

EXHIBIT MS-2

WASTEWATER RECLAMATION PROJECT

FISCAL SPONSORSHIP AGREEMENT

between the

MONTEREY PENINSULA WATER MANAGEMENT DISTRICT

and

PEBBLE BEACH COMPANY

Dated as of October 3, 1989

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Exhibits

Exhibit "A"	Benefitted Properties and Water Entitlement
Exhibit "B"	Open Spaces
Exhibit "C"	Description of Project

WASTEWATER RECLAMATION PROJECT

FISCAL SPONSORSHIP AGREEMENT

This Wastewater Reclamation Project Fiscal Sponsorship Agreement is entered into as of October 3, 1989, by and between the Monterey Peninsula Water Management District, a California public agency ("WMD"), and Pebble Beach Company, a California general partnership ("PBC").

Recitals

A. WMD was created to manage and regulate the use, reuse, reclamation and conservation of water on the Monterey Peninsula and the bond financing of related public works projects.

B. WMD is desirous of implementing methods of conserving potable water consumption, and making available existing potable water, on the Monterey Peninsula for uses and purposes other than the uses and purposes for which it is presently being utilized.

C. WMD desires to cause a wastewater reclamation facility, capable of producing at least 800 acre feet per year of subpotable water suitable for irrigation of existing golf courses and other open spaces on the Monterey Peninsula, and related distribution system and irrigation systems, to be financed and constructed on the Monterey Peninsula, with the understanding that such open spaces will utilize such subpotable water for irrigation, thereby conserving potable water consumption and making available existing potable water for other uses and purposes on the Monterey Peninsula.

D. On February 13, 1989, the Board of Directors of WMD adopted Ordinance No. 39, authorizing WMD to invite proposals to finance a water reclamation project, as described in such ordinance, in consideration of the fiscal sponsor's receipt of certain water entitlements. On March 24, 1989, WMD issued such invitation. On or before April 24, 1989, each of PBC, J. Lohr Properties, Inc., in conjunction with the Winifred H. Braun Charitable Annuity Trust, ("Lohr") and the Hester Hyde Griffin Trust ("Griffin") submitted to WMD its proposal in response to such invitation. On April 28, 1989, the General Manager of WMD, by letters to each of PBC, Lohr and Griffin, sought clarification of certain provisions in, and additional information with respect to, its response to such invitation. On or before May 15, 1989, each of PBC, Lohr and Griffin responded to such request for clarification and additional information to the satisfaction of WMD and indicated it would act as fiscal sponsor of such water reclamation

project in the manner set forth in PBC's written response, dated May 15, 1989. On October 3, 1989, WMD approved this Agreement and PBC acting as the fiscal sponsor of such water reclamation project pursuant to such invitation, the responses thereto and this Agreement.

E. PBC is willing to assist, and WMD desires that PBC assist, with the implementation and financing of such wastewater reclamation project in consideration of WMD transferring to PBC, Lohr and Griffin entitlements to an aggregate of 380 acre feet per year of potable water for use on property in the Del Monte Forest which they own.

F. This Agreement constitutes an integral part of a joint financing arrangement among PBC, WMD and other public agencies to provide an essential public service to the Monterey Peninsula.

Agreement

NOW, THEREFORE, in consideration of the foregoing, and the covenants and representations and warranties set forth in this Agreement, the parties have agreed as follows:

1. Definitions. As used in this Agreement, the following terms shall have the following meanings:

1.1 "Ancillary Project Costs" means net revenues (gross revenues less allocable operation and maintenance costs and administrative and general costs, as such terms are defined in accordance with generally accepted utility practices), with respect to the potable water, subject, from time to time, to the Water Entitlement, which Cal-Am does not receive by reason of operation of the Project, all as more fully described in the Service Agreement. Such costs shall not include any return on assets of Cal-Am which have been removed from the water distribution system rate base by reason of the Project. Such costs shall be reduced over time by net revenues received by Cal-Am by reason of sales of potable water to the Benefitted Properties following the Commercial Operation Date.

1.2 "Benefitted Properties" means those properties described on Exhibit "A" hereto and upon which Water Entitlements granted pursuant to this Agreement are dedicated and may be utilized.

1.3 "Board" means the Board of Directors of WMD.

1.4 "Bond Carrying Costs" means the following costs incurred with respect to the Bonds or additional bonds or certificates of participation: fees and expenses of trustees,

remarketing agents, tender agents and paying agents, arbitrage rebate calculation fees, costs incurred in connection with renewals of the Bond Letter of Credit or additional letter of credit (including bond, WMD and bank counsel fees and rating agency fees), fees for preparing or updating offering circulars, auditor or accounting fees, bond counsel and other counsel fees generally, and other similar ordinary and necessary costs, incurred with respect to the Bonds or additional bonds or certificates of participation.

1.5 "Bond Documents" means the Bond documents and the terms and conditions of all Bond issuance documentation, including, without limitation, the authorizing indenture or resolution, lease or installment sale agreement, purchase agreement and Bond Letter of Credit.

1.6 "Bond Requisite Credit Rating" means a credit rating in one of the rating categories of AAA or AA or Aaa or Aa, without reference to plus or minus subcategories, from either Moodys or S & P, respectively, for bonds or certificates of participation issued by public agencies.

1.7 "Bonds" means the bonds or certificates of participation issued by any Public Participant to finance the Capital Costs of the Project, as more fully described in Section 3.1 hereof.

1.8 "Business Day" means any weekday which is not a Federal or California state holiday.

1.9 "Cal-Am" means the California American Water Company, a California corporation, and its successors and assigns.

1.10 "Capital Costs", as applied to the Project or any portion thereof, means all or any part of:

(a) the cost of acquisition of all lands, structures, real or personal property, rights, rights-of-way, franchises, easements, and interests acquired or used for the Project, inclusive of fees and commissions for acquisition;

(b) the cost of construction of the Project, including, without limitation, demolition, modification, replacement or renovation of existing structures, facilities, fixtures or equipment essential to the construction and operation of the Project; cost of improvements and materials; direct and indirect Public Participant construction and administration expenses properly allocable to the Project in accordance with generally accepted accounting principles; cost

of painting, decorating, furnishing and landscaping; contractor and subcontractor profit; and costs related, by reason of the Project, to plumbing, mains, tanks, or pipes which are modified, replaced or renovated, whether owned by Public Participants or others;

(c) the cost of demolishing or removing any buildings, fixtures, equipment, or structures on land so acquired, including, without limitation, the cost of acquiring any lands to which such buildings or structures may be moved;

(d) the cost of all new machinery, piping, equipment and furnishings and the lesser of (i) the fair market value, or (ii) depreciated value for purposes of the applicable rate base, of machinery, piping, equipment and furnishings made obsolete or unusable to Cal-Am or any of the Public Participants** by reason of the Project to the extent not replaced by the Project;

(e) costs of selling and issuing the Bonds, including, without limitation, the underwriter's discount;

(f) interest on any funds advanced to permit payment of any of the Capital Costs prior to, during, and for a reasonable period after completion of the construction of the Project as determined by PBC and WMD, including, without limitation, capitalized interest on the Bonds;

(g) the Operating Reserve;

(h) the Bond Carrying Costs, to the extent reasonably determinable by the commencement of the offering of the Bonds and payable within one year after the closing of such offering; and

(i) the cost of architectural, engineering, planning, environmental analysis, financial, accounting, auditing and legal services, plans, specifications, estimates, administrative expenses, permits, fees, adverse claims, personnel and overhead costs (both direct and indirect, to the extent properly allocable to the Project in accordance with generally accepted accounting principles), and other expenses necessary or incident to determining the feasibility of construction of the Project or incident to the planning, construction, acquisition, or financing of the Project, including, without limitation:

(1) payment during the construction period of the premiums for all title and other insurance, bonds, or undertakings required to be obtained and maintained

with respect to any part of the Project, to the extent such amounts are not paid by any contractor who constructs or installs any portion of the Project;

(2) payment of the taxes, assessments and other fees or charges, if any, that may become payable during the construction period with respect to the Project, or reimbursements thereof; and

(3) payment of expenses incurred in seeking to enforce any remedy against any contractor or subcontractor in respect of any default under a contract relating to the acquisition, construction or installation of any portion of the Project.

1.11 "Commercial Operation Date" means the date on which the Project is capable of operating at its designed capacity on a continuing basis, as determined by the Management Committee, in good faith and on any reasonable basis, after all required testing of the Project is completed, as evidenced by the issuance by the Management Committee of a certificate setting forth its determination of such date.

1.12 "CSD" means the Carmel Sanitary District, a public agency.

1.13 "Distribution System" has the meaning given to it in Section 2.1 hereof.

1.14 "Facility" has the meaning given to it in Section 2.1 hereof.

1.15 "Financial Commitment" means the commitment of PBC to provide for payment of (a) the Capital Costs of the Project, (b) the Net Operating Deficiencies of the Project, and (c) the Ancillary Project Costs, all in the manner described in Sections 3.2 through 3.5 hereof.

