing on the date hereof of the Supplemental Bonds, respectively, in order that the interest on the Original Bonds and the Supplemental Bonds be and

remain excludable from gross income for federal income tax purposes. Failure to comply with such requirements could cause the interest on the Supplemental Bonds (as well as the interest on the Original Bonds) to be included in gross income for federal income tax purposes retroactive to the date of original issuance of the Original Bonds, or to the date of conversion and remarketing on the date hereof of the Supplemental Bonds, depending on which requirements have not been complied with. The Issuer and the Corporation have covenanted in the Indenture, and the Lessee has covenanted in the Lease, to comply with such requirements. We have also assumed that, immediately prior to the execution and delivery of the Lease Documents and the conversion and remarketing on the date hereof of the Supplemental Bonds, the interest on the Original Bonds was excludable from gross income for federal income tax purposes.

The opinions in paragraphs 4 and 6 above on the enforceability of the Supplemental Bonds and the Lease Documents are subject to the qualification that enforcement may be limited by bankruptcy, reorganization, moratorium, insolvency or other laws relating to or affecting the enforcement of creditors' rights, and by the exercise of judicial discretion in accordance with equitable principles. We express no opinion on enforceability of any document except as expressly stated herein, and we call your attention to the fact that certain provisions of the Lease Documents may not be enforceable, including provisions requiring the Lessee to enter into future contracts for the acquisition, construction or installation of a Project, restricting the power of the Lessee to substitute collateral or to assign Lease Documents or sublease a Project, requiring the Lessee to pay indemnification and waiving appraisalment, valuation, stay, extension and redemption laws.

We are not expressing an opinion on the investment quality of the Original Bonds or the Supplemental Bonds. We call your attention to the fact that the Supplemental Bonds are special and limited obligations of the Issuer, payable solely from the Series Trust Estate as defined in the Supplemental Indenture. The Original Bonds are special and limited obligations of the Issuer, payable solely from the Trust Estate as defined in the Indenture. The Lease is payable solely from revenues, if any, of the Lessee from its water and sewer system as described in the Lease. Neither the Supplemental Bonds nor the Original Bonds pledge the general credit of the Corporation or the general credit or taxing power of the Issuer, the Lessee, the Commonwealth or any political subdivision or taxing authority of the Commonwealth. The Lease does not pledge the general credit or taxing power of the Lessee. The Corporation has no taxing power.

Yours truly,

WYATT, TARRANT & COMBS, LLP

APPENDIX C

**Estimated Debt Service Schedule;
City of Shelbyville (KY) Municipal Water and Sewer System;
Calculation of Estimated Coverage of Maximum Debt Service by Net Revenues**

\$2,390,000
CITY OF DANVILLE (KY) MULTI-CITY LEASE REVENUE BONDS
CITY OF SHELBYVILLE, KENTUCKY WATER AND SEWER REFUNDING PROJECT
SERIES 2002

ESTIMATED DEBT SERVICE SCHEDULE

<u>Date</u>	<u>Principal</u>	<u>Interest</u>	<u>Period Total</u>	<u>Fiscal Total</u>
1/1/03		\$ 23,597.50	\$ 23,597.50	\$ 23,597.50
7/1/03	\$ 240,000	35,396.25	275,396.25	
1/1/04		33,416.25	33,416.25	308,812.50
7/1/04	240,000	33,416.25	273,416.25	
1/1/05		31,196.25	31,196.25	304,612.50
7/1/05	250,000	31,196.25	281,196.25	
1/1/06		28,383.75	28,383.75	309,580.00
7/1/06	255,000	28,383.75	283,383.75	
1/1/07		25,005.00	25,005.00	308,388.75
7/1/07	260,000	25,005.00	285,005.00	
1/1/08		21,105.00	21,105.00	306,110.00
7/1/08	270,000	21,105.00	291,105.00	
1/1/09		16,650.00	16,650.00	307,755.00
7/1/09	280,000	16,650.00	296,650.00	
1/1/10		11,610.00	11,610.00	308,260.00
7/1/10	290,000	11,610.00	301,610.00	
1/1/11		6,100.00	6,100.00	307,710.00
7/1/11	<u>305,000</u>	<u>6,100.00</u>	<u>311,100.00</u>	311,100.00
Totals	<u>\$2,390,000</u>	<u>\$405,926.25</u>	<u>\$2,795,926.25</u>	

Source: Financial Advisor

Water and Sewer System Description

The City of Shelbyville (the “City”) owns a combined water and sanitary sewer system serving Shelbyville and areas surrounding the City which is operated by the Shelbyville Municipal Water & Sewer Commission (the “Commission”). The Commission was established in 1955 when the Water System was initially purchased from the Kentucky Water Service Company.

Sanitary Sewer System – The Sanitary Sewer System has been operated by the City since 1900, and by the Commission since 1955. In March 2000, the Commission took over ownership of the Sanitation District #1 of Shelby County with its 1,459 sanitary sewer connections. In July 2002, the number of Sanitation District #1 connections increased to 1,747 sanitary sewer connections, an increase of approximately 20% in this rate area since acquisition.

The Commission presently has 5,035 sewer connections compared to 3,306 connections in 1990. The sewer system consists of the collection system, and treatment facilities which was last expanded in 1991. The treatment facility consists of a 1.07 MGD (million gallon/day) advanced secondary RBC plant, in parallel with a 0.8 MGD Oxidation Ditch plant, for a total dry weather treatment capacity of 1.87 MGD. Average annual treatment in 2001 was 1.583 MGD, or 85% of plant capacity.

The Commission shall soon complete a “201 Facilities Plan” in advance of the regulatory requirement “to begin the Plan” when treatment capacity reaches 90%. Upon completion of this plan, the Commission should initiate a design contract for plant expansion within the next 6 months.

Since the acquisition of the Sanitation District #1 of Shelby County, the collection system now consists of approximately 64.3 miles of gravity sewer lines operated by the Commission consisting of predominately lines between 8 and 15 inches in diameter, with a very few 6 inch lines. There are also 24 sewage pumping stations. The service area is now approximately in excess of 20 square miles.

The Sanitary Sewer System is in compliance with all Federal and State laws that regulate such facilities, and has a very consistent record in passing Quarterly Chronic Toxicity testing.

Water System – The Commission presently has 6,765 water connections (from 4,494 connections in 1990), and serves two Water Districts. Usage by the two Water Districts has dropped significantly since 1996 when annual billing was for 216.25 million gallons a year, compared to 137.4 million gallons in 2001. This reduction has been with the encouragement of the Commission as the Water Districts have increased their purchase of water from the Louisville Water Company and the Frankfort Plant Board. The net positive effect to the Commission is reduced demand on the reservoir for the long term. In addition, increased revenue from a greater number of retail customers have offset lost revenues from these wholesale customers.

Potable water supply and water for fire fighting are provided by a treatment facility at Guise Creek Lake. This reservoir has a capacity of 1.444 billion gallons and a drainage area of 18,575 acres (29 square miles). Of this total capacity, it is estimated that in excess of 630 million gallons of water storage are available to service the water needs of the Commission’s system. The Water Treatment (Filtration) Plant was expanded from 4.5 MGD to 6.0 MGD in 2000.

The State of Kentucky completed modification to the emergency spillway for Guist Creek Lake during construction in 1994-1996, to ensure compliance with dam safety criteria for existing dams.

Parallel transmission mains, ranging in size from 12 inches to 18 inches, connect the water treatment plant to the City and its environs. The total elevated storage within the system is 3.0 million gallons, with 1.25 million gallons of ground storage at the treatment plant. There are currently in excess of 140 miles of water lines 6 inches and greater, servicing 56 square miles within the Commission’s service area.

The Water Treatment Plant is currently meeting all Federal and State requirements for Drinking Water Facilities.

Management and Operation of the Water and Sewer System

Responsibility for management of the system is vested in a seven member Board of Commissioners. The Mayor of the City of Shelbyville is the Chairman, with a Vice-Chairman elected by the Commission. In addition to the Mayor, the City Council appoints one member of the City Council, and two additional non-elected persons as Commissioners. The Shelby County Fiscal Court appoints one Magistrate to the Commission and 2 other non-elected persons as Commissioners.

The Commission has sole and exclusive authority in all matters of management, and may enact such rules and regulations as it deems necessary. The Commission collects all moneys due, holds them separate from all other City funds, and authorizes all expenditures for the System(s).

Rate increases for the System(s) must be approved by the City Council of the City of Shelbyville. In addition, any borrowing for the System(s) is undertaken through the City of Shelbyville.

The Commission employs a Manager (presently a Professional Engineer) who is responsible for the daily operations of the System(s). The Manager directs the activities of the employees through the Assistant Manager and Department Heads, and is responsible for the operation of the water and sewer plants, distribution and collection systems, billing/collections and purchases. In addition to the Manager, the Commission employs an Assistant Manager, Office Manager, Water Treatment Plant Superintendent, Wastewater Treatment Plant and Wastewater Collection System Superintendent, and Superintendent of the Water Distribution System, as well as other staff and maintenance employees.

Water Rates and Charges (effective May 1, 2001)

1. For customers who are both within the City limits of Shelbyville (KY) and within the City water service area:

<u>QUANTITY BILLED</u>	<u>RATE PER 1,000 GALLONS</u>
First 1,000 gallons used per month	\$6.22 Minimum
Next 9,000 gallons per month	\$1.67
Next 15,000 gallons per month	\$1.60
All over 25,000 gallons per month	\$1.50

2. For customers who are within that area extending south of I-64, then East and West and being served by the water mains constructed in 1978 and additions thereto and defined as the Finchville rate area:

<u>QUANTITY BILLED</u>	<u>RATE PER 1,000 GALLONS</u>
First 1,000 gallons used per month	\$8.63 Minimum
Next 9,000 gallons per month	\$2.39
Next 15,000 gallons per month	\$2.02
All over 25,000 gallons per month	\$1.80

3. For customers outside City limits, but not in Finchville rate area, and who are within the City water service area:

<u>QUANTITY BILLED</u>	<u>RATE PER 1,000 GALLONS</u>
First 1,000 gallons used per month	\$7.16 Minimum
Next 9,000 gallons per month	\$1.92
Next 15,000 gallons per month	\$1.84
All over 25,000 gallons per month	\$1.72

4. Minimum monthly charges for meters greater than 5/8", and 1,000 gallons or less used each month:

<u>METER SIZE</u>	<u>INSIDE CITY</u>	<u>OUTSIDE CITY</u>	<u>FINCHVILLE AREA</u>
1"	\$ 8.29	\$ 9.52	\$ 11.67
1½"	10.34	11.90	14.70
2"	16.02	18.46	23.09
3"	57.94	66.73	84.72
4"	73.47	84.60	107.54
6"	109.70	126.31	N/A

5. Commercial Haulers

- A. Inside City \$2.00 per 1,000 gal
- B. Outside City \$2.88 per 1,000 gal

6. Water Districts

- A. West Shelby Water District \$1.62 per 1,000 gal
- B. North Shelby Water Company \$1.50 per 1,000 gal
- C. Quantities over the contract limits shall be charged normal rate plus: \$1.00 per 1,000 gal

7. Fire Protection

- A. Service for public hydrants outside City limits: \$1.00/month
- B. Service for private hydrants outside City limits: \$7.50/month/hydrant
- C. Service for sprinkler systems \$0.0006 sq. ft. area

Sewer Rates and Charges (effective June 1, 1998 (except for 3. below))

1. For customers who are within the City limits of Shelbyville (KY) and within the City sewer service area, except for HiPoint Shopping Center, which has an additional surcharge of \$0.25 per 1,000 gal for use of Sanitation District #1 lines:

<u>QUANTITY BILLED</u>	<u>RATE PER 1,000 GALLONS</u>
First 1,000 gallons used per month	\$6.25 Minimum
Next 9,000 gallons per month	\$2.10
All over 10,000 gallons per month	\$1.95

2. For customers who are outside the City limits, but within the City service area, excluding the area of Sanitation District #1:

<u>QUANTITY BILLED</u>	<u>RATE PER 1,000 GALLONS</u>
First 1,000 gallons used per month	\$7.19 Minimum
Next 9,000 gallons per month	\$2.42
All over 10,000 gallons per month	\$2.24

3. For customers who are within the Sanitation District #1 rate area (effective April 1, 2002):

<u>QUANTITY BILLED</u>	<u>RATE PER 1,000 GALLONS</u>
First 1,000 gallons used per month	\$4.95 Minimum
All over 1,000 gallons per month	\$4.95
All over 10,000 gallons per month	\$2.24

System Development Charges

System Development Charges are a one-time, up-front charge based upon usage. By Ordinance these funds may only be used for expansion of Water and/or Sewer facilities.

Water System – Effective January 1, 2000

1.	Residential (Single family or Duplex)	
	Inside City	\$365.00
	Outside City	\$475.00
2.	Apartments (per unit)	
	Inside City	\$183.00
	Outside City	\$237.00
3.	Industrial/Commercial/Other	
	Inside City	\$73/1,000 gallons per month
	Outside City	\$95/1,000 gallons per month

Sewer System

1.	Residential (Single family or Duplex)	
	Inside City	\$544.00
	Outside City	\$731.00
2.	Apartments (per unit)	
	Inside City	\$272.00
	Outside City	\$366.00
3.	Industrial/Commercial/Other	
	Inside City	\$128/1,000 gallons per month
	Outside City	\$172/1,000 gallons per month

Meter Setting Fees

5/8" Meter	
Inside City	\$340.00
Outside City	\$415.00
1" Meter	
Inside City	\$440.00
Outside City	\$515.00

Water Plant Billing Treatment

Water Treatment Plant (Plant Capacity 6.0 MGD)

Year	Annual Water Sales Million Gal/Yr	Average Annual		
		Water Treated MGD	Peak Day MGD	Peak Month MGD
2001	813.04	3.30	5.03	3.88
2000	842.15	3.16	4.64	3.55
1999	863.54	3.44	4.59	4.17
1998	843.80	3.13	4.53	3.85
1997	814.49	3.14	4.43	3.78

Wastewater Treatment Plant (Plant Capacity 1.87 MGD)

Year	Annual Sewer Sales Million Gal/Yr	Average Annual	
		Sewer Treated MGD	Peak Month Sewer Treated MGD
2001	526.46	1.58	2.04
2000	201.16	1.51	2.02
1999	467.78	1.40	2.35
1998	447.28	1.62	2.00
1997	442.18	1.49	2.34

Customers of the Water & Sewer Commission

Year	Total Water Services	Total Sewer Connections
2002 (July)	6,765	5,035
2001	6,563	4,817
2000	6,356	4,696
1999	5,914	4,532
1998	5,672	4,295
1997	5,406	4,050

Ten Largest Customers

	Annual Sales (Million Gallons) Calendar	Annual Revenues			% of Total Revenue	Mo. Usage (1,000 Cubic Ft.)
		Water \$\$\$\$\$	Sewer \$\$\$\$\$	Total \$\$\$\$\$		
		West Shelby Water District	113.84	\$182,372		
Logan's Healthcare	28.62	42,851	55,884	98,736	2.9	318.87
Lawson-Mardon	14.47	22,285	28,288	50,573	1.5	161.24
Logan's Uniform	10.45	17,800	23,487	41,287	1.2	116.43
Bekaert	17.35	0	38,938	38,938	1.1	193.31
Ind. Powder Coatings	7.62	13,712	17,146	30,858	0.9	84.90
Ichikoh	8.48	12,738	16,613	29,351	0.9	94.48
Black & Decker	7.32	12,514	16,485	28,999	.08	81.56
Budd Company	10.42	0	23,432	23,432	.07	116.10
North Shelby Water District	14.12	0	21,162	21,162	.06	157.32

Annual Total Revenue FYE June 30, 2002 \$3,419,598

Outstanding Water and Sewer Certificates of Participation

<u>Date of Issue</u>	<u>Final Maturity</u>	<u>Amount of Original Issue</u>	<u>Outstanding September 1, 2002</u>
June 1, 1998	7/1/2018	\$9,540,000	\$8,620,000

Debt Service Coverage

The revenues of the System are no less than 1.20 times the maximum amount of principal of and interest on the Prior Bonds and the bonds proposed to be issued in any year prior to the final maturities.

Following is the calculation of estimated coverage of maximum debt service by net revenues, after issuance of the 2002 Bonds, using amounts for the fiscal year ended June 30, 2001:

Gross Revenues		\$3,660,055
Operating Expenses	3,324,841	
Less Depreciation and Interest	<u>(1,627,659)</u>	
Net Operating Expenses		<u>1,697,182</u>
Net Operating Revenues		1,962,873
Debt Service - Estimated Maximum Principal and Interest in 2015		1,001,644
Debt Service Coverage		1.96x

APPENDIX D

Financial Statements of Lessee for Fiscal Year ended June 30, 2001

CITY OF SHELBYVILLE
AUDITED FINANCIAL STATEMENTS
AND OTHER FINANCIAL INFORMATION
JUNE 30, 2001

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INDEPENDENT AUDITORS' REPORT

Mayor and Members of the City Council
Shelbyville, Kentucky

We have audited the accompanying general purpose financial statements of the City of Shelbyville, Kentucky as of and for the year ended June 30, 2001, as listed in the table of contents. These general purpose financial statements are the responsibility of the City of Shelbyville, Kentucky's management. Our responsibility is to express an opinion on these general purpose financial statements based on our audit. We did not audit the financial statements of the water and sewer fund, which represent 88 percent and 72 percent, respectively, of the assets and revenues of the proprietary fund. Those financial statements were audited by other auditors whose report has been furnished to us, and our opinion on the general purpose financial statements, insofar as it relates to the amounts included for the water and sewer fund, is based on the report of the other auditors.

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

In our opinion, based on our audit and the report of other auditors, the general purpose financial statements referred to above present fairly, in all material respects, the financial position of the City of Shelbyville, Kentucky as of June 30, 2001 and the results of its operations and the cash flows of its proprietary fund types for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated August 31, 2001, on our consideration of City of Shelbyville Kentucky's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Our audit was conducted for the purpose of forming an opinion on the general purpose financial statements taken as a whole. The combining and individual fund and account group financial statements and schedules listed in the table of contents are presented for purposes of additional analysis and are not a required part of the general purpose financial statements of City of Shelbyville, Kentucky. Such information has been subjected to the auditing procedures applied in the audit of the general purpose financial statements and, in our opinion, is fairly presented in all material respects in relation to the general purpose financial statements taken as a whole.

Louisville, Kentucky
August 31, 2001

CITY OF SHELBYVILLE

COMBINED BALANCE SHEET - ALL FUND TYPES AND ACCOUNT GROUPS

JUNE 30, 2001 (with comparative amounts for 2000)

	GOVERNMENTAL FUND TYPES		PROPRIETARY FUND TYPES	ACCOUNT GROUPS		TOTALS (MEMORANDUM ONLY)	
	General	Special	Enterprise	General	General	2001	2000
		Revenue		Fixed	Long-Term		
			Assets	Debt			
ASSETS							
Cash	\$2,001,861	\$ 101,673	\$ 192,976			\$ 2,296,510	\$ 1,965,320
Restricted cash			408,889			408,889	226,569
Restricted funds and investments			3,603,079			3,603,079	2,766,452
Savings & certificates of deposits			25,090			171,412	68,352
Accounts receivable	100,000	46,322	346,740			346,740	334,806
Due from others			9,522			9,522	18,963
Property taxes receivable						9,091	22,903
Materials inventory	9,091		100,994			100,994	91,896
Other assets			967			967	755
Utility fixed assets			37,438,214			37,438,214	36,424,059
Unamortized debt discount & expenses			573,003			573,003	617,887
Land			2,956,223			2,956,223	2,956,223
Golf course fixed assets			979,422			979,422	897,109
Accumulated depreciation			(11,439,444)			(11,439,444)	(10,486,561)
General fixed assets				\$ 5,057,858		5,057,858	5,017,350
Amount to be provided for lease payments					\$ 224,416	224,416	260,881
Amount to be provided for revenue bonds					2,105,000	2,105,000	2,200,000
Amount to be provided for compensated absences					281,542	281,542	239,862
TOTAL ASSETS	\$ 2,110,952	\$ 147,995	\$ 35,195,675	\$ 5,057,858	\$ 2,610,958	\$ 45,123,438	\$ 43,622,826

CITY OF SHELBYVILLE
COMBINED BALANCE SHEET - ALL FUND TYPES AND ACCOUNT GROUPS (CONTINUED)

JUNE 30, 2001

(with comparative amounts for 2000)

	GOVERNMENTAL FUND TYPES		PROPRIETARY	ACCOUNT GROUPS		TOTALS	
			FUND TYPES			(MEMORANDUM ONLY)	
	General	Special Revenue	Enterprise	General Fixed Assets	General Long-Term Debt	2001	2000
LIABILITIES AND FUND EQUITY							
Liabilities							
Accounts payable	\$ 22,799	\$ 1,764	\$ 98,036			\$ 122,599	\$ 96,247
Accrued payroll	5,820		922			6,742	12,564
Accrued expenses and withholdings	44,094		41,862			85,956	104,265
Notes payable - bank			86,552			86,552	301,076
Notes payable - KY Infrastructure Authority			1,549,093			1,549,093	1,661,709
Obligations under capital lease agreement			113,425		\$ 224,416	337,841	807,639
Obligations for revenue bonds					2,105,000	2,105,000	2,200,000
Obligations for compensated absences			42,496		281,542	324,038	267,782
Accrued interest			38,775			38,775	33,831
Fixed rate lease obligation			11,935,000			11,935,000	11,235,000
Accounts payable - construction			71,214			71,214	22,479
Customer deposits			109,372			109,372	99,393
Accrued interest - customer deposits			50,044			50,044	45,734
Revenue bonds outstanding			3,505,000			3,505,000	3,630,000
TOTAL LIABILITIES	72,713	1,764	17,641,791	\$ -0-	2,610,958	20,327,226	20,517,719

CITY OF SHELBYVILLE
COMBINED BALANCE SHEET - ALL FUND TYPES AND ACCOUNT GROUPS (CONTINUED)
JUNE 30, 2001 (cont'd)
(with comparative amounts for 2000)

	GOVERNMENTAL FUND TYPES		PROPRIETARY	ACCOUNT GROUPS		TOTALS	
			FUND TYPES			(MEMORANDUM ONLY)	
	General	Special Revenue	Enterprise	General Fixed Assets	General Long-Term Debt	2001	2000
Fund Equity							
Investment in general fixed assets				5,057,858		5,057,858	5,017,350
Reserved for streets		134,902				134,902	128,695
Reserved for community development economic assistance		-0- 6,025				-0- 6,025	101 4,612
Reserved other		5,304				5,304	13,146
Unreserved	2,038,239					2,038,239	1,305,233
Retained Earnings - unreserved			5,642,291			5,642,291	5,386,024
Contribution in aid of construction			3,979,484			3,979,484	3,717,837
Municipal contribution			155,962			155,962	155,962
Sanitation District No. 1 contribution			958,688			958,688	958,688
Grants			6,817,459			6,817,459	6,417,459
TOTAL FUND EQUITY	2,038,239	146,231	17,553,884	5,057,858	-0-	24,796,212	23,105,107
TOTAL LIABILITIES & FUND EQUITY	\$ 2,110,952	\$ 147,995	\$ 35,195,675	\$ 5,057,858	\$ 2,610,958	\$ 45,123,438	\$ 43,622,826

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

CITY OF SHELBYVILLE
COMBINED STATEMENT OF REVENUES, EXPENDITURES AND
CHANGES IN FUND BALANCES - ALL GOVERNMENTAL FUND TYPES
FOR THE YEAR ENDED JUNE 30, 2001
(with comparative amounts for 2000)

	Governmental Fund Types		Totals (Memorandum Only)	
	General	Special Revenue	2001	2000
TOTAL REVENUES	\$ 4,236,389	\$ 246,722	\$ 4,483,111	\$ 4,515,033
TOTAL EXPENDITURES	3,429,187	219,854	3,649,041	4,349,712
Excess of Revenues Over (Under Expenditures)	807,202	26,868	834,070	165,321
Other Financing Sources (Uses)				
Operating transfers in	110,000		110,000	584,989
Operating transfers out			-0-	(476,554)
Payment of lease principal		(23,900)	(23,900)	(332,600)
Payment of lease interest	(1,440)	(3,291)	(4,731)	(20,914)
Bond payment - City Hall	(80,000)		(80,000)	(75,000)
Bond payment - Clear Creek	(15,000)		(15,000)	(5,000)
Interest expense	(88,290)		(88,290)	(81,880)
Special assessment bond	54,159		54,159	76,105
Special assessment payment	(53,625)		(53,625)	(75,365)
Total Other Financing (Uses)	(74,196)	(27,191)	(101,387)	(406,219)
Excess of Revenues and Other Sources Over (Under) Expenditures and Other Uses	733,006	(323)	732,683	(240,898)
Fund Balances, July 1, 2000	1,305,233	146,554	1,451,787	1,692,685
Fund Balances, June 30, 2001	\$ 2,038,239	\$ 146,231	\$ 2,184,470	\$ 1,451,787

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

CITY OF SHELBYVILLE
COMBINED STATEMENT OF REVENUES, EXPENDITURES AND
CHANGES IN FUND BALANCES - ALL GOVERNMENTAL FUND TYPES (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2001
(with comparative amounts for 2000)

	Governmental Fund Types		Totals (Memorandum Only)	
	General	Special Revenue	2001	2000
REVENUES:				
Ad valorem taxes	\$ 1,213,522		\$ 1,213,522	\$ 1,046,491
Insurance tax	668,237		668,237	615,602
Franchise tax	101,414		101,414	122,121
In lieu of franchise tax	127,843		127,843	120,007
Housing Authority, in lieu of taxes	13,459		13,459	13,931
Streetscape assessment	9,950		9,950	19,267
Penalties and interest	19,366		19,366	15,249
Net profit license	169,556		169,556	189,284
Occupational license	1,107,810		1,107,810	1,202,302
Occupational interlocal agreement	405,396		405,396	274,320
Permits	8,655		8,655	12,632
Interest	64,000	\$ 6,235	70,235	62,338
Building inspector	24,239		24,239	1,888
Rent	28,548		28,548	24,600
Intergovernmental:				
State grant	8,000	50,983	58,983	169,931
Kentucky municipal aid		96,969	96,969	100,715
Economic assistance		2,251	2,251	-0-
Base court revenue	29,811		29,811	29,811
Police and fire incentive pay	125,164		125,164	117,463
Community Development Grant		2,250	2,250	138,716
Reveune 911 Board	84,000		84,000	84,000
Law Enforcement Grant			-0-	15,709
Justice Grant	9,432	88,034	97,466	70,473
Dare			-0-	1,955
Other	17,987		17,987	66,228
TOTAL REVENUES	\$ 4,236,389	\$ 246,722	\$ 4,483,111	\$ 4,515,033

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

CITY OF SHELBYVILLE
COMBINED STATEMENT OF REVENUES, EXPENDITURES AND
CHANGES IN FUND BALANCES - ALL GOVERNMENTAL FUND TYPES (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2001
(with comparative amounts for 2000)

	Governmental		Totals	
	Fund Types		(Memorandum Only)	
	General	Special Revenue	2001	2000
EXPENDITURES				
Current				
:				
Police department	\$ 739,302		\$ 739,302	\$ 802,124
Fire department	615,595		615,595	589,773
Street department	281,647	\$ 41,502	323,149	330,848
Recreation	137,000		137,000	137,500
Administrative and general	1,403,277	96,075	1,499,352	1,470,269
Community development	184,616		184,616	192,665
CDBG urban rehabilitation		54,334	54,334	308,973
Capital Outlay	67,750	27,943	95,693	517,560
	<u>67,750</u>	<u>27,943</u>	<u>95,693</u>	<u>517,560</u>
TOTAL EXPENDITURES	\$ 3,429,187	\$ 219,854	\$ 3,649,041	\$ 4,349,712

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

CITY OF SHELBYVILLE

COMBINED STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE-BUDGET AND ACTUAL-GENERAL FUND

FOR THE YEAR ENDED JUNE 30, 2001

	Budget	Actual	Variance - Favorable (Unfavorable)
REVENUES			
Property tax	\$ 1,206,000	\$ 1,466,188	\$ 260,188
Licenses and permits	2,215,000	2,359,654	144,654
Intergovernmental revenues	191,700	196,646	4,946
Fines and penalties	10,000	19,366	9,366
Charges for services	84,000	84,000	-0-
Rent	22,000	28,548	6,548
Interest	38,000	64,000	26,000
Other	5,000	17,987	12,987
TOTAL REVENUES	3,771,700	4,236,389	464,689
EXPENDITURES			
Current			
General government	1,143,750	1,163,111	(19,361)
Insurance	307,500	240,166	67,334
Police	843,400	739,302	104,098
Fire	624,050	615,595	8,455
Streets	290,750	281,647	9,103
Community development	194,500	184,616	9,884
Parks and recreation	137,000	137,000	-0-
Capital Outlay	40,000	67,750	(27,750)
TOTAL EXPENDITURES	3,580,950	3,429,187	151,763
Excess of revenues over (under) expenditures	190,750	807,202	616,452
Other Financing Sources (uses):			
Operating transfers in	110,000	110,000	-0-
Interest expense	(88,385)	(88,290)	95
Payment of lease interest	-0-	(1,440)	(1,440)
Bond payment - City Hall	(80,000)	(80,000)	-0-
Bond payment - Clear Creek	(15,000)	(15,000)	-0-
Special assessment bond	82,000	54,159	(27,841)
Special assessment payment	(54,000)	(53,625)	375
Total Other Financing (Uses)	(45,385)	(74,196)	(28,811)
Excess of revenues and other sources over expenditures and other uses	145,365	733,006	587,641
Fund Balance, July 1, 2000	1,305,233	1,305,233	-0-
Fund Balance, June 30, 2001	\$ 1,450,598	\$ 2,038,239	\$ 587,641

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

CITY OF SHELBYVILLE
COMBINED STATEMENT OF REVENUES, EXPENDITURES AND CHANGES
IN FUND BALANCE – BUDGET AND ACTUAL - SPECIAL REVENUE FUNDS
FOR THE YEAR ENDED JUNE 30, 2001

	Budget	Actual	Variance - Favorable (Unfavorable)
REVENUES			
Intergovernmental			
State Grant	\$ 50,985	\$ 50,983	\$ (2)
Local Government Economic Assistance	2,200	2,251	51
Justice grant	88,034	88,034	-0-
Kentucky municipal aid	98,000	96,969	(1,031)
Community development block grant	2,350	2,412	62
Interest	4,637	6,073	1,436
TOTAL REVENUES	246,206	246,722	516
EXPENDITURES			
Current			
Street department	44,150	41,502	2,648
Police department	96,075	96,075	-0-
Community development	55,336	54,334	1,002
Capital outlay	26,000	27,943	(1,943)
TOTAL EXPENDITURES	221,561	219,854	1,707
Excess of revenues over (under) expenditures	24,645	26,868	2,223
Other Financing Sources (uses):			
Payment of lease principal	(23,900)	(23,900)	-0-
Payment of lease interest	(3,300)	(3,291)	9
Total Other Financing Sources (Uses)	(27,200)	(27,191)	9
Excess of revenues and other sources over (under) expenditures and other uses	(2,555)	(323)	2,232
Fund Balance, July 1, 2000	146,554	146,554	-0-
Fund Balance, June 30, 2001	\$ 143,999	\$ 146,231	\$ 2,232

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

CITY OF SHELBYVILLE
STATEMENT OF REVENUES, EXPENSES AND CHANGES
IN UNRESERVED RETAINED EARNINGS - BUDGET AND ACTUAL
PROPRIETARY FUNDS (WATER AND SEWER-COMPONENT UNIT)
FOR THE YEAR ENDED JUNE 30, 2001

	Budget	Actual	Variance - Favorable (Unfavorable)
TOTAL REVENUES	\$ 3,399,690	\$ 3,660,055	\$ 260,365
TOTAL EXPENSES	1,793,240	1,697,182	96,058
Excess of Revenues Over (Under) Expenses	1,606,450	1,962,873	356,423
Non-Operating Income (Expenses):			
Interest Expense	-0-	680,016	(680,016)
Depreciation and Amortization	-0-	947,643	(947,643)
	-0-	1,627,659	(1,627,659)
Income before operating transfers	1,606,450	335,214	(1,271,236)
Fund Transfers	-0-	(151,019)	(151,019)
Income after operating transfers	1,606,450	184,195	(1,422,255)
Retained Earnings, July 1, 2000	5,137,347	5,137,347	-0-
Retained Earnings, June 30, 2001	\$ 6,743,797	\$ 5,321,542	\$ (1,422,255)

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

CITY OF SHELBYVILLE
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN RETAINED EARNINGS
PROPRIETARY FUNDS (WATER AND SEWER-COMPONENT UNIT)
FOR THE YEAR ENDED JUNE 30, 2001
(with comparative amounts for 2000)

	2001	2000
OPERATING INCOME		
Sale of water	\$ 1,783,231	\$ 1,765,396
Sewer service	1,643,553	1,352,479
Other revenues	69,177	18,687
Interest earned	164,094	118,538
TOTAL OPERATING REVENUE	3,660,055	3,255,100
OPERATING EXPENSES		
Direct water expenses	587,516	573,022
Direct sewer expenses	398,182	370,723
Administrative expenses	711,484	699,505
TOTAL OPERATING EXPENSES	1,697,182	1,643,250
OPERATING INCOME BEFORE		
DEPRECIATION AND INTEREST	1,962,873	1,611,850
OTHER DEDUCTIONS		
Interest on long-term debt	680,016	568,825
Amortization - debt discount and expense	53,173	51,430
Depreciation - water plant	487,138	407,293
Depreciation - sewer plant	397,329	298,612
Depreciation - office building	10,003	10,003
TOTAL OTHER DEDUCTIONS	1,627,659	1,336,163
INCOME BEFORE OPERATING TRANSFERS	335,214	275,687
FUND TRANSFER TO GENERAL FUND	(151,019)	(151,395)
INCOME AFTER OPERATING TRANSFERS	184,195	124,292
RETAINED EARNINGS - BEGINNING OF YEAR	5,137,347	5,013,055
RETAINED EARNINGS - END OF YEAR	\$ 5,321,542	\$ 5,137,347