1.16 "Financial Institution Requisite Credit Rating" means a credit rating, with respect to long-term unsecured obligations of a corporation, in one of the rating categories of AAA or AA or Aaa or Aa, without reference to plus or minus subcategories, from either Moodys or S & P, respectively.

1.17 "Griffin" means the Hester Hyde Griffin Trust, dated October 31, 1988.

1.18 "Interest Reserve" means the amount of interest on the Bonds or additional bonds or certificates of

limitation, (a) all income, rents, rates, fees, charges or other moneys derived from the sale, furnishing and supplying of Reclaimed Water or from potable water supplied in lieu thereof, (b) insurance and condemnation proceeds resulting from damage to or destruction of any of the Project's facilities or from the condemnation of any of such facilities, and (c) interest earned on all revenues referenced in (a) or (b) above, on the Operating Reserve or on any other fund or account relating to the Project (excluding any amounts required to be rebated to the United States pursuant to Section 148 of the Internal Revenue Code); provided, however, that such term shall not include customers' deposits or any other deposits subject to refund until such deposits are no longer subject to refund and have become the property of one of the Public Participants.

1.29 "Operation and Maintenance Expenses", as applied to the Project, means all expenses and costs of management, operation, maintenance and repair of the Project, including, without limitation, payments to be made by the Public Participants under agreements with Cal-Am for the purchase of potable water and all incidental costs, fees and expenses incurred for such purpose properly chargeable to the Project in accordance with generally acceptable accounting principles, subject, however, to the limitation with respect to depreciation, amortization and obsolescence described in Section 3.8(a) hereof.

1.30 "Ordinance" means Ordinance No. 39, as approved by the Board on February 13, 1989.

1.31 "PBCSD" means the Pebble Beach Community Services District, a public agency.

1.32 "Project" means the Facility, Distribution System and Irrigation Systems (including, without limitation, lands, facilities, equipment, furniture and fixtures).

1.33 "Public Participant" means any one or more of the following: WMD, CSD, PBCSD, or any successor public agency, including, without limitation, any joint powers agency formed by one or more of such agencies.

1.34 "Reclaimed Water" has the meaning given to it in Section 2.1 hereof.

1.35 "Related Agreements" means the agreements, in form and substance satisfactory to PBC and WMD, between or among two or more of CSD, PBCSD, WMD, Cal-Am, an owner of one or more of the Open Spaces and PBC, as the case may be, as contemplated by the Ordinance and this Agreement, or

otherwise reasonably necessary to implement the Project, and addressing all matters related to the Project as PBC deems necessary or advisable, including, without limitation, the following agreements:

(a) Agreement Among PBC, WMD and CSD/PBCSD Relating to the Reclaimed Water and Construction and Management of the Project - the agreement pursuant to which WMD will be entitled to own and control all water produced by the Project in exchange for the payment of all Capital Costs and Net Operating Deficiencies; CSD and PBCSD will undertake to construct and manage the Project; and PBC will be given certain rights to review and participate in decisions with respect to such construction and management.

(b) Sale Agreement Between WMD, Cal-Am and Owners of Open Spaces - the long-term sale agreement with respect to the sale and delivery of the Reclaimed Water to the Open Spaces.

(c) Delivery Agreement Among CSD or CSD/PBCSD, WMD, and Cal-Am - the agreement which will define the rights and responsibilities of each of the parties with respect to the operation and maintenance of all distribution systems for Reclaimed Water, distribution of the Reclaimed Water to the users thereof and the billing and collecting of the charges for use of the Reclaimed Water.

1.36 "Service Agreement" means the agreement between Cal-Am and PBC pursuant to which Cal-Am agrees to reserve the necessary water supply and to serve the Benefitted Properties and PBC agrees to pay the Ancillary Project Costs.

1.37 "S & P" means Standard & Poor's Corporation.

1.38 "Water Entitlement" means an aggregate of 380 acre feet per year of potable water which is dedicated to the Benefitted Properties as a vested property right and interest, as more fully described in Section 4.1 hereof.

1.39 "Water Use Permit" means a writing from WMD which evidences the dedication of the Water Entitlement as a vested property right and interest enuring to the use and benefit of the Benefitted Properties. A Water Use Permit shall, by non-discretionary ministerial action, cause the expansion/extension of the Cal-Am water distribution system for the Benefitted Properties, upon designation of the location of use, and upon payment of applicable connection fees and charges, by the owner thereof, as more fully described in

Section 4.3 hereof. A Water Use Permit shall take the place of, and be used in lieu of, any expansion/extension permit upon any Benefitted Property.

2. The Project.

2.1 Description. Each of the parties desire to cause the financing and construction of (a) a wastewater reclamation facility at the present CSD treatment plant site, capable of producing at least 800 acre feet per year of subpotable water suitable for irrigation of the Open Spaces (the "Reclaimed Water"), as more specifically described on Exhibit "C" hereto (the "Facility"), (b) a distribution system which is capable of distributing the Reclaimed Water from the Facility to a point of distribution in the Del Monte Forest for further distribution to the Open Spaces, as more specifically described on Exhibit "C" hereto (the "Distribution System"), and (c) irrigation systems on each of the Open Spaces which, in combination with the present irrigation systems on such Open Space, are capable of accepting and dispensing the Reclaimed Water for irrigation, as more specifically described on Exhibit "C" hereto (collectively, the "Irrigation Systems").

2.2 Role of Public Participants. In connection with the financing, construction and operation of the Project, (a) WMD shall (i) cause the funds necessary to construct and operate the Project to be provided and utilized for such purposes, (ii) own the Reclaimed Water, (iii) cause the Reclaimed Water to be sold and distributed to the owners of the Open Spaces and other users, (iv) cause the owners of the Open Spaces and other users of the Reclaimed Water to be billed for the purchase price of such water and such bills to be collected, (v) cause the Bonds to be paid from the revenues derived from the Project or from the Bond Letter of Credit, if such revenues are insufficient for such purpose, and (vi) cause the Net Operating Deficiencies to be paid from the Operating Reserve or from the NOD Letter of Credit, as contemplated by Section 3.3 hereof, and (b) CSD and PBCSD shall construct, own and operate the Project, all as further described herein and in the agreements referenced herein.

2.3 Use of Reclaimed Water.

(a) WMD shall sell a portion of the Reclaimed Water to each of the owners of the Open Spaces in such quantities as each such owner shall require for irrigation purposes, from time to time, in lieu of the potable water historically utilized by such Open Space for irrigation purposes, all as more fully described in the Sale Agreement between WMD and such owner. In addition, the owner of each

Open Space shall have a pro-rata right-of-first-refusal with respect to the purchase of Reclaimed Water, for use on its Open Spaces or other similar properties owned by such owner, that is not being utilized, from time to time, by one or more of the other Open Spaces, as more fully described in such Sale Agreement. All Reclaimed Water sold for use on the Open Spaces, or for use on other similar properties owned, from time to time, by the owners of the Open Spaces, shall be sold at charges which are not in excess of Cal-Am's charges for potable water, in similar quantities for similar uses and to similar users, from time to time.

(b) To the extent the Facility produces Reclaimed Water, from time to time, in excess of the aggregate requirements of the Open Spaces and such other similar properties for water suitable for irrigation, WMD shall use its best efforts to sell such excess Reclaimed Water to users other than the Open Spaces at the highest price then available in the market; provided, however, any agreement to sell such excess Reclaimed Water to such users shall not obligate WMD to do so for a period of time in excess of six months. So long as, and to the extent, WMD is incapable, after using its best efforts to do so, from time to time, of selling such excess Reclaimed Water to such users, WMD may sell such excess Reclaimed Water, at the cost of the production thereof, to be used for any public benefit, rather than commercial use; provided, however, any agreement to sell such excess Reclaimed Water for such uses shall not obligate WMD to do so for a period of time in excess of 30 days.

3. Financing of Project.

3.1 Bonds. WMD or another Public Participant shall issue bonds or certificates of participation (the interest on which, at the election of PBC, is excludable from income for Federal income tax purposes, to the extent permitted under applicable law) for the purpose of financing the Capital Costs of the Project. WMD will engage in best efforts to cause the Bonds to be offered for sale within 30 days after the final design and construction budget for the Project have been approved and all of the construction contracts for the Project have been approved and become effective, subject to closing of the sale of the Bonds; provided, however, the Bonds shall not be offered for sale prior to 30 days after WMD or the Issuer gives PBC written notice of its intent to commence such offering. The maturity date of the Bonds shall be 30 years from the closing of the sale of the Bonds, or an earlier date, if so requested by PBC, specified in a written notice to WMD which is effective on or before 30 days prior to the commencement of the offering of the Bonds. The Bonds shall

bear interest on a fixed or variable rate basis, and will have such other terms and conditions, as may be approved in writing by PBC, which terms shall be compatible with the maintenance of the Bond Requisite Credit Rating. Each Bond Document prepared or provided by WMD, PBC or the Issuer, if other than WMD, shall be submitted to WMD and PBC for its review and comment a reasonable number of days prior to such Bond Document becoming effective or being distributed or delivered in connection with the offering of the Bonds. Each of WMD and PBC shall have the right to approve each of the Bond Documents not prepared or provided by it solely for the purpose of ensuring that such Bond Document is not inconsistent with the terms and conditions of this Agreement or any of the Related Agreements and is in compliance with applicable law. The underwriter for the Bonds and all costs of issuance of the Bonds shall be subject to the prior written approval of PBC, which approval shall not be unreasonably withheld. Disbursement of Bond proceeds shall be limited to payment of authorized Capital Costs of the Project, the establishment of the Operating Reserve and the funding of a debt service reserve to be held under the trust indenture for the Bonds. Upon completion of the Project, at PBC's election, all remaining Bond proceeds (net of the Operating Reserve) shall be applied to prepay the principal payments on the Bonds, in the order of such payments, or shall be added to the Operating Reserve.

3.2 Bond Letter of Credit. PBC shall provide for payment of the principal amount of, and interest on, the Bonds by delivering to WMD, on or before the closing with respect to the sale of the Bonds, a letter of credit (the "Bond Letter of Credit") in the amount of the principal amount of the Bonds plus the Interest Reserve. The Bond Letter of Credit shall be issued by a banking or other financial institution, the long-term unsecured obligations of which are rated within the Financial Institution Requisite Credit Rating. The terms and conditions of the Bond Letter of Credit, as well as its payment provisions, whether standby or direct pay, shall be adequate to obtain the Bond Requisite Credit Rating for the Bonds, and shall otherwise be reasonably acceptable to each of PBC and WMD and not inconsistent with this Agreement or any of the Related Agreements.

3.3 Net Operating Deficiencies Letter of Credit. PBC shall provide for the payment of projected Net Operating Deficiencies, as determined in the manner described in Section 3.8(a) hereof, in excess of the Operating Reserve, by delivering to WMD a letter of credit, in the amount of such excess (the "NOD Letter of Credit"). The NOD Letter of Credit shall be issued by a banking or other financial institution, the long-term unsecured obligations of which are rated within

the Financial Institution Requisite Credit Rating, and shall otherwise include such terms and conditions as are reasonably acceptable to each of PBC and WMD and not inconsistent with this Agreement or any of the Related Agreements. PBC shall first be required to deliver the NOD Letter of Credit within 30 days of its receipt of written notice from the Management Committee stating that the Operating Reserve has been exhausted and setting forth the projected Net Operating Deficiency for such year. Thereafter, PBC shall be required to deliver a NOD Letter of Credit with respect to each year for which a Net Operating Deficiency has been projected within 30 days after its receipt of a written notice from the Management Committee setting forth such projected Net Operating Deficiency. Each NOD Letter of Credit shall be in the amount of the projected Net Operating Deficiency for the year with respect to which it is delivered. Each NOD Letter of Credit shall have a term which expires 90 days after the end of the year with respect to which it is delivered. Except as provided in Section 3.6 hereof, PBC shall be obligated to provide a NOD Letter of Credit pursuant to the terms of this Section 3.3 so long as the Bonds remain outstanding. In the event PBC is not obligated to provide a NOD Letter of Credit for any year, WMD shall promptly thereafter cause the beneficiary under the NOD Letter of Credit to return the NOD Letter of Credit to PBC.

3.4 Letters of Credit. The Bond Letter of Credit and the NOD Letter of Credit (collectively, the "Letters of Credit") shall be irrevocable and unconditional and shall be renewable at such intervals (but in any event not less than one year) as determined by PBC. Each of the Letters of Credit shall provide that the beneficiary of such Letter of Credit (or its designated representative) may draw upon it in the event PBC does not provide such beneficiary with written confirmation of its renewal, in the case of the Bond Letter of Credit, or of the issuance of a new Letter of Credit, if applicable, in the appropriate amount, in the case of the NOD Letter of Credit, upon its expiration, from the issuing financial institution at least 30 days prior to its expiration. Except as provided in the immediately preceding sentence, the beneficiary under a Letter of Credit (or its designated representative) may draw on such Letter of Credit only to the extent necessary to ensure that, in the case of the Bond Letter of Credit, the principal amount of, and interest on, the Bonds is timely paid and, in the case of the NOD Letter of Credit, any Net Operating Deficiency is timely paid. Each renewal of the Bond Letter of Credit need only be in an amount equal to the then unpaid principal balance of the Bonds plus the Interest Reserve. Notwithstanding any implication to the contrary herein, prior to any proposed draw on any Letter of Credit, such beneficiary shall, in reasonable anticipation of the need to draw on such

Letter of Credit, provide PBC with written notice of its intention to draw on such Letter of Credit, which notice shall set forth the amount of such draw and the date of such draw, at least ten days prior to such draw, and PBC shall have the right to pay to such beneficiary a sum equal to the amount of such draw, at least two Business Days prior to such date, in lieu of such beneficiary (or its designated representative) making such draw. PBC shall only be required to provide one Bond Letter of Credit and one NOD Letter of Credit at a time, with the appropriate beneficiaries thereof to be determined by the Issuer at the time of issuance of the Bonds. PBC shall have the right to substitute, from time to time, for either letter of credit, a letter or letters of credit issued by any banking or other financial institution with the Financial Institution Requisite Credit Rating and otherwise including terms and conditions substantially the same as the then outstanding Letter of Credit, provided the Bond Requisite Credit Rating is not thereby adversely affected.

3.5 Ancillary Project Costs. PBC shall provide for the payment of Ancillary Project Costs pursuant to the Service Agreement, which shall provide that PBC shall pay the Ancillary Project Costs directly to Cal-Am.

3.6 Termination of Financial Commitment. PBC shall have the right to cease providing the Bond Letter of Credit if all principal and interest on the Bonds (and all expenses necessary to defease the indenture or trust agreement under which the Bonds are issued) have been paid or an amount, in cash or other eligible securities, equal to the aggregate of the unpaid principal on the Bonds, such expenses and the Interest Reserve has been set aside, in a trust account (which may be drawn on only to repay the Bonds), for payment of the Bonds. PBC shall have the right to cease providing the NOD Letter of Credit upon the first to occur of either of the following events: (a) the Operating Revenues for the preceding three years for which financial data is then available equal or exceed 125% of Operation and Maintenance Expenses for each such year; and (b) 30 years after the issuance of the Bonds. In the event PBC's obligation to provide either of the Letter of Credits ceases pursuant to this Section 3.6, WMD shall promptly thereafter cause such Letter of Credit to be returned to PBC.

3.7 Capital Costs. CSD and PBCSD shall have responsibility for construction of the Project, subject to the Management Committee's right to approve decisions relating to the design and construction of the Project, including, without limitation, with respect to the matters described in this Section 3.7.

(a) With respect to design and construction of the Project, each member of the Management Committee shall be given advance written notice, in reasonable detail, and a reasonable period of time after its receipt of such notice to comment on, and make suggestions with respect to, each of the following actions prior, as applicable, to such action becoming effective or complete: (i) initial design plans for the Project; (ii) cost estimates for the Project as set forth in a construction budget and other writings, including the setting of a contingency; (iii) the approval of final design plans for the Project; (iv) the establishment of bid criteria for all construction contracts and subcontracts for the Project; (v) the preparation of all construction contracts for the Project; (vi) the letting and approval of all such contracts and the related subcontracts; (vii) the establishment of the construction schedule; (viii) all construction disbursements; and (ix) the adequacy of all payment and performance bonds and insurance requirements. The right to comment on, and make suggestions with respect to, the construction disbursements shall be provided, in part, by each member of the Management Committee being given the opportunity to participate in the periodic (but at least monthly) meetings, between the general contractor(s) for the Project and the construction engineer retained by CSD to supervise the construction of the Project, with respect to the status of construction of the Project and the approval of the payment of each construction disbursement.

(b) Without the written approval of PBC, which shall not be unreasonably withheld or delayed, (i) upon and after the approval by the Management Committee of the final design and scope of, and construction schedule for, the Project (upon which the Capital Costs have been determined), no material change to such design, scope or construction schedule shall be made by the Management Committee, and (ii) upon and after the net effect of all change orders having aggregated an amount which exceeds 5% of the construction budget (upon which the Capital Costs have been determined), without reference to the contingency, no additional change order in excess of \$5,000 may be approved by the Management Committee. Each entity with representation on the Management Committee shall be designated a third party beneficiary of all construction contracts, all payment and performance bonds and all insurance policies in connection with the Project providing coverage with respect to the construction of the Project.

(c) In the event that the actual construction costs of the Project exceed its estimated construction costs (as reflected in the Capital Costs), (i) WMD shall, as soon as is practicable after the amount of such excess costs have been determined, issue, or cause another

Public Participant to issue, additional bonds or certificates of participation to finance such excess costs and to fund a debt service reserve fund with respect to such additional bonds or certificates of participation, and (ii) PBC shall provide for payment of the principal amount of, and interest on, such bonds or certificates of participation by delivering to WMD, on or before the closing with respect to sale of such securities, a Letter of Credit, in the amount of such principal and an Interest Reserve, which meets the requirements of the Bond Letter of Credit under Section 3.2 hereof.