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

CITY OF SHELBYVILLE
STATEMENT OF CASH FLOWS
PROPRIETARY FUNDS (WATER AND SEWER-COMPONENT UNIT)
FOR THE YEAR ENDED JUNE 30, 2001
(with comparative amounts for 2000)

	2001	2000
<u>Operating Activities</u>		
Operating Income	\$ 335,214	\$ 275,687
Adjustment for non-cash operating activities		
Depreciation	894,470	715,908
Amortization	53,173	51,430
Changes in Operating Assets and Liabilities		
Accounts payable	58,334	(786,624)
Other accrued liabilities	(2,700)	17,145
Accounts receivable	(11,934)	(48,620)
Due from others	9,441	47,418
Inventory	(4,609)	1,784
Other assets	(212)	(572)
Customer deposits	9,979	10,929
Accrued interest - revenue bonds	5,965	2,179
Net Cash Provided By Operating Activities	1,347,121	286,664
 <u>Investing Activities</u>		
Purchase of assets	(1,014,155)	(2,139,199)
Funds and investments	(835,714)	1,596,353
Net Cash Used For Investing Activities	(1,849,869)	(542,846)
 <u>Non Capital Financing Activities</u>		
Operating transfers out - General Fund	(151,019)	(151,395)
Sanitation District No. 1 cash transfer	-0-	215,145
Net Cash Used for Non Capital Financing Activities	(151,019)	63,750

CITY OF SHELBYVILLE
STATEMENT OF CASH FLOWS
PROPRIETARY FUNDS (WATER AND SEWER-COMPONENT UNIT)
FOR THE YEAR ENDED JUNE 30, 2001
(with comparative amounts for 2000)

	2001	2000
<u>Financing Activities</u>		
Fixed Capital Lease-Bonds Retired	(415,000)	(380,000)
Fixed Capital Lease-Bonds Issued	715,000	-0-
Notes Payable - KY Infrastructure Authority	(112,616)	(64,195)
Notes Payable - Fiscal Court	-0-	(46,000)
Debt issue cost	(12,944)	583,430
Grants and contribution for construction	661,647	126,984
Net Cash Provided By Financing Activities	836,087	220,219
Increase in Cash and Cash Equivalents	182,320	27,787
Cash and Cash Equivalents, Beginning of Year	251,659	223,872
Cash and Cash Equivalents, End of Year	\$ 433,979	\$ 251,659
Supplemental Disclosure of Cash Flow Information		
Cash paid during the year for interest	\$ 696,310	\$ 566,645

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

CITY OF SHELBYVILLE
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN RETAINED EARNINGS
BUDGET AND ACTUAL - PROPRIETARY FUNDS (GOLF COURSE)
FOR THE YEAR ENDED JUNE 30, 2001

	Budget	Actual	Variance Favorable (Unfavorable)
TOTAL REVENUES	\$ 903,253	\$ 967,592	\$ 64,339
TOTAL EXPENSES	660,173	649,785	10,388
Excess of Revenues Over (Under) Expenses	243,080	317,807	74,727
Non-Operating Income (Expenses)			
Interest expense	(192,852)	(186,547)	6,305
Depreciation and Amortization	-0-	(59,188)	(59,188)
	(192,852)	(245,735)	(52,883)
Net Income	50,228	72,072	21,844
Retained Earnings, July 1, 2000	248,677	248,677	-0-
Retained Earnings, June 30, 2001	\$ 298,905	\$ 320,749	\$ 21,844

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

CITY OF SHELBYVILLE

STATEMENT OF REVENUES, EXPENSES AND CHANGES IN RETAINED EARNINGS

PROPRIETARY FUNDS (GOLF COURSE) FOR THE YEAR ENDED JUNE 30, 2001 (with comparative amounts for 2000)

	2001	2000
OPERATING INCOME		
Green fees	\$ 405,033	\$ 422,611
Driving range	22,307	18,863
Cart rental	266,227	298,155
Sale of merchandise	71,010	77,139
Sale of concessions	139,946	143,842
Season passes	39,177	34,087
Cart passes	15,750	14,000
Interest earned	5,351	2,870
Other revenue	2,791	5,724
TOTAL OPERATING REVENUE	967,592	1,017,291
OPERATING EXPENSES		
Group insurance	15,425	15,546
Driving range	3,053	3,606
Payroll taxes	16,921	15,742
Retirement expenses	12,621	13,015
Salaries	251,651	224,054
Utilities	18,493	15,218
Fuel and oil	4,730	4,293
Fertilizer/chemicals	101,747	67,347
Sand, seed and sod	2,425	3,801
Equipment repair and maintenance	23,218	16,899
Office expense	2,685	3,279
Advertising	1,632	1,698
Irrigation repairs	3,616	2,215
Merchandise	57,921	63,755
Concessions	69,024	70,845
Miscellaneous	1,274	2,555
Uniforms	901	528
Cart repairs	5,673	4,157
Building improvement	5,294	347
Professional fees	2,180	1,394
Dues, travel and training	2,106	1,811
Property maintenance	435	3,641
Credit card charges	6,154	6,079
Sales tax	-0-	791
Workman's comp	10,427	9,196
Building repair and maintenance	16,998	7,155
Course repair and maintenance	10,299	1,176
Handicap fees	2,882	2,090
TOTAL OPERATING EXPENSES	649,785	562,233
OPERATING INCOME BEFORE DEPRECIATION AND INTEREST	317,807	455,058

CITY OF SHELBYVILLE
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN RETAINED EARNINGS
PROPRIETARY FUNDS (GOLF COURSE) (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2001
(with comparative amounts for 2000)

	2001	2000
Operating Income Before Depreciation and Interest	\$ 317,807	\$ 455,058
Interest on long-term debt	186,547	190,418
Operating Income Before Depreciation	131,260	264,640
Other Deductions		
Amortization	775	775
Depreciation - golf course	58,413	63,888
TOTAL OTHER DEDUCTIONS	59,188	64,663
Income (Loss) before Operating Transfers	72,072	199,977
Transfer In	-0-	-0-
Net Income	72,072	199,977
RETAINED EARNINGS - JULY 1, 2000	248,677	48,700
RETAINED EARNINGS - JUNE 30, 2001	\$ 320,749	\$ 248,677

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

CITY OF SHELBYVILLE
STATEMENT OF CASH FLOWS - PROPRIETARY FUNDS (GOLF COURSE)
FOR THE YEAR ENDED JUNE 30, 2001
(with comparative amounts for 2000)

	2001	2000
Operating Activities		
Operating Income	\$ 72,072	\$ 199,977
Adjustment for non- cash operating activities		
Depreciation	58,413	63,888
Amortization	775	775
Changes in Operating Assets and Liabilities:		
Accounts Payable	17,586	(6,730)
Other assets	3,880	3,880
Other accrued liabilities	(4,983)	(7,822)
Inventory	(4,489)	66
Compensated absences	14,576	5,793
Net Cash Provided By Operating Activities	157,830	259,827
Investing Activities		
Purchase of assets	(82,313)	(50,126)
Sale of assets	-0-	-0-
Net Cash Used For Investing Activities	(82,313)	(50,126)
Financing Activities		
Payment on bond issue	(125,000)	(120,000)
Payments on lease obligation	(33,333)	(31,319)
Proceeds from note payable	60,699	25,853
Net Cash Provided By Financing Activities	(97,634)	(125,466)
Increase (Decrease) in Cash and Cash Equivalents	(22,117)	84,235
Cash and Cash Equivalents, Beginning of Year	558,593	474,358
Cash and Cash Equivalents, End of Year	\$ 536,476	\$ 558,593

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

CITY OF SHELBYVILLE
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2001

Note 1 - Summary of Significant Accounting Policies

The financial statements of the City of Shelbyville (City) are prepared in accordance with generally accepted accounting principles (GAAP). The City's reporting entity applies all relevant Governmental Accounting Standards Board (GASB) pronouncements. Proprietary funds apply Financial Accounting Standards Board (FASB) pronouncements and Accounting Principles Board (APB) opinions issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements, in which case, GASB prevails.

The accounting and reporting frame work and the more significant accounting principles and practices are discussed in subsequent sections of this note. The remainder of the notes are organized to provide explanations, including required disclosures of the City's financial activities for the fiscal year ended June 30, 2001.

A. Inventory

The inventory is priced at cost on the first-in, first-out basis.

B. Amortization

The debt issue expense is amortized by the debt outstanding method over the term of the issue.

C. Utility Assets:

All property and equipment is recorded at cost. Interest incurred on funds borrowed for construction is capitalized during the construction period. During the fiscal year ending June 30, 2001, \$22,259 was capitalized for construction in progress. Depreciation is provided using the straight-line method over the estimated useful lives of the assets.

D. Customer Deposits:

Interest is accrued at the rate of 6%, but not paid until service is discontinued.

E. New Customers:

New service connection fees are recorded as an addition to the equity of the water and sewer system. The cost of installation of the new service is recorded as an addition to water or sewer plant in service and is subject to depreciation.

CITY OF SHELBYVILLE

NOTES TO FINANCIAL STATEMENTS - CONTINUED

JUNE 30, 2001

Note 1 - Summary of Significant Accounting Policies (Continued)

F. Cash Equivalents:

For purposes of the statement of cash flows, the City of Shelbyville considers highly liquid investments (including restricted assets) with an original maturity of three months or less when purchased to be cash equivalents.

G. Total Columns (Memorandum Only)

Total columns on the Combined Statements are captioned "memo only" to indicate that they are presented only to aid in financial analysis. Interfund eliminations have not been made in the aggregation of this data; and it is, therefore, not comparable to a consolidation.

H. Fund Accounting

The accounts of the City are organized into funds and account groups, each of which is considered to be a separate accounting entity. The major fund categories and account groups are:

Governmental Fund Types

Governmental funds use the current financial resources measurement focus. Only current assets and current liabilities are generally included on their balance sheets. Their operating statements present sources and uses of available resources during a given period.

1.) General Fund:

The General Fund is the general operating fund of the City. It is used to account for all financial resources except those required to be accounted for in another fund.

2.) Special Revenue Funds:

Special Revenue Funds are used to account for the proceeds of specific revenue sources that are legally restricted to expenditures for specified purposes.

Proprietary Fund Types

Proprietary funds use the economic resources measurement focus. The accounting objectives are determination of net income, financial position, and cash flows. All assets and liabilities associated with a proprietary fund's activities are included on its balance sheet. Proprietary fund equity is segregated into contributed capital and retained earnings.

CITY OF SHELBYVILLE
NOTES TO FINANCIAL STATEMENTS - CONTINUED
JUNE 30, 2001

Note 1 - Summary of Significant Accounting Policies (Continued)

H. Fund Accounting- (Continued)

Proprietary Fund Types – (Continued)

1. The Shelbyville Municipal Water and Sewer System operates a combined water and sewer system, which serves Shelbyville and the surrounding area. The original Commission established in 1955 was dissolved, reestablished, and restructured during 1993. During 2000, the Shelby County Fiscal Court conveyed all property and assets of Sanitation District No. 1 to the Commission and the Commission assumed the debts and obligations of Sanitation District No. 1 to form a newly constituted Commission. The new Commission consists of seven voting members. The Mayor of the City of Shelbyville shall be one voting member and shall serve as chairperson. Three other members are to be appointed by the Mayor, with approval of the City Council. One of the three members appointed by the Mayor shall be a member of the City Council. Three members are to be appointed by the Shelby County Judge Executive, with approval of the Fiscal Court. One of the three members appointed by the Judge Executive shall be a member of the Fiscal Court. Since the City exercises oversight authority over the Water and Sewer Commission, it is treated as a component unit and its operations have been included herein as if it were part of the City's operations. Copies of the Water and Sewer System general purpose financial statements are available at their office. The Shelbyville Municipal Water and Sewer Commission is a proprietary entity of the City of Shelbyville. It derives its revenues primarily from water and sewer receipts.
2. The City of Shelbyville purchased and began operations of a municipal golf course during the 1991-1992 fiscal year. All employees are employed by the City. The City runs the day-to-day operations of the golf course; therefore, the activity has been included herein. The golf course derives its revenue primarily from green fee charges and cart rental fees.

Account Groups

The account groups are used to account for fixed assets and long-term liabilities which are not reported in the respective governmental funds.

I. Fixed Assets

General Fixed Assets

Generally accepted accounting principles for government accounting requires that general fixed assets owned by municipalities be recorded at cost, or if cost is not readily ascertainable, a reasonable estimate of cost, in a general fixed asset group of accounts. As of the balance sheet date, the City of Shelbyville's major equipment, buildings, lots and building contents total \$ 5,057,858.

CITY OF SHELBYVILLE

NOTES TO FINANCIAL STATEMENTS - CONTINUED JUNE 30, 2001

Note 1 - Summary of Significant Accounting Policies (Continued)

I. Fixed Assets – (Continued)

General Fixed Assets – (Continued)

Infrastructure fixed assets including streets, sidewalks and lighting systems are not reported as part of the General Fixed Assets Account Group. Infrastructure assets are recorded as expenditures, and are not capitalized. All other fixed assets are recorded as general fixed assets or as assets of proprietary funds. Expenditures for repairs and maintenance were charged to expense as incurred.

The Shelbyville-Shelby County City of Parks and Recreation is a joint venture whose City members are appointed as follows: four by the Shelby County Judge, four by the Mayor and one which they jointly appoint. For the year ended June 30, 2001, the City and County jointly provided operating funds of \$139,500 each. Copies of financial statements can be obtained at the Shelbyville-Shelby County City of Parks and Recreation offices.

J. Basis of Accounting

1. *Modified Accrual Basis of Accounting*

The City uses the modified accrual basis of accounting for governmental fund types. The modified accrual basis of accounting recognizes revenues when both “measurable and available.” Measurable means the amount can be determined. Available means collectible within the current period or soon enough thereafter to pay current liabilities. Also, under the modified accrual basis of accounting, expenditures are recorded when the related fund liability is incurred, except for general obligation bond principal and interest which are reported as expenditures in the year due.

Major revenue sources susceptible to accrual include: sales and use taxes, property taxes, franchise fees, insurance license fees and intergovernmental revenues.

2. *Accrual Basis of Accounting*

The accrual basis of accounting is used in proprietary fund types. The accrual basis of accounting recognizes revenues when earned. Expenses are recorded when incurred. No provision has been provided for doubtful accounts due to the amount determined to be uncollectible.

K. Debt Service Coverage

The debt service coverage is computed by dividing operating income before depreciation and interest on long-term debt by the maximum annual principal and interest coming due on all system debt outstanding in any year (including base rentals.) The fix rate lease purchase agreements require debt service coverage of 1.20.

CITY OF SHELBYVILLE

NOTES TO FINANCIAL STATEMENTS - CONTINUED JUNE 30, 2001

Note 1 - Summary of Significant Accounting Policies (Continued)

L. Budget Policy and Practice

The City and Water and Sewer Commission follows these procedures in establishing the budgetary data reflected in the financial statements:

- The Mayor and Office Administrator are responsible for preparing the proposed operating budgets prior to each fiscal year commencing on July 1. The proposed operating budget is submitted to the City Council for approval. The budget is legally enacted through passage of an ordinance.
- The Chairman submits an annual budget to the Commission at the May monthly meeting. The budget provides for any request by the Commission for surplus funds deposited in the name of the City. The annual budget is to be approved no later than June 30 of each year. Surplus funds in excess of the amount required to be maintained under the provision of the lease agreements between Kentucky Municipal Finance Corporation and the City of Shelbyville are to be deposited in the name of the City as provided in the lease agreements and may be transferred to the general fund of the City as provided in the lease agreements.
- Budgeted amounts are as originally adopted, or as amended by the City Council or by the Shelbyville Municipal Water and Sewer Commission. The budget for the City of Shelbyville was amended by vote of the City Council.

M. Encumbrances

Encumbrance accounting is used for the General Fund and special revenue funds. Encumbrances are recorded when purchase orders are issued but are not considered expenditures until liabilities for payments are incurred. Encumbrances are reported as a reservation of fund balance on the balance sheet. Encumbrances do not lapse at the close of the fiscal year but are carried forward as reserved fund balance until liquidated.

N. Budget Basis of Accounting

The budgets for the operating funds and proprietary fund operations are prepared on the cash and expenditures/encumbrances basis. Revenues are budgeted in the year receipt is expected; and expenditures, which include encumbrances, are budgeted in the year that the applicable purchase orders are expected to be issued. The budget and actual financial statements are reported on these bases. Unencumbered appropriations for annually budgeted funds lapse at fiscal year-end.