3.8 Calculation and Monitoring of Net Operating Deficiencies.

(a) The calculation of the projected Net Operating Deficiency, if any, for each year, shall be made by reference to the annual budget for the Project for each year. The Management Committee shall cause to be developed, and shall approve, an annual budget for the Project for each year at least 30 days prior to the commencement of such year. In calculating the projected and actual Net Operating Deficiencies for any year: (i) no item of administrative or other overhead expense of the Public Participants, other than such reasonable expenses which relate to the Project, shall be included in the calculation of Operation and Maintenance Expenses without the prior written consent of each of the members of the Management Committee who is not a representative of such Public Participant, with the exact amount of any such includable expenses to be determined by the Management Committee; (ii) Operation and Maintenance Expenses shall only include an allowance for depreciation, amortization and obsolescence (established in the first annual budget for the Project) which is determined pursuant to generally accepted utility practices, but is limited to an amount sufficient to create, over the original term of the Bonds, a sinking fund for replacement and renovation which shall not exceed \$1,000,000, and such allowance shall not be modified if the Bonds are prepaid for any reason; and (iii) no debt service obligation on the Bonds covered by the Bond Letter of Credit shall be included.

(b) CSD and PBCSD shall have responsibility for management and operation of the Project, subject to the rights of each member of the Management Committee to receive financial data (both projected and historical) concerning the Project, and to review, and comment upon, decisions related to such financial data and the management and operation of the Project, including, without limitation, with respect to the matters described in this subsection (b):

(i) Each of the members of the Management Committee shall have the right to participate in the development of an annual budget for the Project, which shall include projected Operating Revenues and Operation and Maintenance Expenses for such year. Only expenses provided in a budget for the Project, or approved in writing by each member of the Management Committee, shall be deemed to constitute Operation and Maintenance Expenses. CSD shall submit to each member of the Management Committee (A) with respect to the first partial and first full fiscal year of the Project, and for each fiscal year thereafter, if, during the immediately prior fiscal year, the actual Net Operating Deficiency exceeded the budgeted Net Operating Deficiency, if any, for such year, unaudited monthly financial statements of the Project, accompanied by an unqualified certificate of the chief financial officer of the Public Participant which owns the Project (an "Officer's Certificate"), on or before the 15th day after each such month, (B) with respect to each fiscal year for the Project not described in clause (A) above, unaudited quarterly financial statements of the Project, accompanied by an Officer's Certificate, on or before the 30th after each such quarter, (C) with respect to each fiscal year of the Project, audited annual financial statements of the Project, accompanied by an unqualified certificate of the auditing firm approved by the Management Committee, on or before the 45th day after the end of each fiscal year, and (D) such other written information with respect to the Project as may be reasonably requested by such person, including, without limitation, such information as may be necessary to make a proper accounting to PBC with respect to its obligations in connection with the Financial Commitment, within a reasonable period of time after it is requested. Each of such financial statements shall consist of a balance sheet, as of the end of the applicable period, and an income statement and statement of changes in financial position, for such applicable period, and shall be prepared in accordance with generally accepted accounting principles consistently applied.

(ii) Each of the members of the Management Committee shall have the right to (A) receive initial drafts of each annual budget with respect to the Project at the same time such draft is first submitted to the General Manager or Board of Directors of the Public Participant which owns the Project, (B) the proposed final draft of each such annual budget at least 30 days before it is submitted to the Management Committee for its approval, (C) make comments to such General Manager and the Management Committee with respect to each such draft of the annual budget and each of the financial statements for the Project which it has the right to receive, and (D) review and audit, or cause its designated

representatives to review and audit, the books and records with respect to the Project, at its own expense, during the business hours of such Public Participant, upon reasonable advance notice of its intention to do so having been given to such Public Participant.

(iii) Any member of the Management Committee may request, from time to time, the General Manager of CSD to prepare projections of the operating results of the Project through the end of the then fiscal year of the Project. Upon receiving such request, such General Manager shall engage in best efforts to prepare and deliver such projections to each member of the Management Committee within 30 days of receiving such request. In the event that any such projections reveal that it is likely that the operating results for such year will involve a Net Operating Deficiency and either no Net Operating Deficiency was included in the budget for such year or such projected Net Operating Deficiency was in excess of the Net Operating Deficiency included in the budget for such year, at the request of any member of the Management Committee, the Management Committee shall retain a consulting engineer to review the operation and maintenance of the Project and to make recommendations with respect thereto. If requested by PBC, the Management Committee shall cause the Project to promptly comply with all such recommendations which are reasonable. The charges of such consulting engineer shall be paid by the Project and shall be deemed to be an Operation and Maintenance Expense.

(iv) Notwithstanding paragraph (i) above, in the event the results of operations (i.e. difference between the Operating and Maintenance Expenses and Operating Revenues) for a fiscal year of the Project, based upon the results of operations of the Project through the first nine months of such year projected through the end of such year, reflects a \$100,000, or greater, negative difference from the results of operations projected in the budget for such year, PBC shall have the right to approve the budget for the immediately succeeding fiscal year of the Project.

(c) CSD and PBCSD and WMD shall maintain separate accounts and budgets with respect to Operating Revenues and Operation and Maintenance Expenses.

(d) The Project shall be owned, operated, maintained and serviced in accordance with applicable regulations, good engineering practice and prudent business practices. Reclaimed Water produced by the Project shall be suitable for irrigation of greenbelt areas (including golf courses) and otherwise meet all regulatory and health standards for such usage.

(e) The Public Participant which owns the Project shall cause an annual inspection of the Project to be performed, during the last month of each fiscal year of the Project, by a consulting engineer acceptable to the Management Committee, and a report of such engineer to be delivered to each member of the Management Committee, on or before the 45th day of the ensuing year. In the event that operating or other deficiencies are disclosed in any such report, at the request of PBC, such Public Participant shall promptly cause measures necessary to correct such deficiencies to be implemented. The charges of such consulting engineer shall be paid by the Project and shall be deemed to be an Operation and Maintenance Expense.

(f) The Public Participant which owns the Project shall obtain and maintain in effect insurance for the Project, with such coverages (including with respect to risks, amounts and deductibles), and with such insurance companies, as are acceptable to each member of the Management Committee, which approval shall not be unreasonably withheld or delayed. In recognition that the Project is dependent upon the continued operation of the existing treatment facilities owned by CSD or PBCSD which produce secondary treatment effluent, each of CSD and PBCSD shall (i) make all reasonable efforts to maintain in place its present insurance coverages (including with respect to risks, amounts and deductibles) for such facilities, (ii) shall promptly provide to all members of the Management Committee such information concerning the insurance in place with respect to such facilities, and the risks of operating such facilities, as may be reasonably requested, from time to time, by any member of the Management Committee, and (iii) shall purchase such additional insurance with respect to such facilities as may be available in the marketplace and is requested by PBC, with the incremental additional cost for such additional insurance to be paid by the Project and deemed to be an Operation and Maintenance Expense. Each such insurance policy shall (i) name each entity which has a representative on the Management Committee and which has an insurable interest thereunder as an additional insured thereunder, and (ii) shall provide that it may not be terminated or amended or otherwise modified, in any material respect, without each additional insured thereunder being given at least 30 days prior written notice of such termination, amendment or modification. Upon the renewal of each such insurance policy and upon the request of any member of the Management Committee, such Public Participants shall provide such person with written evidence, in the form of policies or certificates of insurance, of such insurance.

(g) The generation of Operating Revenues and the application thereof shall include the following:

(i) The price charged by WMD for the Reclaimed Water sold for use on other than the Open Spaces, at all times that any portion of the Financial Commitment is in effect, shall be as described in Section 2.3 hereof.

(ii) All of the Open Spaces shall be obligated for the purchase of Reclaimed Water for a term not less than the term of the Bonds. WMD will engage in best efforts to maximize the sales, and the revenues derived therefrom, of Reclaimed Water, to the extent not required by the Open Spaces, to other users.

(iii) WMD, or Cal-Am on behalf of WMD, shall efficiently bill and collect water charges from, and enforce its agreements with, the Open Spaces and other purchasers of Reclaimed Water and (in the case of Cal-Am) shall promptly remit all Operating Revenues to WMD.

3.9 Application of Surplus Revenue. All Operating Revenues in excess of Operation and Maintenance Expenses ("Net Operating Income") shall be applied against any principal and interest payments on the Bonds which come due, from time to time, any Bond Carrying Costs not constituting a Capital Cost and any Ancillary Project Costs, in that order, and the balance of any such excess ("Surplus Revenue") shall, at the election of PBC, be applied to (a) the early payment or redemption of the Bonds or set aside, in a trust account, irrevocably for such purpose, or (b) the Operating Reserve. In the event that the Bonds are fully paid prior to their maturity date, as soon as the Financial Commitment with respect to Net Operating Deficiencies is terminated, the price of Reclaimed Water charged to the Open Spaces shall be reduced to a level that assures, to the extent practicable, that Operating Revenues do not exceed reasonable Operation and Maintenance Expenses, until the date the Bonds would have matured had they not been paid prior to such date.

3.10 Investment of Operating Revenues. All Operating Revenues of the Project and all amounts in any reserve with respect to the Project, including, without limitation, the Operating Reserve, shall be invested in a manner designed to maximize the investment return on such amounts, subject to applicable legal investment and/or tax law limitations and investment criteria to be agreed upon by the parties.

3.11 Refunding. In the event that general interest rates that prevail in the market at the time the Bonds are sold should decrease, WMD shall, at the request of PBC, cause the Issuer, from time to time, to offer and sell

refunding bonds, pursuant to the same terms and conditions of this Agreement as are applicable to the sale of the Bonds, in an amount equal to the aggregate of the then principal balance on the Bonds, any accrued, but unpaid, interest on the Bonds, and the costs of offering and selling such refunding bonds. Upon the closing of the sale of the refunding bonds, the net proceeds of such sale shall first be applied to redeem the Bonds, and thereafter, for all purposes under this Agreement, the refunding bonds shall be deemed to constitute the "Bonds". Notwithstanding the foregoing, the Issuer shall have no obligation to offer and sell refunding bonds unless the present value saving that is projected to result from the decrease in the aggregate amount of interest payments on the Bonds exceeds the projected costs of offering and selling the refunding bonds, as determined by PBC, by at least one percent of the principal amount of the Bonds.

3.12 Bond Carrying Costs. If, at the time any Bond Carrying Cost not constituting a Capital Cost becomes due and payable, and the Net Operating Income not previously applied pursuant to Section 3.9 hereof is insufficient to fully cover any payment of principal or interest on the Bonds then due and payable and such Bond Carrying Cost, PBC shall pay such Bond Carrying Cost, to the extent not covered from such sources, within ten days of receiving an invoice therefor, describing such Bond Carrying Cost in reasonable detail. Thereafter, at such time as such Net Operating Income is sufficient to fully cover any payment of principal or interest on the Bonds then due and payable, WMD shall cause PBC to be promptly reimbursed from such source for the portion of such Bond Carrying Cost which it paid.

3.13 Guarantee. In the event that the bank or other financial institution issuing either of the Letters of Credit should lose the Financial Institution Requisite Credit Rating and PBC fails to replace such Letter of Credit, within 90 days of WMD requesting PBC to replace such Letter of Credit, with a letter of credit issued by a bank or other financial institution, which has the Financial Institution Requisite Credit Rating, and which includes terms and conditions substantially the same as such Letter of Credit, PBC shall promptly thereafter provide to WMD (a) an irrevocable guarantee of direct and timely payment of the categories and amounts of payments covered by such Letter of Credit until such time as PBC would be entitled, pursuant to Section 3.6 hereof, to cease providing such Letter of Credit, and (b) such security for its obligations under such guarantee as may be reasonably requested by WMD.

4. Entitlement to Water.

4.1 Grant of Entitlement. WMD hereby grants, assigns and transfers to PBC, Lohr and Griffin an irrevocable (except as expressly provided in Section 4.5 hereto), divisible binding entitlement to potable water, as a vested property right and interest, in and for the Benefitted Properties, for use on and by the Benefitted Properties in the aggregate quantities set forth on Exhibit "A" hereto during each consecutive 12 month period, beginning with the first day of the month after the month in which the Commercial Operation Date occurs.

4.2 Issuance of Water Permits.

(a) At or prior to the closing of the sale of the Bonds, WMD shall issue Water Use Permits, in a form consistent with the provisions of this Agreement, to PBC, Lohr and Griffin, necessary to memorialize the Water Entitlement granted to each, with respect to the Benefitted Properties, pursuant to Section 4.1 hereof. Each Water Use Permit shall represent an irrevocable (except as expressly provided in Section 4.5 hereto), vested property right and interest, with respect to each of the Benefitted Properties, for the use and benefit of a specified quantity of potable water per year produced by the Cal-Am water distribution system, and shall authorize the expansion and extension of the Cal-Am water distribution system to provide water service and connections for the benefit of such Benefitted Property.

(b) Each Water Use Permit shall be issued by WMD with respect to a single Benefitted Property and shall identify: (i) the nature (industrial, commercial or residential) and location of the water use to be applied to each Benefitted Property, and the consistency of such water use with the then existing land use plans; (ii) the number and type of connections projected for each Benefitted Property; and (iii) the projected water use required by each connection proposed upon each Benefitted Property and the aggregate projected water use for each Benefitted Property. Estimated water usage for each Water Use Permit shall be based upon the water use capacity for proposed or planned development upon the related Benefitted Property.

(c) Each owner of any Benefitted Property shall, upon request, be entitled to an amendment to any Water Use Permit to: (i) change the nature and location of the water use on such Benefitted Property, provided such use is consistent with the then existing land use plans for such Benefitted Property; (ii) reduce or increase the number and/or

type of connections for such Benefitted Property; and/or (iii) reduce or increase the quantity of annual water use projected for such Benefitted Property and reallocate the Water Entitlement among the Benefitted Properties owned by such owner, provided that the aggregate amount of estimated annual water usage for all of the Benefitted Properties owned by such owner shall not exceed the aggregate Water Entitlement for all of the Benefitted Properties owned by such owner. The holders of the Water Use Permits shall have the right to allocate and use the Water Entitlement on and among the Benefitted Properties in such manner as they may in their sole discretion choose, provided the nature and location of the use is consistent with then applicable land use.

(d) A Water Use Permit issued with respect to a Benefitted Property may be assigned, in whole or in part, in connection with a transfer of title to all or any portion of such Benefitted Property. Upon any such transfer, the holder-assignor of the Water Use Permit shall notify the General Manager of WMD of such assignment, and the General Manager shall (i) issue a separate and distinct Water Use Permit to the assignee for that portion of the Benefitted Property transferred, and (ii) make such notations or adjustments to the Water Use Permit held by the assignor as are required to reflect such assignment. Any Water Use Permit which is held by, or assigned to, a person or entity described in clause (i) of Section 4.5(b) hereof shall provide, by its terms, that it may not be revoked or terminated. Upon a transfer of any portion of a Benefitted Property and assignment of all or any portion of a Water Use Permit to such portion of a Benefitted Property, the portion of the Water Entitlement described in the assignment of the Water Use Permit shall be deemed allocated to the portion of the Benefitted Property so transferred, and such portion of the Benefitted Property so transferred shall be deemed for all purposes to be a "Benefitted Property" under this Agreement.

4.3 Cal-Am System Expansion/Extension Pursuant to Water Use Permits.

(a) Each Water Use Permit shall entitle the owner of a Benefitted Property to service to be provided by the Cal-Am water distribution system for such Benefitted Property, including, without limitation, the installation of water meters and mains as necessary, upon presentation to WMD by the holder of such Water Use Permit of the following:

(i) A written statement by such holder, setting forth the annual capacity of water use that such holder will exercise in connection with the related

Benefitted Property through such expansion/extension of the Cal-Am water distribution system, and the nature of the uses to which such water is intended to be applied in the future;

(ii) At the election of the holder, either (A) a valid municipal or county building permit which will allow construction upon such Benefitted Property; or (B) a complete set of architectural drawings with respect to the proposed improvements to such Benefitted Property; or (C) other documentation sufficient for WMD to determine the quantity and the capacity for annual water use upon the Benefitted Property and the number and type of each requested connection; and

(iii) The payment of any customary fees and connection charges required by both Cal-Am and WMD of water users within the Cal-Am service area, calculated upon the basis of the annual water usage capacity on the Benefitted Property set forth in such holder's statement, including, without limitation, fees and charges due by reason of Rule 24 of WMD's Rules and Regulations.

(b) Upon the filing of the information, and payment of the fees required above, the General Manager of WMD shall make a notation on such Water Use Permit, indicating the location, capacity and nature of each connection for the related Benefitted Property requiring a present expansion/extension of the Cal-Am water distribution system. The aggregate water use represented by such expansions/extensions of the Cal-Am water distribution system for each Water Use Permit shall not exceed the Water Entitlement evidenced by such Water Use Permit. In the event that a holder of a Water Use Permit requests an expansion/extension of the Cal-Am water distribution system with respect to less than all of the Water Entitlement evidenced by such Water Use Permit, the General Manager of WMD shall make a notation on such Water Use Permit, indicating the remaining Water Entitlement to which such holder is entitled with respect to the related Benefitted Property.

(c) Each holder of Water Use Permit shall be entitled to increase the annual water use for the related Benefitted Property, to which such holder has previously applied a portion (but less than all) of the Water Entitlement evidenced by such Water Use Permit through prior expansions/extensions of the Cal-Am water distribution system, upon presentation of the information and payment of the fees described above; provided, however, that any such increases in water use for such Benefitted Property shall not, when aggregated with the permitted water usage for all of the

Benefitted Properties owned by such holder previously granted, exceed in the aggregate the total Water Entitlement of such holder for all of its Benefitted Properties.