CITY OF SHELBYVILLE

NOTES TO FINANCIAL STATEMENTS - CONTINUED JUNE 30, 2001

Note 1 - Summary of Significant Accounting Policies (Continued)

O. Component Unit

The accompanying financial statements present the City's primary government and component units over which the City exercises significant influence. Significant influence or accountability is based primarily on operational or financial relationships with the City (as distinct from legal relationships).

Note 2 - Property Taxes

Property taxes are assessed on January 1 of each year. Tax bills are normally distributed in the fall of the same year and become payable upon receipt. Property taxes unpaid at May 1 of the following year are subject to lien filed against their property. The 2000 tax rate was 26.1 cents per \$100 valuation for motor vehicles and 48.0 for personal property taxes, and 21.9 cents per \$100 valuation for real estate taxes.

During July and August 2001, the City collected ad valorem taxes from prior years. Such amounts are recorded as property taxes receivable at June 30, 2001 and are as follows:

<u>Year</u>	<u>Amount</u>
1995	\$ 687
1996	705
1997	688
1998	976
1999	1,319
2000	<u>4,716</u>
Total	<u>\$ 9,091</u>

Note 3 - Municipal Road Aid

The City receives municipal aid from the Kentucky Department of Transportation to enable the City to meet their responsibilities for local streets and roads. The funds are restricted for construction and maintenance of roads only. As of June 30, 2001, the City had a carryover of \$128,695 from prior years and an excess of revenues over expenditures of \$6,207 for the current period.

CITY OF SHELBYVILLE

NOTES TO FINANCIAL STATEMENTS - CONTINUED JUNE 30, 2001

Note 4 - Community Development Block Grant Program

Fairway Crossing

Working in partnership with developer, Faulkner, Hinton and Associates, the City of Shelbyville will be providing infrastructure, utilities and road, to develop 15.07 acres for commercial use. The project will create 9 commercial spaces, including hotels, fast food, other restaurants, branch bank, and gas/convenience stores, which will provide 137 new jobs. The total infrastructure cost is \$1.422 million. Infrastructure activities associated with this development include a new water tower and the addition of a sewer line to the project site. The estimated price for an elevated tank is \$582,000 with an additional \$50,000 for connecting piping. Valves, telemetry and site work for a total of \$632,000. This amount is to be paid from CDBG funds. The cost to increase the tank size at a cost of approximately \$378,000 will be contributed by the City of Shelbyville.

Project records as of June 30, 2001:	CDBG grant
	<u>monies received</u>
Through June 30, 2000	\$ 800,250
Allowable expenses	(800,250)
Unexpended funds	<u>\$ -0-</u>

Note 5 - KML Lease Program

On June 30, 1997, the City entered into a seven-year agreement with the Kentucky League of Cities Small Issuer Lease Program for the purchase of a fire engine. On April 14, 2000, the City paid this lease agreement balance in full. In April 1999 the City entered into a five-year agreement with the Kentucky League of Cities Small Issuer Lease Program for the purchase of a street sweeper. During November 1999, the City entered an eight-year agreement with Fifth Third Bank for the purchase of an Effluent Water System. The lease is to be paid by the Water and Sewer Commission. On March 9, 2000, the City entered into a three-year lease agreement with Ford Motor Company for the purchase of two police cruisers. In September of 2000, the City entered into a three year lease agreement with Fifth Third Bank to purchase 2 police cruisers.

At June 30, 2001 the City had the following lease obligations:

	<u>Lease # 1</u>	<u>Lease # 2</u>	<u>Lease # 3</u>	<u>Lease # 4</u>	<u>Total</u>
Due in:					
one year	\$ 25,100	\$ 22,376	\$ 13,856	\$ 6,992	\$ 68,324
two years	24,900	23,580	-0-	7,208	55,688
three years	-0-	24,848		7,431	32,279
four years		26,184			26,184
five years		27,593			27,593
Due beyond five years	<u>-0-</u>	<u>14,348</u>	<u>-0-</u>	<u>-0-</u>	<u>14,348</u>
Total Obligation	<u>\$ 50,000</u>	<u>\$ 138,929</u>	<u>\$ 13,856</u>	<u>\$ 21,631</u>	<u>\$ 224,416</u>

CITY OF SHELBYVILLE

NOTES TO FINANCIAL STATEMENTS - CONTINUED JUNE 30, 2001

Note 6 - Compensated Absences

The City allows unlimited accumulation of vacation pay, which is payable upon termination of employment or used by the employee. Sick pay may be accrued to a maximum of 720 hours, but employees who voluntarily terminate employment or who are dismissed or laid off shall not be paid sick leave credit.

Accumulated unpaid vacation and sick leave is as follows:

	<u>June 30, 2001</u>	<u>June 30, 2000</u>
<u>VACATION PAY</u>		
Administration	\$ 13,597	\$ 14,065
Firemen	23,892	23,252
Police	21,966	21,511
Public Works	13,944	13,050
Golf Course	<u>18,551</u>	<u>11,360</u>
Total	<u>\$ 91,950</u>	<u>\$ 83,238</u>
<u>SICK LEAVE</u>		
Administration	\$ 30,615	\$ 22,788
Firemen	53,053	34,995
Police	84,597	73,042
Public Works	42,920	37,156
Golf Course	<u>23,946</u>	<u>16,560</u>
Total	<u>\$ 235,131</u>	<u>\$ 184,541</u>

Note 7 - Funds and Investments - Water and Sewer Commission

The Commission maintains numerous operating and restricted cash and cash investment accounts at various depository banks. At June 30, 2001, the carrying amount of the Commission's cash investments was \$2,657,235 and the various bank balances were \$1,302,057. All cash investments were treasury certificates or were covered by collateral in the form of pledged treasury certificates. All of the bank balances were covered by the \$100,000 federal depository insurance or pledged treasury certificates, with the exception of \$450,542.

Following is a schedule of the restricted funds and investments:

	Debt Service <u>Fund</u>	Debt Service <u>Reserve Fund</u>	Depreciation <u>Fund</u>	Construction <u>Funds</u>	Surplus <u>Funds</u>
Cash	\$ 239,691		\$ 386,660	\$ 1,448,419	\$ 174,295
U.S. Government Securities		<u>\$ 1,010,513</u>			
Total	<u>\$ 239,691</u>	<u>\$ 1,010,513</u>	<u>\$ 386,660</u>	<u>\$ 1,448,419</u>	<u>\$ 174,295</u>

CITY OF SHELBYVILLE

NOTES TO FINANCIAL STATEMENTS - CONTINUED JUNE 30, 2001

Note 7 - Funds and Investments - Water and Sewer Commission – (Continued)

The fixed rate lease purchase agreement dated November 25, 1991 requires that the Commission establish various funds and accounts and makes various monthly transfers. The Commission is in compliance with this requirement, except for their surplus fund is under funded by \$503. The series 1999A fixed rate lease purchase agreement dated June 1, 1999 also requires that the Commission establish various funds and accounts and make various monthly transfers. The Commission is in compliance with this requirement.

Note 8 - Utility Plant

The water system was acquired from the Kentucky Water Service Company and all subsequent additions are recorded at cost. The sewer system is not recorded at cost. The actual cost to the Commission was the payment of outstanding Sewerage System Revenue Bonds in the amount of \$9,000. An appraisal made at the time of acquisition showed the system to have a net sound value of \$200,000. Consequently, entries were made in the Commission's records recording this amount as an asset. Subsequent additions have been recorded at cost. April 1, 2000 the Sanitation Districts assets were transferred to the Commission with a net book value of \$958,688.

Following is a schedule of the utility plant:

	<u>2001</u>	<u>2000</u>
<u>Water Plant</u>		
Source of supply land	\$ 5,000	\$ 5,000
Power of pumping land	21,500	21,500
Source of supply structures	4,633,210	4,627,273
Pumping structures	236,169	236,169
Standpipes	2,251,498	2,251,498
Purification system	2,378,346	2,361,640
Dam and line	240,963	240,963
Shop building	16,000	16,000
Miscellaneous structures	40,915	31,620
Pumping equipment	2,246,964	2,242,444
Distribution mains	4,534,467	4,526,856
Services and meters	1,388,870	1,300,002
Hydrants	<u>199,538</u>	<u>191,742</u>
Total water plant	18,193,440	18,052,707

CITY OF SHELBYVILLE

NOTES TO FINANCIAL STATEMENTS - CONTINUED

JUNE 30, 2001

Note 8 - Utility Plant – (Continued)

Sewer Plant

Land	\$ 42,900	\$ 42,900
Structures	3,250,919	3,245,673
Distribution lines	7,406,339	7,365,446
Manholes	266,866	253,097
Disposal plant equipment	6,388,799	5,891,209
Office furniture and fixtures	<u>18,097</u>	<u>18,097</u>
Total sewer plant	17,373,920	16,816,422

Administrative and General

Land and building	450,744	450,744
Office furniture and fixtures	172,339	168,357
Transportation equipment	372,648	346,092
Shop equipment	<u>353,013</u>	<u>349,048</u>
Total administrative and general	1,348,744	1,314,241

Construction in Progress

Water plant	5,748	1,260
Sewer plant	<u>350,710</u>	<u>73,777</u>
Total construction in progress	<u>356,458</u>	<u>75,037</u>
Total utility plant	<u>\$ 37,272,562</u>	<u>\$ 36,258,407</u>

Note 9 - Unamortized Debt Issue Expense

This amount arose from the issuance of revenue bonds and is being amortized by the bonds outstanding method. During 1991, all earlier bond issues were retired with a capital lease. The refunding cost and the unamortized expenses of the earlier issues are shown as an additional unamortized expense of the 1991 capital lease and are being amortized over a 20-year period. During 1998, a portion of the capital lease was defeased and the remainder is still being amortized over the remaining 20-year period. The portion that was defeased and the new issuance costs is also being amortized over a 20-year period. April 1, 2000 the Sanitation District's assets and liabilities were merged with the Commission. This resulted in additional unamortized debt issue expense that is also being amortized over a 20-year period. July 14, 2000 new revenue bonds were issued. The new issuance costs is also being amortized over a 20 year period.

CITY OF SHELBYVILLE

NOTES TO FINANCIAL STATEMENTS - CONTINUED JUNE 30, 2001

Note 10 - Fixed Rate Lease Obligation

On November 25, 1991, the City of Shelbyville entered into a fixed rate lease purchase agreement with the Kentucky Municipal Finance Corporation as lessor. Under the agreement, revenue bonds of \$7,995,000 were sold at par. Proceeds were used to retire all outstanding revenue bonds and other long-term lease obligations.

The bonds sold under the lease agreement will be retired over a period of twenty (20) years with interest rates from 4.6% to 6.7%. The annual base period rentals, including interest and fiduciary fees, under the agreement range from \$328,138 to \$336,105. The agreement establishes special trust funds as follows: General Revenue Fund, Debt Service Fund, Debt Service Reserve, Operation and Maintenance Fund, Depreciation Fund, and Surplus Fund. These funds are being maintained as required by the agreement except for the surplus fund, which is under funded by \$503. As provided under the Surplus Fund, \$151,019 was transferred to the City of Shelbyville General Fund during the fiscal year. At June 30, 2001 the Commission did comply with the required debt service coverage of 1.20.

On June 1, 1998 the City of Shelbyville entered into a fixed rate lease purchase agreement with the Kentucky Municipal Finance Corporation as lessor. Under the agreement, revenue bonds of \$9,540,000 were sold at par. \$3,607,880 of these funds was used to purchase US government securities. Those securities are deposited in an irrevocable trust with an escrow agent to provide for all future debt payments on a portion of the 1991 lease purchase agreement. As a result the fixed rate lease portion held in escrow is considered defeased and the liability has been removed from the balance sheet.

The bonds sold under the new (1998) lease agreement will be retired over a period of twenty (20) years with interest rates from 4.0% to 5.15%. The annual base period rentals, including interest, under the agreement range from \$680,515 to \$1,025,213. The new agreement establishes special trust funds as follows: Administrative Expense Fund, Project Acquisition Fund, Rental Payment Fund, Debt Service Reserve Fund, and the Rebate Fund. These funds have been established and maintained as required by the agreement.

On July 14, 2000 the City of Shelbyville entered into a fixed rate lease purchase agreement with the Kentucky League of Cities Funding Trust as lessor. Under the agreement, revenue bonds of \$715,000 were sold at par. Proceeds were used for water and sewer line extension and expansion.

The bonds sold under the lease agreement will be retired over a period of twenty (20) years with variable interest rates. The assumed rate of interest for base rental payments is 4.18%. After notice from the lessor, the Commission will either receive a credit against base rental payable on July 15, of each fiscal year in an amount equal to the excess, if any, of the aggregate of the interest components of base rentals paid by the Commission in the preceding fiscal year (at the assumed interest rate) over the

CITY OF SHELBYVILLE

NOTES TO FINANCIAL STATEMENTS - CONTINUED JUNE 30, 2001

Note 10 - Fixed Rate Lease Obligation – (Continued)

Commissions' proportionate share of all interest paid on variable rate bonds or the Commission will immediately pay as additional rentals, an amount equal to the excess, if any, of the Commission's proportionate share of all interest paid or to be paid on variable rate bonds over the aggregate on the interest components of base rentals then required to be paid by the Commission (at the assumed interest rate). Prior to May 1 of each fiscal year during the lease term, the lessor will inform the Commission of the amount of additional rentals that are estimated to be payable during the next ensuing fiscal year. The annual base period rentals, including interest and fiduciary fees, under the agreement range from \$40,729 to \$68,591

Outstanding revenue bonds under the lease agreement July 1, 2000	\$ 11,635,000
Bonds retired during the fiscal year	(415,000)
New bonds issued during the fiscal year	<u>715,000</u>
Bonds outstanding June 30, 2001	\$ 11,935,000
Current bonds outstanding	<u>(440,000)</u>
 Long term bonds outstanding	 <u>\$ 11,495,000</u>

Future maturities of long-term debt

<u>Due date</u>	<u>Interest rate</u>	<u>Amount</u>
2002	4.25 – 6.25	\$ 460,000
2003	4.30 – 6.35	480,000
2004	4.40 – 6.45	505,000
2005	4.50 – 6.55	535,000
2006	4.55 – 6.70	560,000
Thereafter	4.60 – 6.70	<u>8,955,000</u>
Total		<u>\$ 11,495,000</u>

Note 11 – Notes Payable – KY Infrastructure Authority

On March 7, 2000 the Commission assumed the remaining unpaid portion of the debt as part of the Commission's assumption of the obligation to provide sewer service to the territory of the Sanitation District. The unpaid portion at March 7, 2000 was \$1,799,494. The KIA loan consists of two separate loans. Fund A original loan was \$1,402,737 at 2.6% with semi-annual principal and interest payments due on June 1 and December 1. Fund C original loan was \$774,511 at 4.5% to 6.375% with payments due January 1 and July 1.

CITY OF SHELBYVILLE

NOTES TO FINANCIAL STATEMENTS - CONTINUED JUNE 30, 2001

Note 11 – Notes Payable – KY Infrastructure Authority – (Continued)

Future maturities of these notes:

<u>Due date</u>	<u>Interest rate</u>	<u>Amount</u>
2001	2.60 – 5.337	\$ 101,487
2002	2.60 – 5.411	105,436
2003	2.60 – 5.509	109,406
2004	2.60 – 5.621	112,872
2005	2.60 – 4.125	116,915
Thereafter	2.60 – 4.750	<u>1,002,977</u>
Total Outstanding		<u>\$ 1,549,093</u>

Note 12 - Contributions in Aid of Construction

This amount consists of facilities paid for by customers and turned over to the Commission. For periods after July 1, 1978 new meter installation charges are credited to the account. On March 23, 1989, a new ordinance was passed for a system development charge to provide for capital improvements and future expansions to the water and sewer system.

Note 13 - Municipal Contribution

As mentioned in Note 8 on the valuation of the sewer system, this amount represents the excess of the system carried on the books over the cost to the Commission.

Note 14 – Sanitation District No. 1 Contribution

As mentioned in Note 8, this amount represents net assets transferred from Sanitation District No. 1.

Note 15 - Grants

The Commission has received grants from the federal and state governments for new construction and improvements to the water and sewer system. In June 30, 2001 fiscal year, \$400,000 Community Development Block Grant monies were secured by the Shelby County Fiscal Court for the Meadowbrook Sewer System Project.

CITY OF SHELBYVILLE

NOTES TO FINANCIAL STATEMENTS - CONTINUED

JUNE 30, 2001

Note 16 - Funds and Investments

The City of Shelbyville maintains numerous accounts at various depository banks. All of the bank balances were covered by the \$100,000 federal depository insurance. The City has pledged securities for those accounts with balances over \$100,000.

Effective January 1, 1995, the General Assembly enacted KRS 66.480 which limits investments of public funds generally to obligations of the U.S. and certain of its agency and instrumentality, certificates of deposits or other interest-bearing accounts of FDIC insured banks or savings and loan institutions.

Note 17 - Pension Plan

The City and Commission provide pension benefits for regular full-time employees with at least 100 hours of work per month. These benefits are provided under the County Employees Retirement System (CERS) of the state of Kentucky. Regular full-time employees are required to participate. The plan is included in the Annual Report of the Kentucky Retirement Systems. A copy may be obtained from the Kentucky Retirement Systems, Perimeter Park West, 1260 Louisville Road, Frankfort, Kentucky 40601.

Plan Description for Non-Hazardous and Hazardous Employees - CERS is a cost-sharing multiple-employer defined benefit pension plan that covers substantially all regular full-time members employed in non-hazardous duty positions of each county and school board, and any additional eligible local agencies electing to participate in the System. The plan provides for retirement, disability, and death benefits to plan members. Retirement benefits may be extended to beneficiaries of plan members under circumstances. Cost-of-living (COLA) adjustments are provided at the discretion of the State legislature.

Contributions for Non-Hazardous - For the year ended, June 30, 2000 and 1999, plan members were required to contribute 5% of their annual creditable compensation. Participating employers were required to contribute at an actuarially determined rate. Per Kentucky Revised Statute Section 61.565(3), normal contribution and past service contribution rates shall be determined by the Board on the basis of an annual valuation last preceding the July 1 of a new biennium. The Board may amend contribution rates as of the first day of July of the second year of a biennium, if it is determined on the basis of a subsequent actuarial valuation that amended contribution rates are necessary to satisfy requirements determined in accordance with actuarial bases adopted by the Board. For the year ended June 30, 2000 and 1999, participating employers contributed 7.28% and 8.22%, respectively, of each employee's creditable compensation. The actuarially determined rate set by the Board for the Year ended June 30, 2000 and 1999, was 7.28% and 8.22%, respectively, of creditable compensation. Administrative costs of Kentucky Retirement System are financed through employer contributions and investment earnings.

CITY OF SHELBYVILLE

NOTES TO FINANCIAL STATEMENTS - CONTINUED

JUNE 30, 2001

Note 17 - Pension Plan – (Continued)

Contributions for Hazardous - For the year ended, June 30, 2000 and 1999, plan members were required to contribute 8% of their annual creditable compensation. The State was required to contribute at an actuarially determined rate. Per Kentucky Revised Statute Section 61.565(3), normal contribution and past service contribution rates shall be determined by the Board on the basis of an annual valuation last preceding the July 1 of a new biennium. The Board may amend contribution rates as of the first day of July of the second year of a biennium, if it is determined on the basis of a subsequent actuarial valuation that amended contribution rates are necessary to satisfy requirements determined in accordance with actuarial bases adopted by the Board. For the year ended June 30, 2000 and 1999, participating employers contributed 17.55% and 18.85%, respectively, of each employee's creditable compensation. The actuarially determined rate set by the Board for the year ended June 30, 2000 and 1999, was 17.55% and 18.85%, respectively, of creditable compensation. Administrative costs of Kentucky Retirement System are financed through employer contributions and investment earnings.

The City's current year payroll was \$872,995 for non-hazardous and \$1,267,069 for hazardous. The City made the required contributions for the fiscal year amounting to \$263,221. \$243,322 and \$222,230 were contributed for June 30, 2000 and 1999 respectively. The Commission and covered employees made the required contributions for the fiscal year amounting to \$96,043. \$88,235 and \$86,978 were contributed for June 30, 2000 and 1999 respectively.

Note 18 - Weissinger Hills Golf Course Bonds Payable

On October 26, 1992, the City of Shelbyville and Shelbyville Public Recreation Corporation declared a bond issue for the sum of \$3,200,000. These proceeds were to be used for the retirement of the note payable used for purchasing the Weissinger Hills Golf Course. A bond payment schedule, along with interest rates is included within these financial statements. This bond issue is for a term of 20 years. A portion of the bond proceeds in the amount of \$103,651 was used to cover bond issuance costs, which will be amortized over the life of the bonds. In addition to the bond issuance costs, \$314,375 was used to purchase U.S. Treasury Strips with Liberty National Bank of Louisville serving as trustee. These strips were set up as a reserve fund to aid in the retirement of these bonds.

On May 14, 1999, the City of Shelbyville declared a bond issue for the sum of \$3,880,000. Proceeds were used to retire all outstanding revenue bonds from the October 26, 1992 bond issuance and purchase of land adjacent to the golf course. A bond payment schedule, along with interest rates is included within these financial statements. This bond issue is for a term of 20 years. A portion of the bond proceeds in the amount of \$15,500 were used to cover bond issuance cost which will be amortized over the life of the bond. In addition, the bonds were issued at a discount of \$77,600, which is being amortized over the life of the bond. However, the advance refunding resulted in the recognition of an accounting loss of \$279,598.

CITY OF SHELBYVILLE

NOTES TO FINANCIAL STATEMENTS - CONTINUED

JUNE 30, 2001

Note 18 - Weissinger Hills Golf Course Bonds Payable – (Continued)

Debt maturities are as follows:

Principal due October 1,		
2001	\$	130,000
2002		140,000
2003		145,000
2004		155,000
2005		<u>160,000</u>
		730,000
Due beyond 2006		<u>2,775,000</u>
Total		<u>\$3,505,000</u>

Note 19 - Lease Obligations - Weissinger Hills Golf Course

In March 1999, the City (Weissinger Hills Golf Course) entered into a lease agreement with TFC Textron for the purchase of new golf carts. The lease agreement is for a six year period.

At June 30, 2001 the City had the following lease obligation:

	<u>Lease</u>
Due in: one year	\$ 35,477
two years	37,759
three years	40,189
four years	-0-
five years	-0-
Due beyond five years	<u>-0-</u>
Total Obligations	<u>\$ 113,425</u>

Note 20 – Loan Commitment

The City of Shelbyville entered an agreement with Shelby County Trust Bank for a commitment of a \$110,000 term loan at a rate of 7.5% of prime floating to adjust as prime changes. The unsecured loan is for the construction of a storage repair building on Weissinger Golf Course. As of June 30, 2001, The City had received \$84,937 of this commitment.

CITY OF SHELBYVILLE

NOTES TO FINANCIAL STATEMENTS - CONTINUED

JUNE 30, 2001

Note 21 - Fixed Assets

A summary of changes in general fixed assets follows:

	<u>Balance</u> <u>July 1, 2000</u>	<u>Additions</u>	<u>Deductions</u>	<u>Balance</u> <u>June 30, 2001</u>
Land	\$ 815,000			\$ 815,000
Buildings	1,916,531			1,916,531
Equipment	<u>2,285,819</u>	<u>\$ 40,508</u>	<u>\$ -0-</u>	<u>2,326,327</u>
Totals	<u>\$ 5,017,350</u>	<u>\$ 40,508</u>	<u>\$ -0-</u>	<u>\$ 5,057,858</u>

A summary of changes in proprietary fund type (golf course) fixed assets follows:

	<u>Balance</u> <u>July 1, 2000</u>	<u>Additions</u>	<u>Deductions</u>	<u>Balance</u> <u>June 30, 2001</u>
Land	\$ 2,956,223			\$ 2,956,223
Buildings	358,286	\$ 77,560		435,846
Equipment	<u>538,823</u>	<u>4,753</u>	<u>\$ -0-</u>	<u>543,576</u>
Sub-Total	3,853,332	82,313	-0-	3,935,645
Less accumulated Depreciation	<u>374,995</u>	<u>58,413</u>	<u>-0-</u>	<u>433,408</u>
Totals	<u>\$ 3,478,337</u>	<u>\$ 23,900</u>	<u>\$ -0-</u>	<u>\$ 3,502,237</u>

Note 23 - Risk Management

The City of Shelbyville is exposed to various risks and losses related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The City currently carries property and general liability insurance through the Kentucky Municipal Risk Management Association. Workman's Compensation insurance is carried through the Kentucky League of Cities. The City reports all of its risk management activities in its General Fund and Golf Course Fund.

CITY OF SHELBYVILLE
COMBINING BALANCE SHEET - ALL PROPRIETARY FUNDS
JUNE 30, 2001
(with comparative amounts for 2000)

<u>ASSETS</u>	Golf Course Fund	Water & Sewer Fund	Totals (Memorandum Only)	
			2001	2000
Cash	\$ 192,976		\$ 192,976	\$ 216,006
Restricted cash		\$ 408,889	408,889	226,569
Restricted funds and investments	343,500	3,259,579	3,603,079	2,766,452
Savings & Certificates of Deposits		25,090	25,090	25,090
Accounts Receivable		346,740	346,740	334,806
Due from others		9,522	9,522	18,963
Materials inventory	21,800	79,194	100,994	91,896
Other assets		967	967	755
Utility fixed assets		37,438,214	37,438,214	36,424,059
Unamortized debt discount & expenses	78,747	494,256	573,003	617,887
Land	2,956,223		2,956,223	2,956,223
Golf course fixed assets	979,422		979,422	897,109
Accumulated depreciation	<u>(433,408)</u>	<u>(11,006,036)</u>	<u>(11,439,444)</u>	<u>(10,486,561)</u>
TOTAL ASSETS	<u>\$ 4,139,260</u>	<u>\$ 31,056,415</u>	<u>\$ 35,195,675</u>	<u>\$ 34,089,254</u>

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

CITY OF SHELBYVILLE
COMBINING BALANCE SHEET – ALL PROPRIETARY FUNDS (CONTINUED)
JUNE 30, 2001
(with comparative amounts for 2000)

<u>LIABILITIES AND FUND EQUITY</u>	<u>Golf Course Fund</u>	<u>Water & Sewer Fund</u>	<u>Totals (Memorandum Only)</u>	
			<u>2001</u>	<u>2000</u>
Liabilities				
Accounts payable	\$ 27,742	\$ 70,294	\$ 98,036	\$ 70,851
Accrued payroll	922		922	1,460
Accrued expenses and withholdings	11,743	30,119	41,862	52,296
Notes payable - bank	86,552		86,552	25,853
Notes Payable - KY Infrastructure Authority		1,549,093	1,549,093	1,661,709
Obligations under capital lease agreement	113,425		113,425	546,758
Obligations for compensated absences	42,496		42,496	27,920
Accrued interest	30,631	8,144	38,775	33,831
Fixed rate lease obligation		11,935,000	11,935,000	11,235,000
Accounts payable - construction		71,214	71,214	22,479
Customer deposits		109,372	109,372	99,393
Accrued interest - customer deposits		50,044	50,044	45,734
Revenue bonds outstanding	3,505,000		3,505,000	3,630,000
TOTAL LIABILITIES	3,818,511	13,823,280	17,641,791	17,453,284
Retained Earnings - unreserved				
Retained Earnings - unreserved	320,749	5,321,542	5,642,291	5,386,024
Contribution in aid of construction		3,979,484	3,979,484	3,717,837
Municipal contribution		155,962	155,962	155,962
Sanitation District No. 1 contribution		958,688	958,688	958,688
Grants		6,817,459	6,817,459	6,417,459
TOTAL FUND EQUITY	320,749	17,233,135	17,553,884	16,635,970
TOTAL LIABILITIES & FUND EQUITY	\$ 4,139,260	\$ 31,056,415	\$ 35,195,675	\$ 34,089,254

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

CITY OF SHELBYVILLE
COMBINING BALANCE SHEET – ALL SPECIAL REVENUE FUND TYPES

JUNE 30, 2001

(with comparative amounts for 2000)

	Special Grants Fund	Community Development Block Grant Fund	Municipal Road Aid Fund	LGEA Coal Severance Fund	Justice Grant Fund	Local Law Enforcement Block Grant	Public Properties Fund	TOTALS (MEMORANDUM ONLY)	
								2001	2000
<u>ASSETS</u>									
Cash			\$ 96,369		\$ 1	\$ 1	\$ 5,302	\$ 101,673	\$ 105,370
Savings & certificates of deposits			40,297	\$ 6,025				46,322	43,262
TOTAL ASSETS	\$ -0-	\$ -0-	\$ 136,666	\$ 6,025	\$ 1	\$ 1	\$ 5,302	\$ 147,995	\$ 148,632
<u>LIABILITIES AND FUND EQUITY</u>									
Liabilities									
Accounts payable			\$ 1,764					\$ 1,764	\$ 2,078
Notes payable								-0-	-0-
TOTAL LIABILITIES	\$ -0-	\$ -0-	\$ 1,764	\$ -0-	\$ -0-	\$ -0-	\$ -0-	\$ 1,764	\$ 2,078
Fund Equity									
Reserved fund balance	-0-	-0-	134,902	6,025	1	1	5,302	146,231	146,554
TOTAL FUND EQUITY	-0-	-0-	134,902	6,025	1	1	5,302	146,231	146,554
TOTAL LIABILITIES & FUND EQUITY	\$ -0-	\$ -0-	\$ 136,666	\$ 6,025	\$ 1	\$ 1	\$ 5,302	\$ 147,995	\$ 148,632

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

CITY OF SHELBYVILLE

COMBINING STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCECS – ALL SPECIAL REVENUE FUND TYPES

FOR THE YEAR ENDED JUNE 30, 2001 (with comparative amounts for 2000)

	Special Grants Fund	Community Development Block Grant Fund	Municipal Road Aid Fund	LGEA Coal Severance Fund	Justice Grant Fund	Local Law Enforcement Block Grant	Public Properties Fund	TOTALS (MEMORANDUM ONLY)	
								2001	2000
Revenues									
State grant	\$ 50,983						\$ -0-	\$ 50,983	\$ 162,431
Local Government Economic Assistance				\$ 2,251				2,251	1,953
Justice grant					\$ 88,034			88,034	53,018
Law Enforcement grant								-0-	15,709
Kentucky municipal aid			\$ 96,969					96,969	100,715
Community development block grant		\$ 2,250						2,250	138,716
Total Operating Revenues	<u>50,983</u>	<u>2,250</u>	<u>96,969</u>	<u>2,251</u>	<u>88,034</u>	<u>\$ -0-</u>	<u>-0-</u>	<u>240,487</u>	<u>472,542</u>
Expenses									
Street department			41,502					41,502	59,102
Police Department					88,034	8,041		96,075	78,984
Community development	50,983	2,351		1,000				54,334	308,973
Capital Outlay			27,943					27,943	448,748
	<u>50,983</u>	<u>2,351</u>	<u>69,445</u>	<u>1,000</u>	<u>88,034</u>	<u>8,041</u>	<u>-0-</u>	<u>219,854</u>	<u>895,807</u>
Excess of revenue over (under) expenses	-0-	(101)	27,524	1,251	-0-	(8,041)	-0-	20,633	(423,265)
Non-Operating Revenue (Expenses):									
Interest income			5,874	162		37	162	6,235	6,595
Transfers In								-0-	474,989
Transfers (Out)								-0-	-0-
Total Non-Operating Revenue (Expenses)	<u>-0-</u>	<u>-0-</u>	<u>5,874</u>	<u>162</u>	<u>-0-</u>	<u>37</u>	<u>162</u>	<u>6,235</u>	<u>481,584</u>

CITY OF SHELBYVILLE

COMBINING STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCECS – ALL SPECIAL REVENUE FUND TYPES

FOR THE YEAR ENDED JUNE 30, 2001 (with comparative amounts for 2000) (cont'd)

	Special Grants Fund	Community Development Block Grant Fund	Municipal Road Aid Fund	LGEA Coal Severance Fund	Justice Grant Fund	Local Law Enforcement Block Grant	Public Properties Fund	TOTALS (MEMORANDUM ONLY)	
								2001	2000
Other Financing Sources (Uses):									
Payment of lease principal			(23,900)					(23,900)	(22,700)
Payment of lease interest			(3,291)					(3,291)	(4,404)
Total Other Financing Sources (Uses)	-0-	-0-	(27,191)	-0-	-0-	-0-	-0-	(27,191)	(27,104)
(Expenses)									
Excess of revenues & other sources over (under)									
expenses & other uses	-0-	(101)	6,207	1,413	-0-	(8,004)	162	(323)	31,215
Fund Balances, Beginning of year	-0-	101	128,695	4,612	1	8,005	5,140	146,554	115,339
Fund Balances, End of year	\$ -0-	\$ -0-	\$ 134,902	\$ 6,025	\$ 1	\$ 1	\$ 5,302	\$ 146,231	\$ 146,554

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

CITY OF SHELBYVILLE
COMBINED STATEMENT OF REVENUES, EXPENDITURES AND CHANGES
IN FUND BALANCES - BUDGET AND ACTUAL - ALL SPECIAL REVENUE FUND TYPES
FOR THE YEAR ENDED JUNE 30, 2001