4.4 Effect of Water Use Permits. The Water Use Permits shall represent a vested property right and interest upon issuance and shall not be subject to revocation or cancellation except as expressly provided in Section 4.5 hereof. The Water Entitlement evidenced by each Water Use Permit (i) shall not be subject to reallocation pursuant to WMD Rule 30, (ii) shall not be terminated or diminished by reason of any water emergency, water moratorium or other curtailment on the setting of meters for the Cal-Am water system, and (iii) shall not be subject to diminishment or revocation, except as provided in Section 4.5 hereof. The Water Use Permits shall be subject only to the following limitations: (i) the permit shall not limit the power of WMD to curtail water use in the event of a water emergency, as defined in Section 332 of the Monterey Peninsula Water Management Act, so long as WMD does not discriminate, in such curtailments, between any holder of a Water Use Permit and any other user of the same class as such holder; (ii) the permit shall not relieve or reduce any obligation of the holder of a Water Use Permit to pay customary fees, connection charges, use fees, surcharges, taxes, utility taxes, and/or any other customary monetary obligation which may be imposed by the Public Utilities Commission, Cal-Am, WMD, or other Public Participants upon water users of the same class as such holder, including, without limitation, fees and charges due and payable to WMD by reason of Rule 24 of WMD's Rules and Regulations; and (iii) the permit shall enable present use of the Water Entitlement only after the Commercial Operation Date.

4.5 Revocation and Termination of Water Use Permits.

(a) Each Water Use Permit held by PBC or any successor assignee pursuant to Section 11.5 hereof who has assumed PBC's obligations under this Agreement shall provide that, subject to the provisions of Section 4.5(b) hereof, it may be revoked and terminated by WMD in the event that PBC (a) fails to cause the initial Bond Letter of Credit, or the additional letter of credit contemplated by Section 3.7(c) hereof, to be timely issued and delivered to the beneficiary thereunder, (b) fails to cause any NOD Letter of Credit, which may be required hereunder, to be issued and delivered to the beneficiary thereunder within 15 days after PBC receives written notice of such failure, or (c) fails to meet, in any material respect, any of its obligations with respect to the payment of Ancillary Project Costs within 30 days after PBC

receives written notice of such failure; provided, however, that nothing herein shall preclude PBC from disputing in good faith any claim of default made by WMD, nor shall WMD terminate or revoke any Water Use Permit unless PBC shall have been given notice and a reasonable opportunity to cure any such default, so long as such opportunity to cure shall not result in any payment default to the holders of the Bonds. Each Water Use Permit which, on or after January 1, 2075, embodies an annual Water Entitlement in excess of the requirements for planned land uses on the related Benefitted Property shall be subject to modification, in the sole discretion of WMD, such that it thereafter embodies a Water Entitlement which is not in excess of such requirements. Prior to the proposed termination and revocation of any Water Use Permit pursuant to this Section 4.5, PBC and the holder of such Water Use Permit shall be entitled to notice and a hearing, and any termination shall be subject to appeal to the Board by PBC and such holder pursuant to Rule 70 of WMD's Rules and Regulations. A Water Permit may be revoked or terminated only to the extent specifically provided in this Section 4.5(a).

(b) Notwithstanding Section 4.5(a) above or any other provision of this Agreement, the revocation and termination of any Water Use Permit with respect to a Benefitted Property, for any reason whatsoever, shall not diminish or otherwise adversely affect the rights under such Water Use Permit, including, without limitation, the right to the quantity of potable water per year specified in such Water Use Permit, if, at the time of such revocation and termination, there exists an actual use of water on such Benefitted Property by reason of a prior expansion or extension of the Cal-Am water distribution system to such Benefitted Property. For purposes of this section, the "then actual use of water by reason of a prior expansion or extension of the Cal-Am water distribution system", with respect to a Benefitted Property, shall be deemed conclusively to include, without limitation, (i) the holding of a Water Use Permit by Lohr or Griffin or a third party purchaser or lessee of such Benefitted Property who has received such Water Use Permit by assignment from PBC, Lohr or Griffin (or a successor of PBC, Lohr or Griffin) without assuming PBC's obligations under this Agreement, the effect of which shall be that a Water Use Permit that is held by Lohr or Griffin or any such assignee shall not be subject to revocation or termination under the provisions of this Agreement or otherwise; or (ii) the installation of a water meter on the Benefitted Property, to the full extent of the water use authorized for such connection under the related Water Use Permit, without regard to the amount of water use made, from time to time, through such water meter.

4.6 Water Charges. The water subject to the Water Entitlement shall be sold to the owners of each of the Benefitted Properties at charges which are not in excess of Cal-Am's charges for potable water, in similar quantities and sold to similar users for similar uses, from time to time.

4.7 Agreements with Open Spaces. The Related Agreement between WMD and Cal-Am and each of the Open Spaces shall: (a) require the Open Space to purchase Reclaimed Water for a term not less than the term of the Bonds; (b) guarantee delivery to the Open Space of Reclaimed Water in the quantities each shall require, so long as the Project is in operation; (c) guarantee delivery to the Open Space of additional potable water from Cal-Am as may be necessary to fulfill the requirements of such Open Space in the event the Project is incapable of providing subpotable water in such quantities; provided, however, that the use of potable water shall not be guaranteed during any water emergency declared by the Board pursuant to either Section 31026 of the California Water Code or Section 332 of the Monterey Peninsula Water Management District Law; and (d) subject to Sections 3.9 and 2.3(a) hereof, require WMD to impose rates and charges for Reclaimed Water sufficient to maximize Operating Revenues. WMD shall use its powers and authority to cause each owner of an Open Space to purchase Reclaimed Water for use on the Open Spaces it owns, as contemplated by Sections 13500, et seq. of the California Water Code, on terms and conditions which are the same, in all material respects, as the terms and conditions of the agreements that each of the other owners of the Open Spaces enter into with respect to the purchase of Reclaimed Water for use on the Open Spaces it owns.

5. Advance of Costs. PBC has, pursuant to the terms and conditions of a Memorandum of Understanding, dated July 1987, between the parties (the "Memorandum") advanced funds, both prior and subsequent to the date of the Memorandum, for expenditures with respect to design, engineering and other matters incident and preparatory to the Project, including, without limitation, legal and consulting fees and costs associated with the Project and its implementation and this Agreement and each Related Agreement, and shall have the right, but not the obligation, to continue to advance funds for such expenditures unless and until the proceeds from sale of the Bonds is available. All such expenditures incurred by PBC shall be deemed to constitute Capital Costs of the Project and shall be reimbursed to PBC by the Issuer from the proceeds of, and after the closing of, the sale of the Bonds, within 30 days after the receipt by the Issuer, from time to time, of written evidence, in reasonable detail, of PBC incurring such expenditures.

6. Representations and Warranties.

6.1 Mutual Representations and Warranties. PBC and WMD each hereby represents and warrants to the other that:

(a) the execution and delivery of this Agreement and each of the Related Agreements by it, and the performance of its obligations under this Agreement and each of the Related Agreements, have been duly authorized by all necessary action on its part, and it has full power, right and authority to enter into this Agreement and each of the Related Agreements and to perform its obligations hereunder and thereunder;

(b) neither the execution and delivery of this Agreement or any of the Related Agreements by it, nor the performance by it of any of its obligations under this Agreement or any of the Related Agreements, violates any applicable Federal, state or local law, whether statutory or common, or regulation or, with respect to PBC, partnership agreement, or constitutes a violation of, or a breach or default under, any agreement or instrument, or judgment or order of any court or governmental authority, to which it is a party or to which it or any of its property is subject;

(c) this Agreement and each of the Related Agreements is a valid and binding obligation of it, enforceable against it in accordance with its terms, except as such enforceability may be limited by equitable principles or by bankruptcy or other laws affecting creditors' rights generally; and

(d) no consent, approval, order or authorization of any person, entity, court or governmental authority is required on its part in connection with the execution and delivery of this Agreement or any of the Related Agreements or the performance by it of any of its obligations hereunder or thereunder.

6.2 Representations and Warranties of WMD. WMD hereby represents and warrants to PBC as follows:

(a) Upon the effectiveness, and subject to the terms and conditions, of this Agreement, each owner of the Benefitted Properties shall be vested with all right, title and interest to an irrevocable (except as expressly provided in Section 4.5 hereof) property right and interest in the portion of the Water Entitlement and the Water Use Permits which benefits the Benefitted Properties it owns, free and clear of any liens, claims or encumbrances, statutory or otherwise,

including, without limitation, the right to transfer its portion of the Water Entitlement, all as described in Sections 4.1 and 4.2 hereof; and

(b) Each of the Water Entitlements and the Water Use Permits granted pursuant to the terms and conditions of this Agreement shall constitute a valid and binding vested property right and interest, as described in Sections 4.1 and 4.2 hereof, to the potable water subject to such Water Entitlement and Water Use Permit, enforceable according to its terms, except as such enforceability may be limited by equitable principles or by bankruptcy or other laws affecting creditor's rights generally.

(c) The terms and conditions of this Agreement are in compliance, in all material respects, with the terms and conditions of the Ordinance.

7. Covenants.

7.1 Other Agreements. Each of the parties shall, within 30 days after the effectiveness of this Agreement, execute, and deliver to the other parties thereto, each of the Related Agreements to which it is a party and engage in reasonable efforts to cause each of the parties to each such agreement and the Management Agreement and the Service Agreement, other than it, to execute, and deliver to each of the other parties thereto, such agreement.