	CDBG Fund			Municipal Road Aid Fund			LGEA Coal Severance Fund		
	Budget	Actual	Variance Favorable (Unfavorable)	Budget	Actual	Variance Favorable (Unfavorable)	Budget	Actual	Variance Favorable (Unfavorable)
REVENUES									
Intergovernmental									
State Grant									
Local Government Economic Assistance							\$ 2,200	\$ 2,251	\$ 51
Justice grant									
Law Enforcement grant									
Kentucky municipal aid				\$ 98,000	\$ 96,969	\$ (1,031)			
Community Development	\$ 2,250	\$ 2,250	\$ -0-				100	162	62
Interest				4,500	5,874	1,374			
Total Revenues	<u>2,250</u>	<u>2,250</u>	<u>-0-</u>	<u>102,500</u>	<u>102,843</u>	<u>343</u>	<u>2,300</u>	<u>2,413</u>	<u>113</u>
EXPENDITURES									
Street Department				44,150	41,502	2,648			
Police Department									
Community Development	2,351	2,351	-0-				2,000	1,000	1,000
Capital Outlay				26,000	27,943	(1,943)			
Total expenditures	<u>2,351</u>	<u>2,351</u>	<u>-0-</u>	<u>70,150</u>	<u>69,445</u>	<u>705</u>	<u>2,000</u>	<u>1,000</u>	<u>1,000</u>
Excess of Revenues Over									
(Under) Expenditures	(101)	(101)	-0-	32,350	33,398	1,048	300	1,413	1,113

CITY OF SHELBYVILLE
COMBINED STATEMENT OF REVENUES, EXPENDITURES AND CHANGES
IN FUND BALANCES - BUDGET AND ACTUAL - ALL SPECIAL REVENUE FUND TYPES
FOR THE YEAR ENDED JUNE 30, 2001 (cont'd)

	CDBG Fund			Municipal Road Aid Fund			LGEA Coal Severance Fund		
	Budget	Actual	Variance	Budget	Actual	Variance	Budget	Actual	Variance
			Favorable			Favorable			Favorable
			(Unfavorable)			(Unfavorable)			(Unfavorable)
OTHER FINANCING									
SOURCES (USES)									
Transfers In (Out)									
Payment of lease principal				(23,900)	(23,900)	-0-			
Payment of lease interest				(3,300)	(3,291)	(9)			
Total Other Financing									
Sources (Uses)	-0-	0-	-0-	(27,200)	(27,191)	(9)	-0-	0-	-0-
Excess of Revenues and Other									
Sources Over (Under)									
Expenses and Other Uses	(101)	(101)	-0-	5,150	6,207	1,039	300	1,413	1,113
Fund Balance, July 1, 2000	101	101	-0-	128,695	128,695	-0-	4,612	4,612	-0-
Fund Balance, June 30, 2001	\$ -0-	\$ -0-	\$ -0-	\$ 133,845	\$ 134,902	\$ 1,039	\$ 4,912	\$ 6,025	\$ 1,113

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

CITY OF SHELBYVILLE
 COMBINED STATEMENT OF REVENUES, EXPENDITURES AND CHANGES
 IN FUND BALANCES - BUDGET AND ACTUAL -
 ALL SPECIAL REVENUE FUND TYPES (CONTINUED)
 FOR THE YEAR ENDED JUNE 30, 2001

	Special Grants Fund			Public Properties Corp.			Justice Grants Fund			Local Law Enforcement Grant		
	Budget	Actual	Variance Favorable (Unfavorable)	Budget	Actual	Variance Favorable (Unfavorable)	Budget	Actual	Variance Favorable (Unfavorable)	Budget	Actual	Variance Favorable (Unfavorable)
REVENUES												
Intergovernmental												
State grant	\$50,985	\$50,983	\$ (2)									
Local Government Economic Assistance							\$88,034	\$88,034	\$ -0-			
Justice grant												
Law Enforcement grant												
Kentucky municipal aid												
Community development block grant												
Interest				\$ 100	\$ 162	\$ 62				\$ 37	\$ 37	\$
TOTAL REVENUES	<u>50,985</u>	<u>50,983</u>	<u>(2)</u>	<u>100</u>	<u>162</u>	<u>62</u>	<u>88,034</u>	<u>88,034</u>	<u>-0-</u>	<u>37</u>	<u>37</u>	<u></u>
EXPENDITURES												
Street Department												
Police Department							88,034	88,034	-0-	8,041	8,041	
Community Development	50,985	50,983	2									
Capital Outlay				-0-	-0-	-0-						
TOTAL EXPENDITURES	<u>50,985</u>	<u>50,983</u>	<u>2</u>	<u>-0-</u>	<u>-0-</u>	<u>-0-</u>	<u>88,034</u>	<u>88,034</u>	<u>-0-</u>	<u>8,041</u>	<u>8,041</u>	<u></u>
Excess of revenues over (under) Expenditures	-0-	-0-	-0-	100	162	62	-0-	-0-	-0-	(8,004)	(8,004)	
OTHER FINANCING SOURCES (USES)												
Transfers In (Out)												
Payment of lease principal												
Payment of lease interest												
Total Other Financing Sources (Uses)	<u>-0-</u>	<u>-0-</u>	<u>-0-</u>	<u>-0-</u>	<u>-0-</u>	<u>-0-</u>	<u>-</u>	<u>-0-</u>	<u>-0-</u>	<u>-0-</u>	<u>-</u>	<u>-0-</u>
Excess of Revenues and Other Sources Over (Under) Expenses and Other Uses	-0-	-0-	-0-	100	162	62	-0-	-0-	-0-	(8,004)	(8,004)	
Fund Balances - July 1, 2000	-0-	-0-	-0-	5,140	5,140	-0-	1	1	-0-	8,005	8,005	
Fund Balances - June 30, 2001	<u>\$ -0-</u>	<u>\$ -0-</u>	<u>\$ -0-</u>	<u>\$ 5,240</u>	<u>\$ 5,302</u>	<u>\$ 62</u>	<u>\$ 1</u>	<u>\$ 1</u>	<u>\$ -0-</u>	<u>\$ 1</u>	<u>\$ 1</u>	<u>\$</u>

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

CITY OF SHELBYVILLE
SCHEDULE OF BOND REDEMPTION
LEASE REVENUE BONDS
JUNE 30, 2001

Total Value of Bond Issue:		\$3,880,000
Year of Issue:		1998
Interest payable on:		April 1 - October 1
Interest rates:	\$	1,455,000 - 4.90%
		1,295,000 - 5.35%
		1,130,000 - 5.45%

PRINCIPAL AS FOLLOWS:

Due		
<u>October 1,</u>		
2001	\$	130,000
2002		140,000
2003		145,000
2004		155,000
2005		160,000
		730,000
2006		170,000
2007		180,000
2008		190,000
2009		200,000
2010		210,000
2011		220,000
2012		230,000
2013		245,000
2014		260,000
2015		275,000
2016		290,000
2017		305,000
		2,775,000
Total	\$	3,505,000

Funds used to finance the acquisition and construction of golf course facilities.

CITY OF SHELBYVILLE
SCHEDULE OF BOND REDEMPTION
REVENUE BONDS
JUNE 30, 2001

Total Value of Bond Issue:	City Hall	\$1,705,000
	Clear Creek	\$ 495,000
Year of Issue:	City Hall	1996
	Clear Creek	1999
Interest payable on:		Monthly
Interest rates:	6.20%	
	4.46%	

PRINCIPAL AS FOLLOWS:

<u>Due</u>	CITY HALL	CREEK PARK
2001	80,000	20,000
2002	85,000	20,000
2003	90,000	20,000
2004	90,000	20,000
2005	95,000	20,000
	440,000	100,000
2006	100,000	20,000
2007	100,000	25,000
2008	105,000	25,000
2009	110,000	25,000
2010	115,000	25,000
2011	120,000	25,000
2012	125,000	30,000
2013	130,000	30,000
2014	135,000	30,000
2015	145,000	35,000
2016		35,000
2017		35,000
2018		40,000
	1,185,000	380,000
Total	\$ 1,625,000	\$ 480,000

Funds used to refinance the acquisition and construction of City Hall and to assist in the construction of a Family Center at Clear Creek Park.

**CITY OF SHELBYVILLE
CITY OFFICIALS AND COUNCIL MEMBERS
JUNE 30, 2001**

		<u>Term Expires</u>
MAYOR	David B. Eaton	December 31, 2002
CITY COUNCIL	Tom Hardesty	December 31, 2002
	Charles Long	December 31, 2002
	Michael Miller	December 31, 2002
	Donald Cubert, Sr.	December 31, 2002
	Bobby Hudson	December 31, 2002
	Valoise Owens	December 31, 2002
OFFICE ADMINISTRATOR	Judith Smith	
CITY CLERK/TREAS.	Inez Harris	

**CITY OF SHELBYVILLE
AUDITORS' CERTIFICATION
JUNE 30, 2001**

We certify that as part of our examination of the general purpose financial statements we examined those local government economic assistance funds granted to the City of Shelbyville, and that those funds were expended for the purpose intended.

Louisville, Kentucky
August 31, 2001

**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND ON
INTERNAL CONTROL OVER FINANCIAL REPORTING
BASED ON AN AUDIT OF FINANCIAL STATEMENTS
PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS**

To the City Council
City of Shelbyville, Kentucky

We have audited the general purpose financial statements of the City of Shelbyville, Kentucky, as of and for the year ended June 30, 2001, and have issued our report thereon dated August 31, 2001. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether City of Shelbyville, Kentucky's general purpose financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered City of Shelbyville, Kentucky's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the general purpose financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the general purpose financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

This report is intended for the information of management, City Council, others within the organization, the Department of Local Government and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Louisville, Kentucky
August 31, 2001

APPENDIX E

Additional Covenants and Agreements of the City

Additional Covenants and Agreements

Section 1. Definitions. Terms used herein shall have the meanings ascribed to them in Article 1 of the Lease. In addition:

"Aggregate Debt Service Reserve Requirement" means the lesser of (i) the maximum Annual Debt Service Requirement in any succeeding year (ii) 10% of the proceeds of any issue of System Bonds or (iii) 125% of the average Annual Debt Service Requirement.

"Annual Debt Service Requirement" means at any given time of determination, the maximum amount of Principal Installments and interest coming due on all System Bonds outstanding in any year (including Base Rentals hereunder); provided, however, if the terms of any System Bonds are such that interest thereon for any future period of time is to be calculated at a variable rate, then interest on such system Bonds for such period shall be computed by assuming that the rate of interest applicable to such period is equal to the rate of interest (calculated in the manner in which the rate of interest for such period is to be calculated) which would have been in effect for the 12-months immediately preceding the date of calculation; provided further that if more than 25% of the Principal installments of any series of System Bonds come due in any year the Annual Debt Service Requirement for such System Bonds will be calculated as if such System Bonds were amortized on the basis of approximate level debt service over the term of such System Bonds.

"Certificates" shall mean the Certificates of Participation City of Shelbyville, Kentucky (Water and Sewer Revenue Refunding and Improvement Project), Series 1998A, dated as of June 1, 1998.

"Consulting Engineer of National Recognition" means and refers to an Engineer or a firm of Engineers, who, by virtue of experience, reputation and ability, bear a reputation in the field of sanitary engineering which is nationally recognized and known, and upon whose professional judgment sophisticated investors rely in connection with securities which are issued for water purposes.

"Debt Service Fund" means the fund so designated which is established and created by the Lease.

"Debt Service Reserve" means the reserve for payment of principal of, interest on, and redemption requirements in respect of System Bonds, created by the Lease.

"Depreciation Fund" means the fund so designated which is established and created by the Lease.

"Depreciation Reserve Requirement" means the reserve to be maintained in the Depreciation Fund in an amount equal to the greater of \$300,000 or the amount deemed necessary by the Engineers pursuant to a certificate delivered to the Lessee.

"Engineer" or "Engineers" means any firm or firms of consulting engineers who have been or who will be in the future retained by the Lessee for the purpose of preparing plans and specifications for present or future portions of the System.

"Notes" means Notes issued in anticipation of the issuance of Parity Debt under the provisions of the Lease.

"Operation and Maintenance Costs" means, as of any particular date, the operating and maintenance expenses of the System and all other expenses of carrying out and administering the System, and in that regard operating and maintaining the System, and shall include, without limiting the generality of the foregoing, salaries, supplies, utilities, mailing, labor, materials, office rent, maintenance, upkeep, furnishings, equipment, repair of facilities, insurance premiums, legal accounting, management, consulting and banking services and expenses.

"Operation and Maintenance Fund" means the fund so designated which is established and created by the Lease.

"Parity Debt" means Parity Debt issued under the provisions of the Lease.

"Principal Installment" means, as of any date of calculation and with respect to any System Bonds, so long as any System Bonds are outstanding, System Bonds maturing and System Bonds subject to mandatory redemption in such period.

"Prior Bonds" means the City of Danville, Kentucky, Multi-City Lease Revenue Bonds (City of Shelbyville Water and Sewer System Revenue Project), Fixed Rate Series 1991-H.

"Redemption Price" means, with respect to any System Bonds, the principal amount thereof plus the applicable premium, if any, payable upon redemption thereof.

"Revenue Fund" means the General Revenue Fund created by the Lease.

"Revenues" means the totality of all water and sewer service rates, rentals and charges of any and all types and varieties imposed, enforced and collected by the Lessee for any services rendered by the works and facilities of the Lessee which it relates to the System, together with other income received by the Lessee, if any, from any agency of government, both federal and state, as representing income or operating subsidies, as distinguished from capital grants, to the extent not otherwise required to be treated and applied.

"Supplemental Bonds" means the Original Bonds converted and remarketed to Fixed Rate Bonds pursuant to the Supplemental Indenture.

"Surplus Fund" means the fund so designated which is established by the Lease.

"System" means (a) the existing waterworks and water distribution facilities of the Lessee, (b) the existing water treatment works and wastewater treatment works and wastewater collection facilities of the Lessee and (c) all future improvements, additions and extensions thereto.

"System Bonds" means the Supplemental Bonds and any Parity Debt.

Section 2. Additional Representations and Warranties. In addition to the representations, covenants and warranties set forth in the Lease, the Lessee hereby further represents and warrants for the benefit of the Lessor, as follows:

A. Lawful Governmental Functions. During the Lease Term, the Project will at all times be used only for the purpose of performing one or more lawful governmental functions of the Lessee.

B. Further Assurance. Any and all times the Lessee shall, as far as it may be authorized by law, pass, make, do, execute, acknowledge and deliver further resolutions, acts, deeds, conveyances, assignments, transfers and assurances as may be necessary or desirable for the better assuring, conveying, granting, pledging, assigning and confirming all and singular the Revenues hereby pledged or assigned, or intended so to be, or other property which the Lessee may be bound to pledge or assign.

C. Power to Enter Into the Lease and Pledge. The Lessee is duly authorized under all applicable laws to enter into and deliver the Lease and to adopt the ordinance authorizing the execution and delivery of the Lease and to pledge the Revenues in the manner and to the extent provided herein. Except for Permitted Encumbrances and the pledge and assignment created under the Lease, the Revenues are and will be free and clear of any pledge, lien, charge or encumbrance thereon or with respect thereto prior to the pledge and assignment created by the Lease and all corporate and other action on the part of the Lessee to that end has been and will be duly and validly taken. The obligations of the Lessee hereunder are and will be valid and legal obligations of the Lessee, enforceable in accordance with their terms. The Lessee shall at all times, to the extent permitted by law, defend, preserve and protect the pledge of the Revenues and the assignment thereof and all the rights of the Lessor hereunder against all claims and demands of all persons whomsoever.

D. Power to Fix and Collect Rents, Rates and Charges. The Lessee presently has, and will have, as long as any Base Rentals or Additional Rentals are due, good right and lawful power to fix, establish, maintain, charge and collect rents, rates, fees and charges with respect to the use and sale of the services of the System.

E. General. Upon the date of execution and delivery of the Lease all conditions, acts and things required by law and the Lease to exist, to have happened and to have been performed precedent to and in the execution of the Lease shall exist, have happened and have been performed and the Lease shall comply in all respects with the applicable laws of the State.

Section 3. Additional Covenants. In addition to the covenants and agreements otherwise set forth in the Lease, the Lessee hereby further covenants and agrees, as follows:

A. Operation of System. The Lessee will at all times own and operate the System as a combined and consolidated public project on a revenue-producing basis, and will permit no services to be rendered free of charge or without full compensation.

B. Maintenance of System. The Lessee will at all times maintain the System in good condition through application of Revenues accumulated and set aside for operation and maintenance as provided herein and will make renewals and replacements, as the same may be required, through application of Revenues accumulated and set aside into the Depreciation Fund.

C. Compliance with Laws. The Lessee will perform all duties with reference to the System required by the Statutes and Constitution of Kentucky and will not sell, lease, mortgage or in any

manner dispose of the System, or any part thereof except as permitted under law and the terms of the Lease.

D. Disconnection for Unpaid Service Charges. Pursuant to KRS 96.934 and other applicable legal provisions, the Lessee will cause rates and charges for water and sewer services to be billed simultaneously to the same customers, and will provide that water and sewer service will be discontinued to any premises where there is a failure to pay any part of the aggregate charges so billed, including such penalties and fees for disconnection and/or reconnection as may be prescribed from time to time, to the greatest extent permitted by law.

E. Permitted Encumbrances. In addition to the Permitted Encumbrances otherwise provided in the Lease, there shall be permitted any liens or pledges created or made with respect to Parity Debt permitted hereunder.

F. Creation of Liens. The Lessee shall not issue any bonds, notes, debentures, or other evidences of indebtedness of a similar nature, other than the Lease, or additional Parity Debt payable out of or secured by a pledge or assignment of the Revenues which pledge is prior or superior to the pledge created by the Lease and shall not create or cause to be created any lien or charge on the Revenues, which lien or charge is prior or superior to the lien and charge created by the Lease. Nothing contained in this paragraph shall be construed as limiting the Lessee from issuing other obligations, the security and source of payment of which is subordinate and subject to the pledges and assignments for the Lease and any additional Parity Debt.

G. Rates and Charges; Coverage; Annual Budget. The Lessee shall at all times establish, enforce and collect rates, rentals, and charges for services rendered and facilities afforded by facilities constituting the System; and the same shall be reasonable and just, taking into account and consideration the cost and value of the System, the costs of operating the same and maintaining the same in a good state of repair, proper and necessary allowances for additions and extensions, and the amounts necessary for the orderly retirement of all System Bonds and the accruing interest thereon, and the accumulation and maintenance of reserves as provided in the Lease (but excluding depreciation expense); and such rates and charges shall be adequate to meet all such requirements as provided in the Lease, and shall, if necessary, be adjusted from time to time in order to comply therewith (subject to such regulatory approvals as may be required by law); and annual revenue from such rates, rentals and charges shall be further adequate to provide, after fulfillment of all contractual obligations required of the Lessee incident to the Lease and any Parity Debt, including accumulation and maintenance of all reserves required by the Lease, and after payment of Operation and Maintenance Costs 1.20 times coverage of the Annual Debt Service Requirement, and shall, if necessary, be adjusted from time to time in order to comply herewith.

On or before the first day of each fiscal year, so long as the Lease has not been canceled, the Lessee will adopt an annual budget of current expenses for the ensuing fiscal year, and will promptly file a copy of such budget, and of any amendments thereto, in the Office of the City Clerk, and will furnish copies thereof to any holder of any System Bond upon request. The term "current expenses" as herein used, includes all reasonable and necessary costs of operating, repairing, maintaining and insuring the System, but shall exclude depreciation expense and expenditures for extensions, improvements and extraordinary repairs and maintenance, and payments into the Debt Service Fund and the Debt Service Reserve. The Lessee covenants that the current expenses incurred in any year will not exceed the reasonable and necessary amounts available therefor, and that it will not expend any amount or incur any obligations for operation,

maintenance and repairs in excess of the total amount provided for current expenses in its annual budget. At the same time, and in like manner, the Lessee agrees that it will prepare an estimate of Revenues to be derived from operation of the System for such fiscal year, and to the extent that said Revenues are projected to be insufficient to meet all requirements as provided in the Lease, the Lessee covenants and agrees that it will immediately (subject to any regulatory approvals as required by law) revise its rates, rentals and charges for services rendered by the System, so that the same will be adequate to meet all of such requirements.

H. No Decrease in Rates, Rentals and Charges. The Lessee shall not at any time make any reduction in any prevailing schedule of rates, rentals and charges for use of the service and facilities of the Lessee without first obtaining written determination of an Engineer with expertise in the field of water and/or wastewater engineering, as applicable, to the effect that the proposed reduction will not adversely affect the ability of the Lessee to meet all the requirements and covenants set forth in the Lease.

I. Segregation of Funds. The Lessee shall at all times account for the Revenues of the System and distinguish same from all other revenues, moneys and funds of the Lessee, if any, and will promptly and regularly make application and distribution thereof into the special funds identified in and created by Section 5 of this Exhibit E, in the manner and with due regard for the priorities herein attributed thereto.

J. Annual Audit Required. The Lessee shall, within sixty (60) days after the end of each fiscal year, cause an audit to be made of the books of record and account pertinent to the System, and a report of such audit to be issued by an independent certified public accountant, reflecting in reasonable detail the financial condition and results of operations of the System, including the status of the required insurance and fidelity bonding, as provided by the Lease, the current rates, rentals and charges of the Lessee and coverage ratios as set forth in paragraph (G) of this Section, with comments of the certified public accountant concerning compliance with all provisions and requirements of the Lease, such audit to be in accordance with generally accepted governmental accounting principles, and will promptly cause a copy of the audit report of said certified public accountant to be submitted to the Council for review, and when received and approved by the Council, to be filed with the City Clerk, where it will be available for public inspection.

K. Fidelity Bonding of Personnel. The Lessee shall cause each officer or other person (other than depository banks) having custody of any moneys administered under the provisions of the Lease to be bonded at all times in an amount at least equal to \$25,000; each such bond to have surety given by a surety corporation qualified to do business in Kentucky.

L. Personnel and Servicing of System. The Lessee shall at all times cause there to be appointed, retained and employed, personnel for the purposes of administering and managing the System and shall establish and enforce reasonable employment of such personnel at reasonable compensation, qualified for their respective positions.

The Lessee shall in a timely manner file all reports, as may, from time to time be required by law, and shall in the future be required by law, including administrative regulations promulgated by any agency of the federal government or the Commonwealth of Kentucky having jurisdiction.

M. Parity Debt. So long as the Lease has not been canceled, Parity Debt shall be authorized and issued solely pursuant to the authority of the Lease, including but not limited to Section 16 of this Exhibit E.

The Lease, the Certificates and any Parity Debt authorized to be issued by the Lease and from time to time outstanding, shall not be entitled to priority one over the other in the application of the Revenues or the security for payment thereof, regardless of the time or times of their issuance it being the intention that there shall be no priority among the Lease or any such System Bonds regardless of the fact that they may be actually issued and delivered at different times.

The Lessee hereby reserves the right and privilege of issuing Parity Debt from time to time payable from the Revenues on a basis of parity and equality with the Lease and all other (a) reconstruct, repair and improve the System; (b) make, acquire, construct and install additions, extensions, betterments, or improvements thereto; (c) acquire existing waterworks, water distribution systems, wastewater treatment works or wastewater collection systems from any person; and (d) refund any bonds outstanding, provided in each instance that:

(i) the facility or facilities to be acquired, constructed, reconstructed or improved from the proceeds of the Parity Debt is or are made an integral part of the System and its or their income and revenues are pledged as additional security for the Parity Debt and the outstanding System Bonds;

(ii) the Lessee is in compliance with all covenants and undertakings in connection with the Lease and all of its System Bonds then outstanding and payable from the revenues; and

(iii) the net annual income and revenues of the System for a period of twelve (12) consecutive months of the fifteen (15) months immediately prior to the issuance of said Parity Debt are certified in writing by an independent firm of certified public accountants (subject to adjustments as hereinafter provided) to (1.20) times the maximum annual debt service requirement of the Lease and all system bonds outstanding payable from the Revenues, together with the Parity Debt then to be issued.

The words "net annual income and revenues" as used in this paragraph (M) are defined as Revenues, less Operation and Maintenance Costs for the same period, but shall exclude depreciation and interest and Principal Installments payable with respect to the Lease, any System Bonds or any subordinated debt.

With reference to the requirements of subparagraph (iii) of this paragraph (M), the amount of Revenues, and the "net annual income and revenues" of the System, may be adjusted in writing by a firm of independent certified public accountants, which firm shall be the firm performing the certification required by subparagraph (iii) of this paragraph (M), to reflect and take into account for the historical period being tested, any revision in the schedule of water rates, rentals and charges either (i) being actually imposed and billed by the Lessee at the time of issuance of such Parity Debt, and, (ii) where System Bonds are refunded, the additional available "net annual income and revenues" of the System released as a result thereof.

The amount of Revenues and the "net annual income and revenues" of the System may also be adjusted in writing by an Engineer with expertise in the field of water and/or wastewater engineering, as applicable, to take into account and reflect for the historical period being tested, the amount of additional net income and revenues to be realized by the Lessee by virtue of the acquisition by the Lessee of existing and operating waterworks wastewater works, wastewater collection and water distribution facilities. A further

adjustment may be made by adding thereto as estimate of said Engineer of the increase in Revenues anticipated to be derived from the additions, extensions, replacements and betterments to be financed by the Parity Debt then being authorized, for the first twelve months following issuance of said Parity Debt, less said engineer's estimate of any additional expenses of operation and maintenance during said twelve months. Additionally, an adjustment thereunder may take into consideration revenues to be generated by virtue of contractual relationships between the Lessee and other municipal corporations or other entities, either governmental or private, where such income and revenues are historically determinable, for the period being tested, namely, 12 consecutive months of the 15 months immediately prior to issuance of Parity Debt. Provided, however, that any such adjustment by such Engineer shall take into account only such income and revenues as would have been derived during the historical period being tested had the valid and lawful schedule of rates, rentals and charges of the Lessee which is in effect at the time of issuance of Parity Debt been charged during such historical period being tested, and such adjustments shall also take into account all Operations and Maintenance Costs for such historical period being tested.

The Lessee hereby covenants and agrees that in the event Parity Debt is issued, it shall:

(a) adjust the monthly deposits into the Debt Service Fund on the basis prescribed in the Lease to reflect the Annual Debt Service on the Parity Debt; and

(b) adjust the prescribed amount to be accumulated in the Debt Service Reserve in accordance with the provisions of the Lease, and fund said additional Debt Service Reserve Requirement pursuant to the prescribed formula.

The Parity Debt (sometimes herein referred to as "permitted" to be issued) the issuance of which is herein conditioned and restricted, shall be understood to mean Parity Debt payable from the Revenues on a basis of parity and equality with the Base Rentals under the Lease, and shall not be construed to include other bonds or obligations, the security and source of payment of which are subordinate and subject to the priority of the Bonds herein authorized to be issued. The Lessee may issue its bonds or other obligations payable from the revenues herein pledged and not ranking on a basis of equality and parity with the Lease and Parity Debt herein otherwise described, without any proof of previous earnings or net revenues, but only if such bonds or other obligations are issued to provide for additions, betterments, extensions or improvements of the System, and only if the same are issued in express recognition of the priorities, liens and rights created and existing for the security and source of payment and protection of the Lease and all System Bonds herein authorized and permitted to be issued. In the event any of such subordinate issued, the Lessee may authorize and issue subordinated bonds to refund same, pursuant to the terms and conditions of this paragraph (M).

Provided, however, that nothing in this paragraph (M) is intended or shall be construed as a restriction upon the ordinary refunding of the Supplemental Bonds and/or of any Parity Debt which may be outstanding under any of the provisions of the Lease if such refunding does not operate to increase amortization requirements in any year to and including the final maturity of System Bonds outstanding and not to be refunded, if any.

Section 4. Pledge of Revenues. There are hereby pledged for the payment of Basic Rentals, Additional Rentals, Principal Installments, Redemption Price, if any, and interest on all System Bonds, in accordance with their terms, subject only to the provisions of the Lease permitting the application thereof for

or to the purposes and on the terms and conditions set forth in the Lease, (a) the proceeds of sale of any System Bonds to the extent not required to be utilized for payment of Notes, (b) any investment obligations acquired by System Bond proceeds or by application of funds derived from Revenues, (c) the Revenues, and (d) all funds created and established pursuant to the Lease, including accounts thereof and moneys and securities therein, except for any fund established under the requirements to the Code to make rebate payments to the United States Treasury.

The proceeds of sale of any System Bonds, the investment obligations, the Revenues and all funds created and established pursuant to the Lease, including accounts thereof and moneys and securities therein, hereby pledged, shall immediately be subject to the lien of the pledge of this Section without any physical delivery thereof or further act, and the lien of said pledge shall be valid and binding as against all parties having claims of any kind in tort, contract or otherwise against the Lessee, irrespective of whether such parties have notice thereof.

Section 5. Establishment of Funds and Accounts. There is hereby established and created the following special trust funds and the following accounts within such funds:

- (a) General Revenue Fund
- (b) Debt Service Fund
 - Interest Account
 - Principal Account
- (c) Debt Service Reserve
- (d) Operation and Maintenance Fund
- (e) Depreciation Fund
- (f) Surplus Fund

Upon the refunding of the Prior Bonds, amounts in the System's Water and Sewer Revenue Fund, Water and Sewer Bond and Interest Redemption Account, Depreciation Fund and Operation and Maintenance Fund funds shall be transferred to the Revenue Fund, the Debt Service Fund (or Debt Service Reserve as designated by the Lessee Representative), the Depreciation Fund and the Operation and Maintenance Fund, respectively.

The above identified funds and the accounts thereof shall be held and maintained by the Lessee in financial institutions (being hereinafter sometimes referred to as "depositories."

Section 6. Application of Funds: General Revenue Fund.

(1) The Lessee shall cause all moneys received as Revenues, together with income from the Debt Service Reserve pursuant to Section 8(5) of this Exhibit E, to be deposited promptly into the General Revenue Fund.

(2) To the extent moneys are received by the Lessee representing any legislative appropriation or grant, federal or state, for purposes of deposit to the Revenue Fund, the Debt Service Fund or the Debt Service Reserve, or for the defrayal of Operation and Maintenance Costs, or for improvements, repairs or replacements to the System (from amounts in the Depreciation Fund) such funds shall be promptly transmitted by the Lessee to the appropriate depository for deposit to the fund or account so specified.

(3) The Lessee shall cause all moneys received as Revenues to be transferred from the Revenue Fund and deposited to the following accounts and funds on no less than a monthly basis (except for items FIFTH and SIXTH) in the amount hereinafter stated and in the prescribed sequence:

FIRST: Into the Interest Account within the Debt Service Fund an amount when added to the amount then on deposit therein, equal to (i) the interest portion of Base Rentals and Lessee's Proportionate Share of Recurring Program Expenses under the Lease plus (ii) the interest on all outstanding Parity Debt accrued and unpaid in respect of the next interest payment date for such Parity Debt divided by the number of months preceding such interest payment date or to reimburse a credit provider for its direct payment of interest on System Bonds under an agreement with such credit provider.

SECOND: Into the Principal Account within the Debt Service Fund an amount when added to the amount then on deposit therein, equal to (i) the principal portion of Base Rentals and (ii) the Principal Installments on any Parity Debt accrued and unpaid in respect of the next Principal Installment Date for such Parity Debt divided by the number of months preceding such Principal installment Date or to reimburse a credit provider for its direct payment of principal of Parity Debt under an agreement with such credit provider.

THIRD: If at any time the amount in the Debt Service Reserve is less than the Aggregate Debt Service Reserve Requirement, there shall be deposited into the Debt Service Reserve, on no less than a monthly basis, an amount equal to 1/24th of such deficiency so that the balance in the Debt Service Reserve will equal the Aggregate Debt Service Reserve Requirement in the month that is twenty-four (24) months from the month such deficiency first existed. Thereafter such monthly payments may cease for so long as the required balance in the Debt Service Reserve is maintained and such monthly payments may cease for so long as the required balance in the Debt Service Reserve is maintained and such monthly payments shall resume again if at any time said balance is less than the Aggregate Debt Service Reserve Requirement and shall continue until said balance is established.

FOURTH: On or before the tenth day of each month, into the Operation and Maintenance Fund, (i) the amount of money, after adjusting for moneys then on deposit in such Fund and which are not otherwise required for the operational reserve, equal to the reasonable and necessary Operation and Maintenance costs and any Additional Rentals (the "Monthly Requirement") for the next succeeding month, plus (ii) an amount which, after taking into account the sums then on deposit in said Fund will equal the estimated and budgeted Operation and Maintenance Costs for two (2) additional months, such additional sums to be held as an operational reserve and expended as required, subject to replacement in the same manner, if so expended.

FIFTH: If at any time the amount in the Depreciation Fund is less than the Depreciation Reserve Requirement, there shall be deposited into the Depreciation Fund, on no less than a monthly basis, an amount equal to 1/24th of such deficiency so that the balance in the Depreciation Fund will equal the Depreciation Reserve Requirement in the month that is twenty-four months from the month such deficiency

first existed. Thereafter such monthly payments may cease for so long as the required balance in the Depreciation Fund is maintained and such monthly payments shall resume again if at any time said balance is less than the Depreciation Reserve Requirement and shall continue until said balance is established .

SIXTH: On a periodic basis, but no less frequently than annually, the revenues remaining in the General Revenue Fund at the end of the month, or in the case of annual transfers, the preceding calendar year, after making the payments required by paragraphs FIRST to FIFTH, inclusive, hereof, including any balances to be accrued and maintained, shall be transferred to the Surplus Fund; provided that no such transfer shall be made to the Surplus Fund until the respective reserve requirements set forth in paragraphs FIRST to FIFTH are funded, amounts remaining in the General Revenue Fund shall be deposited in the appropriate funds in the prescribed in order until such reserve requirements are fully funded.