7.2 Conflicting Agreements or Actions. WMD shall not enter into any agreements, or take any actions, which may adversely affect or impair the right, title and interest of the owner of any portion of the Water Entitlement to such portion or the use or enjoyment of such portion with respect to the Benefitted Properties it owns, including, without limitation, any amendment, repeal or revocation of the Ordinance.

7.3 Validation Proceeding. PBC shall have the right to initiate and prosecute, in WMD's name, an action, in a court of competent jurisdiction, for the purpose of having this Agreement validated under California law. WMD shall cooperate with PBC in its efforts in connection with such action. PBC shall reimburse WMD for the reasonable out-of-pocket expenses it incurs in connection with such action. PBC shall be represented by such counsel in connection with such proceeding as is reasonably acceptable to WMD.

8. Effectiveness. This Agreement shall become effective upon its execution and delivery by each party.

Notwithstanding any implication to the contrary herein, this Agreement may be terminated, at the election of PBC, unless each of the parties to each of the Related Agreements, the Management Agreement and the Service Agreement shall have executed, and delivered to each of the other parties thereto, such agreement on or before July 31, 1990. Upon any such termination, neither party hereto shall have any further obligation hereunder to the other party or any other person or entity.

9. Termination of Agreement.

9.1 Termination for Breach. In the event that either party fails to perform, in any material respect, any of its obligations under this Agreement, the other party shall have the right, in addition to all other remedies it may have under law or in equity, to terminate this Agreement, within 30 days after the breaching party receives written notice of such termination, if such failure is not cured by the breaching party prior to such date; provided, however, if such cure cannot practicably be effected within such 30 day period, and the breaching party, upon receiving such written notice, promptly initiates efforts to cure such failure and diligently pursues such cure, the other party shall not have the right to terminate this Agreement unless such cure is not effected within 90 days after the breaching party receives such written notice. The provisions of Section 4.5 hereof, with respect to a right to notice and a hearing and an appeal to the Board, shall be applicable, as well, to any proposed termination of this Agreement by WMD. No termination of this Agreement by PBC shall affect the Water Entitlement or the Water Use Permits, or any rights thereto. Notwithstanding any implication to the contrary herein, given that, as provided in Section 3.4 hereof, the beneficiary under the Bond Letter of Credit shall have the right to draw on such Letter of Credit in the event it is not timely renewed, the failure of PBC to timely renew such Letter of Credit shall not constitute a breach by PBC of its obligations under this Agreement which would entitle WMD to terminate this Agreement, the Water Entitlement or any Water Permit. Notwithstanding any implication to the contrary in this Section 9.1 or in Section 9.2 hereof, (a) unless WMD breaches any of its representations and warranties or covenants with respect to the grant of the Water Entitlement or the right of PBC, Lohr or Griffin, or any of their respective assignees, to use, retain or enforce the Water Entitlement, PBC shall have no right to terminate its obligations hereunder with respect to the NOD Letter of Credit or Ancillary Project Costs, and (b) PBC shall have no right to terminate its obligations hereunder with respect to the Bond Letter of Credit.

9.2 Remedies for WMD Breach. In the event WMD breaches any of its representations and warranties or covenants in this Agreement with respect to the Water Entitlement or the Water Use Permits: (a) in the event that, after such breach, an owner of a Benefitted Property is entitled to less potable water for use on such Benefitted Property than is contemplated by this Agreement or ceases to be entitled to a Water Use Permit for such Benefitted Property, as and to the extent contemplated by this Agreement, WMD shall utilize its regulatory powers to the fullest extent to immediately ensure that the owner of such Benefitted Property is entitled to receive, and does receive, potable water at such times, in such quantities and pursuant to such terms and conditions as are substantially equivalent to its rights with respect to potable water specified in this Agreement; (b) because the damages which such owner would suffer as a result of such breach would be irreparable and are difficult to quantify, such owner shall be entitled to specific enforcement, by a court of competent jurisdiction, of its rights hereunder which are affected by such breach; and (c) if any such breach is with respect to the grant of the Water Entitlement or the right of PBC, Lohr or Griffin, or any of their respective assignees, to use, retain or enforce the Water Entitlement, so long as such breach continues, PBC's obligations under this Agreement with respect to any NOD Letter of Credit and any Ancillary Project Costs shall not be enforceable.

9.3 Termination by PBC. PBC shall have the right, in its absolute discretion and for any reason whatsoever, to terminate this Agreement at any time prior to the commencement of the offering of the Bonds upon delivering WMD written notice of such termination. Upon any such termination, neither party hereto shall have any further obligation hereunder to the other party or any other person or entity.

10. Indemnification.

10.1 Protection of Parties. Subject to the limitations in this Section 10, each party shall defend and indemnify, and hold harmless, the other party from and against any and all damages, liabilities, losses, and costs and expenses suffered or incurred by the other party, arising out of, or resulting from, any breach of its representations, warranties or agreements set forth in this Agreement.

10.2 Procedure For Indemnification. In the event that any legal proceedings are instituted, or any claim or demand is asserted, by any third party which may give rise to any damage, liability, loss, or cost or expense in respect

of which either party has indemnified the other party under Section 10.1 hereof, the indemnified party shall give the indemnifying party written notice of the institution of such proceedings, or the assertion of such claim or demand, promptly after the indemnified party first becomes aware thereof; provided, however, any failure by the indemnified party to give such notice on such prompt basis shall not affect any of its rights to indemnification hereunder unless such failure materially and adversely affects the ability of the indemnifying party to defend such proceeding. The indemnifying party shall have the right, at its option and at its own expense, to utilize counsel of its choice in connection with such proceeding, claim or demand, subject to the approval of the indemnified party, which approval shall not be unreasonably withheld or delayed, and to defend against, negotiate with respect to, settle or otherwise deal with such proceeding, claim or demand; provided, however, that no settlement of such proceeding, claim or demand shall be made without the prior written consent of the indemnified party, which consent shall not be unreasonably withheld or delayed, unless, pursuant to the terms and conditions of such settlement, the indemnified party shall be released from any liability or other exposure with respect to such proceeding, claim or demand; and provided, further, that the indemnified party may participate in any such proceeding with counsel of its choice at its own expense. In the event, or to the extent, the indemnifying party elects not to, or fails to, defend such proceeding, claim or demand and the indemnified party defends against, settles or otherwise deals with any such proceeding, claim or demand, any settlement thereof may be made without the consent of the indemnifying party if it is given written notice of the material terms and conditions of such settlement at least ten days prior to a binding agreement with respect to such settlement being reached. Each of the parties agrees to cooperate fully with each other in connection with the defense, negotiation or settlement of any such proceeding, claim or demand.

10.3 Payment of Indemnified Claims. Upon a final judgment or award with respect to any proceeding of the nature described in Section 10.2 hereof having been rendered by a court, arbitration board or administrative agency of competent jurisdiction and the expiration of the time in which an appeal therefrom may be made (a "Final Judgment"), or a settlement of such proceeding, claim or demand having been consummated, or the parties having arrived at a mutually binding agreement with respect to each separate matter indemnified hereunder, the indemnifying party shall forthwith pay all of the sums so owing to the indemnified party. In the event any such proceeding is brought, in which allegations of fault are made against both of the parties, the extent of any

indemnification shall be determined in accordance with the findings of the court as to the relative contribution by each of the parties to the damage suffered by the party seeking indemnity with respect to such proceeding.

10.4 Securities Law Indemnification. Subject to the limitations in this Section 10, each party shall defend and indemnify, and hold harmless, the other party from and against any and all expenses suffered or incurred by the other party as a result of any written information provided by the indemnifying party for inclusion in any of the Bond Documents, or any Bond Document prepared by the indemnifying party (except with respect to the portion thereof prepared based on written information provided by the other party for inclusion in such Bond Document), containing any untrue statement of a material fact or omitting to state a material fact necessary to make such written information or Bond Document not misleading.

11. Miscellaneous.

11.1 Further Assurances. Each of the parties agrees to execute, and deliver to the other party, such documents and instruments, and take such actions, as may reasonably be required to effectuate the terms and conditions of this Agreement; provided, however, such covenant shall not have the effect of increasing the obligations of any party pursuant to this Agreement or require any representations and warranties by any party in addition to those of such party set forth herein.

11.2 Relationship of the Parties. Nothing in this Agreement shall create a joint venture, partnership or principal-agent relationship between the parties.

11.3 Notices. Whenever any matter herein provides for notice or other communication to be given to either of the parties, such notice shall be in writing and given to the persons, and at the addresses, designated below for such party, or to such other person or other address as such party shall provide, in writing, to the other party. All notices may be given by being personally delivered, placed in the United States mail, postage prepaid, certified or registered mail, or sent by overnight, prepaid air freight, addressed to the party to whom notice is to be given. Each such notice shall be deemed to be effective upon receipt, if personally delivered or sent by air freight, or five days after being so mailed.

If to PBC:

Pebble Beach Company
P.O. Box 1767
Pebble Beach, CA 93953

Attn: Steven Eimer

Miller-Klutznick-Davis-Gray
4643 South Ulster, Suite 1500
Denver, CO 80237

Attn: Myron M. Miller and
Donald E. Spiegleman

If to WMD:

Monterey Peninsula Water
Management District
187 Eldorado, Suite E
Monterey, CA 93940

Attn: General Manager

David C. Laredo
Delay & Laredo
606 Forest Avenue
Pacific Grove, CA 93923

11.4 Exhibits. All exhibits referred to in this Agreement and attached hereto are hereby incorporated herein and made a part of this Agreement, for all purposes, by this reference.