Section 7. Debt Service Fund. (1) The Debt Service Fund shall be maintained by the Lessee in the appropriate depository so long as and of the System Bonds authorized or permitted to be issued by the Lease remain outstanding; and all moneys deposited in the Debt Service Fund from time to time shall be used, disbursed and applied, and are irrevocable pledged solely for the purpose of paying the Base Rentals and the Principal Installments of, and interest on all System Bonds as may be issued and outstanding from time to time pursuant to the provisions of the Lease. Funds in the Debt Service Fund may, from time to time, at the option of the Lessee, be used and employed to purchase sufficient term System Bonds, if any be outstanding, to satisfy a sinking fund installment due within the next succeeding twelve (12) months. The Lessee shall direct the depository to, and the depository shall, pay out of the Interest Account to the Lessor and to any paying agents for any Parity Debt (a) on the day preceding each payment date, the amounts required for the payment of interest portion of Base Rentals and program Expenses hereunder and interest on the Outstanding Bonds due on such date, and (b) on the date preceding the redemption date or date of purchase, the amounts required for the payment of accrued interest on System Bonds redeemed or purchased for retirement unless the payment of such accrued interest shall be otherwise provided for.

(2) The Lessee shall direct the depository to, and the depository shall, payt out of moneys credited to the Principal Account to the Lessor and to the respective paying agents for any day preceding each payment date for any Base Rentals or for any Parity Debt, the amounts required for the payment of principal due on such date.

Section 8. Debt Service Reserve. (1) there shall be deposited to the credit of the Debt Service Reserve (a) all amounts from the Revenue Fund required to be deposited therein by tyhis Lease, (b) all moneys received on account of or in connection with investment obligations credited to the Debt Service Reserve asd in this Section provided, and (c) all System Bond proceeds which may be required to be deposited in the Debt Service Reserve.

(2) The Debt Service Reserve is pledged to and shall be used for the payment of principal of, interest on, and Redemption Price, if any, in respect of any outstanding System Bonds, including Base Rentals hereunder, as to which there would otherwise be a default in payment, and sums in the Debt Service Reserve shall be transferred to other funds and accounts in a timely manner upon due certification as provided in paragraph (3) of this Section in order to effectuate the Reserve. In the event that amounts in the Debt Service Reserve are reduced below the Aggregate Debt Service Reserve Requirement by transfer to the Debt Service Fund or as a result of a reduction in value of investments upon a determination of value in accordance with Section 12 of this Exhibit E, the deficiency in the Debt Service Reserve shall be cured from

the first available Revenues as applied in accordance with Section 6 of this Exhibit E.

(3) The Lessee shall cause the depository from time to time to transfer or pay out moneys in the Debt Service Reserve for the purpose of making payments and transfers to other funds and accounts pursuant to paragraph (2) of this Section upon receipt by said depository of written direction of an authorized officer stating with respect to each payment or transfer to be made:

- (a) The account or fund to which the payment or transfer is to be made,
- (b) the purpose of the payment or transfer, and
- (c) the amount to be paid.

(4) Any interest earned or sums realized as a result of investment of moneys in the Debt Service Reserve shall accrue to, and be a part of, said Debt Service Reserve; provided, however, that so long as the Debt Service Reserve contains the Aggregate Debt Service Reserve Requirement, any such interest earned or sums realized shall be transferred, as received, to the Revenue Fund.

(5) In lieu of the deposit of funds in the Debt Service Reserve, the Lessee may obtain a Debt Service Reserve Guaranty. Any Debt Service Reserve Guaranty shall be considered a deposit of funds in the Debt Service Reserve equal to the Debt Service Reserve Guaranty Agreement.

As conditions precedent to delivery of a Debt Service Reserve Guaranty, the Lessee shall obtain (i) a Debt Service Reserve Guaranty, (ii) an option of counsel addressed to the Lessee stating that the delivery of such Debt Service Reserve Guaranty to the Lessee is authorized under and complies with the terms hereof, and (iii) written evidence from a Rating Agency, if the System Bonds are rated by such Rating Agency, Reserve Guaranty and that (x) the issuance of the Debt Service Reserve Guaranty to the Lessee and (y) if a Debt Service Reserve Guaranty is then in effect with respect to the Debt Service Reserve, the substitution of the proposed Debt Service Reserve Guaranty for the Debt Service Reserve Guaranty then in effect, will not, by itself, result in a reduction or withdrawal of its rating on the System Bonds. If the System Bonds are insured by a bond insurer, the references to Rating Agency in the prior sentence shall be read to mean such bond insurer and the substitution of the proposed Debt Service Reserve Guaranty shall not result in the cancellation of the bond insurance provided by such Bond Insurer.

"Debt Service Reserve Guarantor" means the issuer of a Debt Service Reserve Guaranty.

"Debt Service Reserve Guaranty" means a letter of credit, surety bond or similar arrangement representing the irrevocable obligation of the Debt Service Reserve Guarantor to pay to the Lessee upon request made by the lessee upon to an amount stated therein for application has provided in this Section.

"Debt Service Reserve Guaranty Agreement" means the reimbursement agreement, loan agreement or similar agreement between the Lessee and a Debt Service Reserve Guarantor with respect to repayment of amounts advanced under the Debt Service Reserve Guaranty.

"Debt Service Reserve Guaranty Coverage" means the amount available at any particular time to be paid to the Lessee under the terms of the Debt Service Reserve Guaranty.

"Debt Service Reserve Guaranty Limit" means the maximum aggregate amount available to be paid to the Lessee under the terms of a Debt Service Reserve Guaranty.

"Rating Agency" means either Moody's Investors Service, Inc. or Standard & Poor's Corporation, both corporations and organized under the laws of the States of Delaware and New York, respectively, and their successors and assigns.

Section 9. Operation and Maintenance Fund. (1) The Operation and Maintenance Fund shall be used to pay Additional Rentals and the reasonable expenses of operating, maintaining and repairing the System and for paying Operation and Maintenance Costs. There shall be paid into the Operation and Maintenance Fund the amounts required to be so paid by the provisions of Section 6 of this Exhibit E, and there may be paid into the Operation and Maintenance Fund any moneys received by the Lessee from any other source, unless required to be otherwise applied as provided by the Lease.

(2) Subject to the provisions and requirements of subsection (3) of Section 6 of this Exhibit E, moneys in the Operation and Maintenance Fund shall be withdrawn and paid out from time to time by the Lessee for the purpose of paying Additional Rentals and reasonable or necessary Operation and Maintenance Costs and when so withdrawn and paid out shall be free and clear of any lien, pledge or assignment in trust created by the Lease, provided, however, the Lessee may at any time withdraw moneys into other funds or accounts created by the Lease, other than the Depreciation Fund and the Surplus Fund.

Section 10. Depreciation Fund. (1) The Depreciation Fund shall be available and shall be utilized to balance depreciation, to make unforeseen major repairs and replacements of the System and to pay the costs of constructing additions, extensions, betterments and improvements to the System which will either increase income and revenues or provide a higher degree of service. There shall be deposited or transferred to the Depreciation Fund any moneys required to be deposited or transferred thereto by the provisions of Section 6 of this Exhibit E.

(2) In addition, so long as the balance in the Depreciation Fund is less than the Depreciation Reserve Requirement, there shall be transferred to and deposited in such Fund any other moneys:

(a) received by the Lessee from any other source and duly determined and ordered by the Lessee to be deposited therein, unless required to be otherwise applied as provided by the Lease,

(b) for which the Lessee has exercised a discretion to do so deposit or transfer as permitted by the Lease, and

(c) ordered to be so deposited from the proceeds of any System Bonds.

(3) To the extent that other moneys will not be available for the payment of Base Rentals or Principal Installments of an interest on System Bonds when due or the payment of Operation and Maintenance Costs, amounts in the Depreciation Fund shall be transferred by the Lessee, upon written

direction by an authorized officer and be deposited in the Debt Service Fund or Operation and Maintenance Fund, as applicable.

(4) The depository shall from time to time pay out or permit the withdrawal of moneys from the Depreciation Fund for the purpose of making payments pursuant to paragraph (3) hereof upon receipt by said depository of written direction of an Authorized Officer stating the following with respect to each payment to be made:

- (a) the fund from which the payment is to be made,
- (b) the name of the person or party to whom the payment is to be made, and
- (c) the amount to be paid.

Section 11. Surplus Fund. The Surplus Fund shall be maintained by the Lessee in the appropriate depository so long as any System Bonds remain outstanding; and all moneys deposited in the Surplus Fund may be used as follows: (a) to the extent necessary from time to time monies in the Surplus Fund shall be transferred to the Debt Service Fund to permit payment of all obligations payable from such Fund without drawing on the Debt Service Reserve; (b) monies in the Surplus Fund shall be used for payment of principal of and interest on any outstanding bonds and notes issued by the Lessee to pay for costs of improving or extending the System or may be transferred to the appropriate fund or account created herein to permit such payment; and (c) monies in the Surplus Fund otherwise may be used for any other lawful municipal purpose; provided that the remaining balance in the Surplus Fund following any such withdrawal, is equal to at least 5% of the System's Revenues for the fiscal year in which the withdrawal is made.

Section 12. Investment of Funds; Valuation. Except as otherwise provided for in this General Waterworks Bond Ordinance:

(a) Investment Obligations purchased as an investment of moneys in any fund or account held by the Lessee or the depository under the provisions of the Lease shall be deemed at all times to be a part of such fund or account and the income or interest earned, gains realized or losses suffered by a fund or account due to the investment thereof shall be retained in, credited or charged thereto as the case may be, subject, in the base of the Debt Service Reserve, to the provisions of Section 8 of this Exhibit E; provided that escrow agreements may provide otherwise.

(b) In computing the amount in all funds, including the accounts thereof, investments purchased as an investment of moneys therein, shall be valued at the lesser of cost or fair market value. The value of investments in the Debt Service Reserve and the Depreciation Fund shall be determined as of the first day of each fiscal year. Valuation as of any date of computation shall include the amount of interest or gain realized to such date.

(c) The Lessee shall sell at the best price obtainable, or present for redemption or exchange, any investments purchased by it pursuant to the Lease whenever it shall be necessary in order to provide or account for which such investment was made. The depository shall advise the

Lessee in writing, at such times as may be requested by the Lessee, of the details of all investments held for the credit of each fund or account in its custody under the provisions of the Lease. The depository shall review and advise the Lessee annually on the nature and value of investments in each fund or account. In the event the depository shall notify the Lessee and the Lessee shall cure such deficiency as provided in Section 8 of this Exhibit E.

Section 13. Notes and Other Obligations. (1) The Lessee may, at any time or from time to time, issue notes, bonds and other obligations having such terms and provisions and secured by a pledge of such funds as the ordinance or resolution authorizing the same shall provide; provided, however (except as otherwise provided in subsection (2) of this Section), that any pledge of any fund or account created under the Lease to the holders of any such notes, bonds or other obligations shall be, and shall be expressed to be, subordinate in all respects to the pledge created under the Lease for the benefit of the holders of System Bonds.

(2) Whenever the Lessee shall have authorized or made provision for the authorization of, the issuance of a Parity Debt, the Lessee may by ordinance authorize the issuance of Notes in anticipation of the sale of such Parity Debt in a principal amount not exceeding the principal amount of such Parity Debt; provided, however, that the principal amount of a grant or grants of any federal or state agency for which a commitment has been received may be included in determining the maximum principal amount of Notes. The principal or any interest on such Notes and renewals thereof may be payable from other moneys of the Lessee available therefor and not pledged under the Lease, including, but not by way of limitation, investments purchased from Note proceeds and may further be secured by a subordinate pledge of revenues. The principal on such Notes shall also be payable from the proceeds of the sale of the Parity Debt in anticipation of which such Notes are issued. Such proceeds may be pledged for the payment of the principal of such Notes and any such pledge shall have priority over any other pledge created by the Lease. The proceeds of sale of such Notes shall be applied to the purposes for which such Notes are authorized, and, if the ordinance or ordinances authorizing such Notes so provide, to the payment of interest and other costs in connection with the sale and issuance of such Notes.

Section 14. Additional Default. In addition to the Events of Default set forth in Article 12 hereof, any default with respect to any Parity Debt shall constitute an Event of Default under the Lease.

Section 15. Additional Remedies. In addition to the remedies set forth in Article 12 hereof, upon the occurrence of an Event of Default hereunder, the Lessor, or the trustee or other applicable party with respect to or the holders of any Parity Debt, shall have the right to appoint a receiver to administer and operate the System in accordance with the requirements of the Lease for the benefit of the Lessor and the holders of any Parity Debt.

Section 16. Additional Covenants of Lessee for the benefit of MBIA Insurance Corporation.

Notwithstanding any of the foregoing provisions of this Exhibit E, the Lessee specifically covenanted for the benefit of the holders of the Certificates, the Bonds and for the benefit of MBIA Insurance Corporation ("MBIA") that, without the prior written consent of MBIA, no obligations shall be issued by or on behalf of the Lessee on a parity as to security or source of payment with the Certificates and

the Bonds.

APPENDIX F

Book-Entry System

APPENDIX F

THE INFORMATION PROVIDED IN THIS APPENDIX F HAS BEEN PROVIDED BY DTC. NO REPRESENTATION IS MADE BY THE ISSUER AS TO THE ACCURACY OR ADEQUACY OF SUCH INFORMATION PROVIDED BY DTC OR AS TO THE ABSENCE OF MATERIAL ADVERSE CHANGES IN SUCH INFORMATION SUBSEQUENT TO THE DATE HEREOF.

The Depository Trust Company (“DTC”), New York, NY, will act as securities depository for the Bonds. The Bonds will be issued as fully-registered securities registered in the name of Cede & Co. (DTC’s partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully-registered Security certificate will be issued for each issue of the Bonds, each in the aggregate principal amount of such issue, and will be deposited with DTC.

DTC, the world’s largest depository, is a limited-purpose trust company organized under the New York Banking Law, a “banking organization” within the meaning of the New York Banking Law, a member of the Federal Reserve System, a “clearing corporation” within the meaning of the New York Uniform Commercial Code, and a “clearing agency” registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for over 2 million issues of U.S. and non-U.S. equity issues, corporate and municipal debt issues, and money market instruments from over 85 countries that DTC’s participants (“Direct Participants”) deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities, through electronic computerized book-entry transfers and pledges between Direct Participants’ accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation (“DTCC”). DTCC, in turn, is owned by a number of Direct Participants of DTC and Members of the National Securities Clearing Corporation, Government Securities Clearing Corporation, MBS Clearing Corporation, and Emerging Markets Clearing Corporation, (NSCC, GSCC, MBSCC, and EMCC, also subsidiaries of DTCC), as well as by the New York Stock Exchange, Inc., the American Stock Exchange LLC, and the National Association of Securities Dealers, Inc. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly (“Indirect Participants”). DTC has Standard & Poor’s highest rating: AAA. The DTC Rules applicable to its Participants are on file with the Bonds and Exchange Commission. More information about DTC can be found at www.dtcc.com.

Purchases of Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Bonds on DTC’s records. The ownership interest of each actual purchaser of each Security (“Beneficial Owner”) is in turn to be recorded on the Direct and Indirect Participants’ records. Beneficial Owners will not receive written confirmation from DTC of their purchase. Beneficial Owners are, however, expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the Bonds are to be accomplished by entries

made on the books of Direct and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in Bonds, except in the event that use of the book-entry system for the Bonds is discontinued.

To facilitate subsequent transfers, all Bonds deposited by Direct Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co., or such other name as may be requested by an authorized representative of DTC. The deposit of Bonds with DTC and their registration in the name of Cede & Co. or such other DTC nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Bonds; DTC's records reflect only the identity of the Direct Participants to whose accounts such Bonds are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. Beneficial Owners of Bonds may wish to take certain steps to augment the transmission to them of notices of significant events with respect to the Bonds, such as redemptions, tenders, defaults, and proposed amendments to the Security documents. For example, Beneficial Owners of Bonds may wish to ascertain that the nominee holding the Bonds for their benefit has agreed to obtain and transmit notices to Beneficial Owners. In the alternative, Beneficial Owners may wish to provide their names and addresses to the registrar and request that copies of notices be provided directly to them..

Redemption notices shall be sent to DTC. If less than all of the Bonds within an issue are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such issue to be redeemed.

Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to Bonds unless authorized by a Direct Participant in accordance with DTC's Procedures. Under its usual procedures, DTC mails an Omnibus Proxy to Issuer as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Redemption proceeds, distributions, and dividend payments on the Bonds will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts upon DTC's receipt of funds and corresponding detail information from Issuer or Registrar, on payable date in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of such Participant and not of DTC, Registrar, or Issuer, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of redemption proceeds, distributions, and dividend payments to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of Issuer or Registrar, disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the

Beneficial Owners will be the responsibility of Direct and Indirect Participants.

DTC may discontinue providing its services as depository with respect to the Bonds at any time by giving reasonable notice to Issuer or Registrar. Under such circumstances, in the event that a successor depository is not obtained, Security certificates are required to be printed and delivered.

Issuer may decide to discontinue use of the system of book-entry transfers through DTC (or a successor securities depository). In that event, Security certificates will be printed and delivered.

The information in this section concerning DTC and DTC's book-entry system has been obtained from sources that Issuer believes to be reliable, but Issuer takes no responsibility for the accuracy thereof.