11.5 Assignment. This Agreement shall be binding upon, and inure to the benefit of, the successors and permitted assigns of the parties. Notwithstanding the foregoing, (a) WMD may assign any of its rights or obligations hereunder only to any successor agency to WMD, and (b) PBC and any successor assignee may at any time assign any of its rights hereunder and/or may assign any of its obligations hereunder to any person or entity which assumes such obligations in writing. In the event any permitted assignment occurs, the assignor shall thereafter have no further responsibility with respect to such obligation.

11.6 Cumulative Remedies. Except as specifically provided to the contrary in Section 9.1 hereof, No remedy or election hereunder shall be deemed exclusive, but shall be cumulative with all other remedies at law or in equity.

11.7 Severability. Although it is the intent of the parties that each obligation of the parties in this Agreement, including, without limitation, the fiscal sponsorship of the Project by PBC pursuant to Section 3 hereof and the grant of the Water Entitlement by WMD pursuant to Section 4 hereof, be valid and enforceable, should any provision of this Agreement be declared invalid or unenforceable in any jurisdiction by a court of competent jurisdiction, then such portion or provision shall be deemed to be severable, to the extent invalid or unenforceable, from this Agreement as to such jurisdiction (but, to the extent permitted by law, not elsewhere) and shall not affect the remainder hereof. Notwithstanding the foregoing, (a) such provision of this Agreement shall be interpreted by the parties and by any such court, to the extent possible, in such a

manner that such provision shall be deemed to be valid and enforceable, and (b) such court shall have the right to make such modifications to any provision of this Agreement as do not materially affect the rights or obligations of either of the parties and as may be necessary in order for such provision to be valid and enforceable.

11.8 Waiver. No waiver of any obligation of either of the parties shall be effective unless in a writing, specifying such waiver, executed by the other party. No waiver of any right of either of the parties shall be effective unless in a writing, specifying such waiver, executed by such party. A waiver by either of the parties of any of its rights or remedies under this Agreement on any occasion shall not be a bar to the exercise of the same right or remedy on any subsequent occasion or of any other right or remedy at any time.

11.9 Headings and Titles. The designation of a title, or a caption or a heading, for each section of this Agreement is for the purpose of convenience only and shall not be used to limit or construe the contents of this Agreement.

11.10 Presumptions. Because both parties have participated in preparing this Agreement, there shall be no presumption against any party on the ground that such party was responsible for preparing this Agreement or any part hereof.

11.11 Amendment or Modification. This Agreement may be amended, altered, or modified only by a writing, specifying such amendment, alteration or modification, executed by both parties.

11.12 Counterparts. This Agreement may be executed in two or more counterparts, each of which shall be deemed an original, but all of which shall constitute one and the same instrument.

11.13 Entire Agreement. This Agreement and the Related Agreements constitute the entire agreement between the parties regarding the subject matter hereof and thereof, and supersede all prior or contemporaneous negotiations, understandings or agreements of the parties, whether written or oral, with respect to such subject matter, including, without limitation, the Memorandum.

11.14 Limitation on Liability of Partners. No recourse shall be had against any partner of PBC or any partner or subpartner of a partner of PBC, or any legal representative, heir, successor or assign of any thereof, on account of any covenant, agreement or indemnification contained herein or in

any of the Related Agreements, or for any claim arising out of or with respect to this Agreement or any of the Related Agreements, or the performance hereof or thereof. Recourse therefor shall be limited solely to PBC and the assets of PBC (a deficit capital account of any partner of PBC or other funding obligation of a partner under the partnership agreement of PBC shall not be deemed an asset or property of PBC), and no action or proceeding on account of any such covenant, agreement or indemnification shall be sought, obtained or enforced against any partner of PBC or any partner or subpartner of PBC, or heir, successor or assign, or against their respective individuals assets.

IN WITNESS WHEREOF, this Agreement has been executed by .. the duly executed officers of each of the parties effective the date first shown above.

MONTEREY PENINSULA WATER
MANAGEMENT DISTRICT

By: 

Its: 

PEBBLE BEACH COMPANY, a California
general partnership

By: MKDG II, a Colorado general
partnership, General Partner

By: 

Thomas J. Klutznick dba TJK
Company, a sole proprietorship,
General Partner

By: MKDG IV, a Colorado general
partnership, General Partner

By: 

Thomas J. Klutznick dba TJK
Company, a sole proprietorship,
General Partner

EXHIBIT A

BENEFITTED PROPERTIES AND WATER ENTITLEMENT

DMF LUP DESIG	WATER ENTITLEMENT (AF/YR)
PBC	
B	18.52
C	17.68
D	11.20
F	34.84
G	46.31
H	19.44
I	23.49
J	8.90
K	8.91
L	14.58
M	27.54
N	11.75
O	6.89
P	8.10
Q	18.23
R	30.38
U	5.66
V	21.06
Qry.	21.76
Drive	1.51
Lodge	1.48
Equest.	1.12
B.Club	1.00
PB Ten	1.00
SpyHill	1.65
S.Bay	1.00
P.Hay	1.00
Lohr	S 10.00
Griffin	W 5.00

Definitions

"DMF LUP Area Desig." refers to the Benefitted Property by reference to the lettered development area in the Monterey County Del Monte Forest Land Use Plan, or as follows: "Qry" refers to the 5-acre quarry area adjacent to the PBC Corporation Yard. "Drive" refers to the 17 Mile Drive. "Lodge" refers to the Lodge at Pebble Beach. "Equest." refers to the PBC Equestrian Center. "B.Club" refers to the PBC Beach Club. "PB Ten." refers to the PBC Tennis Club. "SpyHill" refers to Spyglass Hill Golf Course and Clubhouse. "S.Bay" refers to the Spanish Bay Inn, Links and Residences. "P.Hay" refers to Peter Hay 3 Par Course.

Legal Descriptions for all of the Benefitted Properties are attached as a part of this Exhibit A.

The Water Entitlement is listed in acre feet per year (AF/YR).

EXHIBIT "B"

OPEN SPACES

Pebble Beach Golf Course
Cypress Point Golf Course
Spyglass Hill Golf Course
Poppy Hills Golf Course
Monterey Peninsula Country Club Dunes Course
Monterey Peninsula Country Club Shore Course
Spanish Bay Golf Course
Peter Hay Par 3 Golf Course
Collins Field
Pebble Beach Practice Fairway
Robert Louis Stevenson School athletic fields

EXHIBIT "C"

DESCRIPTION OF PROJECT

The Project is described in the Basis of Design Report, dated June, 1988, prepared by Engineering Science for CSD, and consists of the following components:

(1) Construction of a new 9,000 square foot treatment plant, at the existing CSD sewage treatment plant located immediately south of the Carmel River and west of California State Highway One, capable of producing 1.5 million gallons per day (MGD) of tertiary treated reclaimed water suitable for irrigation. The location of the tertiary treatment plant has been moved from land outside the existing CSD boundaries (as originally proposed and studied in the Basis of Design Report) to land within the existing CSD boundaries. The new treatment facility will divert and treat secondary level effluent from the existing CSD plant to levels suitable for reuse as irrigation water (i.e., tertiary treatment). The plant will have a treatment process consisting of: secondary effluent flow equalization; influent pumping; polymer and alum addition with rapid mixing for coagulation; low energy mixing for flocculation; filtration; chlorination; dechlorination; and reclaimed pumping.

(2) Improvements to the existing CSD plant facilities in order to assure consistent and reliable quality of secondary effluent from the existing CSD plant to be diverted to the tertiary treatment plant. These improvements include construction of a secondary clarifier flow split control and replacement of the existing mechanical aeration diffusers.

(3) A reclaimed water distribution system consisting of approximately 38,000 feet of distribution pipeline and a steel water storage tank (described below) in Del Monte Forest. The main transmission pipeline will begin at the treatment plant site and terminate at the southern portion of the Spanish Bay Golf Course and Resort in Del Monte Forest. The pipeline will be constructed primarily within existing roads and road rights-of-way extending through the City of Carmel-by-the-Sea and incorporated areas of Monterey County, including areas of Del Monte Forest. A connection for emergency potable water supply will also be constructed to provide irrigation water to the Open Spaces in the event of failure of the reclamation plant or distribution pump station.

(4) Construction of a 2.5 million gallon reclaimed water storage tank adjacent to the Poppy Hills Golf Course maintenance yard north of Viscaino Road in Del Monte Forest.

The tank will be a 35-foot tall, 115-foot in diameter enclosed steel structure.

(5) Irrigation of the Open Spaces. Modification of the existing Open Space irrigation systems will be necessary to convert from the existing potable water supply to the reclaimed water supply. These modifications consist of disconnection from the potable water main and connection to turnouts on the reclaimed water distribution pipeline, separation of potable water uses, such as drinking fountains, from the irrigation system, and identification of reclaimed water facilities.